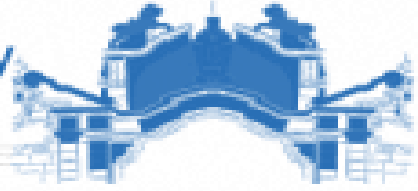




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ADDIS ABABA UNIVERSITY COLLEGE OF BUSINESS AND ECONOMICS

DEPARTMENT OF ACCOUNTING AND AUDITING

**CHALLENGES AND PRACTICES OF ANTI-MONEY LAUNDERING AND
COMBATING OF TERRORISM FINANCING-THE CASE OF THE ETHIOPIAN
COMMERCIAL BANKS**

BY: MEKDES GEREMEW

**A RESEARCH PROJECT SUBMITTED TO ADDIS ABABA UNIVERSITY COLLEGE
OF BUSINESS AND ECONOMICS IN PARTIAL FULFILLMENT OF THE
REQUIREMENTS FOR THE AWARD OF MASTER OF SCIENCE DEGREE IN
ACCOUNTING AND AUDITING**

ADVISOR

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DECEMBER, 2022

ADDISABABA, ETHIOPIA

DECLARATION

I, the undersigned, declare that this study entitled: Challenges and Practices of Anti-Money Laundering and Combating of Terrorism Financing in the Case of the Ethiopian Commercial Banks, is original work and has not been presented for a degree in any other university, and all sources of materials used the study have been duly acknowledged.

Candidate's Name: Mekdes Geremew

Signature _____

Date _____

STATEMENT OF CERTIFICATION

This is to certify that the research project prepared by Mekdes Geremew, entitled “Challenges and Practices of Anti-Money Laundering and Combating of Terrorism Financing in the Case of the Ethiopian Commercial Banks”. Submitted in partial fulfillment of the requirements for the Degree of Master of Accounting and Auditing, complies with university standards for originality and quality.

Approved by the Board of Examiners:

Internal Examiner _____ Signature/Date _____

Advisor Takele Fufa, Ph.D Signature /Date  _____

ACKNOWLEDGMENTS

All praise and gratitude are due to God, the Creator of all things, Most Gracious, Most Merciful. First, I want to convey my sincere gratitude to Takele Fufa (PHD) for his essential help, advice, and direction over the course of the study.

Secondly, this thesis would never been accomplished without the cooperation of all staff of banks and FIC. Therefore, I am deeply thanks all of them. Finally, I would like to express my deeply grateful to all my friends.

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Acronyms

AML-Anti Money Laundering

AML/CFT- Anti Money Laundering /Combating of Terrorist Financing

CDD-Customer Due Diligence

CTF-Combating Terrorism Financing

CTR-Cash Transaction Report

CBE-Commercial Bank of Ethiopia

DNFBP-Designated Non-Financial Business and Professionals

EFIC-Ethiopian Financial Intelligence Centre

ESAAMLG-Eastern and Southern Africa Anti-money Laundering Group

FATF-Financial Action Task Force

FIC/FIU-Financial Intelligence center/Unit

IMF-International Monetary Fund

ICRG- International Cooperation Review Group

KYC-Know Your Customer

ML-Money Laundering

OFAC–Office of Foreign Assets Control

PEP-Political Exposed Person

STR-Suspicious Transaction Report

UN–United Nation

WB-World Bank

Abstract

This study aims to assess the Anti-Money Laundering (AML) and Combating of Terrorist Financing (CFT) practice and challenges of commercial banks in Ethiopia in accordance with international standards and applicable laws. The study adopted a Descriptive research design whereby the researcher employed questionnaires and interviews for data collection and also a quantitative and qualitative research approach was used to collect and analyze primary data. Primary data was collected through a survey instrument adapted from different business researches; a stratified and purposive sampling technique was chosen to get the required sample size. About six banks on the basis of year of establishment and assumed to have best experience in handling money laundering were targeted to study. Data gathered were analyzed based on 54 responses and two interviewees. The survey data were analyzed through descriptive statistics analysis. The result indicates that commercial banks in Ethiopia have been discharging their responsibilities by implementing and practicing Anti Money Laundry and combating of terrorism financing. However, Money Laundry and terrorism financing preventive measures revealed that commercial banks do not have automatic electronic customer/transaction screening and the finding confirmed that absence of national ID and lack of list of Political Exposed Persons, lack of technology to enhance Anti Money Laundry and combating of terrorism financing activities and lower awareness in the country are serious challenges for banks. Therefore EFIC and NBE and other responsible organs of the country have to focus their efforts on the most fundamental tasks and main challenges, and need to give utmost priorities about Anti Money Laundry and combating of terrorism financing. Finally, as this study focuses on commercial banks, further research is needed on the other financial and nonfinancial sectors which are vulnerable to money laundering and terrorist financing.

Key Word: Money Laundering, Terrorist Financing, Banks, Financial Intelligence center.

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

According to Dobrowolski and Sulkowski (2019), the money laundering process has a long history, but it has evolved and adapted to modern society, globalization, and digital transformation, causing significant harm to citizens, businesses, and states, acting as a catalyst for illegal actions (terrorism, fraud, and corruption), resulting in decreased integrity and transparency, and creating a widespread need for market self-assurance. Money laundering is the illegal act of concealing money from illicit activities and converting it into legitimate money (Le-Khac et al., 2016; Nazri et al., 2019), thereby changing the clandestine nature of money.

Whereas, Terrorism is not a 21st century phenomenon, have its roots in early resistance and political movements. Modern terrorism largely came into being after the Second World War with the rise of nationalist movements in the old empires of the European powers. These early anti colonial movements recognized the ability of terrorism to both generate publicity for the cause and influence global policy (Max Roser, 2018).

According to FATF (2012-2018), money laundering and terrorist financing brought distressing impact and hence FATF come up with legally binding recommendations (40+9) to deal with the issue of the funding of terrorist acts and terrorist organizations in 2001. FATF recommendations have been revised to address new and emerging threats and to clarify and strengthen many of the existing obligations. The FATF recommendations set out a comprehensive and consistent framework of measures which countries should implement in order to coat money laundering and terrorism financing. Countries have diverse legal, administrative and operational frameworks and different financial systems, and so cannot all take identical measures to counter these threats. The FATF Recommendations, therefore, set an international standard, which countries should implement through measures adapted to their particular circumstances. Additionally, The Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG) were launched on 27th August 1999 on the need to develop a regional mechanism to co-operate in the implementation of AML programs. Their objective was to develop a strong and dynamic FATF Style Regional Body committed to eradicate money laundering and terrorist financing in the Eastern and

Southern African region. ESAAMLG had to quickly embark on developing capacity to implement the core functions of the Group that is, undertaking evaluations of member countries AML / CFT systems.

FATF requires the implementation of AML measures since the duties of banks are relatively more transnational than other the remaining financial service. This unique nature attracts money launderers and terrorist financiers. For countries that do not comply with FATF's recommendations, economic sanction is stated as a sanction toward enforcement. This sanction has adverse impacts on the economy of a nation as screening imports and exports are complicated (FATF, 2013).

In this regard, Ethiopia has joined the world in combating money laundering and terrorist financing by ratifying AML/CFT regimes in 2009 G.C., which is subsequently amended in 2013 through the Prevention and Suppression of Money Laundering and Financing of Terrorism proclamation Number 780/2013. The proclamation criminalized money laundering and financing of terrorism with the main objective of ensuring the integrity of the financial system (Tu'emay, 2013).

Following the Proclamation the FIC has issued a directive (No. 01/2014) in consonance with FATF recommendations to streamline the effort in combating ML. As per the directive, banks are required to develop compliance policies and procedures aligned with the directive.

In September 2013, Ethiopia was accepted as a full member of the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG). As part of the membership process, the FIC is participating in an ongoing mutual evaluation with the assistance of the World Bank and ESAAMLG, which included an on-site visit involving an evaluation team and relevant stakeholders to assess the country's compliance with international AML/ CFT standards. As a full member of the ESAAMLG, the FIC gains access to a regional network of AML/ CFT professionals and benefits from opportunities for enhanced cooperation with other financial intelligence units (FIUs). In addition, full membership helps to advance Ethiopia's reputation in the international AML/ CFT community and its journey toward joining the Egmont Group of Financial Intelligence Units.

Ethiopia underwent a first AML/CFT and Combating Proliferation financing mutual evaluation assessment that was conducted by the World Bank and was approved at the ESAAMLG Council

of Ministers meeting held on the 5th of June, 2015. Since then, the country has been accomplishing significant AML/CFT activities.

Financial institutions shall enter into business operation when only authorized by the National Bank of Ethiopia. In order to ensure compliance requirements, the AML/CFT Proclamation gives the EFIC the power to supervise FIs and DNFBPs, independently or in collaboration with regulatory bodies. To that end, EFIC has developed Risk-based approach manuals, and accordingly, has so far conducted AML/CFT supervisions at reporting entities and NPOs.

If money laundering and terrorism financing are not controlled and eliminated, the future may worsen corruption, exacerbate poverty, make financial institutions vulnerable, destabilize countries, and harm domestic and foreign direct investments in countries involved at the expense of ordinary citizens (Chutia, 2013).

Although the country has conducted several awareness creation programs, lack of awareness coupled with cash based economy is still a major challenge for the AML/CFT regime; therefore, it needs further efforts. In addition, the inappropriate human power and skill at competent authorities undermine the AML/CFT regime.

Therefore, adoption of appropriate AML/CFT regime with all banks is an essential task to safeguard the confidence and integrity of the banking sector. In line with this, the data to be collected from banks in Ethiopia reflects the stakeholder's opinions towards the effectiveness of AML/CFT regulations: this provides paramount importance for all stakeholders in this area. Thus, this study is scrutinized Challenges and Practices of Anti-Money Laundering and Combating of Terrorism Financing in the Case of the Ethiopian Commercial Banks.

1.2 Statement of the Problem

Money laundering and terrorist financing are among the growing criminal activities in East Africa and the Greater Horn region. (Mutual evaluation report, 2015). Money laundering and terrorist financing are transnational, cross-border, multifaceted, and complex problems that require cooperation and coordination among actors looking to successfully respond to them. Not only do money laundering and terrorist financing negatively affect the integrity and stability of the financial sector, but they also undermine national security and economic development goals.

Strong measures on anti–money laundering (AML) and countering the financing of terrorism (CFT) can help mitigate criminal behavior by reducing or eliminating the economic gain from criminal activities (Tu‘emay,2013).

Messay and Daniel (2021) examined the cash intensive nature of Ethiopia’s economy has enabled a significant amount of cash to circulate outside of the formal financial system. Because of that Ethiopia is exposed to terrorism financing and money laundering activities. In addition, limited awareness of the problems of money laundering and terrorist financing and their impacts and limited measures on anti–money laundering and countering the financing of terrorism (AML/CFT) and inadequate capacities to implement existing frameworks and legislation was another problem. Customers usually use structuring their money to be free from being reported when they deposit and withdraw (FIC, 2013).

Although the country has conducted several awareness creation programs, lack of awareness coupled with cash based economy is still a major challenge for the AML/CFT regime; therefore, it needs further efforts. In addition, the inappropriate human power and skill at competent authorities undermine the AML/CFT regime.

Even if there are various researches on the AML/CFT, the concept is not yet well researched. Among these studies, Ayele Yitayew 2014 has studied the Practices and Challenges of Anti-Money Laundering and Combating of Terrorist Financing in Commercial Banks in Ethiopia “his work discusses the potential challenges as level of awareness among senior management, technological advancement and cooperation among law enforcement agencies but this study was conducted before Ethiopia out of FATF Public Statement which is list of Countries that have been identified as having strategic AML deficiencies. Belay Sileshi 2022 has studied Effectiveness of Anti-money Laundering Preventive Measures in Ethiopia: Case Study on Commercial Banks and Financial Intelligence Center but he studied on money-laundry he does not include terrorist financing And also (Frehiwot 2018) studied the extent of compliance to Anti Money Laundering and Countering Terrorist Financing (AML/TCF) standards in Dashen Bank. This study about one bank and not address others bank. Therefore, this study attempts to fill the above research gap by examine AML/CFT practices and challenges of commercial banks in Ethiopia as the leading institutions and the measures being taken by FIC in light of FATF recommendations and best practices.

1.3 Research Question

1. To what extent the policies and procedures that guide Anti Money Laundering and Combating of Terrorism Financing available in commercial banks?
2. What is the existing practicing of preventive mechanisms to fight Money Laundering and Terrorism Financing act in Commercial Banks?
3. What are the challenges of implementing effective Anti-Money Laundering and Financing of terrorism practices in commercial banks in Ethiopia?
4. What are the efforts made by the Ethiopian financial regulatory bodies in fighting against money laundering and terrorist financing, toward compliance to the international standards (FATF)?

1.4 Objectives of the Study

1.4.1 General Objective

The general objective of the study is to assess challenges and practices of Anti-Money Laundering and Financing of terrorism in Ethiopian Commercial Banks.

1.4.2 Specific Objective

- To assess policies and procedures that guide Anti money laundering and Combating of Terrorism Financing.
- To identify the preventive mechanism used in Commercial Banks to fight Money Laundering and Terrorism Financing act.
- To point out the challenges of implementing effective Anti-Money Laundering and Financing of terrorism practices in commercial banks in Ethiopia.
- To identify the efforts made by the Ethiopian financial regulatory bodies on fighting against money laundering and terrorist financing, toward compliance to the international standards.

1.5 Significance of the Study

This study explores the “Challenges and Practices of "Anti-Money Laundering and Combating of Terrorism Financing”-The Case of the Ethiopian Commercial Banks. As such, the study yields great contribution to research and practice.

It is believed that the findings were added to the growing knowledge of money laundering as international crime and the measures the international community are taking to curb its severe impact on national and international socioeconomic conditions. Despite the growing interest in Money Laundering research, in the Ethiopian context, there are limited studies, most of which are not even published. The findings may also be used as a source of reference for other researchers.

1.6 Scope of the Study

According to Part 1, Articles 9 and 10 of the FIC Proc. 780/2013, the AML/CTF regime covers 'Financial Institutions' such as banks, insurance companies, micro finance institutions, postal savings, money transfer agents or any other institution designated by the National Bank of Ethiopia. Designated Non-Financial Businesses and Professions include real estate agents and brokers; dealers in precious metals or precious stones; lawyers, notaries and other independent legal professionals when they prepare for, carry out or engage in transactions for their clients concerning; independent accountants; and such other businesses and professions as may be designated by the FIC. From these legal coverage of entities, only commercial banks are purposely selected, has focus on Head Office (particularly Risk and Compliance Department) of selected banks located in Addis Ababa and the remaining are excluded from the study. Those financial institutions are selected from the total population; based on their real AML/CTF regime practices in the country. Hence, in this regard, the purposive sampling procedure decreases the generalizing of findings and this study might not be generalize to all areas of financial institutions.

1.7 Limitation of the Study

The study was focused on assessing the challenge and practice of Anti-money laundering and combating of terrorism financing in commercial banks of Ethiopia and the greatest limitation of

this paper was getting relevant literature on money laundering and terrorism financing in Ethiopia's banking sector.

1.8 Organization of the Research

The research has five chapters. Chapter one introduce about the whole study. The second chapter deals with review of theoretical and empirical literatures reviews. The third chapter provides details of research design, source and instrument of data collection, the procedures and the methods of data collection and the methods of analysis. Chapter four contains results and discussion of the research. Finally, the last chapter presents summary of the results, conclusion of the research and recommendations forward based on the findings.

CHAPTER TWO

RELATED LITERATURE REVIEW

2.1. Review of Theoretical Literature

2.1.1. Money Laundering and Financing of Terrorism: Conceptual Framework

Money laundering and terrorist financing pose significant problems for most countries in terms of prevention, detection, and prosecution. The sophisticated techniques used to launder money and finance terrorism add to the complexities of these issues. Such sophisticated techniques may involve various types of financial institutions; multiple financial transactions; the use of intermediaries such as financial advisers, accountants, shell corporations, and other service providers; transfers to, through, and from different countries; and the use of various financial instruments and other types of value-storing assets (Schott, 2006).

As per the UNTOC (2000) (Palermo Convention)¹, money laundering can be defined as the process of converting illegitimately obtained proceeds into seemingly legitimately obtained proceeds by concealing or disguising the true Nature and Source, Location, And ownership of illicitly obtained proceed.

Where does the dirty money that needs to be laundered come from? On a global scale, dirty money stems from all types of criminal activity. Drug trafficking, illegal arms trading, human smuggling, prostitution, corruption, fraud, forgery, armed robberies, blackmail extortion, arts and antique fraud, internet fraud, smuggling, and tax fraud are some of the sources (Lilley, 2006). The movement of profits from illegal sources through a series of bank or brokerage accounts to appear to be the proceeds of legitimate business activity is a common example of money laundering. This process is critical because it allows those who commit criminal acts to profit without disclosing their sources, making detection of the criminal activity less likely (Maney, 2002).

In contrast, the International Convention for the Suppression of Terrorist Financing (1999)², Article 2, defined terrorism financing as "the act of providing a person funds by any means (directly or indirectly), deliberately and knowingly so that the funds will be used in full or part to carry out a terrorist act by a terrorist or a terrorist organization." Terrorist financing is also a mechanism through which funds are processed from any source, including legitimate ones, to

finance frontline terrorist activities or those who encourage, plan, or engage in terrorism (Lilley, 2006). Terrorism can be funded through a variety of means including: donations, the use of charities and non-profit organizations, fraud, smuggling, the drug trade, and other criminal activities (Lilley, 2006).

2.1.2. Stages of Money Laundering

Profiteering crime is the primary focus of criminal organizations. They are established for this purpose, as well as to exploit crime opportunities on a large scale. As a result, the operation of a criminal organization may generate a large amount of wealth, but also a large number of problems. The cash generated is neither easily hidden nor easily used. Unexpected use of wealth may raise suspicion. Investigators can easily connect cash, illegal activities, and their perpetrators. It is thus necessary, for criminal organizations to;

- I. Erase the link between the crime and the money;
- II. Erase the link between the money and its new owner and finally;
- III. Shelter the profits¹ from possible confiscation.

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

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

II. Layering: The second phase entails putting funds that have entered the financial system through a series of financial operations with the goal of misleading potential investigators and giving these funds the appearance of having a legal origin. This is the stage of money laundering where offshore mechanisms are most commonly used. Multiple comings and goings between financial havens and launderer banks, punctuated by false invoices, false loans, or other devices, eventually mislead investigators about the origin of the money.

III. Integration: Once these funds appear to have a legitimate origin, the third and final step in money laundering is to reintroduce them into the legal economy.

- Through consumption of luxury items, because the goal of profitable criminal activity is first to be able to burn the ill-gotten funds; - Through investments in commonplace assets, such as shares in companies, real estate, and so on; - Through investments in economic entities that are susceptible to becoming money laundering machines, such as casinos, hotels, restaurants, cinemas, and so on, as well as in companies where payments are made in cash and where the dirty money is kept; These three stages are also seen in terrorist financing schemes, with the exception of stage three integration, which involves the distribution of funds to terrorists and their supporting organizations, whereas money laundering, as previously discussed, goes in the opposite direction—integrating criminal funds into the legitimate economy (Schott , 2006).

2.1.3. Links between Money Laundering and Terrorism Financing

Money laundering techniques are synonymous with those used to conceal the origins and uses of terrorist funds. Monies used to fund terrorism may come from criminal activities, legal sources, or both. However, regardless of whether the sources are legitimate or not, it is necessary to conceal the origins of terrorism funding. The implication is that if the source of funds can be concealed, prosecuting terrorist acts will be difficult. Furthermore, terrorists and terrorist organizations must conceal the source of their funds so that the funding can continue undetected (Schott, 2006).

Money laundering and terrorism financing may be considered separate activities, but laundering of criminal funds aims to give dirty money a legal appearance, whereas laundering of terrorist funds aims to obscure assets of legal origin (such as public funding or so-called charities). This distinction is meaningless because the goal of public policies is not to address the issue of illegal funds processing, but the funds themselves and the organizations that support them. In this regard, criminal assets and terrorist assets pose the same threats to financial systems and public institutions, and it is clear that the strategies designed to combat criminals when their funds are channeled through financial systems may also be effective in combating terrorists financing cases. (Thony, 2000)

2.1.4. The Impact of Money Laundering and Terrorist Financing

Criminal enterprises and terrorist financing operations are successful in large part because they can conceal the origins or sources of their funds and sanitize the proceeds by moving them through national and international financial systems. In a particular country, the absence of, or a

negligent or corrupt, anti-money laundering regime allows criminals and those who finance terrorism to operate, using their financial gains to expand their criminal pursuits and fostering illegal activities such as corruption, drug trafficking, illicit trafficking and exploitation of human beings, arms trafficking, smuggling, and terrorism (Schott, 2006).

A. Increased Crime and Corruption

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

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

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

B. International Consequences and Foreign Investment

A country's reputation as a haven for money laundering or terrorist financing could have serious consequences for its development. Foreign financial institutions may decide to limit their transactions with institutions located in money laundering havens, subject these transactions to additional scrutiny, increasing the cost of the transaction, or terminate correspondent or lending relationships entirely (Schott, 2006).

Money laundering and terrorist financing can directly threaten financial stability and macroeconomic performance in some cases, resulting, for example, in a loss of access to global financial markets and destabilizing inflows and outflows (IMF, 2012).

C. Weakened Financial Institutions

The soundness of a nation's financial system and the stability of specific financial institutions can both be negatively impacted by money laundering and terrorism financing in a number of ways (FATF, 2010)²⁵. The same or equivalent effects apply to other types of financial institutions,

such as securities businesses, insurance companies, and investment management firms, even though the majority of the discussion concentrates on banking institutions. The negative effects that are typically categorized as operational, legal, reputational, and concentration hazards are interconnected.

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

D. The Economic Effects of Money Laundering

It is challenging to put a dollar figure on the detrimental economic effects of money laundering on economic growth. It is evident that such activity harms the financial sector's institutions, which are essential to economic growth, lowers productivity in the real sector of the economy by diverting resources and fostering crime and corruption, which slow economic growth, and can stifle long-term economic development by affecting international trade and capital flows (Bartlett, 2002).

In the past, Michael Camdessus, a former director of the International Monetary Fund (IMF), estimated that the amount of money laundering was between 2% and 5% of global GNP (GPD). These illegal profits may outpace government budgets in several developing market nations, which would mean that governments would lose control over economic policy. Indeed, in some instances, the sheer size of the amassed asset base of laundered proceeds can be leveraged to corner markets, or even small economies (McDowell, 2001). Currency and interest rates can also be negatively impacted by money laundering since launderers reinvest their money in places where their schemes are less likely to be discovered rather than where rates of return are higher. Furthermore, resource misallocation brought on by artificially inflated prices for commodities and assets can result in money laundering, which heightens the risk of financial instability. (McDowell, 2001).

E. Compromised Economy and Private Sector

The private sector is one of the areas where money laundering has the most severe microeconomic effects. Front firms or organizations that appear genuine and do legitimate business but are actually run by criminals, are frequently used by money launderers (McDowell,

2001). To conceal the proceeds of crime, these front firms combine illegal funds with legal ones. Due to their access to illegal cash, front firms are able to offer their goods and services for less than market value. Because of this, genuine businesses find it challenging to compete with such front companies, whose only goal is to safeguard and preserve the illegal funds rather than to turn a profit (Lilley, 2006). It is possible to dominate entire industries or segments of the economy of some countries by utilizing front firms and other investments in respectable businesses. This raises the risk of financial and economic instability since resources may be misallocated as a result of artificially inflated prices for commodities and assets. It also offers a means of tax evasion, depriving the nation of money (IMF, 2012)

F. Damaged Privatization Efforts

Money launderers threaten the efforts of many countries to reform their economies through privatization. These criminal organizations are capable of outbidding legitimate purchasers of former state-owned enterprises (Schott, 2006). When illicit proceeds are invested in this manner, criminals increase their potential for more criminal activities and corruption, as well as deprive the country of what should be a legitimate, market-based, taxpaying enterprise. Furthermore, once a country's financial reputation is damaged, reviving it is very difficult and requires significant government resources to rectify a problem that could be prevented with proper anti-money-laundering controls (McDowell, 2001).

G. Social Costs

There are significant social costs and risks associated with money laundering. Money laundering is a process vital to making crime worthwhile. It allows drug traffickers, smugglers, and other criminals to expand their operations. This drives up the cost of government due to the need for increased law enforcement and health care expenditures (for example, for treatment of drug addicts) to combat the serious consequences that result (Aluko, 2011). Among its other negative socioeconomic effects, money laundering transfers economic power from the market, government, and citizens to criminals. In short, it turns the old proverb that crime doesn't pay on its head (McDowell, 2001). Furthermore, the sheer magnitude of the economic power that accrues to criminals from money laundering has a corrupting effect on all elements of society. In extreme cases, it can lead to the virtual take-over of legitimate government (McDowell, 2001). Therefore, it is important to note that having in place an effective AML/CFT regime is of

paramount importance towards fighting crime and corruption, enhancing financial institutions and encouraging economic development (Schott, 2006).

2.1.5. AML/CFT and its Preventive Measures

The FATF forty recommendations on Money Laundering have established a number of preventative measures that a country should adopt in the anti-money laundering (AML) area. These preventative measures are applicable to all financial institutions.

In order to prevent financial institutions from being used by criminals, internal policies which vary depending on the type and size of a particular financial institution and the scope and nature of its operation need to be in place. Internal policies should include ongoing training that keeps employees well-informed of the latest developments on AML and CFT.

The FATF Recommendations 5 – 25 are for preventive measures these recommendations enable countries to enter in to global alliance to fight the activities of money laundering and criminals. Such as:-

i. Customer Due Diligences (CDD)

Sound customers due diligence (CDD) procedures are the critical element in the effective management of banking risks as provided under recommendation. 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 including proactive account monitoring for suspicious activities in combination with different profits.(FATF,2012)

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 Customer 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 (Patrick Hardouin, 2009).

ii. 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 PEPs 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 institutions to implement CDD with regard to PEPs.

iii. Record Keeping

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, 10 years in Ethiopian case. Such records must be sufficient enough to permit reconstruction of individual transaction including the amount and type of currency involved in the transaction in a way that may help investigations at the time of prosecution.

Financial institutions should record the following information for each and every transaction name of the customer and/or beneficiary, address, date and nature of the transaction, type and amount of currency involved in the transaction, type and identifying number of account; and other relevant information typically recorded by the financial institution (FATF, 2012).

iv. Correspondent Banking

In addition to performing normal CDD, banks should gather sufficient information about a correspondent institution, assess the correspondent institutions AML/CFT controls, and clearly understand the respective responsibilities of each institution.

v. New Technologies: Banks should identify and assess the ML/TF risks that may arise in relation to the development of new product and business practices and also the use of new or developing technologies for both new and pre-existing products.

vi. Wire Transfers: Banks should include required and accurate originator information, and required beneficiary information, on wire transfers and related messages, and that the information remains with the wire transfer or related message throughout the payment chain.

vii. Internal Control and Audit

Financial institutions should establish and maintain internal policies and procedures to prevent their institutions from being used for purposes of money laundering and terrorist financing. Internal procedures include ongoing training that keeps employees informed and up-to-date about developments on AML and CFT. An audit function is also a required internal policy and

procedure that needs to be established; the audit function should be separate from the compliance administration function, in order to test and assure the adequacy of the overall compliance function (Ibid).

Viii. Suspicious Transaction Reporting/Report (STR)

Special attention should be paid to unusual patterns of transactions and complex and unusual large transactions (FATF,). These transactions should be examined thoroughly and the findings should be recorded systematically.

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).

ix. Adopt Risk Based AML/CFT Compliance Programs

A risk-based approach to AML/CFT is essential for the implementation of an effective AML/CFT risk management framework the risk based approach allows for the implementation of appropriate customer due diligence, verification and monitoring procedures that are proportionate to the identified ML/TF risks that the financial institution is exposed to from its customers, products and countries with which it transacts business.

The risk-based approach requires financial institutions to implement measures to mitigate the risks identified from its enterprise business risk assessment that are appropriate for the nature, size and complexity of the financial institution.

x. Transaction Monitoring

Financial institutions must have appropriate processes in place that allow for the identification of unusual transactions, patterns and activity that is not consistent with the customer's risk profile. Since these will not all be suspicious, financial institutions should also have processes to analyze transactions, patterns and activity to determine if they are suspicious and meet the reporting threshold. (Ibid)

Financial institutions should also have systems and procedures to deal with customers who have not had contact for some time, such as dormant accounts or relationships, to be able to identify future reactivation and unauthorized use.

2.1.6. Challenges of AML/CTF Implementation and Practices

According to Yepes (2011), population size, the country's level of development, geographical factors, cultural links, political stability, IT infrastructure, compliance costs are the major challenges in implementing AML/CTF in financial services of a country. Other contextual challenges that might significantly influence the effectiveness of a country as well as its banks' AML/CFT measures include the maturity and sophistication of the regulatory and supervisory regime in the country; the level of corruption and the impact of measures to combat corruption; or the level of financial exclusion. Such factors may affect the ML/FT risks.

On the other hand, in addition to the above mentioned challenges, FATF (2013) stated as "an effective AML/CFT system normally requires certain structural elements to be in place, For example: political stability; a high-level commitment to address AML/CFT issues; stable institutions with accountability, integrity, and transparency; the rule of law; and a capable independent and efficient judicial system. The lack of such structural elements, or significant weaknesses and shortcomings in the general framework, may significantly hinder the implementation of an effective AML/CFT framework.

(African Dev. Bank, 2007) revealed that implementing comprehensive AML/CFT policies in the context of developing countries offers some unique challenges. All countries face certain challenges in fully implementing the FATF 40+9 recommendations, but the capacity and resource constraints of low income countries make it particularly difficult for them to implement all the necessary measures simultaneously. For instance the frequent absence of the required legislative framework, Lack of effective criminalization of ML/FT, and the relative ineffectiveness of financial sector supervision are all factors which render financial sectors in Africa alarmingly vulnerable, there is a significant cash-based and parallel economy in which money circulates outside of conventional financial systems.

Economic Community of West African States (ECOWAS) members converged in Dakar, a 2day regional workshop, 9-10 July, 2010, identified that challenges facing financial institutions in GIABA member States are weak internal control framework, poor corporate governance framework, dearth of competent internal control officers, lack of central database, reluctance of banks to share customer information, weak legislations and lack of awareness and training on AML/CFT issues.

Other challenges identified in the implementation of AML/CFT issues by financial institutions at the workshop are inability to authenticate and verify documents submitted by customers and genuineness of officials documents from issuing authorities, unhealthy competition, lack of adequate and timely feedback on reported cases and suspicious transactions and lack of political will and commitment to the fight against money laundering and financing of terrorism etc.

The emergence of new technologies such as cards and ATMs, commodity transactions, and electronic wire transfers led to new ways of ML crimes. This was noticed by Zagaris and MacDonald who came up with a long term plan in fighting against emerging ML. These methods demand strict KYC requirement, audit trials, regulation of non-bank business sectors, create awareness on complex, unique and huge transactions, monitoring of cash at the border, enhancing supervision of banks and other financial institutions, and building an effective international financial sub-regime (Zagaris and Maccdonald ,(1992-1993).

2.1.7. The Role of International Organizations in Anti-Money Laundering

Following the devastating terrorist attack in the United States of America on September 11, 2001, global efforts to combat money laundering gained traction. As a result, some major international organizations have expressed genuine concern about combating money laundering activities. The following institutions are included in this paper.

i. The United Nations

In the convention held in Vienna to discuss the issue of Illicit Traffic in Narcotic Drugs and Psychotropic Substances, the United Nations took the first step against money laundering activities (UNODC, 1998). Following that, in 1999, the UN issued Model Legislation on Laundering, Confiscation, and International Cooperation in Relation to Crime Proceeds, which provides comprehensive guidance for countries developing AML laws.

Furthermore, the UN included anti-money laundering measures in two of its other conventions: the UN Convention against Transnational Organized Crime (UNTOC, 2000) and the United Nations Convention Against Corruption.(UCC, 2003).

ii. The Financial Action Task Force

As previously stated, the Financial Action Task Force (FATF) developed the Forty Recommendations on Money Laundering as a tool for effectively implementing AML measures.

FATF members are reviewed on a regular basis to ensure compliance with these 40 recommendations, and suggestions for improvement are made (FATF, 2001). This is accomplished through annual self-evaluation exercises and periodic mutual evaluations of its members. Because of the dynamic nature of ML, FATF was forced to closely study new methods of money laundering and develop methods to combat them. Governments must step up efforts to encourage global cooperation against ML in order to mitigate the severe negative impact of ML on the international financial system. Since its inception, the FATF has been involved in identifying major AML weaknesses in both member and non-member countries. Its goal is to ensure global acceptance of its laws by all financial institutions in order to prevent, detect, and defeat ML (FATF, 2003).

The revised 40+9 FATF recommendations from 2003 are used as basic requirements that countries follow, with implementation tailored to their specific circumstances and constitutional frameworks. Countries, for example, develop their own AML preventive measures that can be imposed on their financial institutions, such as training, Know Your Customer (KYC) and Customer Due Diligence (CDD), record-keeping, reporting of cash and suspicious transactions, compliance, other ML deterrent measures, and measures to be taken with regard to countries that do not or inadequately comply with the FATF Recommendations, as well as regulation and supervision of reporting entities.

The most recent FATF Recommendations, issued in 2012, emphasized the importance of identifying the illicit proceeds of corruption, tax evasion, and proliferation financing, indicating the path forward for future global AML activities (FATF, 2012).

iii. The Basel Committee of Banking Supervision

The Basel Committee, now known as the Basel Committee on Banking Supervision (BCBS), was formed at the initiative of the G10 central bankers in response to the 1973/74 collapse of the international financial market. The Committee was established to serve as a forum for regular cooperation among its member countries on banking supervision issues. Its primary goal is to improve financial stability by improving supervisory knowledge and the quality of banking supervision globally (Paul A Schott, 2006).

The financial sector's smooth and stable operations have become the foundation for successful economic policy and global cooperation. Three important papers on AML measures were

contributed by the BCBS. These are: Core Principles for Effective Banking Supervision (1997), Money-Laundering Prevention Using the Banking System (1998), Core Principles Methodology (1999), and Customer Due Diligence for Banks (2001).

These papers focused on important principles that seek to ensure that banks are not used to conceal or legitimize criminal profits; established standards for evaluating the adequacy of KYC requirements, suspicious transaction reporting, and information exchange with both local and international law enforcement agencies; and incorporated the importance of managing operational risk and improving internal controls and corporate governance (Basel, 2001).

iv. The International Monetary Fund and the World Bank

The International Monetary Fund (IMF) has played an important role in protecting the integrity of the international financial system by raising awareness of sound financial systems and good governance. In 2001, the IMF defined financial system abuse, financial crime, and ML and provided empirical evidence on its macroeconomic impact (IMF, 2001). Its primary goal is to include comprehensive work on financial system abuse in international efforts to combat ML in its various endeavors.

The World Bank (WB), through its development authority, plays a critical role in providing countries with legal reform in the context of national anti-corruption programs, designing and implementing capacity-building programs, and advocating for good governance.

Since 2002, the IMF and the World Bank have been playing a role in combating ML and financial crime and protecting the international financial system. They proposed strengthening their role in the global fight to reduce the vulnerability of the financial system and ML by publicizing official statements, cooperating with major international AML groups, and enhancing technical assistance in the fight against ML (IMF and WB, 2002).

A study conducted in relation to their major roles included the following: 1) publicizing the role that both the IMF and WB should play through official statements and other forms of outreach; 2) recognizing the FATF 40 Recommendations as an instrument for AML related activities; and 3) increasing the emphasis on AML elements in the assessment of supervisory standards included in the Basel Committee principles (BCPs). 4) Regular collaboration with major international AML groups; 5) Increased provision of technical assistance programs.

v. **Interpol**

Interpol has a dedicated unit called the Anti-Money Laundering Unit that fights money laundering. The unit focuses on improving the successful operation of its partners in combating money laundering and assigning local liaison officers around the world to create effective communication; this includes the development of improved information exchange with financial intelligence Centers (FICs). It is also involved in AML/CFT training and technical assistance (Interpol <http://www.fatf-gafi.org/pages/interpol.html>).

vi. **The Eastern and Southern Africa Anti-Money Laundering Group**

The Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG) aims to combat money laundering in eastern and southern Africa by implementing the FATF Forty Recommendations. Following the events of the September 11, 2001 US terrorist attack, the ESAAMLG expanded its efforts to combat terrorist financing. The ESAAMLG member countries conduct a periodic self-assessment process to assess the implementation of the FATF Forty Recommendations. Ethiopia, for example, as a member of the ESSAMLG, went through the process in 2014. (ESSAMLG, 2015).

vii. **The Wolfsberg Principles**

In addition to the organizations mentioned above, international banks implemented self-regulation measures to promote AML culture. This was evident at the October 2000 meeting in Wolfsberg, Switzerland, which included eleven large international banks and Transparency International (TI). They issued the Wolfsberg Principles, a set of Global Anti-Money Laundering Guidelines for Private Banking. These principles are intended to provide significant international guidance for good business ethics in global private banking.

The Wlofsberg group's goal is to create financial services industry standards, as well as related products, for Know Your Customer, Anti-Money Laundering, and Counter Terrorist Financing policies, client files, suspicious activities, and monitoring accounts that adhere to supervisory principles (Wolfsburg Group, 2001).A study conducted by Hinsterseer indicates the significance of the Wolfsberg AML Principles.

He identified that the majority of the 11 banks that signed the Wolfsberg AML Principles had previously been involved in an ML scandal. As a result, they pledged to make private banks part

of the solution rather than the problem in the fight against money laundering. In his research, he looked at the Wolfsberg AML principles. The Wolfsberg AML principles include AML activity sequences that are voluntarily adopted by certain banks without the imposition of regulatory bodies, and they are determined to make a significant contribution to the fight against ML (Hinsterseer, 2001).

2.1.8. Banks and Money Laundering

Banks play an important role in a country's economic system. They are involved in project financing, salary payment, fund transfer from one location to another, and deposit mobilization. Because of these facts, the banking sector is vulnerable to financial crimes committed by government officials through corruption, criminal groups, and some individuals who seek to profit from their criminal acts and launder illicit money through the banking system, integrating it into the economy by concealing its sources. This has prompted the global community to band together to protect the integrity of the international financial system by enacting laws and regulations to monitor transactions within their banks (Paul A Schott, 2006).

Banks, more than any other financial institution, could play a significant role in the fight against money laundering due to their extensive involvement in the collection and transfer of funds. Money launderers, according to Reuter and Truman, "subvert legitimate financial mechanisms and banking relationships by using them [banks] as protective covering for the movement of criminal proceeds and the financing of crime and terrorism." The "often-stated goal of AML/CFT regimes is to protect the integrity of the financial system [particularly banks]," in this sense]".

2.2. Empirical Literature Review

A group of studies have taken initiatives to examine the magnitude and scope of money laundering and terrorism financing problems (Schott, 2006; Biagioli, 2008; Zdanowicz, 2009; Walker & Unger, 2009) and investigated how the money is being laundered (Unger et al., 2006; Unger, 2007). Other studies focused on the role of technology in money laundering compliance (Reuda, 2001), money laundering techniques and typology (Ping He, 2010; Irwin, 2011) and money laundering focusing on Hawalla (Bala, 2005). Generally, the findings revealed that the banking sector is the most risky sector. Irwin et al. (2011) have examined the size of

moneylaundering and terrorism financing problems, identifying threats and trends, the techniquesemployed and the amount of funds involved. The findings revealed that money launderers preferto use techniques that maintain high levels of anonymity and appear innocuous.

Ping He (2010) examined money-laundering techniques and he discovered that the ways money is laundered include cash smuggling, making use of banks or insurance company, or making use of shell-company or front-company. He also found that criminals often prefer to launder money through non-face to face transactions.

Regarding the national studies Biniam(2011) aimed to critically examine the anti-money laundering framework of the country with specific reference to the banking sector and to 22 suggest ways of enhancing the effectiveness of the law in achieving its objective. The study suggested the existence of money laundering in Ethiopia and outlined that corruption, human smuggling, contraband and tax evasion activities are in need of money laundering in which banks have been wittingly or unwittingly participants in the process. In order to achieve its objective, the researcher attempted to examine the existing laws enacted to tackle money laundering to assess their adequacy or otherwise. Subsequently, the researcher critically analyzed the Ethiopian money laundering framework in comparison with internationally accepted standards.Accordingly, the study revealed that the Ethiopian law promulgated to fight money laundering was not fully-fledged and does not go in line with some internationally accepted principles as proposed by international initiatives. In addition, it was indicated that the law concerning KYC requirements, CTR, STR and other preventive measures suffer loopholes and such gaps create a fertile ground for money launderers to exploit the banking system. In conclusion the researcher acknowledged the remarkable progress made by the country in fighting money laundering activities while suggesting that provisions regarding confiscation, corruption and terrorist financing nexus with money laundering and the insufficiency of the anti-money laundering law in relation to banking sector needs reconsideration.

Belay (2022) examines the Effectiveness of Anti-money Laundering Preventive Measures in Ethiopia on Commercial Banks and Financial Intelligence Center. He indicates that no regular training is provided to concerned employees on the various aspects of money laundering and terrorist financing alongside methods of identification and reporting suspicious transaction and customers. And Commercial banks did not communicate the AML policies, procedures and

manuals are to the concerned employees as well as do not communicate new Anti-money laundering related laws or changes to the existing policies or practices to concerned employees.

Ayele (2014) indicate that Commercial Banks have been taking their responsibilities in combating money laundering or terrorist financing compliance preventive measures and opportunities are obtained following the success of banks responsibilities. However, Ayele identified some challenges within cashed- society, difficulty of PEPs and CDD without national identification card, banking technology infrastructure, AML/CTF costs, and lack of awareness in media about AML/CTF.

Bethelihem (2019) examines the challenges and practices of anti-money laundering and combating of terrorism financing-in Ethiopian commercial banks. She evaluate the existence of the necessary resources and frameworks, analysis is made whether banks put in place the preventive mechanism to safeguard their banks from launderers and terrorists, and respondents give high score to regular supervision on branches for their effective implementation, and conducting KYC before establishing business relationship with customers as well as correspondent banks and the grand result shows the existence of preventive mechanisms. In addition she indicates indicated absence of national ID and list of PEP's as well as local sanction lists to identify and verify customers before establishing relationship with them, lower level of awareness in media, public and stakeholders, lack of technology to enhance the AML/CFT activities are so challenges.

Solomon (2016) Assess the Role of Ethiopian Private Banks in Combating Money Laundering and Their Effectiveness. He indicates that the Banks are making the efforts in the implementation of AML regulations imposed by the regulatory bodies, but so far they are unable to achieve effectiveness. This implies the lack of self initiation and the existence of conflict of interest because pursuits of deposit mobilization can result in their failure in the implementation of AML.

Amanuel (2016) examines anti-money laundering and Combating of Terrorist Financing practices and challenges of commercial banks in Ethiopia. He indicate that Ethiopia has made a significant progress in terms of combating money laundering and terrorist financing efforts, which is acknowledged by the international standard setter Financial Action Task Force (FATF), sizeable gaps still remain in meeting international standards which can be attributed to lack of

awareness among the concerned stakeholders leading to reluctance to discharge respective responsibilities.

Messay and Daniel (2021), examine the Cash economy, criminality and cash regulation in Ethiopia", they indicated that the cash intensive nature of Ethiopia's economy has enabled a significant amount of cash to circulate outside of the formal financial system. Because of that Ethiopia is exposed to terrorism financing and money laundering activities. In addition, limited awareness of the problems of money laundering and terrorist financing and their impacts and limited measures on anti-money laundering and countering the financing of terrorism (AML/CFT) and inadequate capacities to implement existing frameworks and legislation was another problem.

National risk assessment (2016), According to risk assessment conducted in 2016 by the national risk assessment it was identified that the overall risk of ML and TF of Ethiopia was medium and medium high respectively. From the assessment high level threat predicate crimes were known, and these include corruption, tax fraud human trafficking and migrant smuggling, good smuggling (contraband), illegal hawala and fraud. With objectives of developing and strengthening the AML/CFT regime in Ethiopia to protect the integrity of the financial system, the national AML/CFT policy was formulated to step forward the fight against ML/TF in Ethiopia.

2.3. Research Gap

The amount of empirical studies of money laundering and terrorism financing in Ethiopia's banking sector is inadequate. From the literature survey, it is observed and practical that Even if there are various researches on the AML/CFT, the concept is not yet well researched. Among these studies, Ayele Yitayew 2014 has studied the Practices and Challenges of Anti-Money Laundering and Combating of Terrorist Financing in Commercial Banks in Ethiopia "his work discusses the potential challenges as level of awareness among senior management, technological advancement and cooperation among law enforcement agencies but this study was conducted before Ethiopia out of FATF Public Statement which is list of Countries that have been identified as having strategic AML deficiencies. Belay Sileshi 2022 has studied Effectiveness of Anti-money Laundering Preventive Measures in Ethiopia: Case Study on Commercial Banks and Financial Intelligence Center but he studied on money-laundry he does

not include terrorist financing And also (Frehiwot 2018) studied the extent of compliance to Anti Money Laundering and Countering Terrorist Financing (AML/TCF) standards in Dashen Bank. This study about one bank and not address others bank. Therefore, this study attempts to fill the above research gap by examine AML/CFT practices and challenges of commercial banks in Ethiopia as the leading institutions and the measures being taken by FIC in light of FATF recommendations and best practices

CHAPTER THREE

RESEARCH METHODOLOGY

Introduction

The main objective of the study is to assess the Anti-Money Laundry and combating of terrorism financing challenge and practice in Ethiopian commercial Banks. To this effect, this chapter involves the research design, the method of sampling, type of data source, tools of data gathering and analyzing of data are presented below.

3.1. Research Design

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

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

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

3.2. Research Approach

The researcher used mixed approach in research. Quantitative approach of doing research was employed because, quantitative research answers questions through a controlled deductive process allowing for the collection of numerical data, the prediction, the measurement of variables, and the use of statistical procedures to analyze and develop inferences from the data.

In addition, Qualitative research is an approach for exploring and understanding the meaning of individuals or groups ascribe to a social or human problem. Researchers are interested in gaining a rich and complex understanding of peoples experience and not in obtaining information which can be generalized to other larger groups. Thus the researcher applied qualitative research method to analyze the primary data obtained through interview method of data collection.

3.3. Sampling Design

3.3.1. Target Population of the Study

Population is the entire aggregation/total of items from which samples can be drawn (Ilker, et al., 2016). Determining type and method of sampling mainly depends on the types of population that the study covers. There are twenty two Banks in Ethiopia. The study focuses on the commercial banks since the Anti-Money Laundry and combating of terrorism financing practice is being fully implemented only in the banking sector (The Mutual Evaluation Report (MER, 2021). Therefore, employees of risk and compliance staff of six selected bank staffs and staffs of financial intelligence center were the target population.

3.3.2. Sampling Technique

This study has employed purposive and stratified techniques due to the nature of the study. The researcher used stratified sampling technique to determine the appropriate sample size from commercial banks of Ethiopia. A stratified random sampling technique is preferred because it is used to assist in minimizing bias when dealing with those populations who are heterogeneous in nature. Janet (2006)

According to Kummar (2005), the purposive sampling is the judgment of the researcher as to who can provide the best information to achieve the objectives of the study. Further, the reason why this technique chosen is due to the expectation that these Compliance Officers/Managers

and Risk and Compliance Directors and financial intelligence center staffs would have adequate knowledge on ML/TF and subsequently have knowledge on the prevention measures adopted in their respective banks. Therefore, stratified sampling was used to select commercial banks and purposive sampling was used to choose samples size of respondent.

3.3.3. Sample Size

Out of the 22 commercial banks operating in Ethiopia, the researcher has decided to select a sample of six banks by using stratified sampling on the basis of year of establishment and assumed to have best experience in handling money laundering. Therefore, Commercial Bank of Ethiopia, Awash Bank, Dashen bank, Bank of Abyssinia, Wegagen bank and NIB bank were selected. And by using purposive sampling all Risk and Compliance department staffs of six banks are used as sample size.

Table 1 Population of the Compliance Staff Members of selected Commercial Banks

S/N	Name of the bank	Year of Establishment	Total Number of Compliance Staff
1	Commercial Bank of Ethiopia	August, 1942	14
2	Awash Bank	November, 1994	11
3	Bank of Abyssinia	February, 1996	11
4	Dashen Bank	September , 1995	8
5	Wegagen bank	June, 1997	7
6	NIB bank	October , 2003	7
Total population			58

Thus, the sample sizes of this study are about 58 staffs of banks. The numbers of respondents differ from bank to bank because of the size of the banks. For this research, other 2 staffs of financial intelligence were used as an additional interviewee.

3.4. Data Sources and Methods of Collection

3.4.1. Data Sources and Types

Data was gathered from both primary and secondary sources. In an effort to obtain information relevant to the study both primary and secondary source of data was used as source of data.

According to Hollensen (2007) primary data can be defined as information that is collected first-hand, generated by original research tailor-made to answer specific current research questions.

There are several methods of collecting primary data, particularly in surveys and descriptive researches. Important ones are: interview and questionnaires

3.4.2. Data Collection Methods

For this study the researcher was prepared close ended questionnaires and interview to collect primary source of data and to achieve all the specific objectives. According to Saunders et al. (2009) structured questionnaire was used to collect data from different employees to gather the information needed for the research by using a five point likert response scale. This study established that the responses were measured on five point likert scale with 1= Strongly Disagree; 2= Disagree; 3= Neutral; 4= Agree; and 5 = Strongly Agree. The questionnaire has two parts; first part focuses mainly about the personal profiles of sample respondents such as age; gender, education status etc., whereas part two of the questionnaire deals with state of agreement by respondents on agreement state on different practices of anti-money laundry and combating of terrorism financing. Some previously arranged questionnaires were taken from different related sources. The researcher conducted structured and semi-structured interviews with the financial intelligence center executives and specialists to gather information that would not be answered by questionnaire especially to assess the effective countermeasures taken by financial intelligence center.

3.4.3. Reliability and Validity Test

According to Creswell (2014) validity is one of the strengths of quantitative and qualitative research and is based on determining whether the findings are accurate from the standpoint of the researcher, the participant, or the readers of an account. The questionnaire will be carefully designed and tested with a few members of the population for further improvements. Content validity of the survey questionnaire will be validated by professionals and some parts of the questionnaires were taken from previous documents and secondary sources in order to keep the validity. To ensure the reliability of the measurement scales, Cronbach's alpha was used in the calculation. Whereby a higher value of above 0.7 indicated that the variables were reliable but

Table 2 Reliability Analysis Results

Variables	Number of Items	Cronbach Alpha
AML/CFT policies and procedures	9	0.86
ML/CF preventive mechanisms	18	0.74
AML/CFT implementing challenges	13	0.98

Source survey result and own computation

3.5. Methods of Data Analysis

3.5.1. Data Processing and analysis

Data analysis consists of examining, categorizing, tabulating, or otherwise recombining the evidence, to address the initial proposition of a study (Yin, 1989). The data received from respondent's evaluated using the appropriate statistical techniques and amended for any errors or omissions and interpretation presented through mean and standard deviation. Descriptive analysis was used to analyze data gathered through questionnaires. At last presentation and report was done through figures and tables. The arithmetic mean is a measure of central tendency which was used to represent data in an entire population. Standard Deviation is a widely used to measure the variability in statistics and probability theory. It shows how much variation there is from the mean.

The researcher was summarize the responses of concerned respondents and describe challenges and practices of the banks to the effective implementation of Anti Money Laundry and combating of terrorism financing thereby seeking answers to the research questions and achieving envisaged objectives.

3.6. Ethical Consideration of the Study

In doing any research as according to Leedy and Ormrod (2013), there is an ethical responsibility to do the work honestly and with integrity. Before the data collection, the ethical issues have been taken in to kindness when the study is conducted. Appropriate communication was undertaken with the respondents. During data collection respondents had informed the objective of the research. Anyone who was not interest to involve and bring any information was not included in the study. For the purpose of respondents security their names were not written on the questionnaire. As a general rule, therefore the study had not raised any ethical anxiety.

CHAPTER FOUR

RESULT AND DISCUSSION

This chapter explains the analysis and interpretation part of the study. It focuses on assessing the AML/CFT practices and challenges of commercial banks in Ethiopia. This chapter presents the findings of the data analysis in accordance with the research methodology covered in chapter three. The Bank's publications, another website, and pertinent NBE directives all provided the secondary data that was used. Additionally, information from Risk management and compliance department of selected commercial Banks was used to compile the primary data. Accordingly, the chapter has two sections in which the first section contains analysis of the data collected through questionnaire while the second section deals with presenting results of the interview conducted.

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

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

4.1.1. Response Rate of Respondents

Out of 58 questionnaires 54 was completed and collected.

Table 3 Response Rate

Question Distributed	Question Returned	Percentage (%)
58	54	93.1

Source survey result and own computation

According to Mugenda and Mugenda (2003) a 50% response rate is adequate, 60% good and above 70% rated very good. This implies that basing on this assertion; the response rate in this case of 93.1% was very good as shown in Table 4.1 above.

4.1.2. Demographic factors of Respondents

Table 4 Analysis of demographic factors

No	Factors	Categories	Frequency	Percentage (%)
1	Gender	Male	39	72.2
		Female	15	27.8
2	Age Category of the respondents	18-25	11	20.4
		26-35	28	51.9
		36-45	10	18.5
		Above 45	5	9.2
3	Educational Qualification	Masters and above	35	64.8
		Degree	19	35.2
		Diploma & Certificate	0	0
4	Current position	Managerial	12	22.2
		Non-managerial	42	77.8
5	Year of service in the bank	<5	12	22.2
		6-10	24	42.6
		11-20	12	24.1
		Above 20	6	11.1

Source survey result and own computation

Gender frequency of the respondents shows that only 27.8% of the respondents are female while the majority (72.2%) is male. Regarding their age, (51.9%) of respondents fall within the age category of 26 up to 35 years and (20.4 %) of respondents fall within the age category 18 up to 25 years. The remaining (18.5%) and (9.2%) of the respondents are between 36 up to 45 and above 45 years old respectively.

As the result shows here are no respondents below first degree. Most of the respondents (64.8%) of respondents are second degree holders while the rest (35.2%) of the respondents are first degree holders. This shows that Risk management and compliance department has man power with first and second degree to handle AML/CTF compliance duties.

In relation with current position 77.8% of respondent are non-managerial and the reaming 22.2% are managerial on their current bank. The other relevant demographic characteristic is experience, (42.6%) of the respondents are between 6and 10 years of banking experience, (24.1 %) are between 11 and 20 years of experience while (22.2%) of the respondent are less than 5 years' experience. Only (11.1%) of respondent have experiences more than 20 years.

4.1.3. Descriptive Analysis of the Study Variables

This part of the analysis was made based on survey schedule gathered from 54 employees of the selected commercial banks of Ethiopia by using close-ended questionnaires 5-point Likert's scale questions. For a consistent interpretation of descriptive analysis of 5-point Likert's scale questions, the following criterion described in Table 4.2 was used.

Table 5 Likert Scale points

Likert Scale	Average Score	Rating
Strongly agree	Average Score = 4.21 – 5.00	Very high
Agree	Average Score = 3.41 – 4.20	High
Neutral	Average Score = 2.61 – 3.40	Neutral
Disagree	Average Score = 1.81 – 2.60	Low
Strongly disagree	Average Score = 1.00 – 1.80	Very low

Source: Chaihiranwattana & Nookua (2010)

4.1.4. AML/CFT Policies and Procedures

The AML/CFT Policies and Procedures in selected commercial banks of Ethiopia were analyzed through several questions for the study's primary goal. The research findings are summarized within the sections below.

Table 6 AML/CFT policies and procedures

CODE	STATEMENTS ON AML Policies and Procedures	Mean	SD
PP1	The Bank's board of directors has approved a compliance program, policy, and procedure in accordance with international standards.	3.81	1.107
PP2	Written policy framework is adopted stating the bank's commitment to comply with AML/CFT obligations in accordance with applicable proclamations and laws.	3.76	0.961
PP3	An adequately resourced and independent audit function is designated to assess the effectiveness of the compliance program in relation to international standards, proclamations, and laws.	2.24	1.29
PP4	A sufficient amount of resources is allotted for the proper operation of AML/CFT compliance.	2.48	1.134
PP5	Procedure is in place to identify, assess and understand money laundering and terrorist financing risks in the bank.	4.02	0.871
PP6	Internal controls and procedures are in place to prevent criminals from using the bank's facilities to launder money or finance terrorism.	3.36	1.059
PP7	Written policies are developed to document the process of preventing, detecting, and reporting suspicious transactions.	3.81	0.9
PP8	Record retention procedures are in place in accordance with applicable laws.	4.28	0.87
PP9	There are policies, manuals, and procedures in place to manage and mitigate identified risks.	3.69	0.939
	Composite Statistics	3.49	1

Source survey result and own computation

The respondent feedback shows that the Bank's board of directors has approved a compliance program, policy, and procedure in accordance with international standards (M=3.81, SD=1.107), Written policy framework is adopted stating the bank's commitment to comply with AML/CFT obligations in accordance

with applicable proclamations and laws (M=3.76, SD=.961), Procedure is in place to identify, assess and understand money laundering and terrorist financing risks in the bank (M=4.02, SD=0.871)

The respondent disagree on the statement, An adequately resourced and independent audit function is designated to assess the effectiveness of the compliance program in relation to international standards, proclamations, and laws (M=2.24, SD=1.29) and A sufficient amount of resources is allotted for the proper operation of AML/CFT compliance (M=2.48, SD=1.134)

Internal controls and procedures are in place to prevent criminals from using the bank's facilities to launder money or finance terrorism(M=3.36, SD=1.059), Written policies are developed to document the process of preventing, detecting, and reporting suspicious transactions(M=3.81 SD=0.9), Record retention procedures are in place in accordance with applicable laws (M=4.28, SD=0.87) and There are policies, manuals, and procedures in place to manage and mitigate identified risks (M=3.69 , SD=0.939)

Finally, the composite statistics result with (M=3.49, SD=1) implies that the Ethiopian commercial banks developed policies and procedures to identify assess and understand ML and TF.

4.1.5. The Practices of ML and CF Preventive Mechanism in Commercial banks

Table 7 ML and CF Prevention Mechanism

CODE	ML and CF Prevention Mechanism	MEAN	SD
	Transaction monitoring and reporting		
PM1	The board of directors monitors the bank's compliance risk exposure on a regular basis and provides high-level guidance.	3.41	1.24
PM2	The bank conducts risk based assessment on its customer base and their transactions.	4.19	0.944
PM3	Relevant customer and transaction records are kept in accordance with applicable laws.	4.56	0.497
PM4	Automated compliance system is in place to detect and report suspicious transactions	2.1	1.165
	Statement on AMLCFT training		
PM5	A Compliance Officer is designated at a senior management level alongside appropriate employees with relevant competence and authority to oversee the bank's AML/CFT compliance program.	3.24	1.035
PM6	Regular training is provided to concerned employees on the various aspects of money laundering and terrorist financing as well as methods of identifying and reporting suspicious transaction and customers.	1.96	0.922

PM7	Existing AML/CFT policies, procedures and manuals are communicated to the concerned employees.	2.48	1.228
PM8	New AML/CFT related laws or changes to the existing policies or practices are timely communicated to concerned employees.	2.83	1.244
	Statement on audit practice		
PM9	Risk Based Approach is adopted to assess the bank's exposure to money laundering and terrorist financing risks.	4.22	0.853
PM10	Regular supervision is conducted on branches and subsidiaries to ensure that the compliance program is being implemented effectively.	2.07	1.152
PM11	The Bank have an internal audit function, a testing function that assesses FCC AML, CTF and Sanctions policies and practices on a regular basis.	2.39	1.297
PM12	FCC AML, CTF and Sanctions policies and practices on a regular basis.	1.98	1
	Statement on KYC and conducting diligence		
PM13	Automated screening tool is in place to identify Politically Exposed Persons (PEPs).	1.74	0.886
PM14	Customers due diligence (CDD) procedures are carried out on customers on an ongoing basis.	4.04	1.17
PM15	KYC procedure is conducted and AML/CFT controls are assessed before establishing business relationship with potential correspondent banks and money transfer agents.	3.94	1.061
PM16	Customers are screened against international SDN sanctioned lists such as; UN before establishing business relationship and on an ongoing basis.	3.52	1.487
PM17	Accurate originators' and beneficiaries' information is captured during local and international wire transfer.	4.09	0.866
PM18	Enhanced customer due diligence is conducted on high risk customers such as, PEPs, NGOs, Non-resident customers and transactions from high risk jurisdictions.	3.85	1.112
	Composite Statistics	3.15	1.06

Source survey result and own computation

The respondents feedback shows that the board of directors monitors the bank's compliance risk exposure on a regular basis and provides high-level guidance (M=3.41, SD=1.24) The bank conducts risk based assessment on its customer base and their transactions (M=4.19, 0.944)

Relevant customer and transaction records are kept in accordance with applicable laws (M=4.56, SD=0.497) but the respondent not agree on the statement Automated compliance system is in place to detect and report suspicious transactions (M=2.1, SD=1.165).

In relation to transaction monitoring and reporting measures the respondent feedback indicate that the banks board conducts periodic monitoring about the compliance risk, banks in Ethiopia assess on its customer base and their transactions and banks record and kept safe their customer and transactions records. But banks in Ethiopia didn't place the automated compliance system to detect and report suspicious transactions

A Compliance Officer is designated at a senior management level alongside appropriate employees with relevant competence and authority to oversee the bank's AML/CFT compliance program (M=3.24, SD=1.035), Regular training is provided to concerned employees on the various aspects of money laundering and terrorist financing as well as methods of identifying and reporting suspicious transaction and customers (M=1.96, SD=0.922), Existing AML/CFT policies, procedures and manuals are communicated to the concerned employees (M=2.48, SD=1.228), New AML/CFT related laws or changes to the existing policies or practices are timely communicated to concerned employees (M=2.83, SD=1.244)

In relation to AML/CFT training the respondents feedback indicate that banks have senior compliance officers who have relevant competence and authority to oversee the bank's AML/CFT compliance program but banks did not give regular training for their compliance officers and they did not communicate the AML/CFT policies, procedures and manuals to the concerned employees. In addition banks do not communicate New AML/CFT related laws or changes to the existing policies or practices to concerned employees.

Risk Based Approach is adopted to assess the bank's exposure to money laundering and terrorist financing risks. (M=4.22, SD=0.853), Regular supervision is conducted on branches and subsidiaries to ensure that the compliance program is being implemented effectively (M=2.07, SD=1.152), The Bank have an internal audit function, a testing function that assesses FCC AML, CTF and Sanctions policies and practices on a regular basis(M=2.39, SD=1.297) and FCC AML, CTF and Sanctions policies and practices on a regular basis (M=1.98, SD=1).

In relation to AML/CFT audit practice the respondents' feedback indicates that banks adopt Risk Based Approach to assess their exposure to money laundering and terrorist financing risks but

regular supervision is not conducted on branches and subsidiaries to ensure the effective implementation of the compliance program. Banks in Ethiopia have no internal audit function and other independent third party to audit and assess FCC, AML, CTF and sanctions policies and practices

Automated screening tool is in place to identify Politically Exposed Persons (PEPs)(M=1.74, SD=0.886), Customers due diligence (CDD) procedures are carried out on customers on an ongoing basis (M=4.04, SD=1.17), KYC procedure is conducted and AML/CFT controls are assessed before establishing business relationship with potential correspondent banks and money transfer agents (M=3.49, SD=1.061), Customers are screened against international SDN sanctioned lists such as; UN before establishing business relationship and on an ongoing basis (M=3.52, SD=1.487), Accurate originators' and beneficiaries' information is captured during local and international wire transfer (M=4.09, SD=0.866), Enhanced customer due diligence is conducted on high risk customers such as, PEPs, NGOs, Non-resident customers and transactions from high risk jurisdictions (M=3.85, SD=1.112).

In relation to KYC and conducting diligence the respondents' feedback indicate that customers due diligence (CDD) procedures are carried out on customers on an ongoing basis, KYC procedure is conducted and AML/CFT controls are assessed before establishing business relationship with potential correspondent banks and money transfer agents and banks screen UN international sanctioned individuals before establishing business relationship. In addition banks capture originators and beneficiaries information during international wire transfer and conduct customer due diligence on high risk customers but there is no automated screening tool in Ethiopia to identify Politically Exposed Persons (PEPs)

Finally, the composite statistics result with (M=3.15, SD=1.06) implies that the respondents are neutral about ML/TF preventive mechanism.

4.1.6. AML/CFT Implementation Challenges in Commercial Banks

Table 8 Analysis of AML/CFT Implementation Challenges

Code	Statements on AML/CFT Implementation Challenges	Mean	SD
IC1	The tone at the top is not set, and senior management is not given enough emphasis on instilling a strong AML/CFT culture throughout the bank.	3.7	0.955
IC2	The costs of implementing AML/CTF are higher.	3.93	0.9
IC3	The presence of a large proportion of the population without access to financial services and a cash-based economy	4.61	0.488
IC4	The lack of a National ID card impedes effective KYC procedures.	4.72	0.448
IC5	Lack technology to improve AML/CFT activities.	4.09	0.866
IC6	Adequate resources are not allocated to implement the designed compliance program.	4	0.9
IC7	not appoint competent personnel to oversee compliance activities	3.44	0.786
IC8	AML/CTF awareness in media is lower in the country.	4.13	0.818
IC9	Not all domestic stakeholders actively participate in the fight against ML/TF.	3.96	0.942
IC10	It is difficult to integrate AML/CFT requirements with business objectives, customers, products, and operations.	3.72	0.97
IC11	Concerned regulatory bodies do not provide a list of Politically Exposed Persons or local sanction lists.	4.26	0.672
IC12	A lack of support from supervisory bodies (NBE and EFIC) for AML/CFT capacity building	3.85	0.931
IC13	The cooperation and coordination of law enforcement agencies and regulatory bodies in preventing and combating money laundering and terrorist financing is inadequate.	4.04	0.9
	Composite Statistics	4.03	0.81

Source survey result and own computation

The results in Table 4.6 indicate that according to the respondents of the selected commercial banks of Ethiopia, the factors that present challenges in terms of implementing AML/CFT had scored an average mean value between 3.44 and 4.72 with a standard deviation value between 0.448 and 0.955. The mean value above 3.4 indicated that the respondents of the selected commercial banks of Ethiopia agreed on the overall items of challenges and the standard deviation less than 1 indicates that the respondents have the same perceptions towards the raised questions.

The respondents agreed that the factors that present challenge in terms of implementing AML/CFT measures include; lack of tone at the top and adequate emphasis by senior management leading to weak compliance culture, customer's negative attitude towards AML/CFT practices, prevalence of high percentage of unbanked population and cash based economy alongside the lowest awareness of AML/CTF by media in the country.

Likewise, it was indicated that absence of National ID, list of PEP or local sanction lists which have to be provide by concerned regulatory bodies hinder the effective KYC and CDD procedures which are vital part of AML/CFT practices. Elsewhere, lack of technology and difficulty of integrating AML/CFT requirements with business objectives, clients, products and process were also deemed challenges.

Moreover, inactive involvement of domestic stake holders in fighting ML/TF and the higher costs of implementing AML/CTF are another challenges.

In addition to the above respondents agreed that adequate resources are not allocated to implement the designed compliance program and not to appoint competent personnel to oversee compliance activities.

Furthermore, challenges of commercial banks related to regulatory organs to implement AML/CFT include: A lack of support from supervisory bodies (NBE and EFIC) for AML/CFT capacity building and an inadequate cooperation and coordination of law enforcement agencies and regulatory bodies in preventing and combating money laundering and terrorist financing.

4.2. Analysis of Interview Conducted with FIC Official

Towards meeting the study's outlined objectives, interview was conducted with Financial Intelligence Center of Ethiopia. A total of 4 questions were forwarded of which results are presented below.

The first question raised was regarding Expectations of Regulatory Bodies from Commercial Banks. However, it was indicated that banks and non-banking financial institutions are required to have in place an up to date manual that defines all procedures in place to combat the financing of terrorism and prevent money laundering and terrorist financing activities. And the compliance manual of every financial institution requires the approval of the Board of Directors who must satisfy themselves of the adequacy of the compliance policy guidelines as presented to them by the management of the financial institution. According to FIC, copies of the manual must be submitted to the FIC within three months of release and this has been included in the Directives.

The interviewer indicate that the compliance officer should be a senior official and shall among others develop AML/CFT compliance program, receive and vet suspicious transaction reports from staff, file such suspicious transaction reports to the Financial Intelligence Centre, ensure that the financial institution's compliance program is implemented and co-ordinate the training of staff in AML/CFT awareness, detection and reporting. It was expected of Banks to hold both in-house and third-party facilitated training sessions for its staff within short intervals in each year especially for the Compliance officers.

Accordingly the interviewer indicates that CDD is to be performed in instances where a business relationship is established, or where transactions with a minimum threshold of Br. 300,000, USD 15,000 or equivalent in other foreign currency are carried out, where there is a suspicion of money laundering or terrorist financing and where there are doubts about the authenticity of previously obtained information about the customer. According to the Directives, for all wire transfers, the ordering financial institutions should obtain and maintain information associated with the originator of the wire transfer including, the name of the originator, the originator's account number or a unique reference number if no account number exists; and the originator's address which can be substituted with identity number, customer identification number or date and place of birth.

The Directives mandate financial institutions to perform an enhanced due diligence for higher risk categories of customers, countries or geographical areas and business relationships or transactions. The interviewers, mentioned categories of customers whom the FIC deems as high risk to be non-resident customers, high net worth individuals, trusts, Political exposed persons (PEPs) and cross-border business relationships. Additionally the interviewers indicate that, financial institutions shall give special attention to their business relationships and account transactions with legal persons and other financial institutions from countries which do not or insufficiently apply the FATF recommendations

One other expectation of financial institutions is not to deal with shell banks or banks that have correspondent banking relationship with shell banks. According to interviewer, a shell bank is a bank that has no physical presence within the country where it was licensed and not affiliated to any Bank in that country.

According to interviewer, the Directives require financial institutions to formally order their employees to co-operate with the Regulators and law enforcement agencies. They are also required to make it possible for employees to report any non-compliant acts of the institution's AML/ CFT compliance program to the AML/CFT Reporting Officer. The interviewers indicate that employee accounts are to be monitored by financial institutions for transactions that are potential signals of money laundering. Any account found to be inconsistent with the salary pattern of the staff is subjected to investigations. This is also contained in the AML/CFT Directives.

The interviewers indicate that, Directives require all financial institutions to identify, assess, and understand the money laundering and terrorist financing risks. This includes but not limited to: document their risk assessments; include all the relevant risk factors before determining the level of overall risk and the appropriate level and the type of mitigation to be applied; keep assessments up to date; and have appropriate system to provide risk assessment information to the NBE and the FIC.

The second question forwarded was regarding the various challenges facing the FIC towards instilling a robust AML/CFT regime in the country specifically in the banking sector. As per the interviewer, one of the main factors that facilitate money laundering in Ethiopia is the countries' economy being highly cash based. These results in the difficulty to identify source of funds, the

legality of the cash involved in transactions, and lack of controlling mechanism when large amount of money exchanged within the economy. They expressed that the competent authorities are not cooperative to exchange information on any suspicious financial activities with the FIC which created information gap and difficulty in detection of predicate crimes that are related with ML. The interviewer also said that even if there are laws that are set out to prevent ML/TF they are not being fully implemented in the country which may create ML/TF to take place.

The number of suspicious transaction reported are minimal compared to their high volume of transactions. According to the interviewer, the reason for this are lack of understanding in the part of front line staff, fear of losing confidentiality and loss of customers and their deposits. Additionally they indicate that the core banking system of Banks does not have a feature that enables to extract cash transactions within the threshold limit i.e. 300,000 and above or its equivalent to foreign currency. That means the Banks are required to manually input details of these transactions on a daily basis and report it to the Financial Intelligence Centre. As a result some such cash transactions are omitted from the reports.

The third question was regarding efforts made by regulatory bodies in combating ML/TF. Accordingly, the Financial Action Task Force requires financial institutions to maintain records of customer transactions for a minimum period of 5 years and for customer identities, a minimum of 5 years following the termination of business relationships. The FIC however requires the retention of these records for a minimum of 10 years as against the 5 years prescribed by the Financial Action Task Force.

According to FIC, Prior to 2014 Ethiopia has been listed as one of high risk jurisdiction countries which have AML/CFT strategic deficiency. In order for the country to be out of the FATF black list efforts such as the enactment of proclamation on AML by the Ethiopian Government in 2009 followed by its implementation Directive of the National Bank of Ethiopia by 2010 were made. After these initial measures the FIC was established as a sole authority to handle any and all issues related to AML/CFT. The FIC is an independent institution which regulates the financial institutions through its AML/CFT laws and Directives and set up to assist in identifying proceeds from illegal activities, make information available to investigative bodies, and liaise with other countries FIUs for the exchange of information that will help fight money laundering and combat the financing of terrorism. The FIC in its turn made efforts of creating awareness about AML,

revised the 2009 proclamation and substituted it by Proclamation No. 780/2013 to include all the 40+9 FATF recommendations, criminalize money laundering, enforced the requirements of these recommendations on all financial institutions in Ethiopia and continues such efforts to this date. As a result the objective of all the efforts has been met and Ethiopia is now one of FATF compliant countries since 2014.

Additionally the interviewer indicates that FIC monitors the banks activities in relation to AML through CTR and STR reports, annual supervision and by checking the structure of the compliance office. Furthermore, the FIC monitors the effective implementation of the AML procedures by checking the compliance function of the bank such as assignment of compliance officers, KYC, CDD, Training programs, record keeping, and the audit function. Furthermore the interviewer indicates that the cash withdrawal limit set by NBE plays a big role in AML/CFT.

The fourth and final question was whether the FIC, according to its mandate and responsibility examines the AML/CFT practice of banks in accordance with applicable laws by conducting regular supervision and communicate results promptly. However, it was indicated that the EFIC transfer its power to NBE to prudentially supervise commercial banks. Accordingly, as a regular duty NBE periodically select banks on risk based approach and made onsite and offsite supervision on AML/CFT practice and communicate them and informs FIC through copy. In addition, it was discussed that the Center maintains all relevant statistics but does not communicate the trends and results of investigations and prosecutions to reporting organs or the public in general owing the sensitivity and confidentiality nature of the cases. However, it was indicated that there is a continuous awareness creation sessions towards suppression ML/TF.

4.3. Comparison of research finding

Bethelihem (2019) find that commercial banks have allocated sufficient resources for proper function of AML/CFT compliance and they have adequately resourced and independent audit function designated to test the effectiveness of the compliance program implemented in their respective banks but according to my finding there is no adequately resource and independent audit function is designated to assess the effectiveness of the compliance program in relation to international standards, proclamations, and laws and a sufficient amount of resources is not allotted for the proper operation of AML/CFT compliance.

According to my research finding the number of suspicious transaction reported are minimal compared to their high volume of transactions, the reason for this are lack of understanding in the part of front line staff, fear of losing confidentiality and loss of customers and their deposits. Additionally the core banking system of Banks does not have a feature that enables to extract cash transactions within the threshold limit i.e. 300,000 and above or its equivalent to foreign currency. That means the Banks are required to manually input details of these transactions on a daily basis and report it to the Financial Intelligence Centre. As a result some such cash transactions are omitted from the reports. And the researcher that I mentioned in empirical review was not addressed this part.

CHAPTER FIVE

Summary of findings, Conclusions and Recommendations

5.1. Summary of Findings

The aim of the study is to assess challenges and practices of Anti-Money Laundering and Combating of Terrorism Financing-the case of the Ethiopian Commercial Banks. The study focuses on the preventive mechanism used in Commercial Banks of Ethiopia, the extent of how commercial banks comply with the AML/CFT practice, the policies that guide AML/CFT, the challenges of implementing effective Anti-Money Laundering and Financing of terrorism practices in Ethiopian commercial Banks and the efforts made by the Ethiopian financial regulatory bodies.

The results in general indicated the existence of effective AML/CFT policies and procedures that guided each commercial bank to implement effective AML/CFT regime according to the compliance requirements. These include, written policy adoption in accordance with applicable laws and international standards, and placing comprehensive AML/CFT framework.

Most of the respondents were agreed that banks' board conducts periodic monitoring about the compliance risk; banks in Ethiopia assess on its customer base and their transactions; and banks record and kept safe their customer and transactions records. Commercial banks in Ethiopia didn't place the automated compliance system to detect and report suspicious transactions. Ethiopian banks have senior compliance officers who have relevant competence and authority to oversee the bank's AML/CFT compliance program but banks did not give regular training for their compliance officers and they did not communicate the AML/CFT policies, procedures and manuals to the concerned employees. In addition banks do not communicate New AML/CFT related laws or changes to the existing policies or practices to concerned employees.

Banks in Ethiopia adopt Risk Based Approach to assess their exposure to money laundering and terrorist financing risks; however no regular supervision is conducted on branches and subsidiaries to ensure the effective implementation of the compliance program. Financial institutions in Ethiopia had not internal audit function to assess anti-money laundering and sanctions and practices and they do not have other independent third party to audit and assess

FCC, AML, CTF and sanctions policies and practices. Additionally the cash withdrawal limit set by NBE plays a big role in AML/CFT

Most of the respondents were agreed that customers due diligence procedures are carried out on customers on an ongoing basis, KYC procedure is conducted and AML/CFT controls are assessed by financial institutions before establishing business relationship with potential correspondent banks and money transfer agents. There is a screening process on UN international sanctioned individuals before establishing business relationship. There is an enhanced customer due diligence is conducted on high risk customers such as, PEPs, NGOs, Non-resident customers and transactions from high risk jurisdictions. However, there is no automated screening tool in Ethiopia to identify Politically Exposed Persons.

The respondents were agreed that the absence of National ID, list of PEP or local sanction lists which have to be providing by concerned regulatory bodies hinder the effective KYC and CDD procedures which are vital part of AML/CFT practices. Lack of technology and difficulty of integrating AML/CFT requirements with business objectives, clients, products and process were also deemed challenges. Additionally lack of tone at the top and adequate emphasis by senior management leading to weak compliance culture, customer's negative attitude towards AML/CFT practices, prevalence of high percentage of unbanked population and cash based economy alongside the lowest awareness of AML/CTF by media in the country, inactive involvement of domestic stake holders in fighting ML/TF and the higher costs of implementing AML/CTF,adequate resources are not allocated to implement the designed compliance program and not to appoint competent personnel to oversee compliance activities. Furthermore, challenges of commercial banks related to regulatory organs to implement AML/CFT include: A lack of support from supervisory bodies (NBE and EFIC) for AML/CFT capacity building and an inadequate cooperation and coordination of law enforcement agencies and regulatory bodies in preventing and combating money laundering and terrorist financing.

According to the FIC the number of suspicious transaction reported are minimal compared to their high volume of transactions, the reason for this are lack of understanding in the part of front line staff, fear of losing confidentiality and loss of customers and their deposits. Additionally they indicate that the core banking system of Banks does not have a feature that enables to extract cash transactions within the threshold limit i.e. 300,000 and above or its equivalent to

foreign currency. That means the Banks are required to manually input details of these transactions on a daily basis and report it to the Financial Intelligence Centre. As a result some such cash transactions are omitted from the reports.

5.2. Conclusion of the Study

In Ethiopian commercial banks there is a compliance program, policy, and procedure in accordance with international standards to identify, assess and understand money laundering and terrorist financing risks in the bank, and also to manage and mitigate identified risks. In addition written policies are developed to document the process of preventing, detecting, and reporting suspicious transactions. However, there is no adequate resource and independent audit function is designated to assess the effectiveness of the compliance program in relation to international standards, proclamations, and laws.

There is money laundry and terrorism financing measures implemented on the banks that's include: The board of directors monitors the bank's compliance risk exposure on a regular basis and provides high-level guidance and the banks conduct Risk Based Approach to assess its customer base, their transactions and to assess the bank's exposure to money laundering and terrorist financing risks. Customers due diligence (CDD) procedures are carried out on customers on an ongoing basis especially on high risk customers such as, PEPs, NGOs and on Non-resident customers. Additionally Customers are screened against international SDN sanctioned lists such as; UN before establishing business relationship and on an ongoing basis. KYC procedure is conducted and AML/CFT controls are assessed before establishing business relationship with potential correspondent banks and money transfer agents. Relevant customer and transaction records are kept in accordance with applicable laws and the banks system captured accurate originators and beneficiaries information during local and international wire transfer.

There is a number of challenge presents in terms of implementing AML/CFT measures include; lack of adequate emphasis by senior management, prevalence of high percentage of unbanked population and cash based economy alongside the lowest awareness of AML/CTF by media in the country. Additionally, absence of National ID, list of PEP or local sanction lists which have to be providing by concerned regulatory bodies hinder the effective KYC and CDD procedures which are vital part of AML/CFT practices. Elsewhere, lack of technology and difficulty of integrating AML/CFT requirements with business objectives, clients, products and process were

also deemed challenges. Moreover, inactive involvement of domestic stake holders in fighting ML/TF, the higher costs of implementing AML/CTF and not to allocate adequate resources to implement the designed compliance program are additional challenges. Furthermore, an inadequate cooperation and coordination of law enforcement agencies and regulatory bodies in preventing and combating money laundering and terrorist financing are the other challenges.

Efforts are made by regulatory bodies in combating ML/TF, FIC requires the retention of the records for a minimum of 10 years as against the 5 years prescribed by the Financial Action Task Force and The FIC made efforts of creating awareness about AML/CFT through revised the 2009 proclamation and substituted it by Proclamation No. 780/2013 to include all the 40+9 FATF recommendations, criminalize money laundering, enforced the requirements of these recommendations on all financial institutions in Ethiopia. FIC monitors the banks activities in relation to AML through CTR and STR reports, annual supervision and by checking the structure of the compliance office. Furthermore, the FIC monitors the effective implementation of the AML procedures by checking the compliance function of the bank such as assignment of compliance officers, KYC, CDD, Training programs, record keeping, and the audit function. Furthermore the cash withdrawal limit set by NBE plays a big role in AML/CFT.

5.3. Recommendations

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

- National ID should be prepared and applied to effectively implement know your customer (KYC) & customer due diligence (CDD) measures.
- List of politically exposed persons (PEPs) and local sanctioned lists should be prepared and provided to the concerned commercial banks towards appropriate enhanced due diligence measures.
- The Financial Intelligence Center of Ethiopia in collaboration with the National Bank of Ethiopia should continuously conduct supervision and ensure the AML/CFT implementation in the banking sector as per international standards and applicable laws.
- Collaboration between law enforcement and regulatory bodies should be strengthened to collectively mitigate money laundering and terrorist financing risks.
- The AML/CFT practice of commercial banks should be supported by the necessary technology to automate and enhance the compliance activities.

- Senior management of commercial banks should set the right direction at the top to instill a strong compliance culture in their respective banks.
- Banks should have internal audit function to assess anti-money laundering and sanctions and practices and they should have other independent third party to audit and assess FCC, AML, CTF and sanctions policies and practices.
- Commercial banks in Ethiopia should place the automated compliance system to detect and report suspicious transactions.
- Banks should give regular training for their compliance officers
- Banks should communicate the existing and new AML/CFT policies, procedures and manuals to the concerned employees.
- There should be regular supervision conducted on branches and subsidiaries to ensure the effective implementation of the compliance program.
- There should be awareness of AML/CTF by media in the country
- There should be automated screening tool that enables to extract cash transactions within the threshold limit.
- The findings of the study have prompted suggestions for further research. This research focused on only in six Banks and it has tried to show the efforts, the challenges and practices they encountered during implantation of AML. But further research needed on another 'Financial Institutions' such as banks, insurance companies, micro finance institutions, postal savings, money transfer agents or any other institution designated by the National Bank of Ethiopia. Designated Non-Financial Businesses and Professions include real estate agents and brokers; dealers in precious metals or precious stones; lawyers, notaries and other independent legal professionals when they prepare for, carry out or engage in transactions for their clients concerning; independent accountants; and such other businesses and professions as may be designated by the FIC.

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APPENDICES

Addis Ababa University

College of Business and Economics

Department of Accounting and Finance

Graduate Studies

Dear respondent,

This research is conducted by Mekdes Geremew, a student at Addis Ababa University for the partial fulfillment of the requirements for master's degree in Accounting and Auditing. Currently, I am conducting a research entitled "Challenges and Practices of Anti-Money Laundering and Combating of Terrorism Financing-The Case of the Ethiopian Commercial Banks. I kindly would like to requisite you that you are one of the best and honorable reliable respondents selected on this study.

Please assist me in giving correct and complete information to present a representative finding on the current status of Challenges and Practices of Anti-Money Laundering and Combating of Terrorism Financing.

Your participation is entirely voluntary and the questionnaire is completely anonymous.

Finally, I confirm you that the information that you share me will be kept confidential and only used for the academic purpose. No individual's responses will be identified as such and the identity of persons responding will not be published or released to anyone. All information will be used for academic purposes only.

Sincerely Yours,

Mekdes Geremew

Instructions

1. No need of writing your name
2. For Likert scale type statements and multiple choice questions indicate your answers with a check mark (√) and by encircling the letter of your choice in the appropriate block.

N. B. If you have any additional comments, clarifications, information, and suggestions, you can contact the researcher in the following addresses:

Name: Mekdes Geremew

Mobile: 251-924-070019

E-mail: mekdiyenazu@gmail.com

Part I: Demographic Characteristics of Respondents

Instruction: Please indicate your answer by encircling the letter of your choice:

Section A: Questions to be filled by all respondents

1. Gender:

- a. Male (1)
- b. Female (2)

2. Age:

- a. 18-25 (1)
- b. 26-35 (2)
- c. 36-45 (3)
- d. Above 45 years (4)

3. Educational level:

- a. Diploma& certificate holder (1)
- b. Degree holder (2)
- c. Master's degree and Above (3)

4. Current position

- a. Managerial (1)
- b. Non-managerial (2)

5. Total service year within the current organization

- a. Less than 5 years (1)
- b. Between 6 and 10 years (2)
- c. Between 11 and 20 years (3)
- d. Above 20 years (4)

Part II: AML/CFT Policies and Procedures

Please indicate to what extent you agree or disagree with the statements provided on the AML/CFT policies and procedures by putting a tick against the options provided: 1=Strongly Disagree, 2=Disagree, 3=Neutral, 4=Agree and 5= Strongly Agree

	General AML Policies and Procedures	5	4	3	2	1
1	The Bank's board of directors has approved a compliance program, policy, and procedure in accordance with international standards.					
2	Written policy framework is adopted stating the bank's commitment to comply with AML/CFT obligations in accordance with applicable proclamations and laws.					
3	An adequately resourced and independent audit function is designated to assess the effectiveness of the compliance program in relation to international standards, proclamations, and laws.					
4	A sufficient amount of resources is allotted for the proper operation of AML/CFT compliance.					
5	Procedure is in place to identify, assess and understand money laundering and terrorist financing risks in the bank.					
6	Internal controls and procedures are in place to prevent criminals from using the bank's facilities to launder money or finance terrorism.					
7	Written policies are developed to document the process of preventing, detecting, and reporting suspicious transactions.					
8	Record retention procedures are in place in accordance with applicable laws.					
9	There are policies, manuals, and procedures in place to manage and mitigate identified risks.					

PART III: ML and CF Prevention Mechanism

Please indicate to what extent you agree or disagree with the statements provided on the ML and CF Prevention Mechanism by putting a tick against the options provided: 1=Strongly Disagree, 2=Disagree, 3=Neutral, 4=Agree and 5= Strongly Agree

No	ML and CF Prevention Mechanism	5	4	3	2	1
	Transaction monitoring and reporting					
1	The board of directors monitors the bank's compliance risk exposure on a regular basis and provides high-level guidance.					
2	The bank conducts risk based assessment on its customer base and their transactions.					
3	Relevant customer and transaction records are kept in accordance with applicable laws.					
4	Automated compliance system is in place to detect and report suspicious transactions					
	Statement on AMLCFT training					
5	A Compliance Officer is designated at a senior management level alongside appropriate employees with relevant competence and authority to oversee the bank's AML/CFT compliance program.					
6	Regular training is provided to concerned employees on the various aspects of money laundering and terrorist financing as well as methods of identifying and reporting suspicious transaction and customers.					
7	Existing AML/CFT policies, procedures and manuals are communicated to the concerned employees.					
8	New AML/CFT related laws or changes to the existing policies or practices are timely communicated to concerned employees.					
	Statement on audit practice					
9	Risk Based Approach is adopted to assess the bank's exposure to money laundering and terrorist financing risks.					

10	Regular supervision is conducted on branches and subsidiaries to ensure that the compliance program is being implemented effectively.					
11	The Bank have an internal audit function, a testing function that assesses FCC AML, CTF and Sanctions policies and practices on a regular basis.					
12	FCC AML, CTF and Sanctions policies and practices on a regular basis.					
	Statement on KYC and conducting diligence					
13	Automated screening tool is in place to identify Politically Exposed Persons (PEPs).					
14	Customers due diligence (CDD) procedures are carried out on customers on an ongoing basis.					
15	KYC procedure is conducted and AML/CFT controls are assessed before establishing business relationship with potential correspondent banks and money transfer agents.					
16	Customers are screened against international SDN sanctioned lists such as; UN before establishing business relationship and on an ongoing basis.					
17	Accurate originators' and beneficiaries' information is captured during local and international wire transfer.					
18	Enhanced customer due diligence is conducted on high risk customers such as, PEPs, NGOs, Non-resident customers and transactions from high risk jurisdictions.					

PART IV: AML & CFT Implementation Challenges

Please indicate to what extent you agree or disagree with the statements provided on the AML/implementation challenge by putting a tick against the options provided: 1=Strongly Disagree, 2=Disagree, 3=Neutral, 4=Agree and 5= Strongly Agree

No	Statements on AML/CFT Implementation Challenges	5	4	3	2	1
1	The tone at the top is not set, and senior management is not given enough emphasis on instilling a strong AML/CFT culture throughout the bank.					
2	The costs of implementing AML/CTF are higher.					
3	The presence of a large proportion of the population without access to financial services and a cash-based economy					
4	The lack of a National ID card impedes effective KYC procedures.					
5	Lack technology to improve AML/CFT activities.					
6	Adequate resources are not allocated to implement the designed compliance program.					
7	not appoint competent personnel to oversee compliance activities					
8	AML/CTF awareness in media is lower in the country.					
9	Not all domestic stakeholders actively participate in the fight against ML/TF.					
10	It is difficult to integrate AML/CFT requirements with business objectives, customers, products, and operations.					
11	Concerned regulatory bodies do not provide a list of Politically Exposed Persons or local sanction lists.					
12	A lack of support from supervisory bodies (NBE and EFIC) for AML/CFT capacity building					
13	The cooperation and coordination of law enforcement agencies and regulatory bodies in preventing and combating money laundering and terrorist financing is inadequate.					

Thank you for your cooperation!

INTERVIEW QUESTIONS

1. What are the Expectations of Regulatory Bodies from Commercial Banks?
2. What is the challenges facing the FIC towards instilling a robust AML/CFT regime in the country specifically in the banking sector?
3. What are efforts made by regulatory bodies in combating ML/TF?