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**ADDIS ABABA UNIVERSITY**

**LAW FACULTY**

**BUSINESS LAW (LL.M PROGRAM)**

**Money Laundering and Countermeasures: A Critical Analysis of Ethiopian  
Law with Specific Reference to the Banking Sector**

**By**

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**A thesis submitted to the Law Faculty of Addis Ababa University in the  
post graduate program in partial fulfilment of the Requirements of the  
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## **Acronyms**

**AACO:** Addis Ababa Clearing Office

**AML:** Anti Money Laundering Law

**APG:** Asia- Pacific Group on Money Laundering

**Art.:** Article

**ATM:** Automated Teller Machine

**CAP:** Customer Acceptance Policy

**CBE:** Commercial Bank of Ethiopia

**CDD:** Customer Due Diligence

**CFATF:** Caribbean Financial Action Task Force

**CICAD:** Inter American Drug Abuse Control Commission (Spanish)

**CIP:** Customer Identification Procedure

**CTR:** Cash Transaction Report

**EAG:** Eurasia Group on Money Laundering and Terrorist Financing

**EFT:** Electronic Fund Transfer

**ERCA:** Ethiopian Revenue and Custom Authority

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

**FATF:** Financial Action Task Force

**FDRE:** Federal Democratic Republic of Ethiopia

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

**FIUs:** Financial Intelligence Units

**FSRBs:** FATF Style Regional Bodies

**GAFISUD:** FATF on Money Laundering in South America

**GATS:** General Agreement on Trade in Service

**GATT:** General Agreement on Tariff and Trade

**GDP:** Gross Domestic Product

**GIABA:** Intergovernmental Action Group against Money Laundering in Africa

**GPML:** Global Program against Money Laundering

**IMF:** International Monetary Fund

**KYC:** Know your Customer

**MENA FATF:** Middle East and North Africa Financial Action Task Force

**MFN:** Most Favoured Nation

**ML/TF:** Money Laundering/ Terrorist Financing

**ML:** Money Laundering

**MLATs:** Mutual Legal Assistance Treaties

**NBE:** National Bank of Ethiopia

**NCCT's:** Non Cooperative Countries and Territories

**NGO's:** Non Governmental Organizations

**NT:** National Treatment

**OAS:** Organization of American States

**ODC:** UN. Office of Drug and Crime

**PEPs:** Politically Exposed Persons

**STRs:** Suspicious Transaction Reports

**SVCs:** Stored Value Cards

**SWIFT:** Society for World Wide Interbank Financial Telecommunication

**TBML:** Trade Based Money Laundering

**TI:** Transparency International

**U.S:** United States of America

**UN:** United Nations

**UNCAC:** United Nations Convention against Corruption

**UNDCP:** United Nations Drug Control Program

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

**USD:** United States Dollar

**VPN:** Virtual Private Network

**WB:** World Bank

**WTO:** World Trade organization

## **Abstract**

**Purpose:** the purpose of this research is to critically examine the anti money laundering framework of the country, the mechanisms to fight it and to suggest ways of enhancing the effectiveness of the law in achieving its objective with specific reference to the banking sector.

**Design/ Methodology/ Approach:** the relevant laws enacted to tackle money laundering are examined to assess their adequacy or otherwise. The research describes the fight against money laundering in Ethiopia, analyses the gaps still remaining between Ethiopia and internationally accepted standards and points out the future efforts to be made in general and from the banking perspective in particular.

**Findings:** Ethiopia has made a remarkable progress in fighting money laundering activities; gaps however are still remaining and further efforts should be made to avoid the lacunae in the anti money laundering laws of the country as recommended.

**Originality/ Value:** the research presents a comprehensive analysis and comment on the new anti money laundering law of the country which would be beneficial to policy makers, relevant administrators and to the banking sector.

**Research Limitation:** the fact that the anti money laundering law is new and the required organs are under establishment, it becomes impossible to evaluate the law from pragmatic approach which constitutes an issue for further research. Freedom of information is also another chronic challenge to the writer.

**Key Words:** Money Laundering, Ethiopia, Banking sector.

**Paper Type:** Research Paper

# CHAPTER ONE

## Introduction

### 1.1 Background of the Study

In the midst of mounting erudition in the use of technology, money laundering and financing of terrorism pose serious threats to the economies, societies and national security of a country as well as to the international community. Financial institutions that became a vehicle for money laundering and financing of terrorism activities incur risks to its operations and reputations as these activities may lead to severe damage.

Money laundering refers to the practice of washing illegally acquired cash through financial and other systems so that it appears to be legally acquired<sup>1</sup>. Financial institutions such as banks, insurers, and securities are usually considered in the frontline in the war against illicit money movements. Money Laundering is being employed by launderers worldwide to conceal criminal activities associated with it such as drug / arms trafficking, terrorism and extortion. In other words the term money laundering brings to our mind those nefarious activities of the criminals who provide an envelope to “slush funds” in order to exhibit those as genuine money. As per an estimate of the International Monetary Fund, the aggregate size of money laundering in the world could be somewhere between two and five percent of the worlds gross domestic product.<sup>2</sup>

Currently with the proliferation of new banks in Ethiopia the issue of strong control and supervision of financial sectors is special interest of the government for different reasons. On top of this, Ethiopia is on the middle of the road to join the giant club: the WTO. So,

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<sup>1</sup> Peter J. Kacarba, (1991), An In depth Analysis of the New Money Laundering Statute, Akron Tax Journal, Vol.8, P. 2

<sup>2</sup> Gal Istvan Laszlo: (2006), Some Thought about Money Laundering, 139 Studia Iuridica Auctoritate Univerties pecc Publicala, P. 167

liberalizing banking sectors is an inevitable fact for acceding countries though a matter of negotiation.

In addition to the growth of financial sectors in dynamism and complexity to become very competitive, the economic changes associated with globalization tighten financial pressure on government to take care of these financial institutions. So on the eve of liberalization and globalization for maintaining international financial relationship, Anti Money Laundering (AML) policies and procedures not only contributes to a bank's overall safety and soundness they also protect the integrity of the banking system by reducing the likelihood of banks becoming vehicles for money laundering, terrorist financing and other unlawful activities.

Money-laundering has acquired a global character that not only threatens security, but also compromises the stability, transparency, and efficiency of financial systems. Money-laundering techniques are becoming more sophisticated and complex with each passing day. Across the world, banks and financial institutions are required to introduce and implement systems to prevent anti-social elements from using banking channels for money laundering.

Therefore, adoption of appropriate Anti-Money Laundering law and know-your-customer procedures within individual banks is an essential part of risk management in banks, needed to safeguard the confidence and the integrity of banking systems and to combat money laundering.

## **1.2. Statement of the Problem**

Money laundering is not a question of one bank only but a problem for the country and for the international community at large. Money laundering becomes complicated for the fact that the business in the financial sector becomes sophisticated due to new technologies like wire transfer.

The negative economic effects of money laundering on economic development are difficult to quantify, yet it is clear that such activity damages the financial-sector institutions particularly banks 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.

Money laundering impairs the development of these important financial institutions for two reasons. First, money laundering erodes financial institutions themselves. Within these institutions, there is often a correlation between money laundering and fraudulent activities undertaken by employees. At higher volumes of money-laundering activity, entire financial institutions in developing countries are vulnerable to corruption by criminal elements seeking to gain further influence over their money-laundering channels. Second, particularly in developing countries, customer trust is fundamental to the growth of sound financial institutions, and the perceived risk to depositors and investors from institutional fraud and corruption is an obstacle to such trust. Believing that this activity is also a smouldering issue in Ethiopia, the government has promulgated a new law that governs the issue of money laundering and terrorist financing. So the following general issues will be the major problems in the study of this research.

- ✓ How much the new law is full-fledged in order to combat money laundering or how much it effectively addressed the associated threats and how much the law goes in line with internationally accepted principles?
- ✓ Is the law sufficient to bring good governance practices in the financial institutions and promote rule of law, economy and national security?

- ✓ How money laundering by Politically Exposed Persons (PEPs) and corruption are controlled in the fight against money laundering?
- ✓ What are the security and policy implications of the new law on money laundering?
- ✓ The banking sectors and their competency in fighting money laundering will also be another point of scrutiny.

### **1.3. Objective of the Study**

Money laundering undermines the stability of financial systems, corrupts government officials, institutions and private sectors and it also undermines the rule of law, economy and national security. Therefore, the study has general and specific objectives.

#### **General Objective**

The general objective is to examine the compatibility of the law on money laundering with internationally accepted principles and its competency in solving the current problem of money laundering in general and in the financial sectors of Ethiopia and assist with the development of appropriate safeguards against corruption as well as other dangerous predicate offences in the anti-money laundering structures.

#### **Specific Objective**

To achieve the general objectives different specific objectives will be addressed. These specific objectives among others are:

- ✓ Examining the international principles in detail vis-à-vis the Ethiopian law on money laundering;

- ✓ Examining the current law of Ethiopia on money laundering in relation to banking sectors i.e. Proc. No.657/2009.
- ✓ Looking the policy objectives behind the law and the connection of money laundering with the society at large.
- ✓ Assessing the money laundering vulnerabilities in banking sectors of Ethiopia and how it would affect financial systems.
- ✓ Identifying the influence of money laundering on the economic development and how corruption affects on anti money laundering measures and the vice versa.
- ✓ Exploring the provisions of the new law on anti money laundering confiscation procedures on criminal proceeds
- ✓ Investigating the regulatory organs in relation to money laundering from banking sectors perspective.

#### **1.4. Significance of the Study**

Throughout the world, financial institutions particularly banks have become a chief end of money laundering operations and monetary crime because they are endowed with a range of services and instruments that can be used to cover up the source of money. With their refined, coherent and beguiling behaviour, money launderers attempt to make bankers lesser their guard so as to accomplish their purpose.

As a result, money laundering becomes a burning issue and legislations are adopted in developing as well as developed countries for different kinds of entities and target groups. Nevertheless, financial institutions attract the attention of the government on the issue of money laundering for a couple of additional reasons. For one thing, the risk in banking

system is increased due to the rapid changes brought about by globalization, deregulation, liberalization and technological advancement and hence susceptible for money laundering and terrorist financing. For the other, failure of one bank is not only the question of stakeholders but also the interest of other banks as well as the government at local and international level.

Further, there is a high hope that Ethiopia will enlist in the membership of WTO. Though a debate exist as to the benefits and challenges of accession, the move is keeping on. As a matter of fact liberalizing its financial sector is most probably a presumable fact even if a matter of negotiation. So, when liberalizing these sectors with the importation of new technologies and improvement of services, the question of malpractices and money laundering will also be increased sophisticatedly. Therefore, a study of such nature will have twofold benefits.

On the one hand, it will ring for the government as well as for the banking sectors by indicating advanced international issues on money laundering, corruption by PEPs, and the lacunae that we have in the new law in order to consolidate the gaps and ensure stability, transparency, soundness and efficiency of the banking system and the current problems thereof in relation to money laundering.

On the other hand, it would make a contribution by looking in to the problems that banking sectors are facing in relation to money laundering and the insufficiency of the law in fighting the problem and thereby enlighten policy makers and the banking sectors about mechanisms in preventing money laundering to bring stakeholders trust up on banking sectors and avoid other risks stemmed from money launderers.

## **1.5 Scope of the Study**

The study is primarily aimed at looking the new money laundering law of Ethiopia vis-à-vis the internationally adopted principles. Further the issue of money laundering in the financial sectors and the laws in relation to these sectors on the issue will be scrutinized. The economic and policy implication of the laws in relation to money laundering is worthy point. The advancement of technologies and its application for money laundering as well as politically exposed persons in this issue will take the lion share of the study. However, the scope of the study will be limited mainly to money laundering excluding terrorist financing as a major point.

## **1.6. Hypothesis of the Study**

With the mounting proliferation of banking sectors in Ethiopia and advancement of technology, complexity and erudition of banking service is escalating from time to time and money laundering as well as other criminal activities may endanger the sector. Advancement in payment system technology has had a wider impact in relation to the potential abuse by terrorist financiers and money launderers of such systems.

The laws promulgated in order to combat money laundering in the financial sectors by the government and regulations by the NBE are not full-fledged. There are still short comings in the provisions on the newly promulgated anti money laundering laws of Ethiopia. Further it lacks some compatibility with internationally accepted standards as propagated by FATF and other international organizations.

The law on money laundering is not sufficient to combat money laundering due to corruption by Politically Exposed Persons (PEPs). Such problem of money laundering will also be inflated in case banking sectors are liberalized due to the accession of Ethiopia to the WTO.

## **1.7. Limitation of the Study**

The major problem that the researcher will face is the infancy of the new proclamation and institutions that are established according to the proclamations like the Financial Intelligence Centre (FIC) which has not started its duties according to the proclamation though established. So measuring the newly promulgated Anti Money Laundering Proclamation from pragmatic perspective is a major limitation in this research.

The other trouble the researcher would face is the question of freedom of information. The writer has faced a chronic problem for different reasons, mainly political, that authorities are not willing to give information in relation to Politically Exposed Persons (PEPs) and corruption.

The other limitation is in relation to literatures. The writings in relation to this issue are general in nature. Money laundering is given a section or sub section in a book so the writer will be dependent on web sources and official sites of FATF, IMF, World Bank and APG as well as other international organizations.

## **1.8. Research Methodology**

The topic being theoretical analysis, I will rely both on literature review and interviews with concerned government organs as well as other scholars on the area. A personal visit and observation will also be employed to familiarize my work with the working condition of the issue. Concerning literature reviews, the annual and quarterly report of the NBE is also another important source. Moreover, I have off-campus access to Warwick University Library. This access is expected to be of great use.

## **1.9. Organization of the Study**

The legislators and regulatory agencies in the country have recently promulgated a flurry of rules and regulations to curtail the practice of money laundering. For this end, they are calling upon banks to play an integral role in the laws' implementation. This research is therefore organized in four chapters in order to address the new law and the mechanisms adopted as well as the role of banks in curtailing money laundering.

The first chapter gives the general background, statement of the problem, objective and significance of the study. The definition of money laundering, the process and impacts of money laundering as well as the international and regional responses to fight such menace are discussed in the second chapter to establish a foundation for discussing the issue from the Ethiopian perspective in the subsequent chapters.

Chapter three critically analyses the Ethiopian money laundering milieu in comparison with international propagations as done by FATF. Following this, the last chapter looks into the law of the country and the countermeasures from the banking perspective together with the conclusion and recommendations.

## CHAPTER TWO

### 2. The Global Threat: Money Laundering, genesis of new crime

#### 2.1. What is Money Laundering? The Problem in Context

“The white collar crime of the 1990’s is here and it is money laundering.”<sup>3</sup>

Elkan Abramowitz.

Money which is not associated with criminal activity can be freely disposed without any fear of incrimination as being part to any criminal misdeeds. Whereas, the sudden acquisition of a large amount of money without explanation invites someone’s suspicion that its source is some illegitimate activity.

Here is the word “Money laundering” that evokes images of sophisticated multinational financial operations that transforms criminal proceeds of dirty money into clean money.<sup>4</sup>

Money laundering has been defined in different ways. Though most countries subscribe to the definition given under the Vienna Convention and the Palermo Convention, the Financial Action Task Force (FATF)<sup>5</sup>, a recognized international standard setter about anti money laundering operation defines it in a similar fashion as:

*the conversion or transfer of property, knowing that such property is derived from serious crime, for the purpose of concealing or disguising the illicit origin of the property or of assisting any person who is involved in committing such an offence or offences to evade the legal consequences of such action; the concealment or disguise of the true nature, source, location, disposition, movement, rights with respect to, or ownership of property, knowing at the*

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<sup>3</sup>Rachel Manney, (2002), Money Laundering: The Global Threat to the Integrity of Financial system, published at wilmcot.com. p.1

<sup>4</sup>Michael Levi, (2002), Money laundering and its Regulations, American Academy of Political and Social Science, Saga Publications, P. 182, Vol.582.

<sup>5</sup> See the discussion in this chapter about the Vienna Convention and the Palermo Convention and the Financial Action Task Force (FATF)

*time of receipt that such property was derived from a criminal offence or from an act of participation in such an offence,*<sup>6</sup>

Money laundering could be defined in multifarious ways but the common element amongst them is ‘the transfer of the illegal assets into the legal economic system’. Generally speaking money laundering is the term used to describe the process that disguises the illegal sources of money and frees the funds for use in the legitimate economy.

The origin of the term is controversial. Some points to the literal meaning of the expression-laundering or washing money free from its criminal association whilst others point to the use of laundries or rather *laundromats* and other cash business by U.S. organized criminals trying to integrate their proceeds of crime in to the legitimate economy during the prohibited era<sup>7</sup>. Whereas, others in a similar fashion argue that the term is derived from the fact that certain organized crime rings in the 1920’s commingled the proceeds of their illicit operations in a practically untraceable manner and thereby making the funds appear to be derived from legitimate activities.<sup>8</sup> Despite the fact that the term ‘money laundering’ may have been originated in the twentieth century, the practice of disguising ill-gotten gains pre-dates recent history and indeed traces its roots back to the dawn of banking itself.<sup>9</sup>

However, money laundering became an issue both at national and international level with the rise of world-wide drug trafficking in the 1980’s and the money laundering operation

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<sup>6</sup> Denisse V. Rudich, (2005), Performing the Twelve Labors: The G 8’s Role in the fight Against Money Laundering, London Metropolitan University, P. 5

<sup>7</sup>Jane Bourne, (2002), Money Laundering: what is being done to combat it? A Comparative Analysis of the Laws in the United States of America, the United Kingdom and South Africa, S. Afr. Mercantile Law Journal, P.475.

<sup>8</sup>Todd Doyle, (2002), Cleaning Anti-money Laundering Strategies: Current FATF Tactics Needlessly Violates Int’l Law, Houston Journal of International Law, Vol.24:2, P.283

<sup>9</sup> Ibid. P.283

associated with such activity and on those involved in it attempting both to stop criminals profiting from their crimes and to trace back those proceeds in order to reach the kingpin.<sup>10</sup>

National legislations in many parts of the world as well as international instruments began misusing the term money laundering with particular reference to drug trafficking, which latter extended to other predicate offences. Now a day, money laundering has received a great deal of attention all over the world for three fold reasons.<sup>11</sup> First, it is a major worldwide problem and countries want to deter money launderers from using their financial system for illicit purposes. Second, it presents the most effective target for law enforcement officials to prosecute and punish those involved in money laundering activities as leaders of organized crimes and lastly money laundering is a simple means to tackle and intercept predicate crimes than the underlying criminal activity itself and it makes investigation easier for government agents to produce measurable and visible results.

Money laundering is regarded as the world's largest industry after international oil trade and foreign exchange.<sup>12</sup> The International Monetary Fund (IMF) estimated the size of money laundering to be between 2-5% of the worlds GDP, when translated in to figures, it is actually between (USD) 590 billion- (USD) 1.5 trillion.<sup>13</sup> The Financial Action Task Force (FATF) also estimates that the sum of the annually laundered dirty money equals to the total annual production of the economy of Spain which also underlines the volume and seriousness of the danger.<sup>14</sup>

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<sup>10</sup>E.P Ellinger and et al., (2006), Ellinger's Modern Banking Law, Oxford University Press, 4<sup>th</sup> ed., P. 94

<sup>11</sup>Scott Sultzer, Money Laundering: (1996), The Scope of the Problem and Attempts to Combat It, Tenn. L. Rev. P. 145, Vol. 63:143

<sup>12</sup>Angela Veng Mei Leong, (2007), Chasing Dirty Money: Domestic and International Measures against Money Laundering, Journal of Money Laundering Control, Vol.10.No.2, P. 141.

<sup>13</sup>Gal Istvan Laszlo: supra note at 2, P. 167.

<sup>14</sup>Rachel Manney; supra note at 3, P. 2.

Despite the fact that money laundering has come to touch every aspects of the lives of society, the use of banks and other financial institutions is often primary means by which money launderers clean otherwise dirty money.

Money laundering has clearly become endemic to country's social, economic and political frameworks; it ultimately affects and often subverts not only banking and other financial institutions, but also both multinational corporations and small businesses, legislatives and law enforcement officials, lawyers and judges, politicians and high ranking officials as well as newspapers and televisions.<sup>15</sup>

In spite the endeavours made both at national and international level, many laundering continues to be the problem of the globe because of its lucrative nature while penalties for money laundering are insignificant in light of the profits generated from the activity.<sup>16</sup>

Of course the historic success of money laundering can be attributed not only to its profitability and the relatively light penalty to which the perpetrators may be subjected, but also to other factors such as the sheer increase of financial transactions, interdependence of global economy, the sophistication and flexibility of money laundering operations as well as the money launderers' ability to exploit advanced technologies associated with modern banking system.<sup>17</sup> However, the fight against money laundering is increasing alarmingly at international as well as domestic level. Here comes the question why money launderers engage in these activities despite the domestic and international efforts to fight the crime?

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<sup>15</sup>Lisa A. Barbut, (1995), Money Laundering: An International Challenge, Tulane J. of Int'l and Comp. Law, P.163, Vol.3

<sup>16</sup>Ibid. P. 164

<sup>17</sup>Bruce Zagaris and Scott B. MacDonald, (1992), Money Laundering, Financial Fraud, and Technology: The Perils of an Instantaneous Economy, Geo. Wash. J. Int'l. L. and Econ., P.62,

Organizations involved in the criminal activity use money as their life blood. Money replenishes inventories, purchases the services of corrupt officials to escape detection and further the interest of their illegal enterprises and pays for an extravagant life style. Further money laundering presupposes the commission of other crimes. Thus a trail of money from an offence to criminals can become incriminating evidence. So in order to ensure that they are not to be prosecuted because of such money, they usually try to obscure the sources of their ill gotten money to make them look legitimate.<sup>18</sup>

## **2.2. Impacts of Money Laundering**

Money laundering can occur in any country and it has a devastating economic and social consequences in developed and developing countries with tragic financial system because those markets tend to be small with inexperienced regulatory organ and therefore more susceptible to disruption from launderers. The absence or lax of anti money laundering regime or the prevalence of corruption in the law enforcement organs entrusted with the task of fighting it in a country therefore, permit the following consequences.

### **2.2.1. Undermining the Legitimate Private Sector**

Money launderers are known for using front companies.<sup>19</sup> These front companies co-mingle the loot with legitimate funds in order to ward off the ill-gotten proceeds. Front companies' access to illicit fund allows them to subsidize the front company's products and services so that they make their goods and services available to the public on lower prices than is normally the case in a competitive market. Consequently, legitimate businesses find it

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<sup>18</sup>Managing Core Risks in Banking: Guidance Notes on Prevention of Money Laundering, Focus Group on the Prevention of Money Laundering, Bangladesh Bank, P.3

<sup>19</sup>Front companies are business enterprises that appear legitimate and engage in legitimate business but are, in fact, controlled by criminals with the aim of facilitating their money laundering activities, not to make profits.

difficult to cope with such front companies.<sup>20</sup> Therefore, legitimate companies will be forced to get out from the market and it will have further consequences up on government as well as the society at large in addition to those private sectors i.e. bad money causes out good.

### **2.2.2. Undermining the Integrity of Financial Institutions**

Money laundering can harm the soundness of a country's financial sector as well as the stability of individual financial institutions in multiple ways.<sup>21</sup> The adverse consequence of money laundering is generally described as reputational, operational, legal and concentration risks as explained hereunder.

Reputational risk is a kind of risk that will have the consequences of customers' confidence loss in the integrity of the institution.<sup>22</sup> As a consequence, customers, borrowers and depositors plus legitimate investors cease doing business with such institutions. This inevitably affects the reputation of a country and forces investors to invest in countries that are less vulnerable to money laundering. Moreover, the fund of money launderers is not reliable for they withdraw the money through wire transfer or other methods causing potential liquidity problem.<sup>23</sup>

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<sup>20</sup>Marco Arnone, (2010), International anti-money Laundering Programs, Empirical Assessment and Misuse in Criminal Regulation, Journal of Money Laundering Control, Vol. 13, No. 2, P. 231

<sup>21</sup>Abdullahi Y, Shehu, (2010), Promoting Financial Sector Stability Through an Effective AML/CFT Regime, Journal of Money Laundering Control, Vol. 13, No. 2, P.141

<sup>22</sup>Riggs National Bank, in Washington DC, as a consequence of bad reputation, (fined more than US. \$ 40 million for lack of AML programs) many customers have terminated their business relation with the Bank. Further it was not able to attract new businesses and make profits. Though it was not closed by regulatory organs, it lost earnings and sold to another banking organization.

<sup>23</sup>Ibid

Operational risk is related to a bank's overall organization and function of internal system, including computer related and other technologies: compliance with bank policies and procedures; measures against mismanagement and fraud.<sup>24</sup>

Legal risk is the potential for law suits, adverse judgments, unenforceable contracts, fine and penalties generating losses, increased expenses for an institution or even closure of such institutions.<sup>25</sup> Due to this, legitimate customers may be victims of such financial crimes, lose money and sue the institution for reimbursement.

Concentration risk refers to all types of exogenous risks or risks resulting from too much concentration of credit or loan to one borrower.<sup>26</sup> Usually, there will be a statutory provision that restricts banks' exposure to a single borrower or group of related borrowers. But lack of knowledge about a particular customer, his business or his relationship with other customers or corrupt practices of bank officials can place a bank at this risk. However, this can be protected with effective customer due diligence (CDD) which is a critical element for an effective anti money laundering regime.

### **2.2.3. Macroeconomic Effects**

Money laundering not only affects the microeconomic environment i.e. the economic lives and wellbeing of individuals and businesses, but also the macroeconomic climate of a country. Nations washed in laundered money have a hard time attracting foreign investment because it may be reasonable for an investor to shy away from an environment where price

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<sup>24</sup>Hennie Van Greuning, (2003), Analyzing and Managing Banking Risk: a Frame work for Assessing Corporate Governance and Financial Risk, 2<sup>nd</sup> ed. P.22.

<sup>25</sup>Basel Committee in Banking Supervision, Customer Due Diligence for Banks, 2001, at <http://www.brs.org/Publ/bcbs85.pdf>. Accessed on: July 5, 2010

<sup>26</sup>Hennie Van Greuning, supra note at 24, P.22

information is distorted by insider trading, fraud and embezzlement.<sup>27</sup> Money launderers tend to be low rate savers, who invest in more speculative venture. This movement from stable, productive business in to risky, less productive portfolio reduces the level of investment available to sustain economic growth, resulting in lowered growth rates.<sup>28</sup> Other launderers tend to put their money in static investments that do not contribute to the nation's productivity. Since these launderers asset tend to accumulate rather than flow through the economic system, there is an increasing danger of destabilizing the international or national mobility of assets.<sup>29</sup> This is because launderers would not look where to best invest their money based on economic principle but rather at where it would be easier to avoid being caught or based on where the cost of avoidance is lower.

This misdirection of resource contributes to economic inefficiency and lowered economic performance there by thwarting a nation's attempt to control money supply, foreign reserves and interest rates.<sup>30</sup> The effect of such activity is general economic malice as investment capital becomes scarce, interest rate rises; as interest rate rises, businesses borrow less; as business borrow less, productive capacity decreases; as capacity decreases, unemployment increases. Therefore, the end result is stagflation- a combination of high unemployment, high inflation and high interest rates.<sup>31</sup>

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<sup>27</sup>Peter J. Quirk, (1997), Money Laundering, Finance and Development Available at, <http://www.worldbank.org/fandd/English/0397/articles/0110397.html>. Accessed on: July 20, 2010

<sup>28</sup>Ricardo Azevedo Araujo, (2000), The Effects of Money Laundering and Terrorism on Capital Accumulation and Consumption, Journal of Money Laundering Control, Vol. 9, No. 3, P.265.

<sup>29</sup>Paul Kennedy, (2003), Watching the Clothes Go Round: Combating the Effect of Money Laundering on Economic Development and International Trade, Int'l Trade L. J. P.143

<sup>30</sup>Ibid

<sup>31</sup>Ibid

#### **2.2.4. Risk to Privatization Efforts**

The efforts of many countries to reform their economies through privatization have also been manipulated by money launderers.<sup>32</sup> Criminal organizations are capable of outbidding legitimate purchases of former state owned enterprises and consequently increase their potential for more criminal activity and corruption using those enterprises as a legitimate fronts to launder funds. This in any way will undermine economic reforms as money launderers are not interested in operating these entities as going concerns but rather as conduits for money laundering activities. This effect may be panic for countries that are in economic transition from socialist ideology to capitalist system where many of government owned organizations would be privatized to the private sector.

#### **2.2.5. Effect on Rule of Law**

Money laundering allows criminal syndicates to expand the scale and scope of their criminal activities by enabling criminal organizations to realize profits from committing crime.<sup>33</sup> It facilitates crime by capacitating criminal groups and networks to self finance, diversify and growth.<sup>34</sup> Thus a country which is viewed as a haven for money laundering is likely to attract criminals and promote corruption.

The lucrative nature of money laundering activity may also be used to bribe officials that in turn affect the everyday lives of money people by creating an environment where launderers'

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<sup>32</sup>Paul Allan Schott, (2006), Reference Guide to Anti Money Laundering and Combating the Financing of Terrorism, The World Bank, 2<sup>nd</sup> ed. P. 35

<sup>33</sup>Perras J., (2001), 'Dirty Money' Foundation of U.S. Growth and Empire Quebec Centre for Research and Globalization, P.31

<sup>34</sup>Financial Action Task Force on Money Laundering, Basic Facts about Money Laundering, <http://www.Fatt.gafi.org/Mlaundering-en.html>. Accessed on: June 5, 2010

activity permeates a country's economic and political system.<sup>35</sup> This spread can hinder the transition to a more democratic form of government. Thus money laundering breeds corruption, violence and undermines the rule of law.<sup>36</sup>

So a comprehensive and effective anti money laundering framework, together with timely implementation and effective enforcement on the other hand significantly reduces the profits of criminals and there by discourages them from illegally utilizing a country's resources.

### **2.3. Money Laundering Process**

It is common to divide the money laundering process in to three stages. These are<sup>37</sup> placement, layering and integration. Experts in the field; however, criticize dividing the process of money laundering in to three distinct stages as it is unclear where one stage begins and the other ends.<sup>38</sup> Nevertheless, both sides and the law enforcement community continue to refer to the different stages while discussing the issue.

#### **2.3.1. Placement**

This stage involves introducing the money in to the financial system in a way that it can be manoeuvred through a series of complex transactions so as to remove the cash from its original location to avoid detection by the authorities.<sup>39</sup>

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<sup>35</sup>Mark P. Hampton and Michal Levi, (1999), Fast Spinning in to Oblivion? Recent Developments in Money Laundering Policies and Offshore Finance Centers, Third World Quarterly, Vol.20, No. 3. The New Politics of Corruption P.646

<sup>36</sup>Ibid

<sup>37</sup>Paul Fagyal, (2006), The Anti-Money Laundering Provisions of the Patriot Act: Should they be allowed to sunset? St. Louis U.L.J. Vol. 50: 1361 P.1364

<sup>38</sup>Ibid P.1364

<sup>39</sup>Vijay Kumar Singh, (2009), Controlling Money Laundering in India-Prospects and Challenges, P.8

Money launderers in the initial stage are exposed to law enforcement detection because there exists a direct connection between the profits and the crime and it also involves the physical disposal of the cash.<sup>40</sup>

However, the placement of funds in to the financial system has become increasingly difficult to discover due to the large number of ways to accomplish it.<sup>41</sup>

In order to avoid deposits of large sum of money that may trigger suspicion and cause detection, they just use a process called smurfing.<sup>42</sup> In this process a number of individuals make small deposits in a number of different depository institutions so as to avoid detection. Therefore, although financial institutions maintain anti money laundering compliance programs, the developing process of smurfing demonstrates the difficulty of eradicating money laundering.<sup>43</sup> Purchasing expensive property and reselling it, creating legitimate or semi legitimate business that typically deals in cash like hotels and bars are among other mechanisms used in the placement stage in order to obscure the source of illegitimate money.<sup>44</sup>

### **2.3.2. Layering**

At this particular juncture of the process, launderers separate the illicit proceeds from their sources through complex and often illusory transactions disguising the provenance of the

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<sup>40</sup>Alison S. Bachus, (2004), From Drugs to Terrorism: The Focus Shifts in the International Fight against Money Laundering after Sep. 11, 2001, Arizona J. Int'l and Comp. Law, Vol.21. No.3, P. 842

<sup>41</sup>Modelyn J. Daley, (2000), Effectiveness of United States and International Efforts to Combat International Money Laundering, St. Louis Warsaw Transatlantic Law Journal, P. 175

<sup>42</sup>Sarah Jane Hughes, (1992), Policing Money Laundering Through Fund Transfer: A Critique of Regulation Under the Banking Secrecy Act, Indiana Law Journal, Vol. 67: 283, P. 16

<sup>43</sup>Paul Fagyal, supra note at 37, P.1365

<sup>44</sup>Ibid

funds.<sup>45</sup> This step is called layering because it conceals the audit trail and provides anonymity. It is the most international and complex of the laundering cycle because money is moved to offshore bank accounts in the name of shell companies, purchasing high value commodities like diamonds and transfer the same to different jurisdictions.<sup>46</sup> Different technique like loan at low or no interest rate, money exchange offices, correspondent banking, fictitious shares and trust offices are utilized for the purpose of laundering the money at this particular juncture.<sup>47</sup>

The technological advancement of Electronic Fund Transfer (EFT) has also contributed for this stage of the laundering process because money movement is a click away not only at national level but at international level too as a result of electronic fund transfer.<sup>48</sup>

However, there are a number of characteristics that might indicate money laundering activities. Seemingly ludicrous financial transactions, large number of sales and purchases subject to commission, numerous accounts, ostensibly unconnected being consolidated in to a smaller amount of accounts and lack of concern over loses on investment, bank charges or professional advisor charges are among the traits to be mentioned.<sup>49</sup>

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<sup>45</sup>Nicholas Clark, (1996), The Impact of Recent Money Laundering Legislation on Financial Intermediates, Dlekinson Journal of International Law, Vol. 14:3, P. 470

<sup>46</sup>Vijay Kumar S. supra note at 39, P. 9

<sup>47</sup>Ibid

<sup>48</sup>International standard to discourage layering have began to develop through a focus on increased transparency in the financial system generally and through increased recognition of the need to eliminate techniques such as the use of nominees and numbered accounts to disguise the actual ownership of assets. Likewise, there has been growing international recognition that bank secrecy rules must give away to permit law enforcement agencies to review financial records in cases where there is an active criminal investigation pertaining to the source of the funds.

<sup>49</sup>Paul Fagyal, supra note at 37, P. 1367

Therefore, once the money has worked its way in to the financial system, it would rarely be detected independently of criminal investigation and hence needs agreement with other countries to have success in stopping money laundering at the layering stage.<sup>50</sup>

### **2.3.3. Integration**

The layering stage of transaction involves the transmission of money to accounts so-called bank secrecy havens or it involves a number of transactions and thus, it becomes difficult to figure out the identity of the account holder and the money's origin.<sup>51</sup>

This makes it possible for the criminal to engage in the final stage. The final stage of money laundering is the integration of the funds in to the legal business environment. At this time, the money has been divided up and intermingled with the legitimate economy and moved between a number of bank accounts and nations making it almost impossible to trace.<sup>52</sup>

The methods adopted to successfully integrate funds from a criminal enterprise would very often be similar to practices adopted by legitimate business and this would make it more difficult to isolate a *modus operandi* that is unique to money laundering.<sup>53</sup>

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<sup>50</sup>Ibid P.1368

<sup>51</sup>Mariano-Florentino Cuellar, (2003), The Tenuous Relationship between the Fight against Money Laundering and the Disruption of Criminal Finance, Journal of Criminal Law and Criminology Vol. No. 2/3, North Western University, P. 329

<sup>52</sup>Kathleen A. Lacey and Barbra Crutchfield George, (2003), Crackdown on Money Laundering: A Comparative Analysis of the Feasibility and Effectiveness of Domestic and Multilateral Policy Reform, 23 NW. J. Int'l Law and Business, P. 295

<sup>53</sup>Schroeder, W.R, (2001), Money Laundering: FBI Law Enforcement Bulletin 70(5), P. 3

## **2.4. International and Regional Anti Money-Laundering**

### **Crackdown: an update on the framework**

Money laundering takes place virtually in every country and territory of the world, it is not just a problem faced by the major financial or the offshore centers'<sup>54</sup> The nature of international financial system and modern technology, particularly electronic fund transfer implies that any country integrated in to that system is at risk. As emerging markets open their economies and financial sectors, they become increasingly targets for money laundering activities.

In order to more effectively deal with the problems associated with money laundering, countries have not only enacted national laws that criminalize money laundering but have also entered in to bilateral<sup>55</sup> and international agreements which seeks to coordinate enforcement efforts.

The genesis 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 issues of the international concern.<sup>56</sup> The monetary costs attributed to international money laundering are staggering and the social cost of money laundering is immense. As well, international banking and

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<sup>54</sup>Dillwyn Griffiths, International Efforts to Combat Money Laundering Developments and Prospects, Common Wealth Law Bulletin, 193, P.1824

<sup>55</sup>For instance, the U.S Securities and Exchange Commission has entered in to bilateral agreements with Canada, Japan, United Kingdom, Brazil, France, the Netherlands, Mexico, Switzerland and Panama to assist one another in conducting investigation and collecting evidence. However, the effectiveness of bilateral agreements is limited because mostly, money laundering outfits operate in more than two jurisdictions at the same time. In such situation, the effectiveness of bilateral agreement is clearly limited there by rendering such agreement more of a policy statement than an effective AML weapon.

<sup>56</sup>Remarking that as of 1993 drug profits estimated at us \$ 300 billion are laundered through international banking system. The illegal drug proceeds from US. drug sales generate about U.S. \$ 110 billion and that because this figure is so alarming, international cooperation has grown in effort to curb drug trafficking in the early days and now money laundering with diverse predicate offences.

monetary regulation, an evolving and dynamic area of international law remains hotly debated and is the focus of many international regulation efforts.<sup>57</sup>

In response to the growing concern about money laundering and drug trafficking in the early time and terrorist financing in the current situation, the international community has acted on many fronts to thwart the effort of launderers. A typical international cooperation system includes rules that require cooperation in the investigation, prosecution, adjudication and execution of judgments in criminal matters.<sup>58</sup>

The main international agreement and institutions addressing money laundering are the United Nations Vienna Convention against Illicit Trafficking in Narcotic Drugs and Psychotropic Substances (1988), the Financial Action Task Force (FATF), 1989, and the Basel Committee on Banking Supervision to mention, but three.

Here is a brief discussion of these main international initiatives and institutions. Examining these international responses against money laundering is worthy for different reasons. Primarily, it will pave the way for better understanding of the concept and secondly, it is blatantly obvious that these initiatives establish the framework, ground rules and benchmarks for national anti money laundering legislations and regulations. Therefore, the discussion unwaveringly will establish a foundation to assess Ethiopia's money laundering laws in the subsequent chapters.

#### **2.4.1. The United Nations**

The United Nations (UN), while not the first institution against international proceeds of crime, but it is the most important to undertake significant actions to fight money laundering

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<sup>57</sup>Daniel Mulligan, (1999), Know Your Customer Regulation and the International Banking System: Towards a General Self Regulatory Regime, Fordham Int'l L. J. Vol. 22: 2324 , P. 2344

<sup>58</sup>Lisa A. Barbot, supra note at 15, P. 171

on truly worldwide basis.<sup>59</sup> The UN in this regard has a paramount importance for several reasons. For one, the UN is an international organization with a broadest membership.<sup>60</sup> For the other, the UN actively operates against money laundering through the Global Program against Money Laundering (GPML) as part of the UN Office of Drug and Crime.<sup>61</sup> Additionally and most importantly, the UN has the ability to adopt international treaties or conventions that have the effect of law in a member country once that country has signed the convention. Thus, the UN treaties and conventions will be a major force in harmonizing national laws and enforcement actions around the world.

In certain cases, the UN Security Council has the authority to bind all member countries through a Security Council resolution regardless of other actions on the part of an individual country. Thus the UN has had different agreements and conventions that provide a minimum baseline against money laundering to which countries can benchmark and assess their own money laundering regime. The United Nations Vienna Convention (1988) and the Palermo Convention (2000) are among the major conventions and benchmarks in the fight against money laundering.

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<sup>59</sup>There were other international efforts like measures against the transfer and safekeeping of funds of criminal origin adopted by the Committee of the Council of Europe in June 27, 1980 and in Dec. 1988 The Basel Committee issued a statement of principles i.e. Statement on use of Banking for the purpose of fighting money laundering.

<sup>60</sup>There are currently 192 member states of the UN. List of member states available at <http://www.un.org/en/members/pomembership.shtml> Last accessed: Sept. 10, 2010

<sup>61</sup>The UNDCP (United Nation Drug Control Program) was renamed as the Office of Drug and Crime Prevention (ODCCP) in 1997 and again renamed as the Office of Drug and Crime (ODC) in October 2002.

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

The seminal agreement, UN Convention against Trafficking in Narcotic Drug and Psychotropic Substance (Commonly, the Vienna Convention) was signed in 1988 after five years of negotiation among 108 nations.<sup>62</sup>

This Convention primarily deals with provisions to fight the illicit drug trade to which 170 countries are parties as of 2005.<sup>63</sup> Despite the fact that the Convention does not use the word ‘money laundering,’ it adopted the now familiarly pronged three fold approaches to combat money laundering at national as well as international level.

One, criminalization of those involved in money laundering.<sup>64</sup> Second the confiscation of the proceeds of crime including the need to identify and trace criminal proceeds<sup>65</sup> and lastly, international cooperation between law enforcement organs and other concerned bodies are the basic tenets in the Convention.<sup>66</sup>

Accordingly, parties to the Vienna Convention are required to criminalize the offence of international drug-related money laundering as part of their domestic laws. Criminalization includes the knowing conversion, transfer, participation in the conversion or transfer of property derived from the illicit drug trade for the purpose of concealing the illegal source, location, disposition, movement or ownership of such property as per Art 3 (1) (a) and (b) of the Convention.

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<sup>62</sup>Jeffrey Lowell Quillen, (1991), The International Attack on Money Laundering: European Initiatives, Duke Journal of Comp and Int'l. Law, Vol. 1991:213, P 216

<sup>63</sup>Paul Allan Schott, supra note at 32, P. 41

<sup>64</sup>The Vienna Convention, Art 3

<sup>65</sup>Id. Art 5

<sup>66</sup>Id. Art 6 and 7

Regarding confiscation, as provided under Art 5, parties can seize assets or request other parties to seize and forfeit assets generated from the drug trade and money laundering activities associated there with. In addition, the Vienna Convention Art.5 (4) (g) encourages the conclusion of bilateral and multilateral agreements that can enhance the effectiveness of international cooperation and the ability of law enforcement organs to seize drug-trade generated assets.

Finally Art 7(1) of the Convention provided for the creation of Mutual Legal Assistance Treaties (MLATs) that serve to ease investigations, prosecutions and judicial proceedings in relation to criminal offences established in the Convention.

Though this Convention was an important first step in combating international money laundering, its viability as an effective weapon in the anti money laundering process is marginal. The provisions in the Convention are subject to countries constitutional principles and the basic concepts of the legal system and it only applies to drug trafficking offences.<sup>67</sup> Art 3 (1) (c) and art 3 (2) of the Vienna Convention require countries to adopt measures in their domestic laws to establish an offence as provided under art 3 of the Convention. For instance Colombia was not bound by Article three Paragraph six and nine and Article six of the Vienna Convention as the 1991 Constitution of Colombia prevented the extradition of any person who is a Colombian citizen by virtue of birth until a constitutional amendment in 1997.<sup>68</sup>

This Convention, therefore, has different contributions for member countries who are engaged in the fight against money laundering. It lays the groundwork for efforts to combat money laundering by creating an obligation for signatory states to criminalize the laundering

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<sup>67</sup> Ibid Art 2

<sup>68</sup> Acevedo Houguin, (2003), Drug Policy in Colombia- In the Ship of Fools, Available at: <http://www.mamacoca.org>

of money from drug trafficking. It promotes international cooperation in investigations and makes extradition between signatory states applicable to money laundering derived from drug trafficking. It also establishes the principle that domestic bank secrecy provisions should not interfere with international criminal investigations.

#### **b. The Palermo Convention (TOC Convention)**

The UN adopted International Convention against Transnational Organized Crime (TOC) at Palermo, Sicily on 15<sup>th</sup> November 2000 by the General Assembly Resolution 55/25.<sup>69</sup> While this is similar to the Vienna Convention, it goes further by expanding the scope of the predicate offence beyond drug trafficking unlike the Vienna Convention that only dealt about drug trafficking. Accordingly, it specifically obligates verifying countries to include all serious crimes as a predicate offence for criminalizing money laundering. Serious crime according to this Convention means an offence punishable by a maximum deprivation of liberty of at least four years or a more serious penalty.<sup>70</sup> The Palermo Convention requires ratifying countries to adopt the following with regard to money laundering:

- To criminalize money laundering including all serious crimes as predicate offences 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;<sup>71</sup>
- To establish a comprehensive domestic regulatory and supervisory regime for banks and non-bank financial institutions that are susceptible to money laundering in order to deter and detect all forms of money laundering. Such measures shall include record keeping, customer identification and suspicious transaction reports (STRs).<sup>72</sup>

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<sup>69</sup><http://www.unodc.org/unodc/en/treaties/CTOC/index.html> Accessed on August 14, 2010

<sup>70</sup> The Palermo Convention, Art 2 (b)

<sup>71</sup> Id, Art 6

<sup>72</sup> Id, Art 7 (1) (2)

- To establish Financial Investigation Units (FIUs) to analyze and disseminate information and to strengthen cooperation both domestically and internationally.<sup>73</sup> It calls upon state parties to use the relevant initiatives of regional, interregional and multilateral organizations against money laundering in establishing a domestic regulatory and supervisory regime as a guideline.
- To develop and promote global, regional, sub regional and bilateral cooperation among judicial, law enforcement and financial regulatory authorities in order to combat money laundering.<sup>74</sup>

The Palermo Convention was necessary to minimize the gaps that the Vienna Convention was suffering. The Vienna Convention does not use the word money laundering and it doesn't directly address issues concerning money laundering. Its major concern is to avoid the threats to the health and welfare of human beings and the adverse consequences of narcotic drugs and psychotropic substances against the economic, cultural and political foundation of society. It provides to deprive persons engaged in illicit traffic of the proceeds of their criminal activities to eliminate the root cause of the problem of abuse of narcotic drugs and psychotropic substances. Whereas the Palermo Convention deals about criminalizing money laundering that includes the proceeds of all serious crimes and it incorporates mechanisms like record keeping, suspicious transaction report and customer identification that are the major tenets of the day to prevent money laundering.

In addition, it includes protocols against the smuggling of migrants and trafficking in person. This is important because human trafficking creates opportunity for criminal syndicates to exploit high risk migrants by forcing them to involve in criminal activities and subsequently this income is laundered in to legitimate business or to further other criminal activities.

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<sup>73</sup>Id, Art 7(1) (b) and Art 7(3)

<sup>74</sup> Id, Art 7 (4)

In conclusion, the United Nations has come up with conventions and resolutions to combat money laundering in different perspectives. It can be said that the UN Conventions discussed above are ground-breaking documents in that they resulted in the elimination of bank secrecy laws in some countries, triggered the drawing up of national legislations, bilateral agreements and Mutual Legal Assistance Treaties (MLATs), encouraged the creation of international organizations against money laundering and it provided a framework within which law enforcement officers can operate.

#### **2.4.2. Financial Action Task Force (FATF)**

Although the UN and other international bodies continued to develop mechanisms to thwart and detect money laundering and latter terrorist financing, it is acknowledged that the lead institution for international initiative to combat money laundering is now the Financial Action Task Force (FATF) on Money Laundering.

Financial Action Task Force (FATF) is an intergovernmental body formed in 1989 by G-7 countries<sup>75</sup> summit in Paris taking the lead and develop a coordinated international response to preclude the use of financial systems from money laundering.<sup>76</sup> It is a policy making body in the prevention of money laundering and it defines the problem and encourages the adoption of effective counter measures.

The foundation of the FATF response against money laundering is its 40 Recommendations that were originally issued in 1990 and updated periodically in 1996 as well as in 2003 so as to take in to account changes in money laundering methods, techniques and trends.<sup>77</sup> Further in October 2001, in the wake of the Twin Tower terrorist attack in New York, FATF

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<sup>75</sup> G -7 Countries are: Canada, United States, Germany, France, Italy, Japan and United Kingdom.

<sup>76</sup> <http://www.fatf-gafi.org> Accessed on: August 19, 2010

<sup>77</sup> H.E. Ping, (2008), The Measures on Combating Money Laundering and Terrorism Financing in the PRC, Journal of Money Laundering Control, Vol. 11: No.4, P. 321

expanded its mandate and issued eight special recommendations to cover the issue of terrorist financing. In October 2004, the FATF published a ninth special recommendation making its overall standard-the 40+9 recommendation- a strong framework for governments to develop their domestic legislations against money laundering.<sup>78</sup>

The FAFT standards have been endorsed directly by more than 180 jurisdictions around the world as well as by the World Bank, the IMF and the UN.<sup>79</sup> As of 2010, it comprises 34 member jurisdictions and 2 regional organizations.<sup>80</sup>

The 40 recommendations are segmented in to four areas:

- The general framework of the recommendations
- Improvements in the national legal system
- Enhancement of the role of the financial system
- Strengthening of international cooperation.

Scrutinizing the 40+9 recommendations in between the lines, it spells out the risk of money laundering and the responses thereof particularly in the banking sector to control and hopefully to eradicate the predicament. Accordingly,

- Countries must criminalize money laundering
- The proceeds of crime should be frozen and ultimately confiscated.

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<sup>78</sup>FATF Annual Report 2006-2007: available at <http://www.fatf-gafi.org>. Accessed on: August 5, 2010

<sup>79</sup>FATF Annual Report, 2009-2010, P.9, Available at: <http://www.fatf-gfi.org>. Accessed on: October 9, 2010

<sup>80</sup>Members are: Austria, Belgium, Brazil, Canada, Denmark, Finland ,France, Germany, Greece, Hong Kong, China, Iceland, Ireland, India, Italy, Japan, Republic of Korea, Luxembourg, Mexico, Kingdom of Netherlands, New Zealand, Norway, People’s Republic of China, Portugal, The Russian Federation, Singapore, South Africa, Spain, Sweden, Switzerland, Turkey, United Kingdom, United States and Regional Organizations are: European Commission and Gulf Co- Operation Council, (2009-10) FATF Annual Report, P. 9

- Banks and similar entities must install vigorous identification procedures of their customers (CDD)
- Banks must keep records
- Banks must install system, train staff and monitor how they are doing
- Countries law enforcement agencies and institutions should share intelligence
- Bilateral and multilateral treaties must be established and offenders must be extradited.

The 40+9 Recommendation enable countries to enter in to global alliance to fight the activities of money laundering and criminals. Further the FATF standards are designed among other things to take away the profits out of crime through confiscation and to investigate crime by following the money laundering trail and targeting the kingpin or professional launderers.<sup>81</sup> Whilst it is noted that all the recommendations are important and equal to some extent, the focus in this topic is on recommendations that deals about banks in relation to money laundering.

#### **a. Customer Due Diligences (CDD)**

The FATF recommendation, after criminalizing money laundering, comes up with different measures that must be taken by financial institutions to prevent it. Accordingly, sound customers due diligence (CDD) procedures are the critical element in the effective management of banking risks as provided under recommendation 5. CDD safeguards go beyond simple account opening and record keeping but require banks to formulate a client acceptances policy that involves extensive due diligence for higher risk accounts and

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<sup>81</sup>Abdullam Y. Shehu, supra note at 21, P. 142.

including proactive account monitoring for suspicious activities in combination with different profits.<sup>82</sup>

CDD will help to protect the regulation and integrity of the financial system by reducing the likelihood of banks becoming vehicles for financial crimes and it also constitutes essential part of sound risk management. In the other edge, the inadequacy or absence of know Your Custom policy (KYC) can subject banks to serious customer or a counterpart risk; especially reputational, operational, legal or concentration risks which can result in significant cost to banks.<sup>83</sup>

### **b. Politically Exposed Persons (PEPs)**

FATF recommendation 6 enjoins countries 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.

Exploring this in the interpretative part, it says countries are required to include names of PEP's within their jurisdiction whereas the UNTOC (2000) under Art 52 (2) obliges state parties to provide such names on an annual basis to guide financial instruments to implement CDD with regard to PEP's.

### **c. Record Keeping and Suspicious Transaction Reports**

After the end of business relations as part of CDD measures, financial institutions are required to keep records on both domestic and international transactions for at least five years (Reco.10). Such record must be sufficient enough to permit reconstruction of individual

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<sup>82</sup>Ibid, P. 143

<sup>83</sup>Patrick Hardouin, (2009), Banks Governance and Public-private Partnership in Preventing and Controlling Organized Crime, Corruption and Terrorist Financing, Journal of Financial Crime, Vol. 16, No.3, P. 202.

transaction including the amount and type of currency involved in the transaction in a way that may help investigations at the time of prosecution.

When financial institutions suspect or have reasonable ground to suspect that funds are the proceeds of crime or related to terrorist activities, FATF under Reco.13 requires them to report their suspicion promptly to a Financial Intelligence Unit (FIU).

The difficulty lies on the word 'suspicious transaction' It sounds subjective; however, FATF says nothing on this except excluding civil or criminal liability of financial institutions, their directors, officers and employees for breach of any restriction on the disclosure of suspicious transaction. (Reco.14)

#### **2.4.2.1. FATF Recommendations Vs. International Agreement**

Despite the role played by FATF in combating ML/TF, it may not be possible to say that FATF Recommendations are full-fledged and without criticism.

One commentator argues that FATF sanction would violate Art 2 of the UN Charter. As per this provision, each member state has the sovereign right to govern its own executive, legislative and judicial affairs. At the twentieth session of the UN General Assembly, it was declared that:

*No state has the right to intervene, directly or indirectly for any reason whatever, in the internal or external affairs of any other state. Consequently, armed intervention and **all other forms of interference [emphasis added]** or attempted threats against the personality of the state or against its political, economic and cultural elements are condemned.*<sup>84</sup>

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<sup>84</sup> Todd Doyle, Supra note at 8, P. 299

Viewed from this perspective, the FATF ‘Name and Shame’<sup>85</sup> list as Non Cooperative Countries and Territories (NCCT’s) against non members violate article 2 of the UN Charter. Therefore, FATF is threatening not only to impinge up on the sovereignty of the targeted nation but usurp every government function of these sovereign states: executive, legislative and judiciary at least on money laundering issues.

Second, FATF sanction would run contrary to its own 40 Recommendations. These recommendations were designed to be:

*...principles for action...for countries to implement according to their particular circumstances and constitutional framework.*<sup>86</sup>

However, the FATF’s black listing is contrary to this principle up on which the FATF was founded. In other words, although the measures set are termed recommendations’ and technically the FATF has no legal basis to enforce them on every jurisdiction except on members, in practice, they are compulsory on all jurisdictions including non members.<sup>87</sup>

Into to, the FATF’s mission is three fold. The first one is to establish worldwide network to combat ML/TF including membership expansion, instituting global money laundering techniques and establishing a working relationship with appropriate international organs. The second is monitoring members’ progress in implementing anti money laundering measures

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<sup>85</sup> ‘Name and Shame’ involves publicizing the names of countries that fail to comply with the FATF 40 + 9 Recommendations as Non Cooperative Countries and Territories (NCCTs) to induce compliance. A country in “name and shame” list may not be able to access the interbank market for their own refinancing, and foreign banks may decide to terminate their correspondent banking relationships with them.

<sup>86</sup>FATF, 2003 Recommendation. Preamble paragraph 3, available at: the Forty Recommendations, [http://www.fatf-gafi.org/pdf/40Recs-2003\\_en.pdf](http://www.fatf-gafi.org/pdf/40Recs-2003_en.pdf), reprinted in Annex IV of this Reference Guide; and Special Recommendations, [http://www.fatf-gafi.org/pdf/SRecTF\\_en.pdf](http://www.fatf-gafi.org/pdf/SRecTF_en.pdf). reprinted in Annex V of this Reference Guide, Accessed on: July 9, 2010

<sup>87</sup> Abdullahi Y. Shehu, supra note at 21 P.143

including annual self assessment and mutual evaluation. The last step includes updating and reporting money laundering techniques, trends and counter measures against such techniques.

### **2.4.3. Basel Committee on Banking Supervision**

The Committee on Banking Supervision (Basel Committee)<sup>88</sup> was formed by a group of 10 world's most influential capitalist countries in 1974.<sup>89</sup> The declaration made by this Committee is similar to the principles set out in the 40 recommendations of the FATF. It should be noted that these principles do not constitute a law per se; rather they formulate broad supervisory standards and guidelines of good practices on a wide range of supervisory issues.

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).

#### **2.4.3.1. Statement of the Principle on Money Laundering**

The Basel Committee issued its Statement on Prevention of Criminal Use of the Banking System for the Purpose of Money Laundering in 1988.<sup>90</sup> Accordingly, since banks can be used wittingly or unwittingly as intermediaries by criminals, the first and most important safeguard against money laundering is the integrity of banks own management and their vigilant commitment to prevent their institution from being used as a channel for money laundering.

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<sup>88</sup> <http://www.bis.org/indea.html>. Accessed on: August 18, 2010,

<sup>89</sup> The Basel Committee members as well as the group of 10 are: Belgium, Spain, Switzerland, United Kingdom and United States, Canada, France, Germany, Italy, Japan, Luxembourg, Netherlands and Sweden

<sup>90</sup> Fair value measurement and modelling: An assessment of challenges and lessons learned from the market stress (2008) Available at: <http://www.bis.org/publ/bcbs137.pdf>.

There are four principles contained in the Statement on Prevention:

- Proper customer identification (KYC)
- High ethical standards and compliance with laws
- Cooperation with law enforcement authorities
- Policies and procedures to adhere to the statement

#### **2.4.3.2. Core Principles for Banking**

In 1997, the Basel Committee issued its Core Principle for Effective Banking Supervision (Core Principles).<sup>91</sup> These principles provide a comprehensive blueprint for an effective bank supervisory system. Out of the total 25 Core Principles, one i.e. Core Principle 15, deals with money laundering. It states:

*banking supervisors must determine that banks have adequate policies, practices and procedures in place, including strict “know your customer” rules, that promote high ethical and professional standards in the financial sector and prevent the bank from being used; intentionally or unintentionally, by criminals.*<sup>92</sup>

These KYC policies and procedures are fundamental part of an effective AML/CTF institutional framework for every country.

#### **2.4.3.3. Customer Due Diligence (CDD)**

KYC principle entitled customer due diligence for banks (CDD) has been issued by the Basel Committee in October 2001. It was issued in response to noted deficiency in KYC procedures and provides more information on Core Principle 15.

In addition the Base Committee strongly supported the adoption of FATF recommendation particularly those related to banks.

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<sup>91</sup>Core Principles for Effective Banking Supervision: (1997), Consultative Paper Issue by the Basel Committee on Banking Supervision, Available at: <http://www.bis.org/publ/bcbs30-pdf>.

<sup>92</sup> Id. Core Principle 15

## **2.5. Regional Anti Money Laundering Initiatives**

### **2.5.1. FATF Style Regional Bodies (FSRBs)**

FATF style regional Bodies (FSRBs) are groups organized according to geographical regions. These groups are very important in the promotion and implementation of anti-money laundering laws and combating the financing of terrorism in their respective regions. In the same token, their primary objective is to facilitate the adoption of universal standards as set out by the FATF and how the 40+9 recommendation can be effectively implemented in their regions.

FSRBs are voluntary and cooperative organizations that administer mutual evaluation of their members so that they can identify their weaknesses and take remedies accordingly. Further, FSRBs provide information to their members about trends, techniques and other development in the money laundering arena in their typology reports with special emphasis to their respective regions.

The FSRBs that have associate membership status in the FATF are: <sup>93</sup>

- Asia-pacific Group on Money Laundering (APG) -40 members
- Caribbean Financial Action Task Force (CFATF)- 31 members
- Council of Europe Committee of Experts on Evaluation of AML Measures and the Financing of Terrorism (MONEYVAL) -28 members
- Financial Action Task Force on Money Laundering in South America (GAFISUD) Spanish abbreviation) -10 members
- Middle East and North Africa Anti-Money Laundering Groups (MENA FATF)-10 members
- Eastern and Southern Africa Anti- money Laundering Groups (ESAAMLG)-10 members

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<sup>93</sup>FAFT 2009-2010 Annual Report, P. 11, [www.fatf.gafi.org](http://www.fatf.gafi.org) Accessed on October 5, 2010

- Eurasia Group on Combating Money Laundering and Financing of Terrorism (EAG)-  
7 members
- Inter governmental Action Group against Money Laundering on Africa (GIABA)-15  
members and
- Off shore Group of Banking Supervisors -15 members

### **2.5.2. Wolfsberg Initiative (1999)**

After a series of reputational disasters for the banking industry, the ‘Salinas’ and the ‘Bank of New York Scandals’ in the USA and the fallout of the various ‘Abacha’ cases in Europe, two leading banks were convinced to form the nucleus group which rapidly grew to twelve key industrial players controlling roughly 60-70% of the world private banking called the Wolfsberg groups.<sup>94</sup>

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<sup>95</sup>

The Wolfsberg group has established four sets of principles for private banking that includes, Wolfsberg Anti Money Laundering Principle on Private Banking (2000) followed by Statements on the Suppression of Financing of Terrorism (2002), AML Principle for Correspondent Banking and texts relating to monitoring, screening and searching.<sup>96</sup>

Accordingly in its Anti-money Laundering principle it provides 11 principles that require due diligence procedures for opening and keeping watch over accounts especially those identified as Politically Exposed Persons (PEPs).<sup>97</sup> Wolfsberg Statement on the Suppression and

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<sup>94</sup>Mark Pieth, (2006), Multi Stakeholders Initiative to Combat Money Laundering and Bribery, 4002 Basel, Switzerland, working paper No. 2, P. 6

<sup>95</sup><http://www.wolfsberg-principles.com/indea.html>. Accessed on: August 18, 2010

<sup>96</sup>Abdullahi Y. Shehu, (2005), International Initiatives against Corruption and Money Laundering: An Overview, Journal of Financial Crime, Vol. 12, No. 3: P. 240

<sup>97</sup>[Http://www.wolfsberg-principles.com/private-banking.html](http://www.wolfsberg-principles.com/private-banking.html). Accessed on: Sept. 5, 2010

Financing of Terrorism described the roles that banks should play in fighting terrorism financing. Assisting competent authorities through prevention, detection and information sharing, adopting KYC policies and procedures and applying extra due diligence when they see suspicious or irregular activities are the principle provided in the statement.<sup>98</sup>

The groups in its principle on money laundering against correspondent banks adopted 14 principles to govern their relation with correspondent banks.<sup>99</sup> As per this principle, it prohibits doing business with shell banks. In general the Wolfsberg principles are a non-binding set of best practice guidelines governing the establishment and maintenance of positive relationship between private banks and clients.<sup>100</sup>

### **2.5.3. Organization of American States (OAS)**

The Organization of American States (OAS) is a multinational regional body designed for developing peace and diplomacy in the western hemisphere in which all 33 countries of the American Continent are members and they all have ratified the charter.<sup>101</sup>

In 1986, OAS established the Inter-American Drug Abuse Control Commission (CICAD) to fight the growing problems of drug trafficking and latter regional money laundering issues.<sup>102</sup>

In May 1992, the General Assembly of the OAS adopted the model regulation concerning laundering offences connected to illicit drug trafficking and related offences.<sup>103</sup>

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<sup>98</sup>[http:// www.wolfsberg-principles.com/financing-terrorism.htm/](http://www.wolfsberg-principles.com/financing-terrorism.htm/) Accessed on: Sep.5, 2010

<sup>99</sup> <http://www.Wolfsberg-principles.com/corresp-banking.html>. Accessed on: Sep. 9, 2010

<sup>100</sup> Kris Hinterseer, (2001), The Wolfsberg Anti money Laundering Principle, Journal of Money Laundering Control, Vol.5, No. 2, P. 25

<sup>101</sup> OAS is signed in Bogota in 1948 and its aim include, inter alia solving common legal problems like the prevention of money laundering through a uniform legal framework. <http://www.oas.org/main/english>. Accessed on: August 20, 2010

<sup>102</sup> Bruc Zagaris and Sheila M. Castilla, (1996), Constructing International Financial Enforcement Sub regime: The Implementation of Anti-money Laundering Policy, Brook. J. Int'l Law. Vol. XIX: 3, P.

<sup>103</sup> Daniel Mulligan, supra note at 57, P. 2355

The primary objective of the model regulation includes:<sup>104</sup> criminalizing laundering of property and proceeds related to illicit drug trafficking, prevent the use of financial systems for laundering money, enable authorities to identify, trace, seize and forfeit property and proceeds connected to illicit acts and to change bank secrecy laws in a way that do not impede effective investigation and to permit governments for information sharing.

The model regulation, although it is considered as soft law<sup>105</sup> complement Latin American Continental and Common Law legal systems and prepare legal models conditioned for enactment, individually or as part of a comprehensive program.<sup>106</sup> While the model regulation is not binding, it serves as a suggested statutory framework designed to facilitate the adoption of anti-money laundering legislation in countries that do not have the resource to develop their own legislation.<sup>107</sup> Further, the model regulation is better tailored than legislations simple borrowed from other countries.<sup>108</sup>

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<sup>104</sup>Paulin L. Jerez, (1997), Proposed Brazilian Money Laundering Legislations: Analysis and Recommendation, Am. U. J Intl'l Law and Policy, P. 345

<sup>105</sup>Ibid P. 345

<sup>106</sup>Soft law refers to inter governmental resolutions and recommendations that are not binding on member states as opposed to hard law.

<sup>107</sup>Phyllis Solomon, (1994), Are Money Laundering All Washed up in the Western Hemisphere? The OAS Model Regulation, Hasting Int'l and Comp. Law, Rev. Vol. 17:433, P. 445

<sup>108</sup>Ibid

## CHAPTER THREE

### 3. Money Laundering Milieu in Ethiopia: Critical Analysis and the International Initiatives

#### 3.1 Introductory Remark

Money laundering as discussed so far is an attempt to hide the proceeds of crime by integrating such proceeds into other legitimate property or by confusing the audit trail in such a way that the authorities cannot trace the proceeds back to the original crime.

The concept money laundering became a phenomenon after the promulgation of the new proclamation No. 657/2009 on the issue and the initiation of some cases in this respect. Due to the clandestine nature of the crime and absence of consolidated data, it is impossible to extrapolate the amount of money laundered in Ethiopia; however, there are indications that money laundering is breaking out in the country.

For instance in 2010, Gebrekidan Beyene, the General Manager and shareholder of Gebrekidan Beyene PLC, has been charged by the Ethiopian Revenue and Customs Authority (ERCA) Prosecutor with seven counts and the largest one is on money laundering for 78 million birr.<sup>109</sup> ERCA has also won similar cases against Ayele Debela (General Manager and Shareholder of ADH International) and Kebede Tesera, General Manager and shareholder for Bereket PLC.<sup>110</sup>

Recently, the Federal Police have arrested 47 people suspected of money laundering on November 9, 2010 and their case is pending at the Arada District of Federal First Instance Court.

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<sup>109</sup>Kebrekidan Beyene has been Sentenced to 21 years of imprisonment and 211,200 br. fine though the prosecutor requested for 25 years of imprisonment, 100 million br. fine and a confiscation of 159 million br., Kebrekidan Beyene Vs ERCA, File No 85362, Federal High Court

<sup>110</sup>Ayele Debela Vs ERCA, File No. 82604 and Kebede Tesera Vs ERCA, File No. 82321, Federal High Court

Corruption, smuggling and contraband as well as tax evasion are the major threats to the country that inevitably involve money laundering activities.<sup>111</sup> The severity may be seen from the fact that the Ethiopian Revenue and Customs Authority has recouped around 400 million birr from contraband and illegal items as well as illegal transfer of duty free items to third parties in the 2008/9 and 2009/10 fiscal year.

These all demonstrate how much emphasis should be given to offences of money laundering to make it unprofitable by taking profits out of the crime. This is possible but only through full-fledged, strong and enforceable anti money laundering law that needs the commitment of the government in every sphere.

Believing this, the government has promulgated a law- the Prevention and Suppression of Money Laundering and Financing of Terrorism No. 657/2009 (here in after the AML law). The AML law does not define the word money laundering rather; it extends to Art 684 of the criminal code. In the same token, this code does not also define money laundering but explains the requirements for an offence to be a money laundering offence. This provision just criminalizes money laundering and enumerates predicate offences of money laundering though not exhaustive.

From the general reading of this provision, it can be understood that money laundering is the process of turning illegitimately obtained money or property into seemingly legitimate money

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<sup>111</sup>It is inescapable to raise the issue of gold-plated iron bars submitted to the NBE which eventually prompted an expensive investigation that revealed a complicate system of corruption and fraud involving officials at both the NBE and Geographical Survey of Ethiopia (GSE) in 2008 (TI Global Corruption Report, 2009). ERCA is playing an important role in addition to its main function against money laundering. It confiscated 2 million br. worth of contraband textiles and electronics in Addis Ababa on Oct. 13, 2010 while trying to smuggle the goods in to the country under a heap of cattle fodder. (Fortune Newspaper, Vol. 11, No 547, Oct. 24, 2010). In the same token, even companies like Niyala Motors is charged by ERCA for alleged tax evasion of 23 million br. of income tax and VAT tax and money laundering of the same amount. (Fortune Newspaper, Vol. 11, No. 542, Sep.19, 2010) These all witnessed how much the problem of money laundering is staggering.

or property and it includes concealing or disguising the nature, source, location disposition or movement of the proceeds of crime or knowingly alerting, remitting, receiving or possessing such tainted money.

Having this in mind, the next subtopic deals about money laundering under Ethiopian context and the strength and pitfalls of the new proclamation as well as other related laws in comparison with international standards as made by the major international initiatives on the same.

### **3.2 Criminalizing Money Laundering**

The first paramount move that a country should take in order to improve its AML framework is criminalizing money laundering. Accordingly, the Ethiopian law criminalized money laundering for the first time under Art 684 of the Criminal Code.

Three wider substantive offences may be discerned from this provision. The first one is concealing of offences under Art 684(1) which covers concealing, disguising or transferring criminal property from one's own act through investment, transfer or remission. The second is an arrangement offence that covers intentional involvement in an arrangement for concealing or disguising the illicit origin of the property or helps any person involved in the commission of the same crime or conceals the true nature, source, location, disposition, movement or ownership or right with respect to the property (Art 684[5]). The third one is acquisition, use and possession of property or money while knowing the unlawful source. (Art 684 [2]) From the reading of Art 684 of the Criminal Code, it embraces a range of predicate offences which among other includes corruption, drug trafficking and illegal arms dealing. It further includes other serious crimes as defined under sub article 7 of the same provision. Serious crime, accordingly, means a crime punishable with rigorous imprisonment

of ten or more years or where the amount of money or the value of the property involved in the crime is at least fifty thousand birr.

A point to be mentioned here is the discrepancy between the Amharic and English version of Art 684(7). The English version uses the above elements i.e. the imprisonment and the amount of money as a cumulative element to define serious crime whereas the latter used these words as an alternative requirement which seems to be more appropriate. Further, since the Amharic version is the authoritative one, the two requirements should be treated separately. When scrutinizing the provision of the Criminal Code in such approach, the following could be included as a predicate offence of money laundering under the guise of serious crimes. Pillage, piracy and looting (Art 273), receipt of ill-gotten gains (Art 307), illicit trafficking in gold, currencies or foreign exchange (Art 346), illicit trafficking in precious minerals (Art 347), endangering sources of revenue (Art 351), contraband in aggravated cases (Art 352(2) and Art 354), forgery (Art 357), debasing (Art. 358), trafficking in women and children (Art 597) and robbery (Arts 670,673) are to be mentioned but some.

However, the definition given for the word 'serious crime' is too narrow. It excludes other offences like trafficking in women as prostitution (Art 635) and organization for this purpose (Art 637), sexual exploitation for pecuniary gains (Art 634), counterfeiting currency (Art 609) which may generate unpredicted profit for those involved in such crime. However, such profit may not make offenders liable under money laundering for the fact that those offences are not included under the definition of 'serious crimes' unless their profit falls beyond 50,000 birr. If not, they escape from money laundering offences. Defining serious crime based on the amount of money or the value of the property involved in the crime may create such escaping line from being punished on money laundering and narrow down the ground play for prosecuting launderers.

The Palermo Convention (2000) defines 'serious crime' as a conduct constituting an offence punishable by a maximum deprivation of liberty at least for four years or a more serious penalty. FATF also requires countries to include all serious crimes punishable by a maximum of more than one year imprisonment or for those countries with a minimum threshold in their legal system predicate offences should comprise offences which are punishable with a minimum penalty of more than six months imprisonment.

The Ethiopian case, however, is ten or more years of imprisonment or if the amount of money or property involved is more than 50,000 birr without regard to year of imprisonment. This therefore, may pave the way to exclude a number of predicate offences from money laundering unlike the FATF's approach.

State of mind is also another contentious issue that must be addressed. Art 684 (2) provides assisting in the process of money laundering as an intentional offence. Assistance may be given recklessly but the law fails to include the probability of being reckless while the perpetrator should have known of such proceeds of crime, i.e. negligent money laundering. Some come up with the idea of 'wilfully blind' state of mind where the accused should have known of the crime by investigation but choose not to pursue investigation because of his ignorance. This accordingly falls in between negligence and intention.

The broad perspective of defining 'state of mind' may be important to alert certain groups like lawyers, accountants and other professionals who may give assistance in the money laundering process in order to narrow the gap of defending themselves using this lacuna. So the Ethiopian approach may be a strong one if designed in such a wider sense.

The other problem is in relation to the property involved in the money laundering crime. This crime is included under title III chapter II of the Criminal Code that deals about movable property and subsequently chapter III comes with immovable property. Hence there could be

an argument that money laundering is about movable property and does not include immovable property. This problem of the Criminal Code could be overridden by the AML proclamation that defines ‘property’ in a wider sense to include movable or immovable, tangible or intangible including currency, monetary instrument and legal documents.

Despite the above lacunae of Art 684 of the Criminal Code, the inclusion of legal persons to be punished in case of money laundering (corporate liability) and the independent existence of the crime is an important move in the fight against money laundering.

### **3.3 Covered Persons**

Without the involvement of financial institutions, certain business organizations and persons, it could not be possible for launderers to launder their ill-gotten money. Accepting this reality, the AML law has come up with a provision that exhaustively enumerates persons who are designated as accountable persons as discussed below.

#### **3.3.1 Financial Institutions**

Financial institutions may be wittingly or unwittingly participants in laundering activities. It is axiomatic that criminals with ill-gotten proceeds must have access to financial institutions in order to clean their dirty money. In most countries and particularly in developing countries including Ethiopia, banking is the most important part that dominates the financial system.

Banks have been the major targets of laundering operations because they provide finance related products and services, facilitating domestic and international payment including cashier’s cheques, traveller’s cheques and wire transfers which can be used to disguise the

origin of funds derived from illegal activities.<sup>112</sup> In this regard, a country's AML regime should start with its Banks.

Ethiopia, no exception to this, has incorporated financial institutions including banks as answerable persons in the fight against money laundering. The AML proclamation does not define financial institutions and it rather leads the definition to be in accordance with the banking business proclamation.

Financial institutions therefore mean insurance companies, banks, microfinance institutions, postal savings, money transfer institutions or such other institutions as may be determined by the National Bank of Ethiopia (NBE).<sup>113</sup>

These institutions are accordingly covered persons in the fight against money laundering indebted with different anti money laundering responsibility. Because of their pivotal role in the financial system, any bank not having effective AML program is the one most likely to be exposed to money laundering risks and liable to be exploited by criminals. In order to protect the integrity of financial institutions therefore, a country must have a full-fledged anti money laundering regime. Since this issue is to be discussed in the next chapter, it suffices to say that Ethiopia has started its fight against money laundering from its banks.

### **3.3.2 Non-Financial Institutions**

The AML proclamation has come up with enumerated non financial institutions and entities that are potentially vulnerable to money laundering. Because of the different business environment, these institutions are not or could not be subjected to the same requirement as

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<sup>112</sup>Money Laundering Prevention, A Money Service Business Guide, Financial Crime Enforcement Network, U.S. Department of Treasury, Washington, DC. P. 5

<sup>113</sup>Banking Business Proclamation No. 592/2008, Art. 2(9)

financial institutions.<sup>114</sup> The details to govern these non financial institutions are yet to be issued by the Financial Intelligence Centre (FIC). The following are covered persons as per the AML proclamation.<sup>115</sup>

- Money transfer agents or a foreign exchange bureau
- A financial leasing company
- The Ethiopian Revenue and Customs Authority (ERCA)
- A notary office or an agent empowered to authenticate documents
- A licensing authority
- Ethiopian Investment Agency
- NGO's, religious institutions or other charitable organizations.
- An advocate, a licensed accountant or an auditor
- A dealer in precious metals and gems
- A broker, dealer or investment advisors

An exhaustive discussion of each accountable person requires further research which is beyond the scope of this research but due to their peculiarly nature I will have a brief discussion about professionals and charitable organizations to initiate further research on these issues.

**Professionals:** the introduction of new and strong measures to close off the conventional means of access into the financial system for dirty money at national, regional and international level has resulted in seeking out and using new get ways.<sup>116</sup> Though it is a huge

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<sup>114</sup>The legislature believing that financial and non financial institutions need different attention, delegates the NBE to issue a directive that would govern financial institutions and the FIC regarding other non financial institutions

<sup>115</sup> A Proclamation on the Prevention and Suppression of Money Laundering and Financing of Terrorism, Art 2

<sup>116</sup>Paul Waller and Katrin Roth V. Szepesbela, (2004), Silence is Gold- or is it? Fintrac and the Suspicious Transaction Report Requirements for Lawyers, Asper Rev. Int'l Bus. and Trade L., Vol. 4, P. 89

loss for the society to lose their educated talent stock to such evil against the society, here are lawyers, accountants and auditors who may be a vehicle for money laundering activities.

Money laundering operation often requires a highly technical knowhow and access to legal business and hence launderers call for such professionals. Lawyers for instance may participate in any one of the three stages of the money laundering process through legal advice, purchase or sale of property, hiding behind corporate or other vehicle and drafting documents.<sup>117</sup>

The 1998/99 FATF annual report notes:

*The experts have observed a growing tendency for professional service providers, such as accountants, solicitors, company formation agents and other similar professionals to be associated with more complex laundering operations*<sup>118</sup>.

The Ethiopian AML law has also included lawyers, accountants, and auditors as professionally responsible in the fight against money laundering. These groups are expected to identify their clientele, keep records and report suspicious activities.

Strictly speaking, the proclamation could not be implemented as long as there is no directive that must be issued by the FIC. Yet, the law provides the framework that should be included in the directive. Accordingly, know your customer rule, suspicious transaction report and record keeping are the common denominations to be included in the directive.

Placing similar obligations upon legal professionals will be problematic for the fact that lawyers are independent professional advisors unlike financial institutions. Further reporting on suspicious client's activity may endanger lawyer's duty of confidentiality.

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<sup>117</sup>Peter Camp, (2004), Solicitors and Money Laundering, A compliance hand book, the Law Society, 1<sup>st</sup> ed P. 7

<sup>118</sup>FATF Annual Report , 1998-99 Available at: [http://www.fatf-gafi.org/pdf/AR1999\\_en.pdf](http://www.fatf-gafi.org/pdf/AR1999_en.pdf) Accessed on August 9, 2020

In conclusion, the FIC should prepare a directive that complements all the special features of the profession so that such professions would be used to fight money laundering and continue serving justice.

**NGO's, Religious Institutions or Charitable Organizations:** Many countries, particularly developing one, recognizes the important and significant role that the voluntary society plays in building a strong, caring and a well functioning society as well as in contributing welfare, employment and economic growth.

Despite their significant role, they may also be harmful if they are to be abused by the donors or third parties such as fraudsters or money launderers.

The proclamation includes these institutions as they are susceptible to many laundering activities. However, the application of preventive measures particularly with respect to religious institutions may be with difficulties. Donors to such religious institutions may reduce their donation if they are to be investigated due to the report of the institutions and hence institutions may not be cooperative to do so.

Measures like KYC, STR and CTR may also contradict with the dogma of some religions. In addition to the burden these responsibilities may impose, it may be difficult to make these obligations applicable to religious institutions. Further, there is no directive that contains specific elements and yet it is impossible to change the proclamation into practice.

### **3.4. Money Laundering-Corruption Nexus**

In many developing countries, money laundering schemes are inextricably linked to corruption. These twin problems have a devastating impact on national economy, international security and human development.

Corruption and money laundering are symbiotic. These two crimes usually occur together but most importantly, the presence of one tends to create and reciprocally reinforce the incidence of the other.<sup>119</sup> Corruption causes significant macroeconomic failures. As stated by the World Bank:

*The Bank has identified corruption as the single greatest obstacle to economic and social development. It undermines development by distorting the rule of law and weakening the institutional foundation on which economic growth depends.*<sup>120</sup>

It can be concluded that corruption and money laundering are a related and self-reinforcing phenomenon.

Similarly, the United Nations has stated:

*There are important links between corruption and money laundering ... A high degree of coordination is thus required to combat both problems and to implement measures that impact on both areas.*<sup>121</sup>

Ethiopia ranks 120 out of 180 countries according to the Transparency International (TI) index of 2009; it does not adequately address the nexus between money laundering and corruption unlike money laundering with terrorist financing.

In the legal regime governing money laundering in Ethiopia, the two issues; money laundering and corruption have been considered in isolation except indicating corruption as a predicate offence under Art 684(1) of the Criminal Code of Ethiopia.

The main reason for the failure to appreciate the close relationship between corruption and money laundering is primarily symbolism. In developing countries, laws are often maintained on sufferance to act as window-dressing in impressing powerful outsiders rather than

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<sup>119</sup>David Chaikin and J. C. Sharman, (2009), Corruption and Money Laundering, A Symbiotic Relationship, Palgrave Macmillan Publisher, 1<sup>st</sup> ed., P. 4

<sup>120</sup>World Bank, [www.worldbank.org](http://www.worldbank.org) Accessed on Sep. 19, 2009

<sup>121</sup>David Chaikin and J. C. Sharman, Supra note 119, P. 3

addressing important local priorities. Many developing countries are passing laws and regulations and establishing institutions to combat money laundering mainly to impress the international community, particularly aid donors, the Bretton Woods Institutions<sup>122</sup> and developed countries.<sup>123</sup> To substantiate this, U.S senator John Kerty, in proposing amendment to the Anti-Drug Abuse Act 1988, said

*...We must force other countries to adopt the same legal standards as we impose on our own institutions, whether they want or not ....*<sup>124</sup>

Subsequent to this year, FATF was established in 1989 by G-7 countries under the leading role of USA which is an international body that sets standards to combat money laundering and latter terrorist financing after 9/11 U.S. terrorist attack. Of course, terrorism was proposed to be included in the UN Convention against Transnational Organized Crime by the delegates of Turkey and Egypt, but most delegates felt terrorism was not a global problem until 11<sup>th</sup> Sep-2001.<sup>125</sup>

In the same vein, many African delegates insisted that corruption should be included among offences of the TOC Convention (2000) however; other delegates felt this type of corruption

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<sup>122</sup> Bretton Woods Institutions are the results of the United Nations Monetary and Financial Conference that took place in July, 1944. The then industrialized countries come together at Bretton Woods to talk about ways of rescuing their economies from the 1930's Great Depression. Thus, this Conference resulted in the creation of the Bretton Woods Institutions- International Monetary Fund ( to help stabilize international exchange rates) and International Bank for Reconstruction and Development ( to provide economic assistance war-ravaged nations and which later came to be known as the World Bank). Andre Solimano, (1999), Globalization and National Development at the end of the 20<sup>th</sup> century: Tensions and challenges, World Bank Policy research Working Paper no. 2137 World Bank, p.2 available at the URL: <http://ssrn.com/abstract=620649>

<sup>123</sup>David Chaikin and J. C. Sharman, Supra note 119, p. 22

<sup>124</sup>Rowan Bosworth-Davies, (2008),The influence of Christian moral ideology in the development of anti-money laundering compliance in the west and its impact, post 9-11, upon the South Asian Market, An independent evaluation of a modern phenomenon, Journal of Money Laundering Control, Vol.11, No. 2, P.181

<sup>125</sup>Abdullahi Y. Shehu, supra note 96, P. 240

(i.e. looting of treasury) was not a serious problem in their countries and consequently rejected the proposals to include corruption in the TOC (2000).<sup>126</sup> No sooner had the convention on TOC been ratified, the UN had initiated a new separate convention against corruption- United Nation Convention against Corruption, (UNCAC) in 2003.

The influence of these international bodies is also reflected in Ethiopia's proclamation on the prevention of money laundering and financing of terrorism as well as on anti-terrorism proclamation. The former in its preamble provides that one of the major reasons for the promulgation of the proclamation is the fight against money laundering and financing of terrorism in various international fora. But being a burning issue for the international community (actually for the developed ones) should not be a major objective for the fight against this crime. I am not arguing that AML is no need for Ethiopia but it should have the objective to address current local issues rather than crooning with developed countries objective, (i.e. in addition to their objective in order to avoid their negative influence). Of course, there is an argument that it may be "an article of faith" among rich countries that poor countries need AML systems, the latter have a much unsure ambivalent attitude to the subject.<sup>127</sup>

Further, Ethiopia fails to appreciate the nexus between money laundering and corruption, while it tries to reconcile its laws with the 40+9 FATF recommendations to escape from 'black listing' of the FATF as it can be envisaged from the preamble of the AML proclamation 657/2009. The FATF recommendations were drawn up to operate in the context of its members' large and sophisticated financial environment and their experience. They basically deal with their own problems; drug trafficking in the early days and terrorism and terrorist financing in the aftermath of Sep. 11 attacks.

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<sup>126</sup>Ibid

<sup>127</sup>David Chaikin and J. C. Sharman, *Supra* note 119, P. 22

In general, corruption can facilitate the laundering of the proceeds of crime, so too money laundering aid corruption. For example, if a minister or other Politically Exposed Person (PEPs) has received a large cash kickback in return for selecting a particular foreign contractor, the officer in question must hide the illicit origins of these funds. In essence the challenge is no different from those faced by drug-traffickers or any other profit-driven crime.

Therefore, the law should create strong nexus between the two to the extent that corruption is kept out of the system and the vice versa and thus money launderers and corrupt individuals will tend to be caught and the associated underlying crimes can be expected to fall.

### **3.5. Money Laundering-Terrorist Financing Nexus**

Governments are more concerned about the physical safety of their citizens, wherever they are, especially about threats that may come from terrorism due to its vast damaging consequences.

Terrorism is the systemic belief in the political, religious, or ideological efficacy of producing fear by attacking- or threatening to attack- unsuspecting or defenceless population and usually by surprise.<sup>128</sup> It requires a huge capital to perform it. The estimated money used for Sep. 11 attack and London bombing<sup>129</sup> invites a more fundamental question: how do terrorists acquire money? Here comes financing of terrorism. Terrorists are able to carry out their insidious activity on a global scale through their undetected financial structures. The

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<sup>128</sup> Encyclopaedia of Espionage, Intelligence, and Security. (2004), Terrorism, Philosophical and ideological Origins Vol. 3, R-Z, Gale Group Inc. P. 148

<sup>129</sup> Michael Levi, (2010), Combating the Financing of Terrorism: A History and Assessment of the Control of Threat Finance, Oxford University Press, The attack on the twin tower of U.S. on Sep.11 costs terrorists U.S. \$ 500,000. The London bombing of July 7 is estimated to have cost around £ 8000. Available at: <http://bjj.oxfordjournals.org> Accessed on August 5, 2010

emphasis on halting the funding of terrorist activities, preventing terrorist financing and ensuring that racketeers do not get benefit from their activities are the underlined principles at international as well as domestic level to combat money laundering.

The turning point in the fight against terrorist financing and money laundering move into the spotlight is the Sep.11 terrorist attack against U.S. Before this day, the issue of terrorist financing was nowhere near the top of the policy agenda at national and international levels.

The UN 1999 Convention for the Suppression of the Financing of Terrorism was ratified by four countries by that milestone date excluding USA.<sup>130</sup> Even the U.S. Government officials were criticizing anti money laundering measure about the cost benefit equation and utility of AML requirements on the financial sector.<sup>131</sup>

All these changed dramatically with the 9/11 furry of terrorism in which international and national measures were introduced in pursuit of this objective. The FATF 9 recommendations against terrorism after one month of Sep.11, 2001, the speedy ratification of the UN Convention (1999) on financing of terrorism, UN Security Council Resolutions 1368 and 1373, the IMF and World Bank incorporation of terrorist finance evaluation practices, new laws aimed at the identification, freezing, seizure and confiscation of assets suspected to be for terrorist or terrorist financiers were the phenomenon envisaged after that cutting edge.<sup>132</sup>

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<sup>130</sup>Nikos Passas, (2006), Setting global CFT Standards: a critique and suggestions, Journal of Money Laundering Control, Vol. 9, No. 3, P. 281

<sup>131</sup>Ibid

<sup>132</sup>Alison S. Bachus, Supra note at 40, P. 859

FATF, the main intergovernmental body fighting money laundering in the international arena, has removed the specific reference to drug in the 2003 version of its recommendations and includes 9 special recommendations that exclusively deal with anti-terrorism.<sup>133</sup>

FATF's special recommendation II requires countries to criminalize terrorist financing, terrorism and terrorist organizations and to designate these offences as predicate offence for money laundering.

The Ethiopian Government acknowledges terrorism and terrorist financing is menace to peace and security to the country, to the people and the world at large; it issued anti-terrorist proclamation No. 652/2009. It also criminalizes terrorist financing under the prevention and suppression of money laundering and terrorist financing law together with the anti terrorist proclamation.<sup>134</sup> Accordingly financing terrorism is a criminal act punishable with rigorous imprisonment from 10 years to 15 years. Looking these provisions from the FATF's perspective, the writer believes that terrorist financing in Ethiopia is adequately criminalized, however, FATF in its ongoing review of compliance claims deficiency in criminalizing terrorist financing.<sup>135</sup> This is not convincing because from the cumulative reading of Art 16 of Anti Money Laundering Proclamation and Art.5 of Anti-terrorist Proclamation, whoever knowingly or having reason to know that his act has the effect of supporting the commission of terrorism or terrorist organizations by providing forged or false documents; giving advice, collecting or making available any property, monetary, financial or other related services is punishable with rigorous imprisonment from 10 years to 15 years. It even goes beyond

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<sup>133</sup>FATF Special Recommendations on Terrorist Financing, Available at: [http://www.fatf-gafi.org/SRecs\\_en.htm](http://www.fatf-gafi.org/SRecs_en.htm), Accessed on July 13, 2010

<sup>134</sup>AML Proclamation, Supra note 115, Art. 16

<sup>135</sup>Improving Global AML/CFT Compliance: on-going process, 25 June 2010, Available at: [www.coe.int/t/dghl/.../About/FATF\\_AMLCFTCompliance\\_June2010.pdf](http://www.coe.int/t/dghl/.../About/FATF_AMLCFTCompliance_June2010.pdf). Accessed on July 20, 2010

material financing by including skill, expertise or any moral support. So, there is nothing more to be criminalized about financing of terrorism than what is provided for.

Regarding the incorporation of terrorist financing as a predicate offence for money laundering, the Ethiopian approach may be seen from two perspectives but the writer does not even agree to the position taken by the FATF in this respect.

Terrorist financing according to the definition given by the Ethiopian Criminal Code, Art 684(7), falls under the category of serious offences. Sub art 1 of the same provision states that:

*Whoever launders money or property, derived from corruption, drug trafficking ...or any **serious crime**, by disguising its sources...*

Since terrorist financing is punishable with rigorous imprisonment from 10 to 15 years, yes, it is a serious crime but, simply because an offence is a serious crime by definition does not make that offence predicate for money laundering. The problem is the absence of definition for the word 'predicate offence'. Reading art 684 of the Criminal Code in between the lines, it can be possible to say that for an offence to be predicate offence for money laundering, the following are mandatory requirements.

1. There must be money or property acquired due to the commission of a crime and
2. The crime should be crimes like corruption, drug trafficking, illegal arms dealing or any similar serious crimes that is;
  - Crimes punishable with rigorous imprisonment for 10 or more years or
  - Where the money or the value of the property involved in the crime is at least fifty thousand birr.

Terrorist financing in this prospect may be seen from two angles. The money or the property to finance terrorism may come from a legitimate source or it may be from illegitimate source.

In case the money used to finance terrorism is from a legitimate source, it could not be in any way a predicate offence to money laundering for lack of the first requirement provided above.

Whereas, if the money or property used to finance terrorism is from illegal source, here again the financing of terrorism by itself will not be a predicate to money laundering but the illegal act that brought the money if it fulfils the second requirement provided above. In other words, terrorist financing by itself will not fulfil the requirements provided under Art 684 of the Criminal Code and hence cannot be a predicate offence for money laundering.

This argument may also be strengthened by looking into the UN Convention against Transnational Organized Crime Art 2(h) that defines predicate offence as:

*Predicate offence shall mean an offence as a result of which **proceeds have been generated (Emphasis added)** that may become the subject of an offence as defined in article 6 of this convention.*

Under this measurement, financing of terrorism is an offence but generates no proceeds rather, takes away a lot of money from the financers and hence cannot be qualified as a predicate offence for money laundering. Therefore, recommendation II of the FATF nine recommendations does not satisfy elements that must be fulfilled in order to be a predicate offence for money laundering. As a matter of fact, even the USA 2007 National Money Laundering Strategy focuses for the first time exclusively on money laundering believing the difference between the two and the strategies to be applied against them.<sup>136</sup>

However, these two offences, money laundering and financing of terrorism may use the same financial channels and employ similar techniques in order to escape from detection by law enforcement organs<sup>137</sup> and hence a similar approach may be adopted to combat the two. It is

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<sup>136</sup>The 2007 National Money Laundering Strategy, USA, P. V

<sup>137</sup>Ibid

precisely at this juncture that the strongest analogy between the two can be seen, otherwise it should be recognized that they are in different categories

### **3.6. Confiscation, Freezing and Seizure**

Confiscation is the deprivation of property rights by the decision of a court as a consequence of a criminal offence that aims to enhance the effectiveness of criminal justice in its fight against any type of profit driven crime.

Since confiscation occurs after criminal conviction, the accused may put away the properties in order to escape confiscation. But here is freezing and seizure that may be used to prevent any dealing, conversion, transfer or disposal of such property before confiscation.

Freezing, according to the Ethiopian AML law is the temporary prohibition of conversion, transfer, disposition or movement of property by order of the court. Seizure in a similar fashion is the temporary control of the property upon order by the court.<sup>138</sup> These two are important tools for the proper implementation of confiscation. The only single provision about seizure other than the definition in the AML proclamation is Art 10 that deals about seizure of foreign property in relation to foreign crimes. This provision extends the issue to be governed by the anti-corruption proclamation *mutatis mutandis* but again, the anti corruption proclamation does not contain any provision about seizure. To avoid this big drafting gap, going to the Ethiopian Criminal Procedure Code may be of some help in avoiding problems in relation to seizure of properties due to money laundering offences.<sup>139</sup> However, the issue of seizure in the fight against money laundering needs to be addressed. In relation to freezing, the provisions in the anti corruption proclamation under the caption

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<sup>138</sup>AML Proclamation Art 2 (7)

<sup>139</sup>Ethiopian Criminal Procedure Code, Art 32

restraining order can be used for the purpose of freezing properties as a result of money laundering offences.

### 3.6.1 Confiscation

There are three types of confiscation.<sup>140</sup>

1. Confiscation of the instruments of crime (*instrument sceleris*)
2. Confiscation of the subject of crime (*object sceleris*)
3. Confiscation of the proceeds from crime (*fructum sceleris* or *productum sceleris*)

The first type of confiscation is associated with the instrument in which the criminal has used for criminal purposes. It is confiscated because the property itself is considered to be contaminated. This type of confiscation has usually a protective nature that protects the society from hysterical use of dangerous property but sometimes it may be of punitive according to the circumstances. Whereas confiscation of the subject of crime is the confiscation of the goods subjected to criminal behaviour. This may as well have a preventive or punitive role. Confiscation of proceeds of crime whilst is a recent vintage that includes the confiscation of financial gains obtained through criminal activities.

Another important point worthy of discussion is the two models of confiscation. These are object confiscation and value confiscation. Object confiscation operates on the property (in *rem*) without paying heed to who is the actual possessor of the property. Value confiscation, however, is not the deprivation of the proceeds of crime itself but an order for the payment of a certain amount of money proportional to the value of the proceeds of crime.<sup>141</sup>

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<sup>140</sup>Guy Stessen, (2003), Money Laundering, A New International Law Enforcement Model, Cambridge University Press, 1<sup>st</sup> ed. P. 30

<sup>141</sup>Ibid, P. 35

Both have their own pros and cons which will be discussed from Ethiopian perspective. Confiscation as defined under the anti money laundering proclamation of Ethiopia is the permanent deprivation of ownership right over a property by the order of the court. This proclamation however does not contain provisos that deal about confiscation exhaustively. Rather it opts to use the provisions of confiscation procedures provided in the Revised Anti - corruption Proclamation on the same by analogy.<sup>142</sup>

When looking into the provisions of the Revised Anti-corruption Special Procedure and Rules of Evidence (hereinafter the Anti corruption Proclamation) Art 29 provides the principle. This article states:

*The court shall issue a confiscation order proportionate to the property acquired by the corruption offence where the accused is found guilty.*

Accordingly, a person who is found guilty of a money laundering offence will be confiscated an amount which is corresponding to the property acquired from such crime by the order of the court. From this it can be concluded that the country as a principle adopted a value confiscation approach like England, Wales and the Netherland.

However the close and technical scrutiny of the following provisions does not reveal that the country opts to give priority to value confiscation over object confiscation.

This argument is based on Art 34 of the Anti-corruption Proclamation that deals specifically about the manner of recovering the property or the benefits thereof at the time of confiscation. However, the English and the Amharic version have a big discrepancy that may bring a difference in the models adopted by the country. It states:

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<sup>142</sup>AML Proclamation, Art 9

*The defendant shall return the property acquired by the commission of the crime and the benefits derived from the property acquired by the commission of the crime or its proportional value (Emphasis added)*<sup>143</sup>

The phrase ‘its proportional value’ is not included in the English version. According to the English version, the defendant should return the property acquired by the commission of the crime and the benefits derived therefrom. There is no alternative than returning the property itself and the benefits. This obviously will make the country follow object confiscation model.

Whereas in the Amharic version, the defendant should return the property acquired after the crime or the benefit derived or the proportional value of the same. Accordingly, the subject of the crime and its proceeds should be returned first and in the absence of these, their proportional value shall be the alternative mechanism to enforce confiscation. Then it can be derived that this version gives primary approach to object confiscation and value confiscation as an alternative.

Hence, according to the Amharic version, it can be inferred from the above argument that the country follows both approaches of confiscation but gives priority to object confiscation over value confiscation when there is a property to be confiscated due to money laundering offences.

However, object confiscation has its own drawbacks and value confiscation as well is not free from criticism though believed to be the preferred one. Even in countries like Belgium and Switzerland that adopt value confiscation as an alternative for object confiscation, in practice, value confiscation may be applied as frequently as object confiscation.<sup>144</sup>

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<sup>143</sup>The word ‘proportional value’ must be added to the English version in order to give a similar meaning for the two versions. Otherwise, it will bring a big conceptual difference.

<sup>144</sup>Guy Stessen, supra note 140, P.35

Object confiscation is criticized for the following insurmountable problems. For one, its aleatory character may prevent justice to be administered. Meaning, if a property is consumable or cannot be traced back at the time of the decision, it may escape confiscation.

An American judge once put it as

*A racketeer who dissipates the profits ... on wine, women and song has profited from organized crime to the same extent as if he had put the money in his bank account.*<sup>145</sup>

So objective confiscation by itself may not achieve the objective of confiscation and opens a gap in such a case when the money or property could not be traced back.

The other most important criticism against object confiscation is the rights of bona fide third parties.<sup>146</sup> Since object confiscation is exercised in *rem*, third parties who acquired the property in good faith may suffer as a result of blind application of the objective model.

The Ethiopian law about confiscation of property due to money laundering does not say anything about good faith purchasers of such property where as Art 3 of the 40+9 recommendations as well as Art 29 of the UN Model Law on money laundering contain provisos in order to protect the rights of third parties. So the Ethiopian law should include provisions about bona fide third parties. Though not perfect, such problem may not be headache as long as there is value confiscation as an alternative because value confiscation unlike object model operates in *personnam*. That means, since value confiscation can be administered over any property of the offender, rights of bona fide third parties may not be affected. However, this again may be circumvented if the offender has already transferred to his families and close relatives all the money and the property that he acquired through predicate offences of money laundering or in other mechanisms.

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<sup>145</sup>Ibid P. 33

<sup>146</sup>Janet Ulph, (2006), Commercial Fraud, Civil Liability, Human Rights, and Money Laundering, Oxford University Press, 1<sup>st</sup> ed. P. 189

From the Ethiopian perspective, two fold arguments may be proposed in order to avoid such lacuna of value confiscation. The first argument is that whoever gives aid for criminals in hiding their criminal bounty is liable for money laundering and aiding as per Art 684 (2) of the Criminal Code. But the required proof may create difficulties to achieve the desired objective because in most cases criminals may not own property in their names as well as relatives and families.

The other argument but futile in this respect may be the promulgation of Disclosure and Asset Registration Proclamation.<sup>147</sup> This proclamation is issued to enhance transparency and accountability in the conduct of public affairs, to enhance good governance by preventing corruption and impropriety as well as to put a demarcation line between public affairs and private interests go without intervening into one another's territory. As per this proclamation, appointees, elected persons and public servants as enumerated are obliged to disclose and register the sources of incomes and assets under the ownership or possession of their family and themselves.<sup>148</sup> Though the objective behind the law is one to be appreciated, the provisions are not designed in a way to achieve the objectives set.

The primary problem is the definition given to the word 'family'. As per art 2 (7), family means:

*the spouse or a dependent child under the age of 18 (emphasis added) of an appointee, elected person...*

Here, what comes to one's mind is the exclusion of a child above the age of 18. Those responsible persons to disclose and register their assets are not obliged to make registration of an asset in the name of their child who is above 18 years of age.

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<sup>147</sup> A Proclamation to Provide for Disclosure and Registration of Assets No. 668/2010

<sup>148</sup> Ibid Art. 2 (4)

Axiomatically, it may be possible to say that such child is included in the definition given to 'close relatives' so that it creates no difficulty. Indeed, the child above 18 years of age is included in the definition, however, the irony is those appointees and other groups are required nowhere in the proclamation to make registration and disclosure of properties under the ownership of their 'close relatives'. Those required to disclose and register their assets may escape simply by keeping the property in the name of their child above 18 years of age or in the name of their close relatives including illegal funds which have been amassed during their tenure, hence Art 2(8) that defines the word 'close relative' has no use at all.

The other drawback in this proclamation is the time of registration. An appointee and those persons obliged to disclose and register their assets are expected to start their responsibilities after six months from the coming into force of the proclamation and to be completed within six months from the starting date that gives a total of one year.<sup>149</sup> It is clear that those responsible persons may stash away any property in their control and their families to either their children above 18 years, to their relatives or to anyone else within one year. So this extended time for registration gives a preparatory time to do so.

Yet, even if they are ready to register their properties, the organ within the Federal Anti Corruption Commission to carry out such registration is under formation though it is expected to start registration from October 4, 2003 onwards.<sup>150</sup> Generally this proclamation may have no role in the confiscation of properties acquired by criminal activities of those politically exposed persons and others who have the duty to make registration.

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<sup>149</sup>Ibid Art 7(1)

<sup>150</sup>Interview with Ato Gezahegn Gashaw (Higher Prosecutor in the Federal Anti Corruption Commission) on Nov. 06, 2010, the Ethics Liaison Unit is under the process of establishment to start registration as of November 2010.

### 3.6.2 Confiscation-Human Rights Contention

The other worthy point while discussing about confiscation is the onus of proof in relation to unexplained property as provided under Art 15 of the AML proclamation and confiscation of properties derived from money laundering offences as per Art 33 of the Anti-corruption Proclamation.

Any person who is in control of pecuniary property disproportionate to his present or past lawful income shall be punished without prejudice to confiscation unless gives a satisfactory evidence as to how he becomes the owner thereof.

In this case, the burden of proof is totally reversed to the defendant and he is expected to prove his innocence to the satisfaction of the court and if failed subject to punishment for imprisonment from three to five years and fine from 5,000 birr to 10,000 birr. The FDRE Constitution, on the other hand provides that the accused persons have the right to be presumed innocent and not to testify against themselves of the charges brought against them during the proceeding.<sup>151</sup> This obviously leads to the conclusion that the reversal of burden of proof circumvents two fundamental principles of fair hearing trial. These are presumption of innocence and the right to keep silent (not to testify against oneself).

These rights as enshrined in the fundamental law of the country cannot be violated by subsequent legislations except by the constitution itself. The constitution, however, contains no exception with respect to these rights. Therefore, Art 15 of the AML proclamation that deals about unexplained property contradicts with the supreme law of the land and hence it shall have no effect according to Art 9(1) of the constitution.

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<sup>151</sup>FDRE Constitution Art 20 (3)

Concerning burden of proof in relation to confiscation of property or benefits acquired by the commission of money laundering offences, the standard of proof is like the one required for civil proceedings (probable cause) instead of beyond reasonable doubt.<sup>152</sup> This to some extent reversed the burden of proof from the prosecutor to the defendant.

This approach, some argue, violates the defendant's right of presumption of innocence and not to testify against one self. Their argument goes; right of presumption of innocence is a right that should be used through the entire criminal proceeding including confiscation.<sup>153</sup> Hence, reversing burden of proof violates the rights of the defendant.

The opposing argument on the other hand argues there is no violation of these rights because the defendant enjoyed a fair trial during the proceeding and then convicted. The confiscation proceeding is merely part of the sentencing process following conviction.<sup>154</sup>

Under Ethiopian context, Art 20(3) of the Constitutions and Art 33 of the Anti Corruption Law come in to picture. The Constitution provides that the accused has the right not to testify against oneself and to be presumed innocent until proven guilty. The question is at what time these rights are to extinguish in the trial process? In short, just after conviction. A parallel question may be when is confiscation to be raised in the trial process? Art 29 states that the court shall give order of confiscation when the accused is found guilty. The succeeding provision also gives a probability for the postponement of confiscation order six months after conviction. These show confiscation will be ordered after conviction.

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<sup>152</sup>Revised Anti Corruption Special Procedures and Rules of Evidence Proclamation No 434/2005, Art 33

<sup>153</sup>The European Court of Human Rights stated in *Minelli v. Switzerland* (1983), presumption of innocence governs in general criminal proceedings irrespective of the outcome of the prosecution and not solely the examination of merit of the case only. Guy Stessen, P. 68.

<sup>154</sup>Janet Ulph, *supra* note 146, P. 172

Therefore, since presumption of innocence is a right to be exercised until the time of conviction and confiscation is to be raised after this, there will be no violation of such right and the position taken by Art 33 of the anti corruption proclamation is the one to be supported for the fact that it would be impossible to prove the criminal origin of assets beyond reasonable doubt. Whereas the issue of unexplained property should be underscored due to its contradiction with the supreme law of the land

### **3.7 Ethiopia's Accession to the WTO Vs Money Laundering**

Ethiopia is in the middle of the road to join the giant club, the World Trade Organization (WTO). The government of Ethiopia while discussing about the rationale for accession to the WTO, proposed four interrelated objectives. To accelerate economic growth, attract foreign investment, secure predictable and transparent market access and to influence the nature and direction of globalization are the major reasons that led the government to start the process of accession.<sup>155</sup> Due to the nature of trade in services and the importance of financial services for the economy at large, negotiation on trade in services is one of the key issues in the accession process of the World Trade Organization (WTO).<sup>156</sup> Liberalizing financial institutions is the most important issue that will take the lion's share of the negotiation. Despite the efforts, liberalizing the financial sector in either of ways is an inevitable fact for acceding countries though a matter of negotiation. The gist of this discussion is not about the benefits and drawbacks that liberalization could bring to the country but its implication in relation to money laundering from Ethiopia's perspective.

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<sup>155</sup>Melaku Geboye Desta, (2009), Accession for What? An Examination of Ethiopia's Decision to Join the WTO, Journal of World Trade, 43, No. 2, P. 352

<sup>156</sup>Gebrehiwot Ageba and Derk Bienen, (2008), Ethiopia's Accession to the WTO and the Financial Service Sector, Ethiopian Business Law Series, Faculty of Law, A.A., Vol.2, P. 1

The GATT and GATS strive to liberalize trade in goods and services. For this purpose financial institutions are entitled to most favoured treatment (MFN) and national treatment (NT).<sup>157</sup> Though the WTO does not have a specific provision about money laundering, but countries like USA ought to impose tariffs on the goods and services on any member country that refuses to criminalize money laundering.<sup>158</sup>

A country while getting benefits from the world trading regime at the same time may derive money laundering profits at the expense of its trading partners that choose to criminalize money laundering.<sup>159</sup> In response, Art XIV (a) of GATS and Art XX (2) of GATT may be used against such act of member countries. So countries may deny favourable market access by increasing tariffs on the financial system of the nation that refuses to become a member for international money laundering agreements or criminalize money laundering.<sup>160</sup>

Art XIV (a) of the GATS permits a contracting party to enforce measures “necessary to protect public morals or to maintain public order”. Art XX (2) of the GATT incorporates a similar provision as general exception.

The public order exception may be invoked only where a genuine and sufficiently serious threat is posed to one of the fundamental interests of society.<sup>161</sup> The question is, does money laundering entail such public disorder? Nations that permit money laundering facilitates

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<sup>157</sup>GATT Art 1 and 3

<sup>158</sup>Matthew B. Comstock, GATT and GATS: (1994), A Public Moral Attack on Money Laundering, Northwestern J. of Int’l L. and Buss. Vol. 15:139, P. 27

<sup>159</sup>There is an academic argument that money laundering is beneficial for those countries that condone this illegal act and even that it should be permitted. However, this argument is not sustainable because the implication for others may bring a devastating effect rather than its short term benefits. This means enabling of criminals and hence allowing other innocent persons to engage in such activity rather than refraining from such act. Moreover, money launderers will invest in short term businesses in order to hide their criminal bounty rather than on long term legitimate businesses that could bring benefits to the country.

<sup>160</sup>Matthew B. Comstock, supra note 158, P. 28

<sup>161</sup>GATS Art XIV foot note 5.

criminal activities all over the world because money laundering has much connection to drug trafficking, illegal arms sales, prostitution, human trafficking and other dangerous activities that may extremely disorder the public. Thus trade sanctions against nations which permit money laundering are justifiable in order to protect public disorder.

Although such sanction on the face seems contradictory with the purpose of GATT and GATS, which is to bolster free trade, this action ensure the integrity of the world's financial system and therefore, WTO has the means to make countries fight money laundering. Therefore, when Ethiopia becomes a member to the WTO, other member countries may use such mechanism to force Ethiopia to join the fight against money laundering and Ethiopia may also use such system on other non complying countries, if needed.

Further the liberalization of financial services as a result of accession may come up with different problems in relation to money laundering. The Government of Ethiopia has a major concern that authorities will be unable to regulate and supervise foreign banks effectively.<sup>162</sup> This concern with respect to money laundering is exacerbated because the authority that has a duty of controlling banks in relation to anti money laundering compliance is established by regulation before a year but still under formation.

The risk to money laundering activities may be different depending on the foreign banks entry into our system. The commercial presence of banks either through equity participation, green-field investment, opening branches or through subsidiaries may have different consequences.

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<sup>162</sup>Kozo Kiyota, Barbara Peitsch and Robert M. Stern, (2007), The Case for Financial Liberalization in Ethiopia, Research Seminar in International Economics, Discussion No. 565, P.15

In case of green-field investment, equity participation or subsidiaries the regulatory organ is expected to be strong enough so it can control the compliance of banks with anti money laundering requirements.

In case of opening branches, since creditors have full right to claim on the institutions asset as a whole, the regulatory organ may benefit from a certain degree of burden sharing with the regulatory organ of the parent institutions' home country.<sup>163</sup> Further the parent institutions commitment to its reputation may provide additional comfort if it has any prior reputation.

On the other hand, parent institutions may exclude themselves from liability by including the so called ring-fencing provisions that relieves the parent institution from obligations of foreign branches.<sup>164</sup> In such a case the parent banks may be set free to repay obligations of foreign branches facing repayment problems. In such a situation the regulatory organ- the Financial Intelligence Centre (FIC) should have strong capacity to control those foreign banks as to their compliance with the requirements of the anti money laundering laws of Ethiopia.

But if there is no strong capacity to control such foreign banks, financial liberalization could lead to potentially high disruptive financial crisis<sup>165</sup> including money laundering risks. The entry of foreign banks may improve bank supervision through regulatory spill over. However experiences of countries that liberalize their financial sector show that strengthening regulatory and supervisory framework before liberalization cope up the effects better than those that liberalized first.<sup>166</sup>

Generally, liberalizing the financial sector means integration into the world's financial system in which the technological advancement and new payment systems may be used to some evil

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<sup>163</sup>Gebrehiwot Ageba and Derk Bienen, *supra* note 156, P. 27

<sup>164</sup>*Ibid* P. 29

<sup>165</sup>Kozo Kiyota, Barbara Peitsch and Robert M. Stern, *supra* note at 162, P. 17

<sup>166</sup>Gebrehiwot Ageba and Derk Bienen, *supra* note 156, P. 16

acts like money laundering. Further, acceding countries will integrate into the international trading system which in turn can be abused for commercial fraud through tax evasion, capital flight and trade based money laundering (TBML).<sup>167</sup> Trade based money laundering can be accomplished through misrepresentation of price either using overpricing or under pricing. Similarly, the quality or quantity of goods can be misrepresented. On the eve of liberalization and maintaining international financial relationship, the country needs to realize the effect of liberalization on money laundering and build up well equipped regulatory organ to control those banks as to their compliance with the anti money laundering requirements and it should negotiate on the type of foreign bank entry that will pose less susceptibility for laundering activities.

### **3.8 Challenges to the Eradication of Money Laundering in Ethiopia**

#### **3.8.1 Cash based payment system**

Although it is impossible to find the exact magnitude or percentage share of cash based payments in Ethiopia, it far exceeds all other forms of payments. Since capturing and monitoring cash transaction is difficult, money laundering is booming without being detected. This becomes a difficult challenge for law enforcement groups and regulators.

#### **3.8.2 Unstable neighbouring and porous borders**

Ethiopia's location within the Horn of Africa makes it vulnerable to money laundering activities as it is surrounded by unstable countries like Somalia, Southern Sudan and Eritria. The politically unstable countries therefore export criminalities into the country and cross border cash smuggling as well as other contraband goods will be easy to be transported

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<sup>167</sup>Global Money Laundering and Terrorist Financing, Threat Assessment, FATF Report, 2010, [www.fatf-gafi.org](http://www.fatf-gafi.org) Accessed on Sep 28, 2010

through border. These situations are highly conducive to money laundering and complicate the fight against the vice.

### **3.8.3 Parallel Banking Activities**

The parallel banking activities internationally known as '*Hawallas*' encourage money laundering activities as they are able to wire funds to and from other jurisdictions without going through the formal banking system.<sup>168</sup> The Ethiopian Federal Police Investigation source indicates that alternative remittance systems particularly '*hawalla*' are widely used.<sup>169</sup> The Federal Police had arrested 47 persons in November 9, 2010 for money laundering and partaking in illegal banking during the second raid on businesses suspected of conducting '*hawalla*', exchange of foreign currency for Birr outside of financial institutions in two years. Close to 40 people were arrested for the same offence in March 2008.<sup>170</sup>

### **3.8.4 Inadequate capacity of law enforcement organs**

The inadequate capacity among law enforcement and regulatory organs to deal with the money laundering process is another challenging task for the country to cope up with money laundering activities. The inadequate police training and lack of resources significantly diminish their investigation ability. The Financial Investigation Centre (FIC) of the country is still under establishment and hence has no capacity of entertaining money laundering issues.

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<sup>168</sup>Sam Vakinin, (2009), *Financial Crime and Corruption*, A Narcissus Publication, 3<sup>rd</sup> ed. P. 48

<sup>169</sup>Available at: <http://www.Knowyourcountry.com/ethiopia1111.html>, Accessed on July 22, 2010.

<sup>170</sup> Fortune newspaper, Vol. 11, No. 551, November 21, 2010, Independent News and Media PLC

## CHAPTER FOUR

### 4. Ethiopian Anti Money Laundering Laws and the Banking Sector

#### 4.1. Banking in the Emerging Economies of Ethiopia

The government has recently unveiled the five years Growth and Transformation Plan (GTP) aimed at spurring rapid growth and stirring up an economic take off. It will not achieve its growth targets and transformation goals without bolstering its source of domestic revenues and creating vibrant financial sectors. The role played by these sectors in prompting rapid growth and development is no subject to debate.

Financial sectors are intermediaries that channel the savings of individuals, businesses and governments in to loans or savings. Despite the long history of financial sectors beginning from the establishment of a bank by historically reminiscent name of Bank of Abyssinia in 1900, the sector is fairly underdeveloped.<sup>171</sup> In Ethiopian, banking has dominated the sector with approximately 80% of the total financial sector assets, with insurance and microfinance sector for 10% each.<sup>172</sup> They all facilitate exchange of goods and services by operating the country's payment settlement systems. It is, therefore, very difficult if not impossible, to achieve the government's goal of rapid and sustainable economic growth and development objectives that the government has planned in its GTP without having vibrant, efficient and strong financial sector which is accessible to the majority of the population, if not all.

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<sup>171</sup>M.Syed Ibrahim, (2006), Ethiopian Financial Sector Performance Review, Ethiopian Economic Association (EEA), proceedings of the 3<sup>rd</sup> International Conference on Ethiopian Economy, vol.1, P. 272

<sup>172</sup> Gebrehiwot Ageba and Derk Bienen, supra more at 156, P.7

Since recent times, Ethiopian banks have grown rapidly and many new banks are under establishment reflecting the improving operation environment as well as the role of banks in boosting the economy of the country.<sup>173</sup>

Banks play a critical role in the emerging markets like Ethiopia. Firstly, banks are intermediaries between depositors and borrowers thereby promoting savings that latter result in capital formation which is the bases for economic progress in the country and a way out from abysmal poverty.<sup>174</sup> Secondly, they encourage industrial progress and business expansion through funds channelled to investors.<sup>175</sup> Thirdly, banks exercise considerable influence on the level of economic activity through their ability to create or manufacture money in the economy and fourthly, the various utility functions performed by banks like accepting and discounting bill of exchange and collection of dividends and interests on behalf of customers are of great economic significance for the economy.

In fact, the economic progress of a country is impossible without a sound system of commercial banks. However, the banking sector inexorably raises concern about risk management. Unlike other sectors, banks face a wider range of complex risks in their day to day business including but not limited to money laundering risks.

Though money launderers use every opportunity, banks are often the primary means by which money launderer's clean otherwise dirty money. Due to the multifarious adverse consequences of money laundering activities and the close nexus of banks with it, the

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<sup>173</sup>These are 15 banks that are operational of which three are owned by the government and twelve are private with total number of 673 branches as of March 2010.

<sup>174</sup>At the end of the second quarter of 2009/10 for instance, the amount of deposits mobilized by the banking sector reached 87.4 billion birr whereas, new loan to the tone of 7.3 billion birr was distributed. NBE, Monetary Development, P.40

<sup>175</sup>Out of 7.3 billion birr loan disbursed by the banking sector, 91% of the new loan went to finance the private sector in general and specifically international trade, domestic trade and housing and construction accounts for 28.8% , 27.7% and 16% respectively followed by 14.4% for industry in 2009/10 second quarter.

government has put banks in the frontage to fight such dire activity. Money laundering has a direct consequence against the banks that embraces reputational, operational, concentration and legal risks.

## **4.2. Money laundering in the Banking Sector: points of vulnerability**

Money laundering has been described as a ‘dirty needle’ injecting and infecting legitimate markets with the disease of greed basically through the system aggregated into one or more accounts of seemingly legitimate business venture and then ‘wired’ to anywhere in the world.<sup>176</sup>

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. 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.<sup>177</sup>

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<sup>176</sup>Gerard Wyrsh, (1992), Treasury Regulation of International Wire Transfer and Money Laundering: A case for a permanent moratorium, Denv. J Int'l L. and Pol'y, Vol. 20:3, P.516

<sup>177</sup>Global Money Laundering and Terrorist Financing Threat Assessment, FATF Report, July 2010, P.24

The use of liquid product i.e. money in the banking transaction makes it vulnerable to be used by money launderers.<sup>178</sup> The liquidity of some products may attract money launderers because liquid products allow them quickly and easily move their money from one product to another, mix lawful and illicit proceeds and integrate it to the legitimate economy.

Electronic transfer exacerbates their vulnerability by making transfer more quickly that may take a time not more than the time to read the above paragraph. It is a high volume activity with millions of legitimate transactions taking place globally each day across thousands of banks involving even greater number of counter parties.<sup>179</sup> Access to the banking system is over the counter, or by using internet or telephone. On top of this, electronic transfer mostly involves non face to face contact with customers enabling cash deposits to be switched rapidly between accounts in different names and different jurisdictions. This provides a favourable ground for laundering activities.

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.<sup>180</sup> 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.

Further, though banks are charged with responsibilities of developing policies and procedures to combat money laundering and to be familiar with such trend, launderers outshine the

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<sup>178</sup>Guidance notes, supra note at 18, P.10

<sup>179</sup>FATF 2010 Report, supra note at 177, P.24

<sup>180</sup>Denisse V. Rudich, supra note at 6, P.4

expectation of banks and policy makers. These make banks liable for money laundering activities abruptly.

The most difficult aspects of banks are their ability to anticipate new criminal behaviour and to proactively implement protocols before the criminal behaviour occurs. It is like to guess what previously unknown disease will be the greatest threat to life next week or next year. Due to this fact, it is often money launderers who determine the direction of the preventive mechanisms to restrict money laundering activities. In between the lines, banks therefore will be vulnerable to be exploited by launderers.

### **4.3. Payment Systems in Ethiopian Banking**

Banks as intermediaries require a system for processing the debits and credits arising from these banking transactions. Payment system is a by-product of intermediation and facilitates the transfer of funds in the financial sector.<sup>181</sup> Payment is the transfer of funds from the payer to the payee.

There are different kinds of payment systems from traditional to modern one. The availability of sophisticated electronic technology brings new techniques of payment in the banking sector and customers may enjoy quick and convenient access to cash from savings and checking accounts that eliminates the physical transfer of paper cheques. Now a days, it becomes possible to move a large sum of money using a single plastic made card.

The development of such technologies is an ongoing process, but it is apparent that these developments have brought and will continue to stimulate substantial changes not only in facilitating transactions but also in the regulatory frame work governing these transactions. There are two risks associated with any payment system.

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<sup>181</sup>Shelagh Heffernan, (2005), Modern Banking, John Wiley and Sons, Ltd. P.32

Liquidity risk: liquidity is the ability to fund increases in assets and meet obligations as they come due.<sup>182</sup> If the settlement is not made at the expected time, the assets/liabilities cannot be transferred from one agent to another via the system. In addition, one individual or money launderer may transfer a huge amount of money at a time and may cause liquidity problem using the technology of payment systems. Indeed, liquidity problem transcends the individual bank and has system wide repercussions and hence managing this risk is the most important activity to be conducted by banks and regulatory organs.

Operational risk is also another problem that may come due to payment system failure. Timely settlement of liabilities may not be possible due to a threat of operational breakdowns. The next part will briefly mention about the system that banks in Ethiopia are using for payment.

#### **a. Cash Payment System**

Cash is by far the most important payment instrument in the banking sector of Ethiopia. Cash becomes a dominant system of payment in Ethiopia because of the particular quality of money.

*Money is the most fungible of all commodities. It can be transmitted instantaneously and at a low cost...it can change its identity easily and...*<sup>183</sup>

These characteristics of money, its transferability, instantaneous purchasing power and zero transaction cost make cash transaction dominant in the country. Further, the less existence of modern payment systems, the high degree of illiteracy and people's resistance to new technology are among others to be mentioned.

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<sup>182</sup>Principle for Sound liquidity Risk Management and Supervision, (2008), Bases Committee on Banking Supervision, P.1

<sup>183</sup>Javiet Garcia, (2001), International Measures to Fight Money Laundering, Journal of Money Laundering Control, Vol.3, No.1, P.39

## **b. Payment through Cheque**

Payment through cheque is a transfer via a signed draft of cheque from the issuer's account to other individuals. The only non-cash payment instrument broadly used in the banking sector next to cash payment is cheque.<sup>184</sup>

However, clearing facilities, Addis Ababa Clearing Office (AACO), is found only for cheques issued in Addis Ababa.<sup>185</sup> To settle cheques issued in other parts of the country is cumbersome and time consuming. AACO carries out its duties manually and its clearing system is far from automated cheque clearing system.<sup>186</sup>

The use of cheque is mostly limited to government institutions, NGO's and some private businesses. The system is used for large value and time critical payment and is systematically important but AACO does not comply with standards of Committee for Payment and Security Settlement (CPSS)<sup>187</sup>

## **c. E-payment system**

E-payment is a subset of payment systems but carried out electronically. It is a payment system that is instituted, processed and received through electronic mechanisms.<sup>188</sup> These days, the contribution of modern technology could not be denied. Banks come up with fast and efficient business transaction within the community as a result of technological innovations.

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<sup>184</sup>Wondwossen Tadesse and Tsegai G.Kidan, (2005), E-payment Challenges and Opportunities in Ethiopia, UN Economic Commission for Africa, P. 33

<sup>185</sup>Jan Woltjer, (2009), Modernization of the National Payment System in Ethiopia, part3, vision and strategic framework, NBE, P.73

<sup>186</sup>Wondwossen and Tsegai, supra note at 184, P. 33

<sup>187</sup>Jan Woltjer, supra note at 185, P.74

<sup>188</sup>Wondwossen and Tsegai, supra note at 184, P. 8

In Ethiopia, there are 15 banks operating in the country until the second quarter of 2009/10 and there are a number of banks under establishment. Despite the rapid proliferation of the banking institutions in the country, e-payment system is nascent. The modern e-payment methods like ATMs, Debit Cards, Credit Cards, Tele banking, Internet banking, mobile-banking and others are new to Ethiopian banks.

The current banking system is short of providing efficient and dependable services and banks in Ethiopia should recognize the need for introducing electronic banking to optimize their contribution for the development process. Now a days, it is not uncommon for a customer to physically visit the branch in which an account has been opened for any service due to the non integration of the branches of the same bank. Of course, it is undeniable fact that the Commercial Bank of Ethiopia (CBE) and some private banks like Dashen Bank are among the pioneers in introducing such electronic payment systems into the country though at its embryonic stage. The government has launched Payment System Modernization Project under the auspices of NBE partly financed by the Financial Sector Capacity Building Project of the World Bank with the aim of establishing modern payment infrastructures.<sup>189</sup> Despite their insignificant use, the following e-payment systems are used in Ethiopia.

## **SWIFT**

The Society for Worldwide Interbank Financial Telecommunication (SWIFT) is an organization maintained by banks and financial institutions throughout the world.<sup>190</sup> It is a message system for banking, foreign exchange, opening letter of credit, payment orders and

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<sup>189</sup>The modernization of NPS project has chosen 2010 E.C to be a year for a cashless society and at least 2/3<sup>rd</sup> of all households to have access to financial sectors. It has to be noted that at the first half of 2009/10 G.C, bank branches to population ratio was estimated to be 120,664 and only 4.3% of the population has opened an account. This makes the country the most under banked country even by sub Saharan standards.

<sup>190</sup>Ellinger's Modern Banking, supra note at 10, P.541.

security deliveries.<sup>191</sup> Banks in Ethiopia settle their international payment primarily through SWIFT and most of the Ethiopian banks are connected to SWIFT.

After analyzing the pros and cons of using the existing SWIFT network or building a Virtual Private Network (VPN), the National Payment System Project has recommended to build Virtual Private Network (VPN) and to use SWIFT channel as a contingency facility in case the VPN is not available.<sup>192</sup>

### **Payment Cards**

Payment cards- pieces of plastic fitting in wallet or purse that may be used to pay for goods or services are widely used in various types of transactions.<sup>193</sup> Payment cards could be of credit cards, debit cards, cash cards, ATM card and digital cash card or electronic purse. Albeit the differences, they basically serve one general objective: to enable the card holder to obtain goods or services or cash by the use of a card there by saving the inconveniency of carrying a large amount of cash.

The use of debit card in Ethiopia banking is considerably at its lowest stage. It is Dashen Bank that has VISA Card and Master Card as a payment mechanism. Such card holders can withdraw up to Birr 3,000 in cash and can buy goods and services up to Birr 5,000 a day. The Commercial Bank of Ethiopia (CBE) has had VISA membership since Nov.4, 2005 but failed to reap the fruits of its membership due to lack of appropriate infrastructures

ATM as well has been started in Ethiopian by CBE with eight ATMs in Addis Ababa followed by Dashen Bank which has installed more than 55 ATMs in the area branches, university compounds, shopping malls, restaurants and hotels. The ATMs of Dashen Provides debit cards, ATM services, Salary card and Student card.

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<sup>191</sup>Ibid

<sup>192</sup>Jan Woltjer, supra note at 185, P.31

<sup>193</sup>Ellinger's Modern Banking, supra note at 10, P. 581

Available services on Dashen ATMs are cash withdrawal, balance inquiry, mini-statement, fund transfer between accounts attached to a single card, Personal Identification Number (PIN) changes and PIN unblock but depositing of money is not possible.<sup>194</sup>

Zemen Bank is also deploying 25 ATMs across various locations with a single branch model whose activities are supplemented by multiple service points such as ATMs, POS terminals, online banking and Kiosks. United Bank is the first in introducing telephone banking. Internet banking and SMS banking are basically used for getting information regarding customer's account except SMS banking is used for account to account transfer.<sup>195</sup>

The agreement between Zemen Bank and Dashen Bank to merge their ATM networks on Sep 22, 2010 and the agreement between three private banks to launch 'Fettan' ATM network in common to install over 140 ATMs and 340 POSs across Ethiopia on Feb 19, 2009 are promising moves to banking technology.<sup>196</sup> The action of these banks may pave the way for technology penetration into the country. But the number of ATMs in the country is very low when compared to Egypt that had 1200 ATMs as of 2002.<sup>197</sup>

#### **4.4. Emerging Technologies Vs Money laundering: tracking the illicit audit trail**

*History has shown us that as we invent new technologies criminals are waiting on the periphery to use them ...*<sup>198</sup>

Industrialization, technology and globalization are the phenomena and progress is the cry of the day that could be witnessed in every sphere of daily life. Indubitably, this is also true for

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<sup>194</sup>Gardachew Worku, (August 2010), Electronic Banking in Ethiopia- practices, opportunities and Challenges, Journal of Internet Banking and Commerce, Vol. 15, No 2, P. 5

<sup>195</sup>Available at [http://www.unitedbank.con.et/SMS\\_banking.aspx](http://www.unitedbank.con.et/SMS_banking.aspx), Accessed on October 20, 2010

<sup>196</sup><http://www.Nibbank.et.com/nes/newsfull.php?id=13>, Accessed on October 16, 2010

<sup>197</sup>Wondwossen and Tsegai, *Supra* note at 184, P. 36

<sup>198</sup>Rajev Saxena, (1998), Cyber Laundering the Next Step for Money Launderers?, St. Thomas Law Review, Vol.10, P.688

crime including money laundering.<sup>199</sup> Traditional laundering, although still prevalent, is slowly being substituted by a 'feat of technology' known as cyber laundering.

New technologies are making money laundering easier to place in and take out their criminal bounty from the financial system to manipulate funds in order to hide their origins and bring it back to the legitimate economy without suspicion.<sup>200</sup> Cyber laundering is the process of using emerging high technology payment systems in money laundering process.<sup>201</sup> Money laundering on the internet or cyber laundering poses huge challenges in the anti money laundering move for two-fold reasons.<sup>202</sup>

The features of internet- speed of transaction, easy access, the relative or total anonymity of the parties and the capacity to traverse jurisdictions in milliseconds are the first reasons. The second is that money launderers operate in risk free zone. The inability of designated institutions like banks to identify and verify their online customers, lack of record keeping and hence absence of money trail and the existence of high level encryption that can block the anti laundering activity makes the area susceptible to money laundering.

Most of the recent developments that technology makes possible have potential use for money laundering purposes. The most significant emerging use for money laundering risks is identified in fund transfer through electronic mechanisms. The heart of modern banking consists of digital money transfer or electronic fund transfers (EFTs) between domestic banks by local clearing house or through international systems like SWIFT<sup>203</sup> to which Ethiopian

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<sup>199</sup>Izeldel Van Jaarsveld, (2004), Following the Money Across Cyber Highways: A Herculean Task or International Challenge? Some Thoughts on Money Laundering on the Internet, S. Afr. Mercantile L. J, P.685

<sup>200</sup>Rajev Saxena, supra note at 198, P.688

<sup>201</sup>Ibid, P.707

<sup>202</sup>Izedevan V. Jaesveld, supra note at 199, P.691

<sup>203</sup>Sarah Jane Hughes, (1992), Policing Money Laundering Through Funds Transfers: A critique of regulation under the Bank Secrecy Act, Indiana Law Journal, Vol. 67:283, P. 288

banks are also using the fruits. The next subtopics deal about three major devices for one they pose risk to money laundering and for the other they are being started in Ethiopian banks to be used for payment.

#### **4.4.1. Internet Banking**

Contactless technology through internet is emerging in the banking payment systems facilitating the services rendered by banks. Internet banking communication network remains mainly internet based but it is noticeable that internet is basically insecure and not controlled by banks.<sup>204</sup> In Ethiopia, internet banking is just at its infant stage started by some private banks. Despite its insignificant use in the country, it is important to click for concerned sectors as to the vulnerability of such system for money laundering.

Internet could be a conduit that facilitates money laundering due to the fact that it is a means to conduct transactions without the limitation of national boundaries and in most cases the provider of this service will not have a face to face relationship with customers.<sup>205</sup> There is no law per se that would govern internet banking in the country. Therefore, the probable anonymity, transboundary and instantaneous nature of transactions may allow internet banking to bypass the existing domain of anti money laundering safeguards in the country.

#### **4.4.2. Mobile Banking**

Mobile banking has the potential of blooming in Ethiopia as started by United Bank due to better mobile infrastructures and the need of banks to come up with innovative services to secure new customers and retain the old ones. Mobile banking is a term used for performing

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<sup>204</sup>Study of Users Identification Methods in Card Payments, Mobile Payments and E-payments, wp3-comparison with 2003 study, V1.2, 2007, P.7

<sup>205</sup>Emerging Anti Money Laundering Risks to Financial Institutions, Lexis Nexis, available at <http://www.risk.lexisnexis.com> Accessed on Sep.25,2010

financial transactions such as balance information, account transaction, payments and stock market transactions via a mobile device such as a mobile phone or Personal Digital Assistant (PDA).<sup>206</sup> Mobile banking is built up on the online banking concept and is practically the same as internet banking but different from internet banking in its access and services.<sup>207</sup> Mobile banking may also be used for laundering money because remote transactions may be conducted through mobile devices and across borders with no physical presence in a nation.<sup>208</sup> Even if the system is not used significantly in Ethiopia, it has a potential to be exploited by money laundering activities and hence needs the close attention of the law making body and those financial institutions to escape from the sacrifice.

#### **4.4.3. Stored Value Cards (SVCs)**

Stored Value Cards (SVCs) or sometimes referred as prepaid cards are means of payment in various forms such as gift cards or network branded cards where funds to be used are paid in advance.<sup>209</sup> SVCs are typically categorized in to open or closed system cards.<sup>210</sup> Open system cards can be used to connect to global debit and ATM networks co branded by VISA or Master Card logo.<sup>211</sup> Open system cards do not require a bank account or face to face verification of card holders where as closed system cards are limited in that it can only be used to buy goods or services from a merchant issuing the card or a selected group of merchants or service providers.<sup>212</sup>

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<sup>206</sup>Jongho kim, (2008), Ubiquitous Money and Walking Banks: Environment, Technology and Competition in Mobile Banking, Richmond Journal of Global Law and Business, Vol.8.2, P.42

<sup>207</sup>Ibid P.44

<sup>208</sup>Ibid P.80

<sup>209</sup>Juni Gurung, M.Wijayas and A.Rao, (2010), AMLCTF Compliance and SMEs in Australia: a case study of the prepaid card industry, Journal of Money Laundering Control, Vol.13. No.3 P.184

<sup>210</sup>Emerging Anti Money Laundering Risks to Financial Institutions, supra note at 205, P. 5

<sup>211</sup>The 2007 National Money Laundering Strategy, USA, supra note at 130, P. 39

<sup>212</sup>Emerging Anti Money Laundering Risks to Financial Institutions, supra note at 205, P. 6

SVCs are considered money launderers friendly for different reasons. The cross border feature of some prepaid cards that allow a person to use a home issued card at foreign country and the vice versa, the difficulty to address SVCs by domestic action alone, their transportability and potentially anonymous way to store and access cash value are among other reasons that make the area vulnerable to money laundering and alternatives to smuggling cash.<sup>213</sup>

In Ethiopia, SVCs like VISA and Master Cards are begun to be used to a limited extent. At this particular juncture, the vulnerability of SVCs and other payment systems may not be a problem; however, with the wider application of such technologies and the integration of the financial system into the global economy, the use of SVCs for money laundering purposes deserves attention. Otherwise, SVCs have a number of characteristics that offer opportunities for launderers unless use of such card is closely monitored.

In conclusion, there is nothing known about the scale of e-crime in Ethiopia. The use of e-payment in the banking sector of the country is just flourishing and the use of such system for money laundering activities could not be considered as a serious problem but while the banking industry is trying to come up with different kinds of modern payment systems, the government, regulatory organs and banks themselves are expected to be ready to combat money laundering activities due to such phenomena.

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<sup>213</sup>The 2007 NML Strategy, USA, supra note at 136, P. 39

## **4.5. The Ethiopian Law to Prevent Money Laundering in the Banking Sector:**

### **New Proclamation and New Directive, but is it enough?**

#### **4.5.1 Know Your Customer (KYC)**

Know your customer, christened as KYC, is the basic tenet of all anti money laundering legislations and regulations. Banks around the world are meticulously adhering to various procedures laid down for opening and conduct of accounts through KYC in order to avoid the pitfalls of operational, legal, reputational and consequential losses thereof.

KYC provides a mechanism to identify the true identity and beneficial ownership of accounts, source of funds, the nature of customer's business and reasonableness of operations in the account of one's business so that banks know the customer with whom they are dealing and minimize the risk of being exploited by money launderers.<sup>214</sup> KYC policy is an integral part and prerequisite for the banking business to ensure the proper implementation of due diligence to identify their clientele and ascertain relevant information as detailed as possible to do business with them.<sup>215</sup>

KYC is most closely associated with the fight against money laundering but its use may not be limited to money laundering only. The interest of Basel Committee in sound KYC stems from its concern for management of banking risks heightened by the losses of banks due to lack of diligence in applying appropriate procedures that could be diminished with effective KYC programs.<sup>216</sup>

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<sup>214</sup> Global Bank Limited, (Dec. 2006), Know Your Customer Policy P.1

<sup>215</sup> Ibid

<sup>216</sup> Basel Committee on Banking Supervision, (2001), Customer Due Diligence for Bank, P. 3

Extending beyond account opening, KYC requires banks to formulate customer acceptance policy (CAP) and Customer identification procedure (CIP) including proactive account monitoring and risk management.<sup>217</sup>

The anti money laundering proclamation of Ethiopia recognizes the role to be played by KYC standards in fighting money laundering. It provides the general requirements and enables the NBE to issue the details regarding financial institutions. Accordingly, the NBE has issued a directive on Customer Due Diligence of Banks Directive No SBB/46/2010 (here in after CDD directive). The directive has a general objective of effective risk management that may result from abuse of money launderers.

**a. KYC Requirement for Natural and Legal Persons**

The customer acceptance policy in the KYC program as per the directive requires banks not to keep anonymous accounts or accounts in fictitious names.<sup>218</sup> Banks are therefore, required to verify customer's identity using as much as possible reliable and independent sources, documents, data or information. For this purpose, the identification criteria for natural persons are provided under Art 4(5) of the directive. Accordingly, the minimum requirements for natural persons are:

- a. given or legal name and all other names used;
- b. permanent address;
- c. telephone number, fax number and e-mail address, if available;
- d. date and place of birth, if possible;
- e. nationality;

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<sup>217</sup> Ibid. P.5.

<sup>218</sup> CDD directive, Art 4(1)

- f. occupation, public position held and/or name of employer;
- g. type of account; and
- h. signed statement certifying accuracy of the information provided.

There are questions to be raised on this particular provision. The first is what does reliable and independent source mean? The answer is left to the discretion of the bank which may be ID card, passport, driving license or any other document. However, the ease with which fraudulent documents can be obtained may make things easy for identity fraud. In such cases, it may not be difficult to pass the KYC test of banks with flying colours and this may circumvent the objective of KYC procedure. Particularly, in countries like Ethiopia where there is poor documentation and data retention systems, one who determines to launder his ill gotten money may not hesitate to defraud his identity using available means. Therefore, to verify the identity of those persons and to avoid identity fraud, banks should go further. They should require for original documents, ask for the provision of recent utility bill or tax assessment, and check for telephone director or home/office visit according to the situation. This may be an additional onus upon banks but important to avoid money laundering risks.

The other lacuna in the KYC requirement is that the law does not require photograph to be attached as an element in the KYC requirements though it plays a pivotal role in identifying customers. Parents' name may also be an important requirement for such purpose though the directive does not require for the same.

As per Art 4(5) (g) of the directive, the type of account opened by the customer is provided as a requirement for identifying customers. However, despite the importance in other issues, it has no relevancy to identify customers.

With regard to legal persons, the position taken by the law is the one that may suffice to identify the legal person and natural persons behind it. Further, special attention should be given to non-resident customers and in no case should a bank short-circuit identity procedures just because new customers are unable to present the necessary documents. Concerning non-resident Ethiopians and foreigners, there is foreign exchange directives that allow opening non-resident foreign currency account in domestic banks. They are required to present valid passport and/or identification card for individuals and certificate of ownership and/or article and memorandum of association for business.<sup>219</sup> These requirements are in no way sufficient to identify natural and legal persons and such further requirements as provided under Art 4(5) and Art 4(6) of the CDD directive shall be applied respectively.

#### **b. KYC Requirement for Politically Exposed Persons (PEPs)**

Regarding PEPs, financial transaction and business relationship with these individuals present a higher money laundering risks and hence require greater security than ‘normal’ financial transaction and accounts.<sup>220</sup> FATF, in addition to normal due diligence measures, provides the following in relation to PEPs under recommendation 6:

- Have appropriate risk management to determine whether a customer is PEPs.
- Obtain senior management approval for establishing business with such customer.
- Take reasonable measures to establish sources of wealth and funds

The interpretive note to recommendation 6 encourages jurisdictions to extend these requirements to domestic PEPs who hold prominent public functions within their own jurisdiction. Under Ethiopian context, CDD directive necessitates for the approval of business

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<sup>219</sup> Directive No FXD/31/2006, Amendment to Directive No FXD/25/2004 Establishment and Operation of Foreign Currency Account for Non- Resident Ethiopians and Non-Resident Ethiopian origin, Art. 2

<sup>220</sup> Kim-Kwang R. (2008), Politically Exposed Persons PEPs: risks and migration, Journal of Money Laundering Control, Vol. 11, No. 4, P.375

relation with PEPs by a senior management member of the bank including those previous customers who subsequently become PEPs.

In this scenario, the question is who are PEPs? The CDD directive defines PEPs as:

Individuals in a *foreign country* (**Emphasis added**) who are or have been entrusted with senior government function, such as heads of the state or of the government...<sup>221</sup>

Accordingly, domestic PEPs are excluded from special CDD requirements and the relationship of banks with domestic PEPs is treated as ordinary relationship with any customer. Our law concerning PEPs does not comply with recommendation 6 of the FATF whilst it is important for such country in which its PEPs are known for their involvement in grand corruption as discussed so far. Therefore, this makes our banks more liable for money laundering risks by domestic PEPs and the law should be revised in a way to allow banks to take additional measures against them and thus they keep themselves from money laundering risk by PEPs thereby contribute for the eradication of corruption by such persons.

#### **4.5.2 Suspicious and Cash Transaction Reports (STR and CTR)**

Suspicious Transaction Report (STR) is a fundamental element of international anti-money laundering systems that require financial institutions including banks to report their suspicion to the concerned authority.<sup>222</sup> The purpose of STR is ambitious and mirrors the general goals of AML/CFT systems- to counter the underground economy, tax evasion and money laundering.<sup>223</sup> Reporting would facilitate the detection of predicate offences, increase the costs of money laundering and consequently prevent and/or reduce crime.

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<sup>221</sup> CDD directive Art 2 (11)

<sup>222</sup>David Chaikin, (2009), How Effective are Suspicious Transaction Reporting System? Journal of Money Laundering Control, Vol.12, No. 3, P.238

<sup>223</sup> Ibid, P. 239

Banks in Ethiopia are required to report to the Financial Intelligence Center (FIC) when they suspect or have reasonable ground to suspect that funds are proceeds of crime and all suspicious transactions regardless of the amount of transactions including attempts.<sup>224</sup>

One of the common questions is how one defines ‘suspicious transaction’. Suspicious transaction is defined under Art 2(14) of the AML proclamation as:

*“suspicious transaction” means a transaction which is inconsistent with a customer’s known legitimate business or personal activities or with the normal business for that type of account or business relationship, or a complex, strange and unusual transaction or complex or unusual pattern of transaction;*

The words used to define are hefty and ambiguous. Words like transactions inconsistent with known customer’s business, complex, strange and unusual transactions or patterns of transaction are ambiguous to be understood. The red flags of suspicious transaction using these words can be seen with examples but it should be kept in mind that customers relationship and account patterns is different and so there can never be a definitive listing of red flags of suspicion. It may be said that one’s transaction is inconsistent with his apparent business if he is previously known to trade only on national bases but having a large number of international transfer in and out.

From another perspective, if such transaction is usual, there is no suspicion and hence no need of reporting. In such a domain, a person may involve in money laundering activities using his known business as a pretext without suspicion unless his transaction exceeds the minimum threshold for cash reporting only in case of withdrawal and deposits.

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<sup>224</sup> CDD directive, Art 10

Another reporting duty of banks to the FIC is Cash Transaction Reporting (CTR). Banks are obliged to report all cash deposits or withdrawals exceeding birr 200,000 and/or USD 10,000 or its equivalent in other foreign currency.

In this scenario, CTR only involves withdrawal or deposits of the minimum threshold without regard to the objective or source of transaction. In this sense, transfer of an amount exceeding the threshold would not be reported when transfer involves none of withdrawals or deposits. That means in case transfer is ordered without withdrawal from account of the one who gives an order. So transfer of funds for more than 200,000 birr may not be reported unless there is suspicion on other grounds. Transfer of cash at international levels, however, is the most common means for laundering activities.

Further, the law does not contain exemptions from CTRs. There could be millions of legitimate transactions above the threshold and consequently would increase the burden of identifying illegal transactions. However, there are certain entities including the government that needs to be exempted despite their involvement above the threshold.

Generally, it is possible to conclude that the law concerning CTR and STR could not be effective in achieving the targets set. There are two likely explanations for this. Banks while at their infant stage may be very reluctant to report on existing high-value clients and for the second, the lacunae that are envisaged in the law may not lead to the objective of reporting.

#### **4.5.3 Record Keeping Requirement**

Records should be kept by banks that substantiate the proper identification of customers and documenting their transactions in order to provide both an audit trail and adequate evidence for the appropriate authorities. A potential customer may not be as likely to try to use banks for illegal purpose if he knows that records are being maintained. As per recommendation 10

of the FATF, financial institutions should keep records on customer identification, account file and business correspondence for at least five years after the business relationship is ended and in case of one off transaction, it runs from the date of completion.

Under Ethiopian case, banks are required to maintain records as stipulated in the Ethiopian National Archives and Library Proclamation No 179/99. This proclamation does not allow any kind of disposal of records by the provenant and disposal is only possible by the Ethiopian National Archive and Library Agency.<sup>225</sup> Applicable legislations on money laundering always spelt out the period of time for which documents and records must be kept. Despite the absence of fixed period, the involvement of Ethiopian Archives and Library Agency in the records of banking seems out of scope and the problem would be solved had there been a provision in the anti money laundering proclamation about record keeping with specified years.

Further, when do we say that records are sufficient to permit reconstruction of individual transaction is an issue that must be addressed in the law but not. Despite such gaps, the following minimum records must be maintained.

- Customer identification documents
- Records in support of transaction
- Account ledger
- Records in support of entities like Credit/debit voucher, deposit slips, cheque and
- Any other document deemed necessarily by the banks

So the law concerning record keeping in the banks should be revised to make it sufficient enough to prevent and detect money laundering activities in this respect.

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<sup>225</sup> Ethiopian National Archives and Library Proclamation No 179/99, Art 14

#### **4.5.4 Regulation and Supervision**

The dynamic evolution of the financial system is stirring up the regulation debate. Recent theoretical insights in the role of financial intermediaries and banks shed new light on the role of financial regulation. Gaps and weaknesses in the regulation and supervision of banks presented challenges to the government's ability to monitor, prevent or address risks including money laundering.

The word regulation and supervision are often used interchangeably albeit distinct. Supervision has to do with monitoring and enforcement while regulation with rule making. Regulation is described as 'actual hard rules that are written down' and supervision as 'the application of these rules to a particular firm or group of firms and going there and making sure that they are following the rules'.<sup>226</sup> The pursuit of financial stability is however, the common goal of both regulation and supervision.

Banks that could be vehicle for money laundering activities incur risks to their operation. So, their responsibility in avoiding money laundering commences with KYC followed by CTR, STR and other obligations. However, it is not uncommon for banks not to comply with all the rules on money laundering and hence regulatory organs take the lion's share in this respect.

##### **a. Financial Investigation Center (FIC)**

A country's effectiveness in the fight against money laundering is dependent upon the strength and weakness of its financial investigation authorities. The architecture of anti-money laundering means and measure will depend to a large extent on the type, structure and information available to the investigation units.

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<sup>226</sup>The Future of EU Financial Regulation and Supervision, European Union Committee Report, July 2009, Published by the Authority of the House of Lords, Vol. 1, p.11

Ethiopia has established Financial Investigation Centre (FIC) as of 4<sup>th</sup> Dec. 2009.<sup>227</sup> Different power and function has been assigned to the Centre based on the enabling clause and the establishment regulation. Before furthering its function, the nature and type of the Centre are worthy points that deserve explanation. The nature of information processing agencies of countries may be law enforcement model, administrative model, judicial model or hybrid of the three.<sup>228</sup> These different models have their own advantages and disadvantages. Countries chose their approach based on their culture, economic, legal and law enforcement considerations. Whichever approach is followed, a system has to be able to achieve the following objectives.<sup>229</sup>

- It must retain the confidence of the banking and other responsible persons.
- It must centralize information
- It must enable data to be cross-checked with other sources of information on organized crime and
- It must be a channel for international cooperation.

The Ethiopian model is the administrative one. It has its own legal personality and uses the budget allocated by the government.<sup>230</sup> The FIC of the country is accountable to the Prime Minister.

The model adopted by the country is unquestionably the one that provides the best inference between banking and prosecuting authorities. However, there is some doubt in relation to independence. The administrative model is criticized for its vulnerability to the supervision of

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<sup>227</sup>The Financial Intelligence Center Establishment Council of Minister Regulation No 171/2009

<sup>228</sup>Paul Allan Schott, *Supra* note at 32, P.144

<sup>229</sup>J. F. Thony, (1996), Processing Financial Information in Money Laundering Matters: The Financial Intelligence Units, European Journal of Crime, Criminal Law and Criminal Justice, P. 278

<sup>230</sup> FIC Establishment Regulation No 171/2009, Art 3(1) and Art 13

political authorities<sup>231</sup>. Investigations in some European countries have uncovered the links that could exist between money laundering, politics and dirty money.<sup>232</sup>

Under Ethiopian context too, the FIC may be vulnerable to a political pressure from the executive organ. The independence of FIC should be guaranteed in different ways but it does not mean that the accountability concept should be forgotten. So, the Ethiopian model of FIC would suffer no such criticism, had their accountability been for the parliament. Despite these pitfalls, the FIC has the following major power and functions provided in the anti money laundering proclamation and its establishment regulation.

**Collection and Centralization of Information:** This is the most crucial function of the Centre. Collecting and centralizing dispersed information and disseminating such information will make data matching and tracing money laundering activities easy. Further, the Centre will play a pivotal role in filtering and analysis of the information obtained from responsible persons as a repository organ.

**Investigation and regulation function:** the FIC is empowered to investigate cases that involve money laundering and terrorist financing based on the information acquired from the concerned body. Some countries like Sweden, Luxemburg and Portugal have designed their intelligence centre to be involved in investigation and criminal proceedings.<sup>233</sup> The Ethiopian FIC, on the other hand, has the power of investigation and it will transfer the case to competent authorities when there are sufficient grounds to file a suit.

Further, it has to ensure that all responsible persons are acting in compliance with their duties like record keeping and reporting requirements.

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<sup>231</sup> J. F. Thony, *supra* note at 229, P. 271

<sup>232</sup> *Ibid*

<sup>233</sup> *Ibid* P.275

**National and International Information Exchange:** the FIC has the power to share financial intelligence with other financial intelligence units or concerned organs in order to be effective in the fight against money laundering both at national and international level. Money laundering is not limited to one's border. The FIC; therefore, has the power to sign memorandum of understanding with foreign counter parts or with government agencies for information exchange.

**Awareness creation:** it is possible to prevent or reduce crime with the help of society. Money laundering in the country is a recent phenomenon which is new to professionals let alone the layman. So the FIC is expected to create awareness about money laundering activities with its up to date knowledge of laundering operations. Training and awareness on the role of the responsible persons in combating money laundering, the potential benefits of doing so and helping bank staffs to detect suspicious transaction are the duty for the FIC to be more effective in its career.

Alas, the FIC after one year of establishment has two employees- one the Director and the other a secretary assigned temporarily by the NBE. Therefore, the Financial Intelligence Centre (FIC), the backbone in the fight against money laundering should be organized effectively as fast as possible and thus it can play its anticipated role.

### **b. National Bank of Ethiopia (NBE)**

Among those financial institutions, banking is the lionized business that needs due attention of the government. It has its own distinct features as compared with all other traders. A banking company mainly deals with the money of a large number of depositors who have hardly any say in the business affairs of the bank with whom they deposited their money. It is palpable that NBE is the main responsible body to regulate banks and other financial institutions. It has to foster monetary stability and sound financial systems as are conducive

to the balanced growth of the country's economy. The regulation and supervision of banks about money laundering is not exclusively given to the FIC.

The NBE has issued a directive on CDD to enable banks cope up with money laundering and other unlawful activities. In this directive, it provides that any training to bank staffs about money laundering should be reported to the NBE at the beginning of each fiscal year.

On top of this, the FIC, in relation to financial sectors, is obliged to act in consultation with the NBE.<sup>234</sup> This kind of approach is the one to be appreciated due to the fact that the FIC is inexperienced in both bank supervision and financial inspection. However, such approach may bring conflict unless there is a clear delineation of points to be consulted by the NBE. The legality of such consultation duty may also be contested. There are powers exclusively given to the FIC by the AML proclamation but the regulation imposes an obligation upon the Center to act in consultation with the NBE regarding financial institutions. This takes away the power of the FIC and obviously the regulation contradicts with its enabling proclamation. Therefore, the FIC may not be obliged to comply with such consultation duty and it can act independently. This necessitates the reconsideration of the laws to reconcile the conflict accordingly.

#### **4.5.5. International Cooperation**

As the financial systems of the world are increasingly interconnected and the Ethiopian financial sectors too, international cooperation has been and must continue to be fundamental in curtailing the growing influence of serious transnational organized crime and the laundering of the proceeds of such crime.

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<sup>234</sup> FIC Establishment regulation No 171/2009, Art 15

Money laundering by its very nature is an international activity that requires, above all, seamless cooperation among states. Having all rounded cooperation framework helps to prevent, direct and prosecute money laundering in one's domestic financial system because launderers are always searching for countries with lax AML regime or limited international cooperation regime.

In order to get the benefits from international cooperation, Ethiopia should establish a strong FIC and be a signatory member to international conventions regarding money laundering<sup>235</sup>

The AML Proclamation provides for international cooperation among courts and competent authorities in Ethiopia with their counterparts in other countries.<sup>236</sup> Despite this fact, there is no specific provision that will help to implement such cooperation. For instance, it allows extradition but no other provision on how to implement such matter and hence the FDRE Criminal Code comes in to play. Provisions in the Criminal Code don't entertain special features of money laundering and it does not go in line with FATF standards. Recommendation 37 of the FATF requires for mutual legal assistance even without dual criminality or with flexible requirement for dual criminality but as stated under Art 21(2) of the Criminal Code, Ethiopian nationals will be tried if their act is crime under Ethiopian law but extradition is impossible at any condition. Regarding properties derived from crimes committed in foreign countries, such will be tried in Ethiopia with dual criminality requirement as per Art 11 of the AML proclamation.

It therefore, can be concluded that though the proclamation believes on international cooperation, the provisions contained in it are not sufficient to govern issues that may arise as

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<sup>235</sup>Currently, Ethiopia is not a member to the FATF or other regional anti money laundering initiatives. In relation to other interrelated matters, Ethiopia is a party to the UN Convention against Corruption, UN Convention against TOC (2000), the 1988 UN Drug Convention and the UN Convention to the Suppression of Financing of Terrorism as of June 20, 2010

<sup>236</sup> AML Proclamation, Art 12

a consequence of request for international cooperation. The provision about international cooperation is general that needs detail explanation and hence the lacunae in the law for international cooperation may create a gap for launderers to use the country and its banking system for laundering activities at international level.

## *Conclusion*

Money Laundering has been described as a ‘dirty needle’ injected and infecting legitimate markets with the disease of voracity basically through the financial system aggregated into one or more accounts of seemingly legitimate business venture and then ‘wired’ into somewhere else in the world.

Money Laundering, the process of disguising illegitimate money into the legitimate economy, is the headache for countries and the world at large. It clearly becomes endemic to country’s social, economic and political frameworks; it ultimately affects and often subverts not only banking and other financial institutions but also both multinational corporations and small businesses, legislatives and law enforcement officials, lawyers and judges, politicians and high ranking officials as well as newspapers and televisions.

Money laundering takes place virtually in every country and territory of the world and the use of banking sector for this purpose has been and still is the pioneer choice for launderers. In response to the growing concern about money laundering, the international community has acted on many fronts to thwart the efforts of launderers. FATF, the UN Vienna Convention of 1988 and the Palermo Convention (2000) are among others to be mentioned in the fight. Whereas FSRBs, the Wolfsberg Principle and Organization of American States (OAS) are among the regional initiatives that take the lion’s share in combating money laundering.

With the mounting proliferation of banking sectors in Ethiopia and advancement of technology, complexity and erudition of financial service is escalating from time to time and so money laundering as well as other criminal activities endangers the sector and the country at large. Together with this, Ethiopia is on the way to join the World Trade Organization (WTO) in which the involvement of foreign investors in the financial sector may be an

inevitable fact. The role of banks free from money laundering activities in the Growth and Transformation Plan (GTP) of the country is also invaluable.

Due to the clandestine nature of money laundering and the absence of consolidated data, it is impossible to extrapolate the amount of money laundered in Ethiopia; however, there are indications that money laundering is taking place in the country. Corruption, smuggling and contraband as well as tax evasion are the major threats to the country that badly need money laundering activities and banks have been wittingly or unwittingly participants in the process.

The Ethiopian law promulgated to fight the calamitous- money laundering, has been discussed so far and it can be concluded that it is not fully-fledged and does not go in line with some internationally accepted principles as propagated by international initiatives. The provisions concerning confiscation, corruption and terrorist financing nexus with money laundering, and the insufficiency of the anti money laundering law in relation to banking sector needs, no doubt, reconsideration.

The law concerning KYC requirements, CTR, STR and other preventive measures suffer lacunae and such gaps create a fertile ground for money launderers to exploit the banking system. The issue of payment systems in the banking sector and the emergency of contactless technologies necessitate emphasis on money laundering matters but no law in the country about payment system. Regulation, supervision and international cooperation are also other worthy points that have been discussed so far.

All in all, the anti money laundering law of the country in general and those provisions to fight money laundering in the banking sector in particular are not sufficient to fight it and its dire consequences and the following recommendations are made accordingly.

## *Recommendations*

- ❖ The provision in the Criminal Code that criminalizes money laundering excludes a number of offences that should be included as predicate for money laundering. The law needs to be amended in order to make the provision full-fledged. So, the country should criminalize money laundering adequately.
- ❖ Considering the special features of money laundering, the law about confiscation should be included in the anti money laundering proclamation rather than cross-referring to the anti corruption law. In doing so, the law should give priority for value confiscation over object confiscation unlike the anti corruption law.
- ❖ The law concerning unexplained property in the anti money laundering proclamation shifts the onus of proof to the defendant. This obviously contradicts with the supreme law of the land and its constitutionality would be contested. Reconciling the provision to go in line with the constitution is a demanding requirement that must be made.
- ❖ Accession to the World Trade Organization (WTO) may pave mechanisms to force member countries to criminalize money laundering. Further liberalizing the banking sector by itself is not a cause to facilitate money laundering but the form of entry of those foreign banks may create some gap for laundering activities. The country therefore should negotiate on the entry of those foreign banks for opening of branches with no 'ring fencing' provision.
- ❖ Reducing cash payment system and improving the country's payment system is another standard move. However advancement in e-payment system in the banking sector creates characteristics that may be attractive to money launderers. So law should be made about payment systems and it should be designed in a way to ensure traceability by

investigative authorities for investigating individual transactions and international cooperation should be heightened for this purpose.

- ❖ Banks should go further about KYC standards when searching for reliable and independent sources beyond ID card like payment bills, passport etc to avoid identity fraud. The NBE should also issue guidelines on Know Your Customer, Suspicious Transaction Report and Cash Transaction Report requirements to avoid the current lacunae in the law and to bring similar requirements in their operation.
- ❖ The Disclosure and Asset Registration Proclamation does not require for the registration of properties in the name of a child above the age of 18 and close relatives of those political officials and others persons who are required to make registration and disclosure. This means funds which have been amassed by officials during their tenure will be transferred to businesses run by their close relatives and children above 18 years of age. These funds then ‘washed’ by infusion into the banking system. Therefore, the law should be amended in order to include such persons and it would achieve its objective that includes fighting money laundering.
- ❖ The law provides special and additional requirements for banks to establish business relation with Politically Exposed Persons (PEPs) which must be approved by a senior management member of the bank. However, the definition given for the word ‘Politically Exposed Persons’ excludes domestic PEPs while it should be a major concern of the law. Thus, the inclusion of domestic PEPs with such requirements is an urgent issue.
- ❖ Banks are required to report cash transactions in relation to deposits or withdrawals with a minimum threshold. The requirements, however, fail to include reporting of transfer which is the most important tool in the laundering process. Further the provision about

suspicious transaction reporting has also used ambiguous and uncertain words to be implemented. Therefore, amendments should be made to avoid such problems.

- ❖ Regarding record keeping, there should be a minimum specific year for maintaining a record usually 5 years and the Ethiopian National and Archives Library Agency should be ousted from banking affairs for money laundering purposes. The minimum requirements to be included in the record should also be precisely provided.
- ❖ A single information in one country may sometimes be insufficient to make a case especially in cross border money laundering cases. It is only the arrangement of the pieces of information in an international puzzle that reveals the whole picture and this needs international cooperation. But the Ethiopian anti money laundering law does not sufficiently address international cooperation in this respect. So the law should include specific provisions about mutual legal assistance, extradition, and the role of the FIC as well as the Courts in such cooperation.
- ❖ The law for the prevention of money laundering and terrorist financing has given power to the Financial Intelligence Centre (FIC) to issue directives for the implementation of the proclamation concerning covered persons in the fight against money laundering except for the financial institutions. However, such directive is still not issued by the FIC. Therefore, the FIC should promulgate the necessary directive concerning non financial responsible persons in the fight against money laundering in order to give effect for the proclamation and to fight money laundering activities through non financial institutions.
- ❖ Financial Intelligence Centre (FIC) of the country would be more effective if independent from the executive and it should be accountable directly to the parliament (HPRs). Despite the fact that it has been more than a year after its establishment, it has not started its function still. So it should start its function urgently with competent human resource

and other infrastructure. The cooperation and consultation between the NBE and the FIC should be delimited specifically so there will be effective cooperation between the two rather than conflict of interest.

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Interview with Ato Alemseged Assefa, Director of the Ethiopian Financial Intelligence Center, on Sep 29, 2010

## 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.

Declared by: Biniam Shiferaw

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Confirmed by: Tilahun Teshome (Prof.)

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