UNIVERSITÀ DELLA SVIZZERA ITALIANA

Doctoral Thesis

Integrating Anti-money laundering compliance duties into the banking culture

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To my grandmothers

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Abbreviations

AML	Anti-money laundering
AMLA	Anti-money Laundering Act
AUM	Assets under management
CC	Criminal Code
CDB	Agreement on the Swiss banks' Code of Conduct with regard to the Exercise of Due Diligence
CDD	Customer Due Diligence
CO	Compliance Officer
FINMA	Swiss Financial Market Supervisory Authority
KYC	Know Your Client
MLO	Anti-money laundering Ordinance
MROS	Money Laundering Reporting Office Switzerland
RM	Relationship Manager
SAR	Suspicious Activity Report
SBA	Swiss Bankers Association

Summary introduction

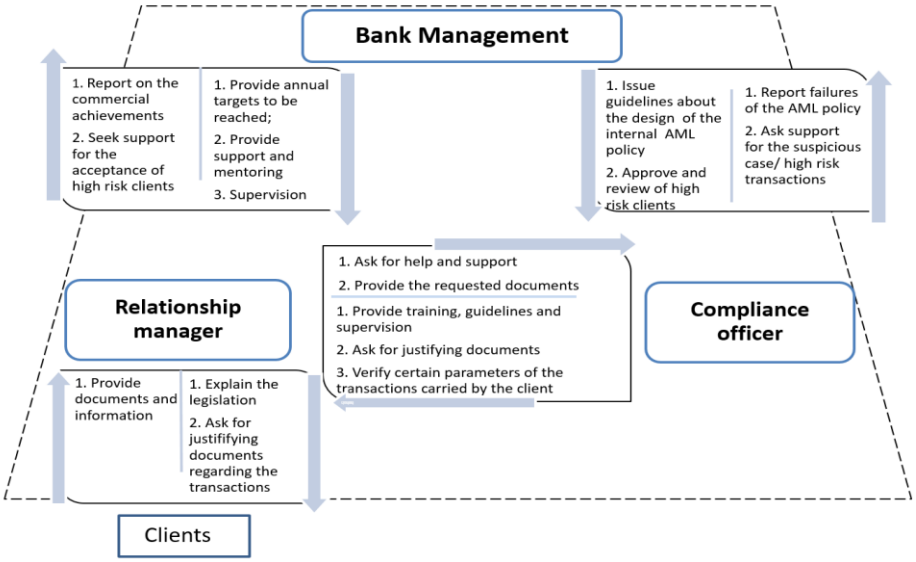
The establishment of the Financial Action Task Force (commonly known as FATF), in 1989 by the governments of the G-7 marked the beginning of the systematic international fight against money laundering. The first measure undertaken by the FATF in 1990 was issuing 40 Recommendations meant to safeguard the integrity of the international financial system by providing effective guidelines on how to prevent criminal money from entering banks and other financial institutions. Even if (officially) not mandatory, such guidelines represented the cornerstone upon which member jurisdictions started drawing their own national anti-money laundering (AML) framework. At the heart of such Recommendations stood the Know Your Customer (KYC) principles and the Due Diligence verification procedures that ought to be conducted by the financial institutions in order to identify both the client and the beneficial owner of the assets they are handling. Moreover, in order to be able to spot and, if necessary, report suspicions of money laundering, financial intermediaries should be continuously monitoring their clients' transactional activity and assess whether such activity is in line with the initial purpose of the business relationship. Following the events of 9/11, FATF issued nine additional recommendations meant to prevent terrorism financing. The Recommendations were then reviewed in 2003 and in 2012 to ensure that they remain up to date and relevant, and can be universally applicable.

In order to be able to observe the above mentioned AML duties banks and other financial intermediaries need to deploy resources to target money laundering and terrorism financing by installing IT dedicated tools and training employees accordingly. One important change regarding the compliance procedures was brought by the shift from a rule-based approach to a risk-based approach. As such, between 2007 and 2009, the FATF has issued a series of guidance notes regarding the relevant sectors in order to assist both public authorities and the private sector in applying a risk-based ap-

proach. The switch to a risk-based approach was the proof that governments understood that the "one size fits all" approach to AML regulation was deemed to be ineffective and burdensome, given the different scopes, sizes, products, markets and clients served by the various financial intermediaries. With this new perspective, the legislator allowed the financial intermediaries to tailor their internal AML policy according to the potential risks they face. The risk-based approach allows for important cost reductions since banks can allocate their investigative resources more efficiently, but it can also create dilemmas, as there is no clear rule to apply when running investigations: *i.e.* there are many instances in which risk cannot be clearly defined and quantified. Hence, banks were required to develop a deeper investigative expertise in order to be able to make sound decisions concerning highly uncertain cases. This was achieved by hiring trained AML experts, capable of dealing with issues that do not directly pertain to the core business of the bank.

Integrating a new resource into the banking processes can pose significant organisational problems. Studies ran in the UK, France and Belgium and focusing on the figure of the compliance officer analysed his specific tasks and role inside the bank; such studies also underlined how challenging is the reconciliation of business growing objectives with AML compliance obligations. As a consequence, business oriented employees will often find themselves in conflict with their colleagues from the compliance department, and everybody will feel the pressure of the management in one way or another, depending on the rigidity of the regulator toward the bank. The scheme below summarizes the relationships as well as the role of each actor involved in the bank's AML compliance process.

ROLES AND INTERACTIONS IN THE BANK'S AML COMPLIANCE PROCESS



Bearing in mind the depicted anti-money laundering framework and the internal communicational flows between the various actors, this thesis sets out to investigate the extent to which the compliance function has been integrated with the banking culture. As such, the main research question is whether after almost 20 years of AML legislation, banks and more exactly relationship managers accepted compliance as part of their day-by-day working routine. Each of the following chapters will cover specific aspects that are supposed to unveil the problems and challenges experienced by both relationship managers and compliance officers.

- The first chapter will put the reader at ease with the Swiss AML regulatory framework by explaining the due-diligence requirements imposed on the banking institutions.
- The second chapter intends to give an idea about the size and importance of the AML phenomenon in Switzerland by briefly discussing the statistics regarding the number of Suspicious Activity Reports (SAR) received yearly by the Swiss Financial Intelligence Unit, the suspicious factors behind the financial intermediaries' decision to file a SAR as well as the supposedly committed predicate offences. Moreover, we discuss the efficiency of the anti-money laundering reporting system by presenting data on the actual status of the SARs as well as the number of prosecutions.

- The third chapter starts tackling the main research question, by investigating the banks' perception of their vulnerability to money laundering operations as well as their motivation to participate in the AML fight. We believe that such data is a good indicator of the banks' willingness and determination to integrate compliance duties in their daily operations. In addition, we try to quantify the banks' efforts in counteracting the money laundering phenomenon by documenting several Know Your Client and reporting procedures they have implemented.
- With the forth chapter we begin investigating the relationship between the compliance officer and the relationship manager, as perceived by the compliance officers. First, the chapter will thoroughly discuss the specific tasks and objectives of each of the two actors that are likely to lead to a conflict. Then, by running a logistic regression I provide empirical evidence about the factors determining the occurrence of such organisational conflict. This chapter is intended to bring to surface the challenges faced by compliance officers when working upon disseminating a money laundering risk adverse attitude among their colleagues.
- The fifth chapter continues to focus on the interaction between the compliance officer and the relationship manager, but this time from the relationship manager's perspective. By employing a different methodology (i.e. interviews), I collect evidence about the difficulties encountered by the relationship manager when adapting to an AML compliant culture. Since the compliance officer's work will largely depend on the input received from the relationship manager, it is very important to understand how the latter assimilated the changes brought by the AML regulations, how he managed to transmit them to the client and which are the factors that are preventing a smooth collaboration with the compliance department.

I chose to study the banking system, not only because 28 of the FATF's 40 Recommendations regard exclusively this sector, but also because of its vulnerability to money laundering operations. Despite the myriad of options to launder ill-gotten profits that do not necessarily imply the use of banks as a primary laundering channel, we argue that in an era in which cash transactions are less and less frequent, the criminal

money will (at a certain stage of the laundering process) finally reach the banking system anyway. Moreover, as we will show in Chapter 2, the majority of the Suspicious Activity Reports received by the Financial Intelligence Unit come from the banking system; this is an indicator of both the importance of the banking system and of the significant resources devoted by banks to reporting procedures.

Beside the important share of the banking system in the country's GDP[1], there are other several reasons for which studying the case of Switzerland is particularly interesting for understanding the extent to which the AML compliance duties have been integrated into the banking culture. First, foreign governments have continuously criticized Switzerland for having a superficial approach when it comes to AML compliance. This has been mainly due to the Banking Secrecy Principle, even if the latter does not apply in case of investigations related to criminal funds. Secondly, since the majority of Swiss banks offer private banking and wealth management services, the trust between the client and the relationship manager and the respect for one's privacy is pivotal for a successful relationship. Very often, these two can become friends, making it even more difficult for the relationship manager to suspect and report the client's transactions. Thirdly, since more than 75% of the assets managed in Switzerland belong to non-residents, banks must dedicate significant resources to the due diligence checks. As compared to local clients, running due-diligence checks on foreign clients can prove quite demanding as the bank is forced to rely on information that is more difficult to verify. Last but not least, the Swiss AML reporting system is based on the existence of a "well-founded" suspicion. Differently than the quasi automatic reporting that banks in other countries are required to do (that is mostly the case for transactions above a certain treshold), Swiss banks must first run an "in-house" investigation and gather sufficient objective proofs before reporting to the authorities.

This study is part of a four-year research project ran jointly between the Faculty of Economics and Faculty of Communications at the University of Lugano. The project members included three Full Professors (one of Finance, one of Communication and one of Law), one post-doc researcher and one PhD student. The research project

[1] Estimated at approx. 9.5% as per 2014 OECD data

enjoyed the support of an External Advisory Committee formed by: one board member of the Swiss Bankers Association, one FINMA consultant, MROS's Vice-Head and a Senior Vice President of a local bank.

Considering both the scale and the scope of the study, it is the first one of this type in Switzerland. Moreover, is the first one to empirically assess the conflict or at least the tensioned relationship between the compliance officer and the relationship manager. Last but not least, given the size and importance of the Swiss financial centre on a global level, we believe that this study's findings can be representative of the challenges and problems faced by banks in other countries.

1. Compliance duties under the Swiss Anti-money laundering framework

There are several publications that describe the organisation and functioning of the Swiss AML system. Pieth *et al.* (2003) and Preller (2008), offer a comprehensive description of the AML regulation implemented in Switzerland focusing on the law provisions, the organisation of the Swiss Financial Intelligence Unit and the management of the Suspicious Activity reports. In her paper, Balleyguier (2003) describes and analyzes three areas connected to the AML fight: (1) the supervised financial institutions with a focus on the non-bank and non-insurance financial institutions, (2) the mix of direct and indirect supervision that has been enacted in this field and thirdly, (3) the relevant AML customer due diligence requirements. Muller-Studer (2003) studies the function of the self-regulating organisations, responsible of defining their own regulations regarding the implementation of the due diligence duties by their affiliates. However, since these organisations only adapt the general AML rules to the specific needs and characteristics of the affiliated members, the author concludes that the Swiss concept of self-regulation is restricted and can be defined as controlled self-regulation.

The Swiss AML framework started to take shape in 1977, when the Swiss Bankers Association's 'Agreement on the Swiss banks' Code of Conduct with regard to the exercise of Due Diligence' (CDB) was issued. Although the said Agreement does not have any regulatory power, it enumerates the minimal due diligence standards regarding the identification of clients and beneficial owners that banks should observe in their course of business. Moreover, the agreement prohibits banks from actively assisting their clients with tax evasion and the flight of capital. Designated investigators

and a CDB Supervisory Board assess breaches of the Agreement, and offences are punishable by fines up to CHF 10 million. The CDB is revised and updated every five years, with the last version coming into force in 2016.

Two decades after the CDB, the Federal Act on Combating Money Laundering and Terrorism Financing in the Financial Sector (AMLA) was enacted and became effective from the 1st of April 1998. The AMLA designates the provisions to combat the crimes of money laundering[2] and terrorism financing[3] -as defined by Art. 305bis and Art. 260quinquies of the Swiss Criminal Code- including: duties of the financial intermediaries, of the supervisory, control and reporting authorities, the organisation of self-regulating entities, the grounds for national and international administrative assistance and the criminal procedures in case of non-compliance.

The national body supervising the implementation of AMLA is the Swiss Financial Market Supervisory Authority, also known as FINMA. The latter was 'born' on the 1st of January 2009 from the merger of three existing supervising authorities: The Swiss Federal Banking Commission, the Federal Office of Private Insurance and the Anti-Money Laundering Control Authority. Financed by the institutions it regulates, FINMA is mandated to protect financial market clients and is responsible for ensuring that Switzerland's financial markets function effectively. By adopting a systematic risk-oriented approach, FINMA authorises, supervises and, where necessary, enforces any financial market legislation.

The AMLA is a framework law, in the sense that it sets out the principles that subsequently have to be adapted by the authorities to the concrete business activities they are supervising. A significant part of the AMLA is dedicated to the due diligence and reporting duties imposed on the financial intermediaries in relation to the handling of third party assets. As such, all the natural persons or legal entities that are subject to the law are required to:

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[2] According to Art. 305bis, any person who carries out an act that is aimed at frustrating the identification of the origin, the tracing or the forfeiture of assets which he knows or must assume originate from a felony or aggravated tax misdemeanor is liable to a custodial sentence not exceeding three years or to a monetary penalty.

[3] According to Art. 260quinquies, any person who collects or provides funds with a view to financing a violent crime that is intended to intimidate the public or to coerce a state or international organisation into carrying out or not carrying out an act is liable to a custodial sentence not exceeding five years or to a monetary penalty.

1. Verify the identity of the contracting partner and of the ultimate beneficial owner (Art. 3 and Art. 4);

2. Repeat the verification if doubt arises as to the identity of the contracting partner and/or of the ultimate beneficial owner (Art. 5);

3. Identify the nature and purpose of the business relationship wanted by the customer (Art. 6, paragraph 1);

4. Clarify the economic background and the purpose of a business relationship/transaction if it appears unusual, if it bears a high risk, if there are indications of money laundering or terrorism financing or if the names of the involved persons appear on an official Sanction List (Art. 6, paragraph 2);

5. Keep records of transactions carried out for a minimum of ten years (Art. 7)

6. Provide adequate AML training to the staff (Art. 8)

As far as the internal monitoring systems put in place are concerned, the Swiss legislator opted for a risk-based approach to AML, leaving the financial intermediaries the possibility to tailor their supervision depending on their type of customers, products and markets targeted.

A peculiarity of the Swiss AML reporting system is that it is based on the notion of 'reasonable suspicion'. As such, if the financial intermediary knows or has reasonable grounds to suspect that the funds originate from a felony or aggravated tax misdemeanour[4], they belong to a criminal organisation or they serve the purpose of financing terrorist acts, it must immediately file a Suspicious Activity Report (SAR) with the Money Laundering Reporting Office (MROS, see Art. 9). The latter is a member of the Egmont Group[5] and functions like a filtration point between the financial intermediaries and the prosecution authorities, conducting a first investigation on the SARs received and deciding whether to drop the case or forward it to the law enforcement

[4] An aggravated tax misdemeanor is any of the offences set out in Article 186 of the Federal Act of 14 December 19903 on Direct Federal Taxation and Article 59 paragraph 1 clause one of the Federal Act of 14 December 19904 on the Harmonisation of Direct Federal Taxation at Cantonal and Communal Levels, if the tax evaded in any tax period exceeds 300 000 francs.

[5] The Egmont Group is an informal international network of financial intelligence units. Formed in 1995, the goal of the Egmont Group is to provide a forum for FIUs around the world to improve cooperation in the fight against money laundering and financing of terrorism and to foster the implementation of domestic programs in this field.

authorities for further analysis. In any case, MROS's work is somehow simplified by the initial 'in-house' investigation run by the banks. As mentioned earlier, contrary to other countries which request banks to automatically file a report in certain instances, in Switzerland banks should gather sufficient objective proofs before reporting to the authorities. However, since the notion of 'suspicion' is extremely subjective and is not always possible for the financial intermediaries to obtain enough elements to justify a suspicion, the legislator provided them with the right to report any indications that assets may originate from a felony (Criminal Code, art 305ter). A SAR sent by virtue of the right to report entails a simple suspicion, whereas a SAR sent by virtue of the duty to report entails a reasonable/grounded suspicion.

Once a SAR has been filed, the financial intermediary is prohibited from informing the persons or third parties concerned (Art. 10a). Moreover, if MROS informs the financial intermediary that the case has been forwarded to the prosecuting authorities, the assets that were the object of the SAR must be frozen until further notifications from the authorities are received, but at most for five working days from the time the financial intermediary was informed that the case has been forwarded to the prosecuting authorities (Art. 10). If the financial intermediary is contacted by MROS, it must provide all the information available that is connected with the client/transaction triggering the SAR.

The AMLA's provisions are further detailed in a directive issued by FINMA, the Anti-Money Laundering Ordinance[6] (MLO FINMA). More precisely, the MLO provides clear guidelines for each type of financial intermediary: banks, securities dealers, fund management companies, insurance institutions and domestic group companies of a financial intermediary. It also includes a list of 38 potential indicators of money laundering and terrorism financing activities. Regarding the tasks of the AML compliance department, the Ordinance deems it responsible for: (a) defining and implementing the internal AML policy; (b) advising and assisting line managers and the senior executive body in implementing the AML regulations; (c) planning and overseeing

[6] Updated the last time on the 3rd of June 2015, applicable from the 1st of January 2016

AML training activities; (d) defining the parameters for and analysing the alerts generated by the transaction monitoring system; (e) providing all the necessary information that the executive body responsible for making decisions regarding the initiation or continuation of high risk relations needs.

Complying with all the duties imposed by the several pieces of regulation described above is a significant administrative and financial burden for the financial intermediaries. Beside the considerable investments in IT tools for transaction monitoring and criminal screening purposes, the most valuable resource for a bank in the fight against money laundering is its compliance department. The trained specialists working inside the department are supposed to act as a watch-dog, protecting the bank's reputation by making sure that no criminal money enters the bank and that the management is well aware of the risks associated with the existing clients.

2. Fighting money laundering in Switzerland: relevant numbers

Every spring MROS publishes a detailed report containing information about the number, the origin and the outcome of the SARs received during the previous year. Moreover, it puts in evidence several typologies of money laundering schemes, discussing the critical aspects that financial intermediaries should consider during their day-to-day operations. By briefly analysing the data available in MROS's past Annual Reports, this section will try to give an idea about the size of the suspicious activity reporting performed by the Swiss financial sector.

Table 2.1 reports the number of SARs received by MROS during the years 2005-2015 from the main categories of Swiss financial intermediaries. During this timeframe, the number of SARs more than doubled, with the peak increase registered between 2009 and 2011, in 2014 and then again in 2015. The first two increases are to be attributed to specific events such as the amendment of AMLA relating to financial intermediaries' exclusion from criminal and civil liability in 2009 (meaning that financial intermediaries no longer have to act "with the diligence required in the circumstances", but only "in good faith") and the political events in the Middle East and North Africa associated with the Arab Spring in 2011. As MROS noted, there have been some cluster cases which generated multiple SARs during both 2014 and 2015 (given the high media exposure of the Swiss banks involved, we believe it is safe to assume such cluster cases were related to the 1MDB, Petrobras or the FIFA scandals). Nevertheless, the significant increase registered in these two years is to be rather attributed to a heightened awareness on the financial intermediaries' side towards money laundering fight.

In the same time, the gradual transition to the "White Money Strategy[7]" might have raised many worries that the deposited assets were not tax-compliant and hence pushed many intermediaries to fill-in a SAR.

Table 2. 1: Number of SARs sent to MROS, by financial intermediary, by year

Financial intermediary	*2005*	*2006*	*2007*	*2008*	*2009*	*2010*	*2011*	*2012*	*2013*	*2014*	*2015*
Bank	294	359	492	573	603	822	1080	1050	1123	1495	2159
Payment services	348	164	231	185	168	184	379	363	74	107	58
Fiduciary	31	45	23	37	36	58	62	65	69	49	48
Asset manager	18	6	8	19	30	40	27	49	74	40	45
Insurance	9	18	13	15	9	9	11	9	19	11	12
Attorney	8	1	7	10	11	13	31	12	9	10	6
Other	21	26	21	12	39	33	35	37	43	41	39
Total	***729***	***619***	***795***	***851***	***896***	***1159***	***1625***	***1585***	***1411***	***1753***	***2367***

Others include: Supervisory authority, Casino, Foreign Exchange trader, Securities trader, Currency exchange, Loan, leasing, factoring and non-recourse financing, Credit Card Company, Commodity and Precious metal trader, Self-reporting organisation, Distributor of Investment funds and Other financial intermediaries

Source: MROS Annual Report 2015

The banking sector is the most "productive" sector when it comes to suspicious reporting, delivering every year about 65% of the total number of SARs received by MROS, except for 2014 and 2015 when the percentage reached all-time high peaks of 85% and 91% respectively. The second highest number of SARs is sent by the payment services providers; however, with the obtainment of a banking license by PostFinance AG (the financial services unit of Swiss Post) many SARs the latter used to submit as a financial services provider are now submitted as a bank (hence the decrease visible since 2012). Another type of financial intermediaries sending a significant number of SARs to MROS are the fiduciaries/asset managers. Until 2010, they jointly contributed an average of 8-10% of the yearly SARs, but in recent years such percentage dropped to nearly 4-5%. MROS itself could not give a reason for such decrease especially since

[7] The "White Money" strategy was intended to prevent the use of the Swiss financial system for circumventing home country tax laws by international clients. A discussion paper concerning the strategy for a tax-compliant and competitive financial center was initially launched in February 2012 by the Swiss Federal Council. One year later, the same Council launched two consultations on combating money laundering and enhanced due diligence obligations regarding taxation. These proposals concerned, among others, the introduction of qualified tax fraud as a predicate offence to money laundering, the adoption of a risk-based approach with regards to unofficial assets and the execution of a full review by the end of 2014 to be concluded with the existing of undeclared clients.

in the case of a reasonable suspicion, both the asset manager/fiduciary as well as the custodian bank must submit a SAR.

Due to the type of clients served, some Swiss banks tend to report more suspicious cases than others. Table 2.2 below shows that most of the SARs come from major banks and foreign-controlled banks, with a yearly average of 30 and 32 percentage respectively in the total number of SARs sent by the banking sector. Such high percentage can be explained not only by their larger client base, but also by the fact that many of their clients are domiciled abroad (hence, the likelihood to be associated with riskier, less transparent activities is higher). Cantonal banks send an yearly average of about 7% of the total SARs even if they account for 30% of the total assets under management in Switzerland; such percentage is in line with both the type of clients (mostly Swiss-domiciled) and the low-risk products (mortgage and savings) offered by these banks.

Table 2. 2: Number of SARs sent to MROS, by type of bank, by year

Type of bank	*2005*	*2006*	*2007*	*2008*	*2009*	*2010*	*2011*	*2012*	*2013*	*2014*	*2015*
Major bank	44	143	213	196	167	214	310	308	324	474	763
Foreign-controlled bank	173	102	120	134	188	290	388	348	240	383	575
Asset management bank	38	53	69	55	72	55	155	127	113	155	303
Other bank	5	8	15	16	14	99	27	42	230	214	212
Raiffeisen bank	3	6	19	107	93	49	60	64	79	134	125
Cantonal bank	23	31	41	47	46	79	75	80	72	75	125
Private bank	3	14	8	5	8	7	26	60	52	39	38
Regional and savings bank	4	1	3	5	10	25	15	19	6	14	11
Branch of foreign bank	1	1	4	8	5	4	21	2	5	3	7
Total	***294***	***359***	***492***	***573***	***603***	***822***	***1080***	***1050***	***1123***	***1495***	***2159***

Foreign-controlled banks are banks under the Swiss law, where the main shareholder is non-Swiss or where a foreign shareholder has a controlling interest in the bank.
Cantonal banks are Swiss government-owned commercial banks, which are provided by the canton in which they are based with a guarantee for the assets held there.
Source: MROS Annual Report 2015

As far as the suspicion triggering the SAR is concerned, from Table 2.3 emerges that every year an average of 27% of the total cases are to be attributed to media coverage, followed by third-party information (23.5%) and information received from the prosecuting authorities (12.8%).

Table 2. 3: Factors arousing suspicion for the SARs sent to MROS, by year

Source	*2005*	*2006*	*2007*	*2008*	*2009*	*2010*	*2011*	*2012*	*2013*	*2014*	*2015*
Media report	83	195	209	192	219	378	483	455	457	494	815
Third-party information	128	108	131	218	267	257	391	414	367	515	578
PA information	90	41	64	128	94	186	218	203	196	213	420
Cash transaction	299	116	166	103	70	67	172	178	106	84	82
Economic background	49	55	71	108	80	147	145	153	124	128	73
Transitory account	6	13	90	13	29	16	16	33	23	22	23
Transaction monitoring	0	0	0	0	0	0	0	0	5	101	168
Internal information	10	8	7	23	36	24	26	25	50	34	34
Forgery (documents/money)	15	19	10	18	44	22	34	28	18	29	5
Currency exchange	6	12	11	9	9	23	14	16	10	13	6
High-risk country	3	1	1	2	2	3	81	1	3	10	2
Opening of account	9	13	21	13	9	13	5	13	5	5	16
Cheque transaction	8	4	4	1	7	4	20	18	11	9	9
Others	23	34	10	23	30	10	20	48	36	96	136
Total	**729**	**619**	**795**	**851**	**896**	**1159**	**1625**	**1585**	**1411**	**1753**	**2367**

Media - media reports reveal that one of the people involved in the financial transaction is connected with illegal activities; **Information from prosecution authorities** - Prosecution authorities initiate proceedings against an individual connected with the financial intermediary's client; **Third-party information** – information is received from outside sources or from within a business about clients who could pose problems.
Source: MROS Annual Report 2015

To perform open media screening, most banks have installed an internal system that regularly checks potential matches between new entries in criminal databases (such as Worldcheck) and their client database. Such systems are an important support for the banks and for the relationship managers, as they offer information about any potential criminal activity conducted by the client. On the other hand, the fact that a bank becomes aware of such potential only when the client is either suspected, investigated or convicted reveals the existing knowledge gap concerning the background of its clients. The fact that around 68.3% of the SARs are triggered by external sources and not

not by the financial intermediaries' in-house screening activities underlines the poor efficiency of the transaction monitoring systems installed and hence the scarce effectiveness of the measures adopted for counteracting money laundering. As such, very often the SAR is sent once the crime was committed and hence the laundering was already accomplished (and hence is in the news) rather than before or during the "washing" of the illegally-obtained funds.

Another important point to be mentioned is the number of SARs filed due to suspicious cash transactions. Whereas in the past the use of cash was a significant element triggering a SAR (40% of the cases registered in 2005 to 20% of the cases registered in 2007), in recent years the percentage has decreased to less than 10% (in 2014 only 4.8% and in 2015 only 3.5% of the cases). There are various factors that had an influence on the use of cash such as: set-up of a strict threshold for payments in cash[8], the continuous development of other payment methods (online banking, etc.) and the stricter controls performed at the Swiss borders.

In each SAR, financial intermediaries must explain the facts that raised a suspicion such that they decided to contact the MROS. Table 2.4 below provides an overview of the suspected predicate offences as per the submitted SARs. It is important to note however that "MROS's legal assessment of the suspected predicate offence is based solely on the financial intermediary's assumption as well as on MROS's own assessment of the facts. When a SAR is forwarded to a prosecuting authority, it is bound neither to the findings of the financial intermediary nor to MROS's legal assessment" (MROS, 2015:29). In all years but 2015, fraud was the most frequently suspected predicate offence, with an annual average of 29.3% of the SARs. The second most suspected predicate offence was bribery with an annual average of approximately 11.6% except for 2014 and 2015 when it reached 20.3% and 25.1% respectively of the annual SARs. MROS noted however that in 2015, one case cluster generated 273 SARs, 98% of which cited bribery as the suspected predicate offence. Money laundering is

[8] In Switzerland, dealers accepting cash payments amounting to more than CHF 100'000 must conduct due-diligence checks such as identifying the customer and the beneficial owner. However such threshold is much higher if one thinks that in Italy for example, since 2011, cash payments of more than EUR 1000 per transaction are not allowed.

the third most cited predicate offence with an annual average of around 9% of the total yearly SARs, followed by the offence of embezzlement and criminal organization with an average of 7.5% and 5.6% respectively. Terrorism financing is suspected on average in 1.3% of the annual SARs, with the exception of 2013, when the percentage amounted to 2.3% due to a cluster case which generated alone 25 SARs (see MROS Annual Report 2013).

Table 2. 4: Suspected predicate offences for the SARs sent to MROS, by year

Predicate offence	*2005*	*2006*	*2007*	*2008*	*2009*	*2010*	*2011*	*2012*	*2013*	*2014*	*2015*
Fraud	126	213	247	295	307	450	497	479	374	448	447
Bribery	52	47	101	81	65	60	158	167	172	357	594
Money laundering	37	45	54	57	81	129	252	209	93	182	164
Embezzlement	40	27	32	67	88	51	124	156	159	157	197
Fraudulent misuse of a computer			18	33	22	49	51	39	121	104	142
Criminal organi-zation	41	31	20	48	83	42	101	98	104	94	120
Drugs	20	14	34	35	32	114	161	97	52	39	54
Criminal misma-nagement	10	11	21	12	20	44	25	34	28	49	219
Document forgery	10	17	10	22	37	28	56	38	15	45	43
Other property offen-ces	12	13	22	22	36	10	7	34	41	25	75
Theft	9	8	4	3	4	12	19	7	7	53	36
Terrorism financing	20	8	6	9	7	13	10	15	33	9	38
Human traffic /sexual offences	1		3	4	3	3	1	19	4	9	7
Non classifiable	346	173	205	138	90	115	131	160	156	100	109
Others	5	12	18	25	21	39	32	33	51	53	77
Total	**729**	**619**	**795**	**851**	**896**	**1159**	**1625**	**1585**	**1411**	**1753**	**2367**

The not classifiable category includes cases where a variety of possible predicate offences are suspected.
Source: MROS Annual Report 2015

For many years, foreign governments have criticised the Swiss financial intermediaries' commitment in fighting money laundering, claiming that too few SARs are filled in compared to the size of the Swiss financial sector. For example, FinCen, the US Financial Intelligence Unit, receives an average of 1.3 million SARs per year plus more than 14 million of Cash Transaction Reports; the National Crime Agency in the

UK must deal with an average of 300.000 SARs per year. However, these countries have admitted that it is almost impossible for them to thoroughly analyse so many reports given the limitations they face in terms of resources. Moreover, in most of the cases, the reports received are just false alerts, sent by the financial intermediaries without necessarily having a founded suspicion. In that regard, they do not reflect a risk-based approach but rather a defensive and automated reporting. On the other hand, as mentioned earlier, the Swiss financial intermediaries will first run an in-house investigation to gather sufficient objective elements or to better "substantiate" their suspicion before sending a SAR.

An indicator of the SARs' quality received by MROS is the percentage of reports that it forwards to the law enforcement agencies after having done a first check (see Table 2.5). Every year an average of almost 81% of the SARs received by MROS were sent for further investigation to the law enforcement agencies, with the lowest percentage of 70% in 2005 and 2015 and the highest percentage of 91% in 2011. Most of such forwarded SARs were those submitted by banks, which analysis is more detailed since they have more resources dedicated to the reporting activity (the average forwarding rate for this type of financial intermediary is 87%).

Table 2. 5: Percentage of SARs forwarded to the prosecuting authorities, by financial intermediary type, by year

Proportion of SARs forwarded	***2005 %***	***2006 %***	***2007 %***	***2008 %***	***2009 %***	***2010 %***	***2011 %***	***2012 %***	***2013 %***	***2014 %***	***2015 %***
Bank	92	94	92	87	91	91	93	89	82	76	72
Payment services	46	57	52	61	85	82	86	81	51	51	53
Fiduciary	100	89	83	92	86	79	86	72	80	78	42
Asset manager	83	33	75	53	83	78	93	86	87	80	89
Insurance	89	72	62	87	67	44	64	78	79	46	33
Attorney	75	0	86	80	100	69	94	75	56	60	50
Others	93	75	80	83	78	50	80	58	62	61	69
Total SARs forwarded (%)	***70***	***82***	***79***	***81***	***89***	***87***	***91***	***86***	***79***	***74***	***71***
Total SARs Received (%)	***729***	***619***	***795***	***851***	***896***	***1159***	***1625***	***1585***	***1411***	***1753***	***2367***

Others include: Supervisory authority, Casino, Foreign Exchange trader, Securities trader, Currency exchange, Loan, leasing, factoring and non-recourse financing, Credit Card Company, Commodity and Precious metal trader, Self-reporting organisation, Distributor of Investment funds and Other FI.

Source: MROS Annual Report 2015

In recent years, the percentage of forwarded SARs by MROS fell below 80%; however, such drop is not to be attributed to a lower quality of the reports but rather to a combination of factors influencing MROS's work such as: additional personnel hired, more authority to gather information granted to MROS as of the end of 2013, and no deadline to provide a feedback for voluntary SARs[9]. All these factors give MROS "the capacity to analyse SARs in greater detail and filter out cases that are unsubstantial or cannot be proven with a reasonable amount of effort" (MROS, 2015:12).

When it comes to the amount of assets involved in the SARs received by MROS, we can notice a sevenfold increase from CHF 681 Mio in 2005 to CHF 4.83 Bn in 2015 (see Table 2.6). With the exception of 2006 and 2010, the evolution of the assets involved in the SARs is positively correlated with the total number of SARs and the various peaks are a consequence of the same events mentioned earlier (see also Table 2.1. for comparison). Moreover, the increase in total assets involved hasn't been proportional to the increase of the total SARs, as in several instances a relatively low number of SARs concerned a significant amount of assets. For example, in 2011 the number of SARs increased by 40.2% compared to 2010 but the total assets involved increased by 287%: such increase was due to 25 SARS involving assets worth approximately CHF 2.26 Bn. Another important observation that can be made from the data in Table 2.6 is that on average MROS forwards around 81% of the SARs it receives yearly, but these forwarded SARs refer to approximately 91% of the total assets initially reported.

Table 2. 6: Total assets value at time of report to MROS, by year

Assets value in CHF millions	***2005***	***2006***	***2007***	***2008***	***2009***	***2010***	***2011***	***2012***	***2013***	***2014***	***2015***
Received SARs	681	815	921	1872	2229	847	3281	3151	2979	3341	4827
Forwarded SARs	614	746	899	1804	2164	715	3223	2832	2796	2852	3564
Forwarded SARs' assets in Total Assets (as %)	***90***	***92***	***98***	***96***	***97***	***84***	***98***	***90***	***94***	***85***	***74***

Source: MROS Annual Reports 2006, 2008, 2010, 2012, 2014, 2015

[9] Voluntary SARs are those sent by the financial intermediaries by virtue of the right to report given by Art 305ter of the Criminal Code.

Another indicator of the SARs' quality is the number of follow-up investigations and convictions. Table 2.7 below evidences the actual status of the SARs forwarded by MROS to the Office of the Attorney General of Switzerland (OAG), and the cantonal prosecution authorities during the period 2006-2015. In most of the cases, the authorities haven't reached a final decision as the SARs are either still pending (41.4%) or suspended (31.8%). Instead, around 21.9% of the cases were dismissed. A final decision was reached by the courts in 4.9% of the cases: 10 acquittals from the charge of money laundering, 11 acquittals from all charges (no charge of money laundering), 303 convictions including that of money laundering, and 188 convictions for offences other than money laundering. When distributed among the 10 years period, an annual average of 49 convictions were issued in connection with the average number of SARs sent, hence meaning that only 3.75% of the average yearly SARs are closed with a verdict.

The picture regarding the status of the forwarded SARs is somehow similar when considering the offence of Terrorism financing. According to the data included in Table 2.8 below in 72.7% of the cases a conclusion hasn't been reached yet as they are either pending (52.5%) or suspended (20.2%). Moreover, 26.3% of the SARs have been dismissed by the public prosecutor, whereas a verdict was issued only in 1% of the cases. The prosecution rate for terrorism financing is lower than the one for other offences, confirming thus the complexity of such cases that often require the collaboration of other countries' intelligence

Table 2. 7: **Status of forwarded SARs by authority/canton: 2006 to 2015**

Status/Level	*Pending*	*Dismissal*	*Suspension*	*Temporary suspension*	*Acquittal*	*Verdict*	*Total*
Confederation	1939	699	1061	284	2	28	4031
Canton	2428	1616	1773	238	19	463	6537
Total (absolute)	**4367**	**2315**	**2834**	**522**	**21**	**491**	**10568**
Total (%)	**41.4%**	**21.9%**	**26.9%**	**4.9%**	**0.2%**	**4.7%**	**100%**

Source: MROS Annual Report 2015

Table 2. 8: Status of forwarded SARs in connection with the financing of terrorism: 2006 to 2015

Status	*Pending*	*Dismissal*	*Suspension*	*Temporary suspension*	*Verdict*	*Total*
	52	26	12	8	1	99
Total (%)	**52.5%**	**26.3%**	**12.1%**	**8.1%**	**1%**	**100%**

Source: MROS Annual Report 2015

Whereas the two estimated prosecution rates might seem too low when compared to the amount of resources invested in the reporting process, there are various elements to which one must pay attention in evaluating the effectiveness of the Swiss SAR reporting system. First of all, the number of convictions included in MROS's Annual Report might be different than the actual ones because MROS is not notified about the convictions which are not related to the offences of criminal organisation, money laundering, lack of due diligence and terrorism financing (as defined by Articles 260ter p.1, Art. 305bis, Art. 305ter and Art. 260^{quinquies} of the Swiss Criminal Code) and even when the convictions are related to the mentioned offences, not always the prosecution authorities fulfil their reporting duties towards MROS. Secondly, several SARs may refer to the same individual who was charged with just one offence; alternatively, one SAR can lead to multiple charges being laid against one or more individuals. Thirdly, no data is provided on the total assets involved in the convictions made, hence one cannot conclude on the importance of the case being successfully closed by the authorities when compared to the volume of assets involved in all SARs. Lastly, as MROS provides just cumulative data over a 10 years period, it is not possible to understand whether most of the convictions were issued in recent years and hence the reporting system became more efficient or vice versa.

Beside the MROS's data limitations discussed above, it must be underlined that at a Swiss level there is no federal office or department providing consistent data on money laundering related offences. There are various instances in which a prosecution can be the result of other factors than a SAR as for example – a case opened as a consequence of an action conducted by the Custom agents or as a result of a request for mutual assistance from foreign public prosecutors. Identifying such cases would

allow us to better differentiate and hence conclude on the contribution of the SAR Reporting system to money laundering related crimes identification and prosecution.

A characteristic of the Swiss legal system and criminal procedure is the enforcement of the *ne bis in idem* principle (*i.e.* no legal action can be instituted twice for the same cause of action). Since the majority of the assets managed in Switzerland belong to international clients, it can happen that criminal proceedings are conducted on the same individual in another country and the case is assessed there. As such, the foreign authorities are assisted by the Swiss authorities through mutual assistance, and proceedings in Switzerland are abandoned based on the aforesaid principle (MROS, 2015).

The number of convictions in Switzerland can also be influenced by the lack of response under the request of Swiss authorities for mutual assistance. The chances of obtaining information from abroad vary from one country to the other and in the past, proceedings were abandoned more often because the network of global FIUs was limited and their powers regarding mutual assistance were more restricted (MROS 2015). Table 2.9 below provides details on the number of natural persons and legal entities mentioned in enquiries between MROS and foreign FIUs. Every year from 2005 to 2015, the number of incoming requests from Foreign FIUs has been higher than the outgoing requests from MROS. Moreover, with the exception of 2014, the number of incoming inquiries has been constantly increasing since 2007, signalling hence the growing interconnectivity of the global financial sector.

Table 2. 9: **Number of natural persons/legal entities mentioned in inquiries between MROS and foreign FIUs, by year**

	2005	***2006***	***2007***	***2008***	***2009***	***2010***	***2011***	***2012***	***2013***	***2014***	***2015***
MROS inquiries	1143	1106	886	1075	1614	1033	999	1066	1471	1630	2144
Foreign FIUs inquiries	1569	1693	1510	1562	1930	1937	2174	2400	3092	2968	3621

Source: MROS Annual Report 2015

The lack of data concerning the amount of confiscated assets and the total number of convictions makes it impossible to understand how often a suspected predicate

offence translates into a prosecution and hence understand whether the efforts of the financial intermediaries are worth. Nevertheless, the findings presented in this chapter provide evidence that the SAR Reporting system has several advantages as it allows the authorities to: gather relevant financial and personal data on certain "suspected" individuals, enhance their mutual exchanges with the international counterparties and punish money-laundering related crimes. Moreover, the overall view of the suspected predicate offences show how the SAR Reporting system can contribute to the detection of various types of crimes which go beyond the simple act of money laundering or terrorism financing.

3. Banks' internal compliance practices and motivations for fighting money laundering: The Swiss case

3.1. Introduction

The inception of FATF determined many countries to implement an AML framework that requires financial intermediaries to properly identify their clients, thoroughly monitor their transactions and report any money laundering attempt.

Whereas Switzerland has been among the first countries to adopt an AML framework with the early (voluntary) CDB in 1977 followed by the mandatory AMLA in 1998, existing studies have barely discussed the changes brought by such legislation and how the Swiss banks stood up to the challenge. At the same time, earlier studies conducted by scholars in the UK, France and Belgium had (already) investigated the way in which local banks organised their resources to cope with the specific legislative requirements, underlying the difficulties experienced by the actors involved in the day-by-day compliance activities. The striking feature of these studies is that even if they were run in different times (i.e. with several years of difference) they bring to light similar problems. That is to say, actors complain about their forced involvement in the 'AML battle', the significant resources deployed in the compliance process and the few benefits it actually brings to the bank, the lack of investigative skills as well as the internal tensions created by the introduction of specific verification and reporting procedures. On the other hand however, there are also noticeable differences between

these countries even if their legislations share the common nucleus of FATF's[10] 40 Recommendations. For example, the underlying predicate offences to money laundering as well as the organisation of the reporting process or the duties of the local FIU can be different.

As such, this chapter is intended to give a picture about: (1) how do local banks assess Switzerland's vulnerability to money laundering crimes, (2) what motivates them to allocate resources to AML compliance and hence actively counteract money laundering attempts and (3) what specific measures they have implemented to identify and report suspicious cases. Nevertheless, it must be emphasized that our study was not concerned with measuring banks' compliance with the AML law. We were interested in understanding where Switzerland stands with regard to other countries, and whether there are common practices applied by banks.

We collected data from AML compliance officers by means of an on-line survey distributed to a total of 139 banks in Zurich, Geneva and Ticino (the three most important financial hubs in Switzerland). At the end of the survey period, 52 responses were received. The survey was divided in four parts, for a total of 30 questions.

The results presented in this chapter about the banks' beliefs and motivations regarding the AML framework as well as their compliance practices are meant to "set the stage" for the next two chapters, in which we will investigate how the compliance function has been integrated into the banking culture and what kind of relationship has developed between the various departments (i.e. compliance vs. the commercial one).

After this brief introduction, the second section will review the existent literature on AML compliance. Section three enumerates the research questions, whereas section four and five describe and discuss the data collection process and the methodological aspects. Section six is divided in several subsections discussing the results of the survey: (1) the banks' perception regarding Switzerland's vulnerability to money laundering

[10] FATF or the Financial Action Task Force is an intergovernmental body which objectives are to set standards and promote effective implementation of legal, regulatory and operational measures for combating money laundering, terrorist financing and other related threats to the integrity of the international financial system. (http://www.fatf-gafi.org/pages/aboutus/)

operations, the perceived clarity and success of AMLA; (2) the current AML process inside the Swiss banks with a focus on the monitoring and reporting procedures and (3) banks' motivation for fighting money laundering as well as the perceived benefits and burdens of AML compliance. The potential limitations of our study are discussed in part seven and the concluding remarks are made in the last section.

3.2. AML compliance in the literature

In their comparative study of the AML framework in Switzerland, UK, US and Singapore, Pieth *et al.* (2003) underline that each national legal system consists of at least three layers: (1) the written laws and regulations, (2) the adoption of these laws in internal policies, procedures and compliance and (3) the corporate culture which guarantees that the regulations actually influence the behaviour of the banking staff. The majority of the studies in the AML field analyse the first two layers; the research regarding the third layer has been rather limited.

Regarding the first layer, we observe that the events of 9/11 pushed many countries to update their national AML framework or, upon FATF's pressure, to introduce one in some of those countries where it was missing completely. In each case, the FATF's 49 'universal' recommendations were incorporated into national regulations by taking into account the specificities of the country. This wave of regulatory updates gained attention among researchers who started to analyse the nature of these laws and their fit in the national political and socio-economical context. As such, we find publications discussing in detail various national AML systems in relation to the internationally proposed recommendations. Beside the studies of Verhage (2011) and Favarel-Garrigues *et al.* (2008) mentioned earlier, other studies focusing on industrialized countries include: Veng *et al.* (2007) which describes UK's AML domestic measures, provide a classification of the money laundering offences and analyse the roles played by the Serious Organised Crime Agency, the Financial Services Authority and the Joint Money Laundering Steering Group; Johnson (2002), Preston (2002) and Van Cleef

(2004) focus on the PATRIOT Act as US's reaction post 9/11's events, Blöcker (2003, 2005) analyses the AML duties imposed in Germany on professionals dealing with assets while Murphy (2003) discusses Canada's laws on money laundering and proceeds of crime. Researchers have also shown interest toward the AML developments taking place in emerging countries - South Africa (de Koker, 2002), China (Ping, 2003) Mexico (Vargas *et al.*, 2003), Turkey (Günes, 2009, Türkşen *et al.*, 2011), Hong Kong (Kwok, 2008) etc. Last but not least, Mugarura (2013) analysed the regulatory environment in less developed countries to evaluate their readiness to AML regimes implementation, whereas Zagaris (2007) discussed the problems connected to the implementation of standard AML procedures to non-financial transactions, "parallel banking systems" and Islamic financial systems in countries such as UAE, Afghanistan, Somalia.

As FATF's encouragement for cooperation continued to gain popularity, countries were stimulated into a kind of competition regarding the comprehensiveness of their AML laws in terms of the 49 Recommendations. The regular Mutual Evaluations carried out by FATF created a clear ranking as to where every member stands in terms of compliance with each recommendation and what should be done in order to improve the existing deficiencies. Several comparative studies of AML regulations have analysed these differences.

One of these studies is the one of Pieth *et al.* (2003) mentioned earlier on. Motivated by the negative comments regarding the Swiss involvement in the money laundering fight, they analysed the 'letter of the law' and the functioning of the reporting systems in Switzerland, UK, US and Singapore. The authors concluded that the US and UK place far more emphasis on an "early reporting system" that favours the building up of a data base of intelligence for future tactical use by police, whereas in Switzerland and Singapore considerable efforts are made in screening and understanding the profile of the clients and their transactions. An immediate consequence of this in-depth knowledge of the client is the filtering out of weak cases such that fewer suspicious cases are reported to the authorities.

This quality of the Swiss monitoring and reporting system is later also confirmed by Chaikin (2009). Another comparison regarding the law provisions, the organisation of the FIU and the management of the SARs in Switzerland, UK and Germany was done by Preller (2008). Her findings concerning the SAR management in Germany and Switzerland are similar with the ones of the previously mentioned studies, plus a remark that, unlike the Swiss FIU, the German and the English ones work as policing agencies and this ensures a smoother integration of the intelligence knowledge relevant to the prosecution authorities.

The second layer mentioned by Pieth refers to the translation of national AML laws into internal corporate policies that must be adopted by all financial intermediaries. Considering the limitations that the Government faces in terms of both resources and access to financial information the best solution proved to be the transfer of monitoring and reporting tasks to the financial sector. As Gallo *et al.* (2005: 329) put it "a war against money laundering and terrorism financing cannot be fought by government forces alone, the entire intelligence gathering and target acquisition process is in the hands of the private sector. There are no reconnaissance troops scouting forward, no spy planes overhead, it is a war that relies on information supplied by the financial industry". In few words, the financial intermediaries were left with the duty to fight the money laundering phenomenon at the front line. As expected, this shift of responsibility from the public to the private sector created several problems.

First of all, the financial intermediaries lack the police's investigative skills (Verhage, 2011). In fact, the financial professions were not meant to identify and manage suspicious transactions. Instead, bankers are known for having developed a culture of privacy and non-interference in the financial transactions of their clients (Favarel-Garrigues *et al.* 2011). Furthermore, as observed by Davies (2007) the financial sector has a different approach than the one of the law enforcement agencies when it comes to money and financial opportunities: professional financiers are paid to make substantial returns for their institutions, dealing in a market where money, be it clean or "dirty" is the most important "raw material". Now they must learn to distrust this raw material.

Secondly, in order to cover this knowledge gap, banks and other financial institutions set up compliance departments, hired specialists in the field, trained the personnel and installed transaction-monitoring software systems. Besides covering the initial set-up costs, the well-functioning of the compliance apparatus requires continuous investment by the banks. From their study of the Swiss wealth management industry conducted in 2003, Bührer *et al.* (2005) found that compliance costs connected with the prevention of money laundering vary from 8.374 CHF per employee for small banks to 5.059 CHF per employee for large banks, while securities dealers in the wealth management and securities trading pay as much as 4.936 CHF and 145 CHF per employee. Moreover, a periodic survey carried out by KPMG measuring the efforts of the banks in the global AML fight constantly report an increase in the costs of AML compliance for the coming years, with the respondents indicating an expected increase of 61%, 58% and 45% respectively (see KPMG 2004, 2007, 2011). It is important to mention though, that such cost projections are only indications of the important investments required by AML compliance. First, as underlined by van Duyne *et al.* (2016) the percentages indicated by the respondents can be little more than subjective projections or guesses without baseline numbers. As such, they can under- or over-estimate the reality. Secondly, AML-associated compliance costs go beyond those items visible in the financial intermediary's Profit and Loss statement and that allow for a mathematical calculus (such as the salary of the compliance officers and the set-up and management of compliance IT). Very often, in managing the reporting of complex cases other departments such as the legal or the top-management are also involved in the decision-making process. Moreover, there are other costs that are very difficult to quantify and to predict: for example, training of client facing employees, redesign of specific bank-documentation to take into consideration compliance matters, management of conflict that can arise between compliance and relationship managers.

Pieth's third pillar is believed to be the most challenging element of an effective AML policy: the development of a corporate culture such that the actual purpose of the policy -be it fighting criminality, or simply protecting reputation- is achieved. A study by Health and Safety Executive (HSE, 2008) presented an extensive list of factors

that determine the adoption of a compliant culture; for example: the possibility to pass on costs to third parties, the imposed sanctions and penalties in case of misbehaviour, the alignment and convergence between the business's interests with those of the government, the degree of cooperation and procedural fairness displayed by the lawmaker, the industry and the size of the firm and the expectations of the public, to name just a few. Although referred to compliance in general, these factors are pertinent also for the AML compliance policy. Moreover, empirical evidence suggests that, depending on the organisational structure, the following factors will all influence compliance: knowledge of the law, type of ownership, costs of compliance, the proximity of the firm to inspectors, workforce resistance or pressure (Genn, 1993).

3.3. Research questions

This study relates to, but in important ways differs from and adds to two previous studies. Favarel-Garrigues *et al.* (2008, 2011) surveys a broad range of participants involved in the AML fight in France: law enforcement agencies, FIU, associations of professionals, compliance officers working inside banking institutions, in order to understand the new relationship that the AML fight has created between the government and the banks. They also analysed the French banks' incentives and efforts in stopping money laundering. Similarly, Verhage (2011) draws a picture of the Belgian AML Complex and Compliance industry. The primary focus of her survey however, is the figure of the compliance officer and more precisely his role inside the bank and his views on the AML regulation in place.

Previous publications focusing on Switzerland were limited to describing the Swiss AML framework, without collecting empirical evidence about the banks' reaction to these changes. In order to cover this knowledge gap but also as a way of comparison with current practices in other countries, we proposed the following three research questions (RQ). First of all, since banks (as well as other types of financial intermediaries) have been 'dragged' by the Governments into counteracting the money

laundering phenomenon, we were interested in understanding, given their day-by-day experience, how they assess Switzerland's vulnerability to money laundering transactions (RQ1). Secondly, even if the AML is compulsory and entails significant costs for the bank, there are also benefits from adopting a compliant behaviour. Hence, we investigated what are the drivers determining the banks to invest in the AML fight (RQ2). Last but not least, given the risk-based approach embedded into the Swiss AMLA, we documented the significant compliance measures that banks have put in place to fight money laundering (RQ3).

3.4. Data collection

Previous research in the field of AML compliance acknowledged the limited availability and comparability of private data. According to Verhage (2011) corporations can be very reluctant to provide data to outsiders such as researchers, especially when the subject matter is very delicate. Indeed, it is very rare that a bank will choose to publish information about its internal AML policy, and even in such a case, it will be limited to what it is required to do by law. This problem pushed many authors to choose the survey as a data collection method: Masciandaro *et al.* (2001), Webb (2004), Bührer *et al.* (2005), Verhage (2009), Harvey and Lau (2009).

Faced with these limitations, we decided to use the survey as a data collection method too. We developed a first draft survey that took into consideration the characteristics of the Swiss AML framework. This draft version contained 50 questions. We solicited feedback from several academic researchers and specialists involved in the Swiss AML system for survey content and structure. We also contacted one survey research specialist in order to obtain advice about how to minimise biases induced by the questionnaire and maximise the response rate.

The final version of the questionnaire had 30 questions and was divided into four sections (The complete questionnaire can be found in Annex 1):

1. The first section was dedicated to general information about the respondent and the banking institution for which he was working.

2. The second section asked practical questions about the internal AML policy. However, in order to minimise biased answers, we tried to avoid questions that could be understood as verifying the banks' compliance with AMLA's requirements. Instead, we were interested in evaluating certain AML practices and behaviours that AMLA left at the discretion of the bank.

3. The next section focused on the compliance process inside the bank: collecting information about the client, deciding whether to report him to MROS and how useful the banks considered MROS's feedback.

4. The fourth and last part referred to general topics connected to the crime of money laundering and the role that the financial institutions have in counteracting this crime.

The on-line questionnaire was to be completed by the compliance officer of the bank. If this person was not available, we required that a person who had enough knowledge about AMLA and about his institution's internal AML policy completed the survey. The questionnaire was available on-line for a period of eight weeks. The respondents were given the possibility to complete the questionnaire in English, German, French or Italian.

From the Swiss Bankers Association's (SBA) Member List we selected all the banking institutions that have their Swiss headquarters in one of the three principal financial hubs in Switzerland: the cantons of Zurich, Geneva and Ticino. A total of 139 banks were contacted for participating in the survey; this means almost 40% of the total banking institutions operating in Switzerland.

The survey was delivered according to the Dillman (2007) procedure: a cover letter explaining the objective of the study sent one week before the questionnaire became available on-line, a letter containing the details for accessing the online platform, a first reminder after three weeks and a second and final reminder after other three weeks. In each of these four communications we mentioned the support of the SBA regarding our study in order to encourage the banks to participate in the survey.

At the end of the survey, we conducted a total of nine interviews with different specialists interested in the Swiss AML system: four compliance officers, two MROS officials, two relationship managers and one executive member of the SBA. These interviews served two different purposes: first of all, the interviews with the compliance officers provided insight and depth to our understanding about the survey responses; secondly, since the majority of the questions asked to the other specialists were similar to those in the questionnaire, we were able to have a better picture about how the different actors involved in the AML fight think about the same issues. All the interviews were conducted in person and were arranged with the agreement that the identity of the banks and individuals will remain anonymous.

In addition to the survey and the interviews, we separately collected data from the Swiss National Bank's database about the total assets of the banks in the survey.

1.1. Methodology

The key difference between this study and the existing research consists in the methodology employed in order to map out significant differences between the perceptions held by the respondents. More precisely, we coded the data collected from the survey as ordinal or interval, depending on the type of questions: we coded the answers related to questions asking the respondent to rank certain characteristics in ascending order from 1 to 6, while for those questions measuring the extent to which the respondents agreed with a certain statement we used a 5-points Likert scale going from -2 (not at all) to +2 (large extent). Moreover, in order to have an idea about what the respondents think on average about the various AML matters for each question we computed a score going from 1 to 6 for the ordinal data and from -2 to +2 for the interval data (as in Graham, Harvey and Rajgopal, 2005).

In a further stage, the sample was divided according to several characteristics of the respondents and of the banking institutions for which they were working. For the

banking institutions we considered: (1) the canton of residence, (2) the type of ownership, (3) the size, (4) the percentage of foreign assets under management relative to the total assets under management. We also checked whether the bank (5) has sent at least a SAR in the previous year and if it (6) has been sanctioned for breaching any of the mandatory AML requirements.

For the respondent we took into account his/her compliance tenure and the daily working time dedicated to AML matters. This differentiation is intended to determine whether and how the accumulated professional experience can influence the beliefs that a compliance officer holds about certain AML matters. The literature on AML compliance has noted that the specific due-diligence duties may go against the bank's *raison d'être* to make profits (see Verhage, 2011; Favarel-Garrigues *et. al*, 2008; Subbotina, 2009). This is because banks must commit sizeable resources to carry out all the CDD procedures. In addition, banks lose business by rejecting clients, whereas, in some cases it will be the clients who will decide to leave the bank, scared by all the (sometimes unnecessary) compliance requests. Since not all compliance officers admit that the AML law threatens the bank's profitability, we differentiated between those who perceived a conflict between the AML compliance duties and the profit maximization-function of the bank from those who did not.

For each question of the survey conditional averages were reported and t-tests were carried out in order to map out significant differences among the groups.

3.6. Results

3.6.1. Respondents

At the end of the survey period, 52 web-questionnaires were returned, even if not all of them were complete. Prior to the survey, we decided to leave respondents the choice

of not answering questions with which they did not feel comfortable. A limited response rate was however expected given the delicate topic of the survey and the well-known discretion of Swiss banks.

Tables 3.1 to 3.3 present summary information about the professionals that submitted the questionnaire and the institutions they represent. The reported statistics are calculated on the non-missing values for each particular characteristic. Table 3.1 divides the banks according to their type and the canton where they are domiciled. The total rate of response was 37.4% and the highest number of responses -in absolute terms- came from the banks domiciled in the canton of Zürich, followed by Geneva and Ticino. As for the type of bank, the majority of responses came from foreign-controlled banks (65.4%), followed by banks that specialize in stock exchange, securities and asset management (15.4%), cantonal banks (5.8%), major banks (3.8%), private bankers (3.8%) and other banking institutions (5.8%).

Table 3. 1: Number of banks in the population and in the sample by canton and by type of bank

	Sample	***% of Total***	***Population***	***% of Total***
Panel A: By canton	N	%	N	%
Geneva	15	29	50	36
Zurich	28	54	71	51
Ticino	9	17	18	13
TOTAL	52	100%	139	100%
Panel B: By type of bank	N	%	N	%
Cantonal Banks	3	6	3	2
Big Banks	2	4	2	1
Banks specialising in stock exchange	8	15	28	20
Other banking institutions	3	6	6	4
Foreign controlled banks	34	65	84	60
Regional and savings banks	0	0	1	1
Branches of foreign banks	0	0	5	4
Institutions with a special business field	0	0	1	1
Private bankers	2	4	9	6
TOTAL	52	100%	139	100%

A bank is deemed to be foreign-controlled if foreigners with a qualified participation in the bank directly or indirectly hold more than half of its voting shares, or if they exercise a controlling interest in any other matter

As expected, the majority of the banks manage mainly assets of foreign origin (65.4%, *i.e.* 34 out of 48 banks, see Table 3.2). Moreover, almost 60% (*i.e.* 27 out of 46) of the banks in our sample reported to the MROS at least one time the year before our study. Finally, a total of 6 banks (out of a total of 46) admitted to have been sanctioned for breaching AML requirements.

Table 3. 2: Bank Characteristics

Variable	***Category***	***Count***	***Description***
Ownership	Swiss (CH)	18	Indicates whether the controlling shareholder of the bank is Swiss or foreign
	Foreign (F)	34	
Assets under management (AUM)	CH	14	Indicates whether the percentage of foreign AUM is greater than 50% of the total AUM of the bank
	F	34	
Size	Small	25	This measure considers the bank's total assets. The sample is divided at the 50% quintile.
	Large	25	
Suspicious Activity Report (SAR)	No	19	Indicates whether the bank has transmitted at least one SAR to the MROS in the year 2011
	Yes	27	
Sanctioned	No	40	Indicates whether the bank has been sanctioned for AML breaches in the last five year
	Yes	6	

Table 3. 3: Respondent Characteristics

Variable	***Category***	***Count***	***Description***
Tenure	Short	26	Indicates whether the respondent has been working for less than 5 years (short tenure) or more than 5 years (long tenure) in the actual department.
	Long	26	
AML tasks	Full	16	Indicates whether the respondent dedicates more than 50% of his working time to AML matters
	Part	36	
Contradiction	Yes	18	Indicates whether the respondent perceives a contradiction between AML compliance requirements and the commercial interests of the bank
	No	30	

Regarding the compliance officers' tenure the sample is perfectly balanced, whereas as far as the time dedicated to AML during the day is concerned, only one third of the respondents dedicate more than 50% of their daily working time to such tasks (or shortly "full time" vs. "part-time" compliance officers, see Table 3.3). This could be an indicator of the limited resources that especially small banks have when it comes to compliance. While bigger banks have dedicated AML departments, medium-sized banks usually centralize all professionals taking care of legal matters and rule

observance in a department called generically "Compliance department". As one RM explained post-survey "Small banks, with fewer employees and a reduced client base, will usually have an attorney managing all the legal problems" [RM1].

Moreover, 38% of the surveyed compliance officers (*i.e.* 18 out of 48) confessed that they perceive a contradiction between AML compliance and the commercial interests of the bank. This perceived contradiction can make the compliance officer experience a role uncertainty, as he has the duty to apply strict AML policies that can limit certain business opportunities but he also needs to acknowledge the bank's need to develop business so it can create value for the shareholders. In such situation, we believe that the compliance officer is more likely to experience doubts regarding the advantages of compliance.

3.6.2. Switzerland's vulnerability to money laundering

The respondents' perceptions about both Switzerland's vulnerability to money laundering operations, and the clarity and effectiveness of AMLA, are very likely to influence the compliance with the AML measures in place. First of all, the resources invested in compliance will depend on the extent to which banks perceive the danger of being used for money laundering purposes. Secondly, if the law is clear and easy to put in practice then it is more likely for the regulated community to be compliant, whereas if the drafting is defective or leaves room for misinterpretation, the perceived legitimacy of the regulations will be affected (Kagan and Scholz, 1984).

On a scale from 1 to 5, respondents judged AMLA to be very clear on average (3.9 points, see Table A.5 for differences among the three cantons). In addition, 75% (39 banks) of the respondents considered AMLA to be successful in its inherent purpose (see Table A.1). However, almost the same percentage (70%; 36 banks) of respondents considered Switzerland to be vulnerable to money laundering operations. Typically, one would observe vulnerability as a result of a deficient law or a scarce

enforcement. On the other hand, vulnerability is a subjective term, such that, despite a well-functioning law, certain compliance officers can still consider their banks vulnerable to money laundering attempts. The conditional analysis discussed in the next paragraph will shed more light on this aspect. It should also be noted that, fearing further regulatory tightening, some respondents might have refrained from expressing a negative judgment regarding AMLA.

Since the banks' suspicion of money laundering is frequently aroused by the news read in the media (See Table 2.3 in Chapter 2) it is useful to understand whether the belief that Switzerland is vulnerable to money laundering operations is due to professional experience or to media coverage. Conditional analysis in Panel B (Table A.1, column 4, row 1) confirms the hypothesis that professional experience is, most likely, the explanation: there is a positive and significant difference between the perceptions held in this regard by full-time compliance officers and part-time compliance officers. We see that the time spent on AML problems by the respondents marks a significant difference also in the way in which AMLA's success is perceived: both full-time and long tenured compliance officers consider AMLA to be more successful (Table A.1, column 3, row 2). In addition, small banks perceive the money laundering danger to a smaller extent since they usually serve only a limited number of clients that were refereed either by a professional company (e.g. corporate trustees, external asset managers, etc.) or an existing client (column 5, row 1). Finally, the compliance officer's having filed a SAR seems to significantly influence his perception about Switzerland's vulnerability to money laundering: the fact that his suspicion was strong enough to translate into a SAR is an indication that the system is vulnerable to these crimes (hence, the difference compared to those compliance officers that didn't sent a SAR, see Panel B, column 9, row 1).

From our post-survey interviews we learn that the belief about Switzerland's vulnerability to money laundering is not shared by all the professionals. According to one compliance officer, foreigners continue to misinterpret the way of doing banking in Switzerland nowadays, and he underlines that "the time when certain things could be done in Switzerland is over (. . .). If I would be in need of laundering money, I

wouldn't come here" [CO3]. Likewise, relationship managers laugh about the foreigners' imagination regarding the "magical" transactions that can be carried in Switzerland which seem to be fuelled by the 007 series in which James Bond deposits his money into a Swiss bank. On MROS's side, the following has been underlined: "Switzerland is not necessarily more vulnerable to money laundering compared to other countries. Our AML legislation is ahead other similar legislations and it works well" [MROS1] and that the problem is "that many clients are foreign and this makes it difficult to investigate the real source of the funds" [MROS2].

To understand how the laundering could take place, we asked which financial instruments are most likely to be used by money launderers. From Figure 1 we see that transactions involving real estate were prevalently mentioned, followed by international wire transfers, operations using the current account and cash operations. As one compliance officer explained, it is much easier to produce documents justifying a real-estate transaction, especially when the buying and selling activities are very intense in this sector. In addition, depending on the culture of the clients one would expect to see different operations in cash (*e.g.* in canton Ticino many operations are concluded in cash, due to the Italians' propensity to use it [CO2]).

Graph 1
Financial instruments vulnerable to money laundering operations

3.6.3 A picture of the AML process inside Swiss banks

3.6.3.1. Discretional CDD and KYC duties

Table 3.4 reports banks' behaviour concerning certain CDD and KYC duties that FINMA's MLO left at the discretion of the financial intermediaries, depending on the cases they encounter. That is to say, in cases of clients or operations that, by their nature, carry a higher money laundering risk, banks are required to ask for additional clarifications, using, among others means, the available sources of investigations (see Row 1 and 3). Likewise, a bank is required to appropriately weight the risks of maintaining a business relation with a client that has not been personally identified (see Row 4). Finally, after having identified the client and his business intentions, if the reasons why he chooses Switzerland for opening an account are not obvious, the bank is entitled to suspect him of money laundering and should ask for additional information to clarify this point (see Row 2). As it emerges from Table 3.4, in all the cases, the majority of the banks choose to be over-compliant.

Table 3. 4: Banks' internal practices regarding discretional Customer Due-Diligence Practices

The following table reports the number of banks answering the question: How often does your bank?

	Always	Usually	Half of the time	Seldom	Never	AVG
Verify the profile of the client against lists of persons	48	2	0	1	0	1.90
Verify the clients' reasons to open an account in a foreign jurisdiction	27	17	0	1	0	1.56
Screen transactions against lists of persons, entities, countries	41	5	0	1	1	1.75
Accept clients that have not been personally identified	1†	3†	3	21	20	-1.17

Respondents were asked to indicate how often they take an action in each case. Columns (1) to (5) present the number of respondents choosing that particular answer. The average rating in Column (6) is based on the following weights: 2 for "Always", 1 for "Usually", 0 for "Half of the time", -1 for "Seldom" and -2 for "Never".

† These 4 banks, by their nature, deal only with institutional investors, for whom identification is not always necessary.

There are two potential explanations for this behaviour. The first one is connected to the risk-based approach that financial institutions are required to apply when implementing the AML requirements. On one hand, giving banks the power to decide how to tailor their decision making depending on their customer base type, their products and the markets in which they operate, is, without any doubt, an unquestionable advantage, as it allows them to focus their resources only on those cases that deserve special attention. On the other hand, the flexibility associated with the risk-based approach disguises the regulators' inability to provide a substantial guidance in the risk definition process and this can lead to potential frictions between AML stakeholders and regulators (Demetis *et al.* 2007). The second explanation is the fear of repression, which implies legal sanctions and reputational damages. This may push banks to do more than required or to do all that is needed to "cover their backs" (Harvey and Lau, 2009), as the fear of being punished turns the risk-based approach into a risk avoiding approach. In fact, when asked whether they consider their internal AML policy to be stricter than other Swiss banks' AML policy 64% of the respondents considered this to be the case (see Table A.1, row 3).

In line with the AML-related training practices observed in other countries -see Webb (2004) for the case of UK - more than 75% of the banks train their employees every one or two years with regard to the main AML practices (Table 3.5).

Table 3. 5: Banks' AML training practices

The following table reports the number of banks answering the question: How often do you train relevant employees with regard to the following issues?

	Never	*Just once*	*Every 1-2 years*	*Every 6 months*	*Total*
(1) Identification and reporting of transactions that must be reported to Government authorities	1	3	40	5	49
(2) Examples of different forms of money laundering involving the banks' products	1	2	39	8	50
(3) Internal policies to prevent money laundering	1	3	36	9	49
(4) Trade based money laundering	5	2	32	3	42

3.6.3.2 Reporting suspicious activities

One specificity of the Swiss AML reporting system is that it "was designed in such a way that the financial intermediaries are part of the system and not subordinates; they are urged to reason, to make choices and justify their decision to send a SAR. [. . .] the system was built in this particular way in order to protect the value of privacy and not to hide things, as it has been often accused" [MROS1]. In fact, many "supposedly suspicious cases" do not reach the MROS because the financial intermediaries' in-house investigations do not provide enough objective elements to substantiate the suspicion [CO1]. The logic consequence of this "reasoned" reporting system is that the number of SARs received annually by the MROS is considerably lower when compared with other countries (as discussed in Chapter 2).

On the other hand, giving the financial intermediaries the responsibility to justify the reasonableness of their suspicion leaves a lot of room for interpretation. In their semantic analysis of the verb "to suspect", Rigotti and Palmieri (2014) conclude that a suspicion can be based on facts/acts that are observable or it can be limited to a simple hunch. To mitigate this individual bias, there will be more than one person deciding whether to report a client.

Table 3. 6: Banks' Suspicious Activity Reporting practices

The following table reports the number of banks answering the question: Through how many layers of decision making a SAR must pass before being transmitted to MROS?

Answer	*Count*	*% of Total*
One layer	8	15
Two layers	26	50
Three layers	9	17
Four layers	1	2
Five layers	1	2
Total	52	100 %

In fact, we see that only 15% of the banks in the sample claimed that the decision to transmit a SAR will be taken by a single individual, whereas in 50% and 17% of the

instances it will be considered at two, respectively three different levels of authority (see Table 3.6). Sometimes, it will even take four (2%) or five (2%) distinct layers of agreement before informing MROS[11]. It must be emphasized that not all the banks can accommodate the bureaucracy costs connected to a manifold decision making process. For small banks, the decision to report a suspicious case will be taken either by the relationship manager/asset manager or by the compliance officer. Medium banks will resort to the conclusion of the relationship manager taken jointly with the compliance officer and sometimes with the executive board. Finally, bigger banks will rely on the opinion of the AML responsible, the head of compliance, a reputational risk committee and, depending on the client, the executive management.

Previous studies have discussed the practice of "defensive filing" or "umbrella reports", meaning that financial intermediaries will report every time they have the merest suspicion of money laundering (see Harvey, 2004; Levi, 2007, Favarel-Garrigues *et al.,* 2008). In the same time, Verhage (2011) found that banks are looking for a balance regarding the number of reports forwarded to the FIU, even if they do not have any benchmark to help them in this respect. In contrast, 75% of the banks in our sample consider the number of forwarded SARs to be fair, *i.e.* everything that should be reported is reported (see Table 3.7). During the interviews, the compliance officers denied the practice of "umbrella reporting", stating that they "never had the tendency to easily report a client, but this does not mean underestimating the facts or covering those situations in which we had a strong suspect" [CO1].

Table 3. 7: Banks' opinion regarding the number of SARs sent to MROS

The table reports the number of banks answering the question: To what extent do you think your institution is under or over reporting suspicious activities to MROS?

Answer	***Count***	***% of Total***
(1) Under reporting	1	2
(2)	1	2
(3) Fair reporting	39	75
(4)	2	4
(5) Over reporting	0	0
Total	43	83%
Average scoring	2,98	

[11] This is usually the case when an important client is involved and the reputational risks at stake are very significant.

With regard to the life of a SAR after leaving the bank, we notice an almost unilateral communication flow between the MROS and the reporting bank. That is to say, MROS can ask the bank additional information about the reported client (cf. to the interviews with MROS analysts and the compliance officers) and communicate the final result of its investigation without any detailed feedback about the bank's judgements or compliance actions. The survey's answers confirm the meagre utility of MROS's feedback, with only 30% of the banks considering it useful in carrying out the due AML tasks (see Table 3.8). This problem has not been encountered only in Switzerland. An early study by the European Commission (2008) pointed out that the feedback from the FIU to the reporting entities may be limited because: FIUs are understaffed and cannot timely provide so many answers; ongoing investigations may be put at risk; or strict secrecy laws prevent FIUs from disclosing specific feedback. Considering all these problems, the FIU is likely to be a kind of "black box" with compliance officers having small or no clue at all about the outcome of their reports (Verhage, 2011). On the other hand, MROS admits that the quality of the received SARs is good, *i.e.* one can really see the efforts made by the financial intermediaries in documenting their suspicions [MROS1, MROS2].

Table 3. 8: Banks' opinions regarding the usefulness of MROS's feedback

The following table reports the number of banks answering the question: To what extent do you consider the information and feedback (technical assistance) provided by MROS and prosecuting authorities to be useful in carrying out your AML tasks?

	Large extent or Certain extent	***Not sure***	***Limited extent or Not at all***	***No answer***
Answer	16	4	20	12

3.6.4. Why do banks involve in the AML fight?

Given the interdependence of the global financial system, governments understood that the fight against money laundering can only be fought by coordinating their efforts internationally. Together with the design of a national AML framework, lawmakers

tried to increase public awareness by underlining the dangers associated with the facilitation of money laundering. More specifically, they claim that if criminals are given the possibility to launder ill-gotten profits and hence perpetuate crime, the stability of the financial sector will be shaken and the economy and society as a whole will be put at peril. However, proven evidence of such effects is very limited and several scholars have discussed the size of this danger. For example, van Duyne *et. al* (2010) surveyed the existing research on the size of the money laundering phenomenon, challenging the conceptual flaws of the two most famous econometrical models employed in this sense: the one of Schneider (2007) and the one of Unger and Walker (2009). The pain point of the first model is the assumption that underground economy concerns only revenues hidden in cash, whereas the second model suffers from the use of arithmetic averages as central tendency instead of the median. In the same paper, van Duyne *et al.* (2010) encouraged researches and authorities to reflect upon the real effects that money laundering can have on the economy and on the financial system's stability. In this regard they questioned the potential inflationary effect that hidden money (typically estimated at 5% of the GDP by IMF) can have on the state budget given that such money are spent on consumer goods which are also taxed. Moreover, they underlined the ridiculously small numbers of banks (most of which were not even internationally known) that actually went bankrupt for facilitating money laundering. Some years later, Halliday, Levi and Reuter (2014) also reviewed the available scientific research on the relationship between proceeds of crime, money laundering and macroeconomic financial stability and concluded that besides being narrowly targeted, well-evidenced impact mostly involves tiny economies, such as those of Caribbean and South Pacific states.

Taking note of the empirical gaps evidenced above, if one is to stick to the general belief that "crime is bad", it is safe to assume that every actor engaging in the AML fight believes that the crime of money laundering must be eradicated. Nevertheless, in times of shrinking profits and increasing compliance costs, the banks' motivations to invest resources in AML can have different origins. The existing literature has often cited the reputational risk, apart from the legal obligation, as the banks' most important

motivation for investing in AML. In this case, reputational risk is given by the probability to incur losses due to a damaged corporate image. This type of loss is difficult to quantify, but one can easily imagine that a depositor will not be happy to find out that his bank has been abetting criminals and that a public authority is investigating and eventually confiscating part of the assets deposited herein.

Whereas Swiss banks have experienced several episodes of "legal irregularities"[12], none of them reported a loss of clients such that to be forced to shut down operations. However, we believe that the recent (global) shift toward increased transparency has pushed banks to place more value on their reputation (especially since clients are no longer willing to pay a price for the banking secrecy).

Our results confirm the above hypothesis, since reputational risks score the highest among the reasons of why banks get involved in the AML fight (4.88 points on average, on a scale from 1 to 6[13)], see Table A.2, Panel A, row 1). This score is significantly higher for banks that manage local assets (5.38 points) and banks that have not sent a SAR in the year prior to our study (5.21 points; see conditional analyses in Panel B, row 1, columns 7 and 9). A possible explanation regarding the latter would be that if a bank thoroughly considers its reputational risks, it can refrain from accepting those clients whose situation is not 100% clear. This will spare them the subsequent burden of harshly monitoring these clients and eventually sending a SAR.

We think that for those banks that choose to focus on local clients reputational issues at stake are higher since the trust placed with the bank is higher given the smaller social distance. Moreover, the scores registered in Table A.2 Panel B, column 6 show that for Swiss-owned banks reputational risks are more important than for foreign-owned banks (even if not significant). In fact, the recent money laundering scandals involving Swiss branches of foreign banks (e.g. HSBC, 2012 and BNP Paribas, 2014) seem to confirm the fact that, despite Switzerland's efforts to implement forefront

12 For example the Chiasso Scandal that led to the introduction of the "Agreement on the Swiss banks' Code of Conduct with regard to the Exercise of Due Diligence" in 1997, the HSBC money laundering case settled with the payment of fine of GBP 28 Mio, the UBS tax evasion scandal regarding US persons in 2008, or the recent 1MDB fraud involving two smaller Swiss banks – BSI and Falcon Bank (2016)

13) Six points were assigned if the reason was ranked as first, five if ranked as second, four if ranked as third and so on. The final score is the weighted average of all the ranks that every single reason got.

AML legislation, foreign investors still believe they can exploit the banking secrecy for criminal purposes or at least apply less rigid AML principles.

In the second place banks ranked regulatory risk (4.02 points) defined as the probability of incurring a loss due to the bank's being fined or suspended by the enforcement authorities. Previous research has shown that large banks follow riskier strategies than smaller banks (Boyd *et. al* 1993, Schnabel 2009). This can be due to the fact that they are more likely to be bailed out in case of failure (i.e. they are considered to be "too big to fail"). However, this fact has come to the public attention during the current financial crisis and many governments took action by making banking regulation more rigorous. In panel B row 2, column 5 we see that larger banks assign a significantly higher importance to regulatory risk; this is because bigger banks are now more monitored and so, more likely to be sanctioned in case of misbehaviour. This is consistent with Scholz and Gray (1990) who found that larger firms may be more attentive to law enforcement, since they are more visible. In addition, the authors also claim that larger firms can better mitigate the risks brought to their attention during inspections, given the greater availability of managerial and investment resources that they potentially enjoy.

Reputational risk and regulatory risk are very connected between them. If a bank is sanctioned for facilitating money laundering operations its reputation will be tainted. As Harvey (2004) noted, the loss of reputation can translate into direct costs (loss of income), indirect costs (clients leaving the bank) and opportunity costs (foregone business opportunities). For more than 75% of the banks in our sample these reputational damages are a valid motivation for considering the investment in AML compliance beneficial (see Table A.3, Panel A, row 1). In addition, full-time compliance officers perceive a greater benefit of using compliance as a shield against reputational damages (see Panel B, column 4).

The next important motivation that push financial institutions to get involved in the AML battle is the protection of the banking system's integrity (3.63 points) and the avoidance of criminal charges (3.60 points, see Table A.2, rows 5 and 6). The failure of a single bank in observing AML obligations can have spill-over effects on the rest

of the banking system. As a consequence, banks will seek not only to protect their own reputation but also that of the whole banking system. In Belgium, banks claimed that financial institutions which get involved with money laundering should be severely punished by means of penal sanctions, blacklisting, license revocation, etc. (Verhage, 2011).

One of the most influential papers in criminology is the one of Becker (1968) who applies the traditional expected utility model to crime. As such, an individual's decision to offend is a function of the perceived certainty and severity of the sanctions to be imposed, weighted against the expected profits. In addition, Grasmick *et al.* (1990) and Pogarsky, Piquero and Paternoster (2004) found that these perceptions are influenced by the individual's past involvement in illegal behaviour. The results registered in Table A.2 Panel B, column 10 show that sanctioning does have a deterring effect on the banks' behaviour, given that previously-sanctioned banks assign a significantly greater importance to the avoidance of criminal charges.

Despite the fact that money laundering perpetuates crime and undermines the legal economy, banks assign limited importance to the social and moral concerns stemming from the AML fight (2.65 points, see Table A.2 row 3). As noted above, if one has been sanctioned, he will completely change his perception about offending (see conditional averages in Panel B, column 10). It can be argued that banks are not concerned with social and moral matters, since these are not directly impacting their object of profit. But if laundering is to take place inside the bank itself, then AML compliance will raise the awareness of this risk and will help the bank to effectively deal with it. In fact, this is acknowledged in 85% of the cases (see Table A.3, Panel A, row 2). Moreover, conditional analysis in Panel B, shows that this kind of benefit associated with AML compliance is more obvious to long-tenured compliance officers (column 3), smaller banks (column 5) and previously sanctioned banks (column 10). Consistent with our beliefs, the perceived advantages of AML legislation are smaller for those compliance officers who experience a role uncertainty: to whom the enactment of the AML legislation raises some doubts as to whether they should behave like the long-

arm of the police and probably limit certain business opportunities (column 8). However, it seems that the avoidance of criminal charges -an inherent but also pragmatic reason for diverting resources to the AML fight- is enough of a motivation for preferring the certain AML compliance over uncertain profitability objectives (Table A.2, Panel B, column 8).

Finally, banks do not seem to value the marketing opportunities given by the information collected for the KYC and CDD procedures (2.21 points, see Table A.2, Panel A, row 4) even if several authors stated that the obligation to construct a complete profile of the client could be used by the bank to offer those products that better suit the needs of the client. However, this might not to be the case for Swiss banks. Since they offer predominantly private banking and asset management services, they already collect a considerable amount of information about their clients. Moreover, the type of information requested by AMLA will not necessarily prove useful in increasing the profitability of the single relationship. In fact, we see in Table A.3 row 3 that only 36% of the respondents consider that compliance can prove useful for marketing purposes and foster the development of new products. For smaller banks managing fewer clients, collecting even more information than they usually do can be useful since it can help them to offer better-targeted products (see conditional analysis in Panel B, column 5).

The findings above indicate a clear tendency of the banking system to look after its own good – *i.e.* protecting its reputation – rather than caring about catching criminals who perpetuate crime in society. This preference for preventing something bad (reputation damage, sanctions, financial loss) rather than obtaining something good (hamper money laundering, catch criminals) has been observed also by Verhage (2011). On the other hand, it is fair to underline that investigating and catching criminals has always been the task of the authorities. They are the ones who are responsible for enacting laws and applying sanctions meant to deter people from offending.

All in all, the diversity exhibited by the respondents' answers with regard to the motivations for AML compliance corresponds to the image pictured by Favarel-Gar-

rigues *et al.* (2008) in France: "in the fight against 'dirty money', some players are seeking to combat terrorism (the police and some compliance officers), while others are seeking to preserve the international financial system (the IMF, the Basel Committee). Within the banks, compliance officers seek to protect their firms against regulatory sanctions".

3.6.5. Costs associated with the AML compliance

Almost every research paper tackling the subject of money laundering brings into discussion the costs associated with its counteraction. The economic costs of AML compliance that a financial institution must bear can be divided in tangible costs -all the physical and human capital needed to perform the due diligence tasks- and intangible costs -given by the inconvenience created to bank's relationship with its clients (Johnston *et al.* ,2006; Masciandaro *et al.*, 2001). Analysing these costs from a broader perspective, Geiger and Wuensch (2007) noticed that the AML mechanism increases the direct costs of legitimate market transactions, hindering the working of the 'invisible hand' and reducing the wealth of nations.

Table 3. 9: Banks' estimated AML compliance costs

The following table reports the number of banks answering the question:
Estimated AML compliance costs in proportion to the total costs of the bank

	Count	*% of Total*
Less than 5%	18	35
Between 5 and 10%	12	23
Between 11 and 20%	1	2
More than 20%	0	0
No answer	21	40
Total	42	100

Table 3.9 reports the answers about the estimated AML compliance costs in proportion to the total costs of the bank. About 35% of the sampled respondents

estimated this proportion at less than five percent, 23% placed it somewhere between five and ten percent, 40% chose not to respond, whereas one respondent representing 2% of the sample said this proportion lies between 11 and 20%. These numbers are in line with the findings of Franks *et al.* (1997) who surveyed both securities firms and investment management firms and reported total average compliance costs (i.e. compliance costs plus incremental compliance costs[14]) of respectively 3,1% and 7,9% of their net operating expenses. The high percentage of non-response to this question could be due to the fact that banks find it very difficult to quantify this type of costs (consistent with Harvey, 2004) or because the respondents were not enough acquainted with the matter. Furthermore, it might also be the case that firms are reluctant to divulge the amount spent on compliance (Harvey and Lau, 2009).

The descriptive data reported in Table A.3, row 6 show that almost 60% of the respondents perceive AML compliance costs as negatively impacting the bank. Moreover, the burden of these costs is significantly higher for the banks that have been sanctioned and the banks that reported to MROS in the previous year (see conditional analyses reported in Panel B column 9 and 10). These results indirectly suggest that reporting and non-compliance are expensive, even if for different reasons. In fact, as emphasized earlier, the AML reporting process inside the Swiss banks can be very time-consuming: the compliance officers need to gather documents justifying their suspicion, analyse them and then together with the management decide whether a SAR should be sent.

Other negative effects of AML compliance that indirectly translate into costs are (a) the slowing down of the business and (b) the potential loss of clients due to the monitoring and reporting procedures (Verhage, 2011). In our study, the presence of these effects was acknowledged by the compliance officers in proportion of 40% and 27%, respectively (see Table A.3 rows 4 and 5). The conditional analysis in Panel B report three interesting differences. First of all, foreign-controlled banks confide a significantly higher loss of clients due to AMLA compliance (row 5, column 6). Secondly,

[14] Incremental compliance costs are defined as the amount by which compliance costs exceed the costs that would be incurred in the course of normal good business practice.

we see that the AML compliance's side effects are significantly more obvious to those compliance officers who perceive a contradiction between AML rule observance and the commercial interests of the bank (row 5, column 8). Thirdly, these negative effects are also higher for the SAR reporting banks, reconfirming thus the burden associated with the reporting process (column 9).

Finally, narrowing down the focus to what the respondents think about the burden associated with the collection of all the documents required by the AML due-diligence procedures, we see that the opinions are somehow mixed. Asking the client to provide all the justifying documents for his transactions (*e.g.* selling a house, buying an expensive watch) before giving the authorization to proceed can prove very time consuming. In fact, even if almost 90% of the compliance officers in our sample consider this to be normal business practice, half of them think that it can nevertheless become an administrative burden (see Table A.4, rows 2 and 3). As both compliance officers and relationship managers explained, the hardest part of the due-diligence process is the initiation of a new business relationship. Knowing very little about the client and the way in which he built his fortune, they try to gather as much information as necessary to construct a valid profile of the client they are about to take in. Beside financial information, banks also need to obtain personal details about the client: place of birth, studies, professional experience, fiscal domicile, marital status, relevant political/economical/religious/social connections. It is not always easy to get all this information from the client. In fact, the relationship managers told us that "certain clients are very talkative and give more than what we ask, whereas some of them don't understand why we need to know all these things. One client told me 'I want to give you (n.n. to the bank) my money, why do you need to know how many children I have?'" [RM2].

As suggested by Verhage's (2011) findings, the typical due-diligence questions could be considered as a violation to one's privacy. As opposed to Belgium where there is no banking secrecy, we were curious to understand whether the due-diligence process raises the same concern for the Swiss professionals who put so much emphasis on one's privacy. Our results indicate that only 17% of the sample considers them as

intrusive (see Table A.4, row 2). The explanation is that in order to be able to offer the typical 'holistic, long term' Swiss specific products and services, the banks would, in any case, need to collect such personal information.

From the conditional results reported in Panel B we see that those banks which handle mainly Swiss assets are significantly more likely to consider the due-diligence procedures as a normal business procedure (column 7, row 2), while the opposite is true for foreign-controlled banks (column 6, row 2). In addition, such foreign-controlled banks also indicated (to a significantly greater extent) that requiring justifying documents from the client might be intruding to one's privacy (column 6, row 1). The latter is true also for banks that have been reporting suspicious activities to MROS (column 9, row 1). Following our earlier results, due to the costs associated with submitting a SAR, banks that have reported to MROS are more likely to consider the due diligence tasks as an administrative burden (column 9, row 3). At last, another statistically significant difference indicate that requiring documents for CDD procedures is more of an administrative burden for those compliance officers who believe that such procedures go against the profit-maximization function of the bank (column 8).

3.7. Limitations

In light of the results presented above, we must acknowledge some limitations connected to the use of a questionnaire as a mean for data collection. First of all, surveys measure beliefs, feelings and perceptions, which can be different from the behaviour in the real life. Furthermore, respondents may be affected by the "social desirability bias", considering the delicate nature of the money laundering subject and the potential reputational damages connected to certain answers. We tried to address these problems when constructing our survey and deciding upon the strategy with which we would approach the respondents. As such, the questions to the respondent were formulated in a way to collect information about certain general AML procedures and not

about specific practices. In any case, we left the respondent with the option of not answering a question, if uncomfortable with it.

Another problem connected with the questionnaire-data is that it is barely quantifiable and the use of conventional scales has been often criticized for their inability to measure the absolute magnitude of the differences between their points. Nevertheless, the validity of the methodology we employ has already been validated in other published works, in other fields (see for example Graham *et al.*, 2005)

Finally, the small sample size makes sample representativeness to the population questionable. To mitigate these concerns, Table 3.1 reports data about the entire population of banks that are members of the SBA and are based in one of the three cantons (Ticino, Geneva or Zurich). One can notice that the distribution of the three categories that represent more than 80% of the total banks in both the population and the sample is pretty similar (see categories 3 to 5), which allows us to safely generalize our results to the entire population. The only type of bank for which we have no observation in our sample is "branch of a foreign bank". Nevertheless, we do not expect major differences in their behaviours towards AML compliance, given that foreign banks opening branches in Switzerland are obliged to follow both their home country's regulations and the Swiss ones. Moreover, we believe that possible differences/characteristics attributed to this bank category are captured by the foreign-controlled banks.

3.8. Concluding Remarks

This chapter was meant to give a first picture about how banks consider their role and efforts in the fight against money laundering, how they organized themselves to cope with client verification and reporting task and which are the costs they must bear. We highlight three important matters with which the majority of the sample seems to agree.

First, banks acknowledge Switzerland's vulnerability to money laundering operations and indicate real estate transactions and wire transfers as the most used instrument for disguising criminal money. In the same time however, the Swiss AMLA was perceived as being enough clear and successful in counteracting this crime. This somehow paradoxical finding has two potential explanations: (1) banks fear tighter regulation, so they declare themselves satisfied with AMLA or (2) even if AMLA is believed to be effective, criminals will always try to find a way to launder money. Hence, even if the threat has not materialised because it is kept at bay by AML regime, the vulnerability still remains. Both alternatives were confirmed during the post-survey interviews.

Secondly, banks ranked reputational risks as the most important incentive to fight money laundering, whereas civic duties were ranked as the last one. As such, there is a clear discrepancy between the objectives of the banks for investing in AML compliance and the Government's ones. This finding is line with what has been previously observed by Harvey (2004) Masciandaro *et al.* (2001), and Verhage (2011), indicating that banks are meant to make profits, not to catch criminals. However, while making profits banks must keep risks at an acceptable level - reputational risks are among those avoidable risks.

Thirdly, even if committing to the due-diligence procedures is seen as a regular business procedure, the banks nevertheless incur significant AML compliance costs that reach an average of 5% of their total annual costs. The fact that the majority of the compliance officers participating in the survey acknowledged the costs and the administrative burden associated with AML compliance has important implications for the organisational integration of the compliance department. Since compliance is a cost center (Gallo *et al.*, 2005), there will often be conflicts between the commercial and the compliance departments. Moreover, from our conditional analyses we noticed that those compliance officers who think that the AML requirements go against the profit maximization of the bank perceive the benefits associated with compliance to a smaller extent and vice versa.

This last finding gives room for further investigation regarding the integration of the compliance function into the banking culture and the interaction schemes it has created inside the organisation. This will be discussed over the next two chapters.

4. Reconciling anti-money laundering compliance duties with the commercial objectives of the bank

4.1. Introduction: compliance and banking

The introduction of the anti-money laundering (AML) legislation twenty years ago has significantly changed the way in which banks were used to do business. The shift of responsibility for combating money laundering from the authorities to the financial sector imposed several duties on the financial intermediaries. As such, they have to run several checks before establishing a new business relationship, to attentively supervise their clients' transactions and to make additional investigations if they observe any possible attempt of money laundering. To fulfil these requirements, banks have hired compliance specialists, whose main task is to protect their institution from regulatory sanctions by providing advice and implementing AML risk management systems that correspond to the business focus of the institution. Furthermore, the compliance officer analyses the alerts regarding suspicious transactions and provides guidance for the management and the other employees. Finally, he is an important connection point between the policy makers and the bank -or, as some authors called him, a "gatekeeper" or a "police auxiliary". While the work of the compliance department is vital for an effective management of the bank's risks, the amounts of money that are invested in compliance systems and personnel training are not negligible (see previous chapter). On top of these tangible costs, banks have to consider also the incidence of the intangible costs given, for example, by the foregone business opportunities due to

increased bureaucracy and privacy violation (Masciandaro *et al.*, 2001, Johnston *et al.*, 2006).

In some cases, these costs can become a significant burden for the bank, jeopardising its profitability. Finding the right balance between the duty to comply with AML requirements on one hand and the need to boost the bank's profits on the other hand, can create tensions between the defenders of these two different objectives, *i.e.* the compliance officer (hereafter CO) and the relationship manager[15] (hereafter RM). What follows is that very often these two professionals will hold conflicting views about how certain suspicious cases should be assessed. Sometimes, a transaction/business relationship does not follow certain predefined parameters in terms of timing, amounts involved, available official documents, etc.; this deviation, which in most of the cases is not due to criminal activities but to the specific business or country, can seem suspicious to the CO. As such, the latter might give a negative advice to the account opening/on-boarding of a new client. By refusing clients or breaking off transactions that the RM considers to be legally and economically viable, the CO can find himself in conflict with the RM.

The aim of this chapter is to provide evidence about the influence that the AML compliance–profit maximisation tension has on the occurrence of a conflict between the CO and the RM. At this point, the conflict is looked at from the CO's perspective. In the next chapter we will present the results regarding the same problems, as perceived by the RM.

Studying the relation between the CO and the RM is important for at least three reasons. First, as previous studies in the AML compliance field have underlined, the CO faces significant challenges when proposing compliance solutions that effectively mitigate the money laundering risk while supporting the profit making business of the institution (de Koker, 2006; Gully-Hart, 2005; Subbotina, 2009; Verhage, 2011). Secondly, implementing these solutions in practice can prove difficult and can create disputes between the various parties involved in the process. In fact, a recent survey by

[15] This term is frequently used in the private banking sector and it designates the person working at the front desk and managing the clients' business relationship with the bank (*i.e.* sales person).

the Society of Corporate Compliance and Ethics (2012) concluded that compliance professionals are very likely to endure an unhealthy level of stress, as they are in conflict with many of their colleagues. Finally, identifying the drivers of this conflict is important, especially since the continuous update of banking regulation–including AML guidelines–keeps compliance matters high on the banks' agenda for the near future (Ernst&Young, 2012).

In order to collect data about the RM-CO conflict, we use a web-based questionnaire. The latter was developed after consulting several compliance specialists, RMs and the law enforcement agency. Using the Swiss Bankers Association's (SBA) member list, a total of 139 banks active in the cantons of Ticino, Geneva and Zurich – the three most important Swiss financial hubs – were contacted for participating in the survey. Subsequently, we specified a logistic regression model in order to understand how the following variables influence the probability of a conflict between the CO and the RM:

1. *Contradiction*: the perceived contradiction between AML compliance and the commercial interests of the bank;
2. *AML-dominance*: the extent to which the AML duties should prevail when compared to profit opportunities;
3. *Foreign assets*: the percentage of the foreign assets under management in the bank's total assets under management and
4. *Decision*: the decisional authority assigned to the CO.

The model specification does not take into account any behavioural, cultural or organisation-specific factors. Its aim is to investigate whether the conflict is due to the requirements imposed by the AML law.

At the end of the survey period, 46 COs provided information about past conflicts with their colleagues 'at the front'. The regression's results confirm that those COs who perceive a contradiction between the AML compliance requirements and the bank's profit maximisation function are more likely to experience a conflict with their colleagues working at the front office. Variables (2), (3) and (4) instead prove not

to be good predictors of the CO-RM conflict, due to the fact that they are not statistically significant.

These findings have important implications for both the banking institutions and the regulating entities. On the one hand, for the banks this conflict represents a cost given by the delay in decisions, distortion of information and the decreased employee performance due to low satisfaction. On the other hand, the amount of compliance that the lawmaker should expect to be observed depends on the costs that the banks are willing to bear.

The rest of the chapter is organised as follows: the second section reviews important findings in the field of organisational conflict and presents the reasons why the compliance department's role may lead to conflicts with the front office; the third section presents the data collection method. The fourth section defines the logistic model and the explanatory variables. The results are discussed in the fifth section whereas the potential limitations of the study are outlined in the sixth section. Finally, conclusions and some recommendations are evidenced in the last section.

4.2. AML compliance and the potential for internal conflicts

4.2.1. Organizational conflict

According to Brickley *et al.* (2002: 1822) a corporation can be defined as "a collection of individuals. Or more precisely, it is a set of contracts (both explicit and implicit) that bind together individuals with different, often conflicting interests". Hence, beyond any legal form and possible economic purpose, the most important dimension of a company is given by its people. The corporate culture that develops inside each company is supposed to create a common ground for all the employees, such that they share the same behaviours, values and beliefs. More precisely, according to Hofstede *et al.* (1990) organisational culture can manifest at different levels of depth that can be

described as an onion diagram: symbols, heroes, rituals and values. In this context, organisational conflict can be defined as a dispute that occurs when interests, goals or values of different individuals or groups are incompatible with each other (Henry, 2009).

After thoroughly reviewing the existent literature on organisational behaviour and management, Rahim (2001) observed that there are two main criteria according to which organisational conflicts can be classified: the *source* of the conflict and the *organisational levels* at which this may originate. With regard to the first criterion, he mentions several sources of conflict: the incompatibility of feelings and emotions regarding a certain issue (Amason, 1996); the disagreements on the tasks to be completed (Eisenhardt *et al.*, 1997); the inconsistency between the preferences for the allocation of a scarce resource; the differences in values or ideologies on certain issues (Druckman *et. al*, 1998); the divergent preferences over the decision outcome, etc.

Secondly, inside an organisation conflict may occur at different levels: within the same individual, between two or more individuals, between the individual and the group, and between groups.

Last but not least, conflict can be either vertical or horizontal; the former occurs within groups of different hierarchical levels, for example managers and subordinates, whereas the latter occurs between individuals of the same level, such as managers of different departments within the same organisation.

In his paper, Corwin (1969) studied the occurrence of a conflict based on several organisational characteristics: structural differentiation, participation in the authority system, regulating procedures, heterogeneity and stability and interpersonal structure.

Contrary to classical organisation theorists like Taylor, Weber and Fayol who, in the late '40s prescribed organisational structures in such a way that members would be unlikely to involve in conflict, modern advocates of organisational theory recognize both a negative and positive side of conflict. Conflict can be functional when it stimulates innovation, synergistic solutions to common problems, improvements in organisational decision making and the clarification of points of view. But conflict can be dysfunctional when it causes job stress, burnout and dissatisfaction, fosters distrust

and suspicion, increases resistance to change, reduces job performance and loyalty (Rahim, 2001). Moreover, previous studies found that factors like a strong corporate culture, as measured by the consistency of perceptions of company values (Gordon and DiTomaso, 1992), the correlation between the attention to an employee's needs and task accomplishment (Hansen and Wernerfelt, 1989) and the strategic decision speed (Baum and Wally, 2003), to name just a few, are all influencing the performance of a company.

4.2.2. Banks, AML regulation and internal conflicts

Benston and Smith Jr. (1975) defined the financial intermediaries as commercial firms producing specialized financial commodities for the individuals who wish to buy them. Moreover, as any firm operating under productive efficiency, a financial intermediary will try to produce the maximum quantity of financial goods at the lowest cost in order maximise its profit. Among the ordinary operating costs, the costs imposed by regulation may represent a significant constrain, especially since banking is one of the most regulated industries. For a bank, the regulatory costs are determined by the total costs incurred for complying with the requirements of a legislation that can refer to: meeting capital requirements, providing the proper disclosure to the clients, restrictions about selling certain investment products, reporting suspicious money laundering transactions, etc.

In almost every bank, the responsibility of keeping these regulatory costs under control by proposing and implementing those compliance policies that correspond to the bank's commercial profile was assigned to the compliance department. Even if AML compliance is the object of interest here, many of the problematic issues discussed below could potentially relate to compliance in general. Moreover, even though the study focuses on Switzerland, several results find support in the international literature.

There are several characteristics that a CO should possess in order to effectively carry out the duties mentioned above. First of all, it is necessary that (s)he has a solid legal background, which makes it easier for him/her to understand the specific legal language. Secondly, a CO must possess strong investigative and analytical skills in order to decide which suspicious cases should be forwarded to the Money Laundering Reporting Office in Switzerland (MROS). Thirdly, when presented with a case, the CO should always objectively analyse the facts, and take a decision based on the results of his investigative research. Finally, on top of these professional requirements, there are also some personal competences that make the CO's work more effective: "to be communicative, discretion, immunity to stress and integrity" (Verhage, 2011:55).

In practice, the implementation of the AML regulations is likely to create an internal conflict for several reasons. The most obvious reason has to do with the profit-maximisation function of the bank. The presence of the compliance department will influence this function in two ways: first, because compliance is a 'cost centre' that needs to be minimised, and secondly, because its inherent role inside the bank can limit certain profit opportunities. The economic costs of AML compliance can be divided in *tangible costs* – referring to all the physical and human capital needed to perform the due diligence tasks, and *intangible costs* – given by the inconvenience created to bank's relationship with its clients (Masciandaro *et al.*, 2001 and Johnston *et al.*, 2006). As Verhage (2011) noted, money is by definition abstract, *i.e.* its value is not dependent on the identity of its owner. As such, money laundering does not harm the commercial interests of the bank: clean or dirty, money can all be part of the bank's investment schemes. Instead, the harm comes from the fact that doing money laundering is illegal. A bank that facilitates money laundering faces important regulatory sanctions, can lose its operating licence and can experience significant reputational damages.

Bearing in mind these premises the CO is facing both an intra- and inter-personal conflict. The intrapersonal conflict stems from the fact that as an employee of the bank, he cannot be indifferent to the business opportunities that generate profit for his employer but at the same time he cannot allow illegal money to enter the bank.

The interpersonal dimension is the one at which an organisational conflict can mostly manifest itself. As members of the same institution the CO and the RM share a common goal: contribute to the bank's profitability. Nevertheless, as members of different departments, they have different functions, pursue different objectives and as such, they can hold different points of view. In fact, the RM is expected to expand his portfolio of clients and bringing new money to the bank in terms of assets under management (AUM) whereas the CO is concerned with protecting the reputation of the bank by assuring complete rule observance. Several studies have reported that the presence of the CO is translated into an additional layer of control and increased bureaucracy (Pieth *et al.*, 2003; Webb, 2004; Masciandaro *et al.*, 2001). Moreover, Gamson (1966) suggested that specialisations (supported by the authority of distinctive competences) are perceived as targets for hostility and as such, they are positively associated with the incidence of conflict.

In her study of the Belgian AML Complex, Verhage (2011:68) observed that since "compliance remains a battle between commercial interests on the one hand and rule observance on the other hand (. . .) it has an inherent contradictory characteristic". Similarly, Favarel-Garrigues *et al.* (2008:9) noted that "the tension inherent in the AML fight between the commercial ethos and regulatory injunctions can, on the practical level, create dilemmas". To some extent, the presence of the CO is hindering the RM's opportunities of doing business by rejecting those clients whose financial situation is not clear (*e.g.* complex operations, offshore accounts, shell companies). However, this loss is not attributed to the illegal money that was forbidden from entering the bank. Instead, is the long time needed for the verification and certification of the client profile and the origin of his funds that can scare clients off and make them leave the bank.

Another determinant of the conflict between COs and RMs is the asymmetric degree of interdependence. According to Kumar *et al.* (1995) asymmetric interdependence is verified when parties have different levels of dependence on each other which can affect the level of trust and commitment of the groups. The CO is required to analyse the alerts generated by the transaction monitoring system and to ask the RM

for additional documentation. He then combines this information with the details obtained from other sources and decides whether to report the client to MROS. In some cases, the decision to send a Suspicious Activity Report (SAR) will belong to the executive board (*e.g.* if important clients are at stake and the reputational risks must be thoroughly considered). As such, a unilateral dependence develops between the CO and the RM since the former does not need the approval of the latter to carry out his investigation. Moreover, the RM is responsible for dealing with those clients that were reported and whose assets were frozen if they show up at the bank's desk. As the law forbids the RM to inform his clients about the SAR, the RM is left with the problem of inventing various excuses why the clients cannot have access to their funds (*e.g.* "problems with the payment system").

Another problem with compliance is that it cannot be assessed in terms of turnover (Verhage, 2011; Demetis and Angell, 2007); as such, the added value of this department is indeterminable and therefore debatable, especially in times of economic austerity. While the performance of the RMs can be easily evaluated by looking at the amount of new AUM, evaluating the compliance department's performance is not straightforward. The best solution is to look at the reputational damages that were avoided due to the CO's ability in identifying and mitigating the risk of money laundering. Even though is impossible to measure the exact cost of reputational damage, Harvey (2004:336) suggested that "it can result in direct costs (loss of income), indirect costs (client withdrawal and possible legal costs) and opportunity costs (foregone business opportunities)".

4.3. Research questions and Data Collection

Building upon the observations of Verhage and Favarel-Garrigues *et al.* mentioned above, this article sets out to provide empirical evidence about the internal conflicts generated by the specific requirements of the AML legislation.

First, we are interested in testing whether the perceived contradiction between rule observance and the commercial ethos of a bank significantly influences the occurrence of a conflict between the RM and the CO.

Secondly, we will consider whether the CO's propensity to strictly applying the AML provision without considering the commercial component of the transaction makes him more likely to be in conflict with the RM.

Thirdly, we will also control whether the decision authority assigned to the CO has any role in mitigating this conflict.

Finally, since foreign assets must undertake additional controls (and thus the decision making process is more complex) before being accepted, we check whether a higher percentage of foreign AUM is associated with a higher probability of CO-RM conflict.

The data used for this study comes from the on-line survey distributed to 139 Swiss banks. Details regarding the survey design, content and distribution can be found in Chapter 3.3.

4.4. Survey sample and population

Even if a total of 52 on-line questionnaires were submitted, not all of them were completed. We collected 46 answers with regard to the CO-RM conflict (*i.e.* a 33.1% response rate). Table 3.1 exhibited in the previous chapter reports detailed information about the type of banking institutions[16] in which the COs worked at the time of the survey. As we can see, the majority (67.4%) represented foreign-controlled banks[17], while 17.4% of the COs worked in banks that specialise in stock exchange, securities

[16] The types of responding banks are defined using the Swiss National Bank's official classification http://www.snb.ch/en/system/glossary#__F

[17] A bank is deemed to be foreign-controlled if foreigners with a qualified participation in the bank directly or indirectly hold more than half of its voting shares, or if they exercise a controlling interest in any other matter (www.snb.ch)

and asset management business. Finally, the rest of 15.2% of the sample represent COs working in cantonal banks (6.5%), major banks (2.2%) private bankers (2.2%) and other banking institutions (4.3%). When considering the canton of residence, we see that almost 57% of the banks were based in Zurich, whereas 28.26% were based in Geneva and only 15.22% in the Italian canton, Ticino.

Beside data about the sample, Table 3.1. contains data about the entire population of banks based in one of the three cantons and that are members of the SBA. By analysing their distributions, we can evaluate the extent in which the sample is a good representation of the population and thus, with what degree of confidence we can generalise the results of the sample to the entire population. Regarding the canton of residence, the banks in our sample have a similar distribution to the ones in the whole population (see Panel A). The same holds true with respect to the type of bank, with some minor exceptions (see Panel B). The latter refer to the branches of foreign banks, private bankers[18] and cantonal banks. Regarding the first category, we do not expect major differences in the conduct exhibited with regard to AML compliance, given that foreign bank branches in Switzerland are obliged to follow both their home country's regulation and the Swiss one. As such, we believe that the possible differences/characteristics attributed to this category are captured by the foreign-controlled banks. Secondly, we collect data from all the cantonal banks. Finally, we have only one observation about private bankers, compared to the nine available in the population. Despite these small differences, the distribution of the three categories that represent more than 80% of the total banks in both the population and the sample is quite similar (see categories 3 to 5). Hence, we can safely generalise our results to the entire population.

4.5. Empirical methodology

This chapter is concerned with understanding whether certain characteristics of the CO can determine him to have a conflictual relation with his colleagues working 'at

[18] Private bankers work in the field of asset management; their partners are jointly and severally liable (www.snb.ch)

the front'. Logistic regression has been increasingly used by researchers for studies in social science related fields which aim was to test the presence or absence of a certain event. Since the data we collect is either binary or ordinal, we use a logistic regression to check how the odds[19] of a CO-RM change depending on how strong the CO's beliefs regarding certain matters are. We develop the following logistic model:

$Log\ CO\text{-}RM\ conflict_i = \beta 0 + \beta 1 Contradiction_i + \beta 2 AML\_prevalence_i + \beta 3 Decision\_authority_i + \beta 4 Foreign\_AUM_i + \varepsilon_i$, where:

CO-RM conflict$_i$ is a binary variable representing a positive "yes" (1) or a negative "no" (0) answer to the question "*Did you ever have any conflictual discussion with your colleagues from the sales department (i.e. front desk)?*"

Contradiction is an ordinal variable corresponding to respondents' answers to the question "*To what extent do you consider that there is a contradictory position between the AML compliance and the commercial interests of the bank?*" The possible values are: 2 for "Large Extent", 1 for "Certain Extent", 0 for "Not sure", -1 for "Limited Extent", -2 for "Not at all".

AML_prevalence is an ordinal variable corresponding to respondents' answers to the questions "*To what extent do you consider that the requirements stemming from the AML law should prevail when compared to the commercial interests of your institution?*". The possible values are: 2 for "Large Extent", 1 for "Certain Extent", 0 for "Not sure", -1 for "Limited Extent", -2 for "Not at all".

Decision-authority$_i$ is an ordinal variable corresponding to respondents' answers to the questions "*To what extent you consider that you are given enough authority to make day to day decisions on problems that arouse routinely in the course of applying AML law provisions?*". The possible values are: 2 for "Large Extent", 1 for "Certain Extent", 0 for "Not sure", -1 for "Limited Extent", -2 for "Not at all".

[19] The odds is the ratio of the probability that the event will happen to the probability that the event will not happen (source: Wikipedia)

Foreign_AUM$_i$ is an ordinal variable indicating the proportion of foreign AUM inside their institution : 1 for "0%", 2 for "less than 10%", 3 for "10 to 25%", 4 for "25 to 50%", 5 for "50 to 75%" and 6 for "more than 75%".

The first explanatory variable (*Contradiction*) is meant to measure the CO's perceptions regarding one of the most debated conflicts of interest determined by the application of AML regulations. The compliance requirements limit certain business opportunities presented to the RM and, in times of economic turmoil, this limitation makes it even harder for banks to grow. Under this assumption, we expect that the stronger the acknowledgement of a contradiction between rule observance and profit maximisation the higher the probability of a conflict between the RM and the CO.

From the interviews conducted prior to the survey we learned that a RM finds it more difficult to interact with a CO if he is too conventional when it comes to applying the law provisions. This conservative behaviour was more obvious in the case of those COs with a legal educational background as they lacked the economic knowledge to understand the bank's commercial needs. We introduced the *AML_prevalence* variable to account for the CO's propensity to strictly apply the AML regulation. We expect the variable's coefficient to be positively related to the occurrence of a conflict.

The variable *Decision_authority* measures the extent to which the CO can independently decide upon daily AML-related matters. To ensure an effective implementation of the law, the lawmaker dictated that the compliance unit should be linked to the executive board; this provision was also supposed to limit potential conflicts of interest (see The Basel Committee on Banking Supervision, 2001). As a consequence, we assume that if one has a high degree of decisional authority, there are fewer opportunities for the others to challenge his decisions (i.e. we will observe a negative coefficient).

The last explanatory variable (*Foreign_AUM*) accounts for the percentage of foreign assets relative to the bank's total AUM. The risk-based approach requires the banks to give special attention to those clients/transactions connected to a high risk

jurisdiction/economic activity. As such, we expect more debate between the CO and the RM over the acceptance of foreign funds since it is easier to verify the origin of the local funds.

The limitations of the model together with the potential biases of the model are addressed in a separate section.

4.6. Results

Table 4.1 reports descriptive statistics for all the variables included in this study. Conventionally, for categorical variables the median should be reported but if the categories are ordered the mean can be used as well (Acock, 2008).

Table 4. 1: Summary statistics

Variable	*Obs.*	*Mean*	*Std. Dev.*	*Var.*	*Min*	*Max*	*Median*
CO-RM conflict	46	0.739	0.444	0.197	0	1	1
Contradiction	48	0.375	1.248	1.558	-2	2	1
Foreign_AUM	48	4.958	0.458	2.126	1	6	6
AML_prevalence	47	1.511	0.975	0.951	-2	2	2
Decision_autority	46	1.391	0.856	0.732	-1	2	2

The correlation analysis reported in Table 4.2 shows that all the explanatory variables are positively and significantly correlated with the dependent variable (*CO-RM conflict*), except for *Decision_authority*. The latter variable has a negative correlation coefficient, as expected, but it is not significant. Since foreign assets pose a higher money laundering risk, we see that there is a positive and significant correlation between *AML_prevalence* and *Foreign_AUM* (meaning that when a bank accepts foreign assets, it has thoroughly gone through all the AML checks).

Table 4. 2: Correlation analysis

The table reports the Spearman correlation coefficients for the variables used in the logistic regression. ***, **, * denote the corresponding statistical significance at 1%, 5%, and 10% levels.

	Conflict CO-RM	***AML_ prevalence***	***Contradiction***	***Decision_ authority***	***Foreign_ AUM***
Conflict CO-RM	1				
AML_prevalence	0.2581*	1			
Contradiction	0.3865***	-0.0971	1		
Decision_autority	-0.1631	-0.0616	-0.0171	1	
Foreign_AUM	0.4144***	0.4939 ***	0.0664	-0.0855	1

Table 4.3 reports the logistic regression's results. The univariate models in columns (1) to (4) show that only the odds ratios for *Contradiction* and *Foreign_AUM* are statistically significant[20]: 2.08, p= 0.014 and 2.02, p= 0.016 respectively. As such, they both positively influence the odds of a CO-RM conflict. The odds ratios for *AML_prevalence* and *Decision_authority* are not statistically significant even if they move in the expected direction (1.69, p= 0.116 and 0.59, p= 0.299). The models in column (5) and (6) show that all the odds ratios are statistically sig-nificant and have the expected positive/negative influence on the dependent variable. In model (5), both the perceived Contradiction and the belief in AML_prevalence positively influence the odds of a conflict between the CO and the RM. They remain significant even after controlling for Decision_authority in model (7).

Finally, when including all the variables in model (8), we see that only the odds ratio for Contradiction remains significant (2.26, p= 0.03). This means that if the score for the perceived contradiction AML compliance-profit maximization increases by 1 unit, the odds for a conflictual situation with the RM increase by 126% ((2.26-1)*100). Simply stated, when the implementation of the AML law create dilemmas about the best courses of action, the parties involved in the implementation process will, most probably, find themselves in conflict with each other.

[20] An odds ratio smaller (greater) than 1 will negatively (positively) influence the odds of an event.

Table 4. 3: Logistic regression analysis

The table presents the results of the logistic regression having as a dependent variable the CO-RM conflict. All the explanatory variables were described in the Empirical Methodology section. For all the variables we report **Odds Ratios,** (Coefficients) and (Standard Errors). ***, **, * denote the corresponding statistical significance at 1%, 5%, and 10% levels. Model specifications are (1) to (8)

	(1)	*(2)*	*(3)*	*(4)*	*(5)*	*(6)*	*(7)*	*(8)*
Constant	**2.55 ***** (0.937) (0.36)	**1.27** (0.236) (0.58)	**6.46** (1.866) (0.89)	**0.17** (-1.785) (1.22)	**0.78** (-0.254) (0.72)	**-2.329** (0.1) (1.45)	**1.40** (0.338) (1.06)	**0.18** (-1.708) (1.71)
Contradiction	**2.08 ***** (0.736) (0.3)				**2.48***** (0.906) (0.34)	**2.24**** (0.804) (0.37)	**2.24**** (0.808) (0.34)	**2.26**** (0.377) (0.38)
AML_ prevalence		**1.69** (0.523) (0.33)			**2.14*** (0.76) (0.41)		**2.09 *** (0.738) (0.42)	**1.42** (0.351) (0.48)
Decision_ authority			**0.59** (-0.535) (0.51)				**0.71** (-0.345) (0.48)	**0.75** (-0.292) (0.49)
Foreign_ AUM				**1.83***** (0.603) (0.25)		**2.02**** (0.704) (0.30)		**1.7** (0.530) (0.34)
No. obs.	46	44	43	43	44	43	42	40
No. EPV	12	12	11	11	6	5.5	3.7	2.75
Chi2 (logit)	6.9 ***	2.64	0.25	6.78 ***	11.47 ***	12.41 ***	10.74 ***	12.90 ***
Cox-Snell R^2	0.139	0.058	0.030	0.146	0.229	0.251	0.226	0.276
NagelKerkeR^2	0.204	0.084	0.044	0.215	0.332	0.369	0.330	0.399
Hosmer –Lemeshow Chi2 (p-value)					5.93(0.31)	3.28(0.77)	4.11(0.85)	2.07(0.98)

As Verhage (2011) noted, the CO can find himself trapped between "the hammer and anvil": he has to choose between destroying potential business opportunities and rigidly applying the AML regulations. According to Rizzo *et al.* (1970), role conflict (*i.e.* incompatibility in the role's requirements) may result in intra-person conflict when the individual needs to manage his own values, resources and capabilities to answer all the demands of the role, but it can also lead to conflicts with other people inside the organisation, as they all have different expectations from him.

The odds ratio for *AML_prevalence* is positive but not significant (1.42, p= 0.465). Prior to the survey, the RMs we interviewed said they were very often annoyed by the CO's propensity to strictly apply the law, without showing the minimum interest for the commercial priorities of the bank. "if my client buys a property, the compliance officer will call me and ask for the documents justifying the transaction. He gives me three days of time, even though he knows very well how long is the bureaucratic process until a document is produced in Italy. And still, he insists 'no document, no payment'" [RM1]. Post-survey however, the COs explained us that even if their job is to safeguard the bank from reputational and legal risks, they are aware of the fact that the bank needs to grow in order for their salaries to be paid. As such, they claim to be helping the RMs, even if they regrettably admit that "it is very difficult that a true friendship will develop between a CO and a RM" [CO2].

Moving further, we see that the odds ratio for *Decision_authority* is negatively related to the CO-RM conflict, though not statistically significant (0.75, p= 0.554). The evidence about the causal link between decisional power and organisational conflict is mixed. Corwin (1969) found that the authority to make routine decisions provides more occasions for disputes to arise. On the other hand, the opportunity to participate in the decision-making process gives occasions for expressing minor forms of conflict and might prevent minor irritations from developing into major incidents.

Finally, the odds ratio for *Foreign_AUM* is no longer statistically significant after controlling for *AML_prevalence* and *Decision_authority*. Nevertheless, the fact that the odds ratio is positive suggests that the additional checks that need to be done in the case of foreign funds could increase the probability of a conflict between the back and the front departments. This is particularly relevant for Switzerland, where more than 70% of the assets managed by Swiss banks belong to non-Swiss clients.

Researchers have been often warned that the use of logistic regression can be problematic when the outcome has few events available relative to the number of independent variables included in the model. In such cases, the estimated odds ratios can be biased and the validity of statistical inference may be adversely affected (*i.e.* the final model may be over fitted , see Peduzzi *et al.*, 1996). Because of these problems,

several authors have drawn guidelines for the minimum events per variable (EPV) required in multivariate analysis. Using a theoretical approach, Harrell *et al.* (1985) suggested that 10 to 20 EPV were necessary. Simulation procedures based on real data employed by Peduzzi *et al.* (1996) and Vittinghoff *et al.* (2006) concluded that 5-10 EPV and 5 EPV respectively, were enough. In our case, the number of EPV is below 5 only in two cases (3.7 and 2.75, see Table 4.3). Nevertheless, we see that the values taken by our main variable of interest (*i.e. Contradiction*) in these cases doesn't register significant variations that could be attributed.

In general, the interpretation of the pseudo R-squared is not recommended in the case of logistic regressions. Researchers however, often report the Cox-Snell and the Nagelkerke R-squared as alternatives to the usual (adjusted) R-squared in OLS regressions. When considered individually, only the variables *Contradiction* and *Foreign_AUM* are able to explain a significant portion of the variability in the CO-RM conflict (between 14% and 21%, see Table 4.3, columns (1) to (4)). In fact, the chi-square statistic is significant only in these two cases (6.9 and 6.78 respectively). When taken together, the variables are able to explain between 27.6% and 39.9% of this variability. Finally, the logistic regression model in column (8) has a chi-square of 12.90 and is significant at 1 percent; this indicates that the combined effect of the explanatory variables is significant and jointly explains the occurrence of a CO-RM conflict.

As an alternative to the chi-square test, I also report the Hosmer and Lemeshow test to check whether the scores predicted by the model significantly differ from the observed scores; since the result is not significant (H-S X^2=2.08, p=0.98), we can conclude that *Contradiction*, *Decision_authority*, *AML_prevalence* and *Foreign_AUM* reliably distinguished between no CO-RM conflict and CO-RM conflict.

Finally, when considering the different models reported in Table 4.1 one can notice that the number of observations varies. This is because the statistical software uses a list wise deletion by default, meaning that if there is a missing value for any variable in the logistic regression, the whole case will be excluded from the analysis.

4.7. Limitations

The analysis presented in this chapter focuses on the potential conflict between the CO and the RM and it is the first one to empirically assess the origins of this conflict. In particular, I consider the rule observance vs. profit maximization contradiction inherent to AML regulations to be the main source of conflict between the CO-RM.

Nevertheless, this conflict could be determined by other factors than the intrinsic organisational role of these two actors - *e.g.* personality, educational background, culture, age, sex, tenure, professional experience, etc. Moreover, certain organisational characteristics can also influence the occurrence of this conflict. According to Osborn and Hunt (1974) the environmental conditions can influence the effectiveness of the different types of organisational structures. For example, bigger banks put more pressure on the achievement of new clients and this can exacerbate the CO-RM conflict, when the CO impedes the development of certain business opportunities and hence prevents the RM from reaching his assigned targets (and the associated bonus). Factors such as the type of clients served, the types of products offered, the degree of differentiation and/or specialization and the organisational culture, will also determine the occurrence of a conflict.

Unfortunately, the use of a questionnaire as a mean for data collection makes it very difficult to obtain information about all the factors listed above. In addition, one must bear in mind that surveys measure beliefs, feelings and perceptions, which can be different from the behaviour in the real life. As such, the COs' answers can be biased, considering the delicate nature of the money laundering subject and the potential reputational damages connected to certain answers.

Finally, it would be interesting to understand whether the CO-RM conflict exists during the normal business relationship with the client or whether it is the reporting duty and the ensuing investigations that triggers its appearance. Furthermore, by observing the frequency or severity of this conflict, one could understand which compliance duties are more likely to influence the emergence of the conflict. Even if the lack

of information regarding all the above elements could jeopardize the study of the CO-RM conflict, the aim of this work was to understand whether the specific nature of the AMLA's requirements have any explanatory power on the CO-RM conflict. The results presented in the previous section showed that this was actually the case.

4.8. Concluding remarks

This chapter developed around the assumption that the supervising and reporting duties stemming from the AML legislation can create a conflict between the CO and the RM. By employing a logistic regression methodology, we conclude that the acknowledgement of a contradiction the AML requirements and the usual profit-boosting objectives of the bank increases the odds of a conflictual discussion between the CO and the RM. However, the CO's propensity to strictly implement the law, the decision authority that is attributed to him and the amount of foreign AUM have no explanatory power since their coefficients are not significant.

Overall, this evidence supports the recent findings of the E&Y (2012) "Banking risk management" survey which showed that one of the biggest challenges around banking culture is resolving potential conflicts between the sales driven front office culture and the risk control culture.

The existence of this conflict has important implications not only for the financial institutions but also for the regulators. First of all, since the inception of the AML regulations, authors have pointed out that "compliance is a cost centre, not a profit centre" (Gallo and Juckes, 2005). Besides the investment in software and personnel training, one has also to consider the cost of foregone business opportunities. The CO-RM conflict, as any other organisational conflict, can generate additional costs for the financial institution due to: delay in decisions, distortion and suppression of information, and disruptions of the chain of command (Rizzo, House and Lirtzman, 1970).

In fact, Jehn (1997) found that the negative emotionality associated with organisational conflicts leads to poor group performance and low member satisfaction.

Secondly, as Braithwaite *et al.* (2007) point out, if the regulations are to be effective, they should be accepted and considered as needed by the regulated community. This means that if the public and business interests are not sufficiently aligned, compliance is difficult or even impossible to achieve (Gunningham and Rees, 1997). These two recommendations hold true also about the AML laws. The fact that the banks in our sample recognised an ongoing contradiction between AML rule observance and the bank's profit maximisation function should push the regulators to evaluate the grounds upon which they expect to observe a compliant behaviour from the financial institutions. This means understanding the extent to which the requirements are going against the bank's functional purpose and resources. Moreover, a further tightening of the law should consider the efforts and the difficulties incurred by the financial institutions to accommodate them. Finally, the lawmakers should also reconsider the incentives given to financial institutions for compliance. The existent literature on AML compliance has persistently underlined that the main reason for which banks involve in the fight against money laundering is the reputational risk caused by non-compliance (Masciandaro *et al.* (2001), Harvey (2004), Verhage (2011)). As such, the lawmaker should emphasise the adverse impact that the involvement in money laundering has for the banks' reputation.

5. Compliance duties and bankers at work: Coping with tensions

5.1. Introduction: Standing up to the AML compliance challenge

Looking back over more than twenty years of anti-money laundering regulations, one can easily notice the important changes undergone within the banking environment, both at an organisational and operational level. As far as the organisational aspect is concerned, banks have organised dedicated compliance departments by hiring specialists that could spot suspicious cases of money laundering, draw up and implement internal AML directives and train employees. Moreover, the approval process of the new clients has become much more structured, such that the management gets often involved into the decision of on-boarding risky clients.

On the other hand, banks have continuously faced significant operational limitations due to AML procedures. First of all, banks must pay particular attention to the sanctions in place regarding the provision of financial services to clients residing in certain countries (consider for example the various sanctions lists – OFAC, UN, UK, etc.) as well as collaborating with financial institutions from countries not having a satisfying AML framework in place. Secondly, protecting the bank from possible reputational and regulatory risks means turning down profitable business opportunities, especially when the boundary between black and white is blurred. Thirdly, the significant financial and human resources that have to be continuously invested into the internal AML compliance machine as well as the red tape often created by the due diligence procedures, divert the bank's profit from other growing opportunities.

Despite the costs it entails, there are several acknowledged benefits to compliance: avoiding the criminal's access to the banking system and hence the perpetration of crime, safeguarding the bank's reputation, lowering regulatory risks, collecting additional information about the client could prove useful for marketing purposes.

This chapter aims at evaluating how the Swiss banking system has adapted to an AML compliant culture, which were the obstacles to overcome and where does it stand today. As a continuation of the previous chapter, which focused on the compliance officers, we are now interested in the relationship managers' part of the story. As such, we investigate which were relationship managers' initial reactions toward the requirements of doing a sort of financial 'striptease' of the client, if these initial problems have been overcome in time and which are the aspects that are still obstructing an efficient collaboration between the relationship manager (RM) and the compliance officer (CO). As it was the case in the previous chapter, we wondered whether the different objectives and 'forma mentis' these two actors have, can give birth to interpersonal conflicts. Last but not least, we tried to identify some communicational and operational strategies that could make their collaboration easier.

After this introduction, the chapter is organised as follows: section two will briefly discuss the relevant findings in the AML literature regarding the challenges faced by banks when coping with AML requirements; section three is dedicated to the particularities of the Swiss AML apparatus and more precisely the financial intermediaries' due diligence duties; the research questions are formulated in section four; section five describes the data collection process; sections six to eight go through the results collected from our interviews regarding the relationship managers' first reactions to the imposed AML duties, how they have integrated such duties into their daily working routine over the time, what are the perceived benefits of AML compliance and which are the problems that obstruct the collaboration between the RM and his colleagues from the compliance department; section nine concludes with several remarks regarding the future of AML compliance as dictated by actual and future regulatory changes as well as possible strategies meant to facilitate the collaboration between the relationship manager and the compliance officer.

5.2. The switch to an AML compliant culture

Prior to the events of 9/11, the research interest in the AML field was rather limited and the majority of publications were made by criminologists and jurists (e.g. Levi, 1992; van Duyne, 1998) or international organisations (e.g. UNODC, 1998; IMF, 2001).

The terroristic attacks of 2001 and the subsequent update of many national AML laws gave birth to a new stream of literature analysing these regulatory updates in the country-specific context: examples can be found for US (Johnson, 2002; Preston, 2002), Canada (Murphy, 2003), Germany (Blöcker, 2003), France (Bardin, 2002), South Africa (de Koker, 2002), China (Ping, 2003) and Mexico (Vargas *et al.*, 2003).

Recent publications in the field focus on the economic impact and the practical issues associated with the implementation of the AML regulations. The constraints that governments face in terms of resources and access to financial information wouldn't have allowed them to efficiently counteract money laundering. They have thus transferred the monitoring tasks to the financial sector, to the extent that nowadays "the entire intelligence gathering and target acquisition process is in the hands of the private sector" (Gallo *et al.*, 2005:329). This shift of responsibility meant forcing the financial intermediaries to do what the public sector was previously required to: monitoring risk, assessing terrorist threats, defining the risk profiles of the politically exposed persons, dig into the clients' private affairs, etc. (Pieth *et al.*, 2003, Levi and Maguire, 2004).

The transition of powers from the public to the private sector was not as smooth as expected. First of all, for the banks, it entailed considerable investments in the acquisition of software and specific know-how. All the surveillance procedures meant acquiring global watch lists (used especially in the KYC (know-your-customer) procedures) and electronic profiling tools together with the installation of software that could monitor financial transactions continuously (Levi and Wall, 2004; Shields, 2005).

Specific AML training has also been provided to all employees. In numbers, compliance costs connected with the prevention of money laundering could vary from 8.374 CHF per capita for small banks to 5.059 CHF per capita for large banks (according to a study focusing on Swiss wealth management industry carried out in 2003, see Bührer *et al.*, 2005).

Secondly, banks' expertise and resources are aimed at the design and promotion of financial services, which is completely different from undertaking criminal prosecution (Geiger and Wüensch, 2007). To cover this gap, banks have hired compliance professionals that were supposed to have the required expertise for identifying potential money laundering cases.

Thirdly, the duty to observe the AML requirements had an important impact on the commercial activities of the bank. Canhoto (2008) argues that AML/CTF compromised the fiduciary duty of financial institutions to their clients, whereas Sinha (2014) claims that banks justify their moral blindness on the fact that critical inquisition of potential customers – legitimate or illegitimate – will simply turn them towards rival banks. Hence, on the one hand, banks can no longer accept certain types of clients, no matter how profitable they are; on the other hand, the questions asked for AML purposes can violate the client's privacy and deteriorate the trustworthy relationship between him and his RM, thereby pushing the client to leave the bank.

Another important challenge experienced by banks when incorporating AML tasks into their working routine is the management of possible conflicts between the RM and the compliance officer. Since they belong to different departments, their preassigned tasks and goals can sometimes be conflicting. As a matter of fact, there have been several cases in which the compliance officer's duty of safeguarding the bank's reputation can prevent the relationship manager from reaching his annual profit targets. Edwards and Wolfe (2004) underline the thick line between what may be deemed to be just acceptable by the compliance function and what may be just unacceptable. According to the authors, when an activity is on the cusp of being compliant RMs will be faced with conflicts of interest between maximising their bonus and dutifully drawing the attention of the compliance officers.

Despite its importance for the bank's performance, there are very few empirical studies regarding the CO-RM conflicts. Still, there is one point upon which various authors seem to agree: the little popularity enjoyed by the CO, considered as "bearer of the poisoned chalice" (Harvey, 2004), "business prevention officer" (Verhage, 2011), "petty sovereign" (Favarel-Garrigues, 2008). As far as the CO's relationship with the RM is concerned, Canhoto *et al.* (2013) noticed that "they are not easy bed-fellows", whereas a study by Ernst&Young (2012) noticed that one of biggest challenge around banking culture is solving the potential conflicts between the two actors, especially since many banks still have inadequate safeguards in place to mitigate RM's conflict of interest (FSA, 2011).

5.3. Research questions and methodology

Building upon the existing findings about the controversies encountered during the implementation of AML compliance in the banking sector, this chapter aims to provide empirical evidence about the integration of these duties in the RM's daily working routine. More precisely, we are interested in understanding whether and to what extent the RMs managed to deal with the new AML tasks in the beginning and whether after almost three decades since the AMLA's introduction, they have accepted the compliance duties as part of their job and duly cooperate with the compliance departments requests.

Considering the significant different ways of doing business in the Swiss banking sector before 1998, we would expect a great opposition toward the new legislation at the time it was introduced. Hence, our first research question (**RQ1**) sets out to document the initial reactions to the requirement of integrating compliance tasks into the business culture.

As time unfolded and international pressures for tougher regulation grew, the employees should by now have started to exhibit greater acceptability of the AML

regulation and hence of the compliance officer. Hence, our second research question **(RQ2)**: As of today, to what extent have the business oriented employees (such as the relationship managers) accepted the compliance duties as part of their job?

If the RM exhibits a certain reluctance toward these duties, which are the underlying causes of this reluctance and can it trigger a conflict between the two units **(RQ3)**?

Finally, if the above mentioned conflict exists, which are the best solutions/attitudes to be adopted in order to mitigate it **(RQ4)**?

The lack of private data in the AML field, has pushed many researchers to resort to the use of surveys and or interviews. For example, Webb (2004) interviewed thirty money laundering reporting officers in order to study their attitudes toward money laundering regulations. Favarel-Garrigues *et al.* (2008, 2011), Harvey and Lau (2009) and Verhage (2011) interviewed several AML actors among which compliance officers, bankers, law makers and law enforcement officials in order to have a complete picture about their duties, difficulties and the communication flows that were established among them. Masciandaro *et al.* (2001) used an indirect survey technique by asking bank managers how the clients reacted to the various requests made by the bank in order to fulfil its compliance obligations.

Since this study aimed at understanding the RM's difficulties in accepting and incorporating AML due diligence duties in his daily work, we collected data from 25 RMs working in the cantons of Ticino, Zurich and Geneva – Switzerland's main financial centers-.

Bearing in mind a precise framework of themes to be explored, the interviews were organised as a free-flowing discussion with the interviewee around the relevant themes. In the case of our research, the use of semi-structured interviews brought us three advantages. First, it allowed new ideas to be brought up during the interview as a result of the interviewee's answers. Secondly, instead of asking direct, open ended questions to which the RMs could prove reluctant to answer, having a free discussion around a certain theme was more comfortable for our interviewees. In fact, the RMs' reactions, fears and constraints observed while doing the first interviews helped us to

better refine our interview scheme. Thirdly, a 'free' narration of one's personal experiences allowed for real stories and concrete examples to emerge.

The interview guide was divided in 7 different parts. We always tried to ask identical questions, even though the same sequence was not, in most of the cases, respected. The first three parts were meant to set "the scene" and create a common ground between the interviewer and the interviewee.

In the first part we asked general questions regarding the background, the years of experience and the type of clients managed by the RM.

The second part asked the respondent details about the way in which he was introduced to the AMLA and what was his initial opinion about the due diligence and reporting duties.

The third part tried to assess the impact that the observance of all the AML compliance duties has on the usual tasks of a RM: what percentage of his working time is dedicated to compliance issues and how this affects the quality of the service offered to the client.

The fourth part explored the relationship between the RM and the compliance department, focusing on the pros and contras of the role that this department has.

The fifth part aimed to understand which arguments were brought forward by the RM when requiring additional information from the client for due diligence purposes. Additionally, we wanted to know whether the RM perceives an on-going conflict between the compliance duties and the request to preserve the trust established between him and the client and which are the measures to be taken in order to avoid tensioned situations.

The sixth part was dedicated to the reactions, attitudes and measures taken in case doubts/suspicions of money laundering arise.

The last part of the interview was conclusive and collected opinions about the future of the Swiss banking sector as a consequence of stiffer regulation.

Before scheduling the interviews, we informed every participant about the purpose and procedures of the research and about the modality of the interview. Additionally, we emphasised the voluntary nature of their participation and the measures

taken to guarantee anonymity. Since not all the participants agreed only 11 interviews were recorded as mp3 files. In most of the cases, the interviews were carried on at the interviewee place of work. The interviews lasted between 45 and 90 minutes. Interviews were conducted in Italian in Ticino and in English in Geneva and Zurich.

In order to trace additional participants or informants, we used the snowball method. The latter consists in asking the participants to recommend other people that could be interviewed (Babbie, 1995). The people through whom access is gained are called gatekeepers (Groenewald, 2004).

5.4. Findings

5.4.1. Introducing AML: A historic background and first reactions

While a historical analysis of the Swiss banking system is out of the scope here, several elements must be mentioned in order to better understand the existing social and economic circumstances at the time when AMLA was introduced.

Switzerland's armed neutrality and national sovereignty were the main elements attracting foreign capitals into the country during the eighteen century. However, it was during the following two centuries that the Swiss banking system registered an unprecedented growth, owed mainly to the stable political climate and to the formal codification of the Swiss banking secrecy in 1934.[21]

After WWII, the unsettled political situation that reigned in Europe further pushed investors to transfer their savings into Switzerland. As Dick Martin[22] emphasized during a recent interview[23], the exponential growth verified during the years 1960s to 1990s by the Swiss banking system gave birth to a 'social phenomenon': due

[21] Federal Act on Banks and Savings Banks (Swiss Banking Act of 1934)
[22] Member of the Swiss Council of States (since 1995) and former member of the Parliamentary Assembly of the Council of Europe.
[23] Falò, RSI, the 3rd of September 2015

to the lack of personnel many banks started to 'steal' qualified workforce from other sectors such that they could accommodate the management of all the new clients. At the same time, the success and wealth exhibited by the banking employees encouraged younger generations to pursue predominantly banking careers.

As the international attention to money laundering and organised crime started to unfold in the US in the early 1980s, Switzerland was among the first countries to introduce an AML framework. However, due to the mentioned historical outset and the Swiss culture of privacy, the introduction of the AML law in 1998 created major problems for the RMs that were now required to follow precise KYC procedures.

In order to introduce their employees to the topic, banks started to organize AML trainings during which the new duties and the risks connected with the inobservance of the law were discussed: "We had seminars on the topic; we were all sitting in a meeting room, with an external specialist explaining all the changes, the cases to which we had to pay special attention; we were doing role-plays on certain types of clients" [RM 16]. At the end of the seminars, the employees "were given a test to control that we understood which were our duties and the responsibilities in case something went wrong" [RM 20].

The first argument raised by the RMs against the AML law was that it required them to carry out a task that belonged to another entity, i.e. the authorities: "The main problem was that we were assigned a task which was definitely not ours: to play the role of the policemen and gather intelligence information" [RM9]. Another RM showed his frustration regarding the matter: "For me it was obvious that certain tasks were to be handled by the public prosecutor. Then, these investigative tasks have been assigned to the financial system" [RM21].

A second problem was the huge responsibility that the AML law placed on the RMs' shoulders as they were asked to run a first screening of the new clients and attentively monitor the transactions of the existing ones: "I was very critical toward this law because I saw it as an obstacle for the business. Moreover, it was a sensitive issue for the banker as he was responsible for identifying what was unusual. Since we had a

lot of payments to verify, we had to learn how to identify unusual cases by really understanding the profile of the client's business" [RM 14].

The great majority of our respondents perceived this burden to be unfair since they did not have enough sensibility toward the matter, specifically underlying the fact that "we are bankers, not policemen" [RM20]. As a matter of fact, existing studies such as Favarel-Garrigues *et al.* (2008) already underlined that financial professions were not meant to identify and manage suspicious transactions. Moreover, in a country where banking secrecy and the respect for privacy reigned, the requirement to dig deeper into the client's personal affairs created a certain confusion among the RMs: "My ex-boss, who has been working as a RM for the last 40 years thought it was unimaginable to start asking the client how much he earns, whether he is married and has children, whether he and his wife had agreed on the separation of assets" [RM3]. As our respondents have indicated, prior to AMLA, the bank had no interest and legal obligation to collect information that was not connected with the account's purpose and expected transactions.

In order to quantify the magnitude of the changes brought up by the new law it is enough to consider the rudimentary due diligence checks that were typically made by the banks prior to its introduction: "The biggest effort that I had to put 40 years ago when I started working was controlling that the name of the account holder corresponded to that on the ID of the person I had in front of me. The bank knew in very broad terms what the client was doing for a living. Many clients said they were "businessman". But we would never investigate what kind of business they were in. Maybe the RM would have some additional details, but they weren't written anywhere" [RM4]. As our results show, the practice of not interfering with the client's private sphere seemed to be common across Switzerland at that time, as another RM indicated: "There were fewer questions. The client would bring his suitcase packed with bills, we would ask for an ID and his occupation. Very often, the client would say, in very broad terms, that he is an entrepreneur. But nobody would ask him in which industry, since when and all the other information" [RM20].

Beside the responsibility of identifying suspect cases, the AML law imposed another heavy responsibility on the RM: the legal responsibility for facilitating money laundering. Prior to AMLA, banks were given only the right to report suspicious money laundering cases (according to Art. 305ter introduced by the Swiss lawmaker in the Penal Code in 1994). However, it was the AML law that forced Switzerland to align to the international standards by introducing the obligation to report any actual or potential case of money laundering. As they managed the clients' interaction with the bank, relationship managers were now required to collect all the necessary information such that the bank fulfilled the newly introduced due-diligence requirements. Failure to do so exposed the bank to a significant legal and reputational risk, which ultimately spilled over the RM himself. In fact, almost half of our respondents considered themselves to be the "scapegoat" if something went wrong: "We are the first ones to be interrogated and fined if something happens" [RM5].

Even though they understood that there was no room for errors "If the judge calls you up, you cannot tell him 'sorry I didn't know'" [RM3], the respondents could not refrain from mentioning their frustration regarding the bank's behaviour in such cases: "We were asked to pay attention to any money laundering attempt, as we will be responsible if the client manages to use the bank to launder his dirty money" [RM 19]. As a matter of fact, several respondents in our sample said that the bank would "abandon" them: "If I commit an error when evaluating an operation/account opening procedure I will be the one to meet the public prosecutor" [RM4].

Another problem exacerbating the acceptance of the new AML law was the opposition that the clients were making toward the RM's requests. This was especially the case with existing clients for whom it was difficult to understand why the bank has suddenly started to ask them so many questions: "Discretion and privacy are at the heart of private banking services. At the beginning, the clients were very reluctant toward our requests" [RM14]. Many RMs recall that besides the specific AML training, they did not receive any guidelines on how the new modus operandi was to be communicated to the client. As a consequence, they leveraged on their experience and on their argumentative capacities in order to make the conversation as less embarrassing

as possible: "At the beginning, we used to apologise in front of the client, blaming the law for the questions we were asking" [RM26].

However, as our respondents indicated, it was not always easy to obtain the needed information by simply putting forward the argument of the new requirements imposed by the AML law. Beside the challenge of educating the clients, the RMs were confronted with another challenge: convincing those clients whose privacy was being "invaded" not to leave the bank: "the educational process toward the clients has been difficult and painful and we lost several clients due to these legislative changes" [RM13].

Hence, the introduction of the AML law not only placed a lot more professional and legal responsibility on the RMs' shoulders, but it also made it harder for them to reach their annual client acquisition and retention targets thus increasing their risk of losing their job.

5.4.2. AML compliant culture: where we stand today

As the fight on money laundering became tougher, a whole compliance industry started to develop, providing the financial industry with several intelligence tools meant to facilitate their decision making process (Verhage, 2011): criminal databases, company information registers, negative news matching software, unusual transactions monitoring programs. Besides these IT investments, banks also deployed significant resources to create dedicated AML compliance departments meant to oversee the implementation of the KYC and CDD procedures. This section sets out to document how these procedures have been introduced in the banking culture and how the RMs feel about having to deal with them on a daily basis.

A first assessment of the respondents' answers indicates that despite the initial reluctance toward the AML duties, they have quickly understood that the way of doing

business was set to change. Such change was dictated not only by the growing international pressures upon Switzerland's banking secrecy as a consequence of both 9/11 events and the 2009 economic turmoil but also by the significant developments of the cyberspace that made banks more vulnerable to fraud attempts. In fact, over the last years the regularisation of the banking sector has developed to such extent that a medium-size bank would be expected to have a compliance department for any service it offers: current accounts, credits, investment products, trading, etc.

One important finding is that these regulatory developments have inevitably pushed for a greater collaboration between the sales/front office employees and the compliance department: "The commercial department has been continuously increasing its sensibility toward the compliance issues. If in the past, these two were running in an almost parallel manner with small occasional intersections, today we work in tandem. Our collaboration is very tight during the account opening procedures but also during the life of the account" [RM1]. As further investigation will show, this collaboration between the RM and the CO has become fruitful for three reasons.

First, more than 50% of the respondents indicated that the presence of a dedicated department that independently evaluates and supervises the client's transactions makes them feel more secure. More precisely, since the RM might disregard some important points during the meeting with the client, the 'four eyes' principle entails lower operational errors: "It's true that all the compliance requests may stress the client, but I feel safer knowing there is somebody else controlling the account opening requests. Sometimes, the compliance officer sees and understands things that I missed" [RM9]. By evaluating the account opening profile, the CO can make sure that the bank has collected the KYC information requested by the law, while controlling if the client is involved in any criminal investigation or judicial proceeding. Moreover, since he sees the picture from a detached perspective: he is able to issue a bias-free judgement regarding the possibility of proceeding with the account opening "Today we see him as a support to the business, whereas 5-7 years [ago] we considered him a kind of scarecrow for the clients. He is our partner, who makes sure that my reasoning is valid" [RM26].

A second reason for which the CO could facilitate the RM's work is because of the greater objectivity with which the former can evaluate a case. When meeting a client for the first time, the RM might tend to focus his attention on the financial aspects of the business while leaving aside details such as the client's personal background and economic history that can prove useful in understanding how he has accumulated his wealth. Since the CO is not paid for bringing new clients to the bank, he is not in danger of getting "enchanted" by the client's financial potential; rather, he is expected to duly verify if the client could have rightfully acquired the wealth he possess given his age, occupation, family background/connections. The same logic applies to existing clients: since the CO is not "emotionally involved" with the client, he can evaluate the client's behaviour in an objective way, which makes it more easy for him to spot unusual transactions: "We might tend to underestimate some risks if we have been managing an account for the last 30 years and nothing strange happened. I will always remember what my teacher at the driving school told me: 'if I am driving on a street for the first time I will notice each sign on the road, but if that is the street I'm driving to get home, at a certain point I will know all the signs by heart and so, I will not pay attention to them anymore. Let's imagine that a certain point a sign is changed: who is more likely to have an accident? The first or the second person?' The same logic goes for RM with old and new clients. You are more careful and maybe also more suspicious when it comes to new clients" [RM3].

Thirdly, about 30% of our sample considered that the obligation to construct a detailed KYC profile allowed them to better understand the client's needs. Not only the RMs considered this information useful for marketing purposes but also as an indicator of how to better focus their energy on those "healthy business opportunities in which the clients' situation is clear" [RM6].

As far as the integration of the compliance duties in the RM's everyday work is concerned, our data suggest that the increasing client awareness regarding the banks' AML obligations has significantly facilitated the process. Both those RMs that worked before AMLA's introduction and the younger ones indicated a good level of client awareness when it comes to current AML practices. This trend is due not only to the

international attention that the fight against money laundering has increasingly gained over the years, but also to the proportions taken by the war on terror since the events of 9/11. Moreover, in order to be able to protect their clients from cyber and identity fraud, banks were forced to collect more detailed information about their counterparties. An early survey by Masciandaro *et al.* (2001) reports that banks' customers are well aware of the existence of AML laws, even if 44.5% of the respondents thought that most clients regard the information collection as a violation of their confidentiality.

As mentioned in the previous section, at the time of AMLA's introduction, the clients' opposition toward the RM's due diligence requests was a significant barrier to overcome when trying to reconcile compliance and commercial objectives. Whereas in the beginning the common strategy adopted by the RM for getting along with the clients was blaming the law itself, in recent times we notice different arguments that are put forward when requesting additional information from the client. In most of the cases the RMs would tell reluctant clients that the bank's AML policy is meant, first of all, to protect the clients themselves: "The great majority of our clients are businessmen, so I expect them to understand my need for cooperation. If they refuse to give me details, I usually ask them 'would you be placing an order with a supplier that doesn't give you all the information you require?' It's important for the client to understand that these questions are more important for him than they are for us: for sure he would not like to read a headline about his bank failed to duly apply the AML directive" [RM24]; secondly, the information collected for CDD purposes enables the bank to better meet the client's needs: "one must not stand in front of the client with a survey and after each question tick the box . . . I find this very uncomfortable and intrusive. Instead you should exhibit interest in the client's story, what were the successful factors that allowed him to build his wealth, etc. It's a mix of communication and psychology; one has to make the client understand that we need those information in order to build a long-term, trustworthy relation and offer him the services that better suit his needs" [RM6].

Another important factor facilitating the adoption of a compliant culture by the RM was the responsibility that the latter was assigned when knowing and understanding the client to such an extent that he should be able to spot any unusual behaviour. More than 60% of our respondents claimed that the probability of being held liable for unknowingly facilitating money laundering is an important deterrent when accepting clients whose intended business purpose is not clear; moreover, bearing this responsibility in mind, they also find it easier to collect the additional information requested by the compliance department "I am always straightforward with my clients. I know I have to obey the rules and if there is something that is not clear I have no problem in contacting the client and asking for clarifications. It's true that we have a relationship based on trust, but is still a working relationship…and the client pays me to do my job" [RM4].

The results presented above reveal how the bank and hence the RM have significantly changed the way in which they perceive and interact with their clients in nowadays. Differently from the past 2-3 decades when banks would eagerly pursue profits at any costs, the AML responsibility has pushed them to see the client not only as an opportunity but also as a liability. The various frauds against banks, suffered as a consequence of poor due-diligence procedures together with the many judicial cases in which the client has blamed the bank in front of the authorities for aiding him in committing (fiscal) crime, has definitely showed the banks that compliance has its advantages. A testimony from one respondent summarize the current way in which the RM perceives the client: "I would say that 30 years ago there was kind of a romantic relationship between the RM and the client, with each of them following his personal interest while making everything that was needed for their relationship to work. Today, this kind of romanticism diminished since the RM has understood that he can be used by the client. In the case of an investigation, very often the client blames the RM for the crime he committed. This is mostly the case for fiscal crimes; over the years, we slowly started to think about our clients as a liability" [RM23]. In fact, many respondents stress the fact that even if in the private banking industry the personal contact between the RM and the client is much more intense than in the retail banking, it's

better to avoid friendships with the clients: "We should never see the client as a friend. Actually, your friends and relatives should never be your clients, as the money involved may ruin your relation. You go playing tennis with your clients, have lunch, discuss the news but still he is only a client, not a friend. To my opinion, a tiny bit of suspicion should always exist regarding a client" [RM21].

This section has underlined the encouraging progress that have been made regarding the switch to a compliant banking culture, totally different than the one that reigned in Switzerland before AMLA's introduction. As the next section will show, there are still certain jolts that prevent a smooth collaboration between the CO and the RM. Still, we can safely conclude that as previous field studies in the AML compliance sector have shown, the AML compliance procedures have become routinely embedded into the work of financial institutions (Canhoto *et al.*, 2013) and most bankers perceive them as part of everyday work (Subbotina, 2009).

5.4.3. Relationship managers' reluctance toward compliance duties: causes and effects

One of the major drawbacks of compliance that has been repeatedly mentioned in the AML compliance literature is the administrative burden associated with its implementation. More precisely, beside the costly investments in designated software and personnel training, AML rule observance also requires a considerable amount of time for collecting the required information, filling in the clients' profile forms and verifying the credibility of the provided information. A decade ago, a study by Gully-Hart (2005) reported that a private banker devoted approximately 30% of his time to all the regulatory matters. Nowadays, our respondents testify that such a percentage corresponds to the average time dedicated only to AML compliance matters. They nevertheless distinguish between the account opening phase and the ongoing monitoring of the account, as the first one requires significantly more time (i.e. ranging from 40% to

60%). Another important difference that needs to be mentioned is between the RMs managing resident clients and the ones managing foreign clients, with the latter indicating a higher time that needs to be devoted to AML practices (*i.e.* 50% as compared to 25-30%).

Even though they value the safety associated with the requirement of ascertaining the clients' origin of funds, RMs underline that the time needed for compliance matters grows at the expense of the one available for clients' needs: "The compliance requests are complicating the daily business because they are forcing me to dedicate time to certain activities which do not produce real business" [RM1]. This "diversion of resources from other aspects of the bank's work" (Johnston, 2006) creates frustration among the RMs as they have less time for doing what they are originally supposed to. In fact, both the old and the young RMs in our sample indicated that the financial advisory discussions are rather limited when meeting with the client and that the recent economic, political and regulatory developments have created the need for a RM that acts as "factotum": "We are not only bankers; often we are lawyers, compliance officers, fiscal advisors . . . the role of the banker changed significantly. If 30 years ago was enough for us to have a certain background, today the requirements for a certain culture and preparation have increased" [RM1]. Moreover, in most of the cases, the challenge lies not only in acquiring all these professional skills, but also in being able to develop the interpersonal ones: "Lately is very usual that I go visiting a client to speak about his financial situation and instead I find myself playing the role of the psychologist for 1 hour and 45 minutes" [RM5].

Beside the increased workload, the compliance duties pose another burden to the RM's daily work, as tougher regulations are limiting his possibility of pursuing certain business opportunities. As such, the RM often finds himself under the pressure of reaching annual profit targets while coping with an immense amount of legal requirements: "We have the feeling that we are becoming more and more controlled, and not only with regard to AML. We are experiencing a conflict because we have the pressure to increase the profit while taking care of all these legal requirements . . . it is like '*climbing a mountain wearing chains*'" [RM14]. This inherent conflict of interest between

"the commercial ethos and regulatory injunctions" (Favarel-Garrigues *et al.*, 2008) can significantly affect the RM's commitment to meet the assigned AML duties (Simonova, 2011). Typically, the cases the RM's salary and bonus depends on the new Assets under Management (AUM) he can bring to the bank, and as such, he might tend to disregard some of the compliance aspects, constructing a superficial client profile. In fact, a study ran by FSA on 27 banking groups in the UK reported that front-line staff, particularly RMs, dismissed or withheld negative information about the client when the bank could profit significantly from the business relationship (FSA, 2011). When asked about the temptation to "close an eye" just to meet AUM targets, most of our respondents acknowledged that the pressure exercised by the bank is an important factor impacting the RM's attitude toward his commitment to AML tasks: "Is hard when you know you can gain some AUM, but it depends also on the bank . . . some may be more aggressive on the objectives. This pressure makes it harder for the RM because he knows he can be fired at the end of the year" [RM17]. The RM's fear of losing his job if failing to reach his yearly AUM target is further exacerbated by two recent developments which significantly limited the banks' growth opportunities: the severe drop in net new money growth registered after 2008 and the shift to a tax compliant banking sector. A report by PWC regarding the Swiss Private Banking industry indicates that AUM per employee have declined by roughly 40% from 2006-2007 to 2011, while mentioning that above average growth can only be achieved by stealing market share from competitors and/or by reducing the outflows from existing clients through retention measures (PWC, 2013).

Given the current banking environment, acquiring new clients has become some sort of "treasure-hunt" where one must juggle regulatory requirements, market-specific difficulties, bank objectives and career plans. Combining all these issues successfully is a challenging task, even for more experienced RMs. The latter expressed their frustration about the duty of growing the bank's AUM, while taking all the responsibility both in front of the client when communicating changes/operational restrictions and in front of the authorities in the case of an investigation. These conflicting behaviours expected from the RM can negatively influence his performance, increasing the

perceived stress and dissatisfaction as suggested by Rizzo, House and Lirtzman's (1970) study on role conflict. In fact, the current legal limitations have cut off some of the RM's past enthusiasm as he continues to see the "red light" from the compliance officer: "before I was the one providing, authorizing and implementing the solution . . . today I can say I am rather an ambassador than a captain" [RM13].

Beside the decreased performance, another important problem created by the obstacles that the RM must continuously overcome is the experience of interpersonal conflicts with the colleagues from the compliance department. An early study by Kahn *et al.* (1964) found that persons reporting role conflict testified a lower trust, personal empathy and lower esteem toward the persons who imposed the pressure while also avoiding communication with these persons. The tensioned and often conflicting relationship between the RM and the CO has been typically considered to be due to the different backgrounds and professional objectives that the two of them have (Verhage, 2011, Favarel-Garrigues *et al.* 2011, Simonova, 2011). Regarding the first aspect, a legal background as well as a previous experience in the regulatory industry allows the CO to better understand the regulatory risks for the bank when drawing and enforcing the AML internal policy. However, the legal/compliance language can sometimes be difficult to understand by the RMs, especially when they do not find any added value in doing so: "Sometimes is annoying because instead of answering my questions, he just sends me the law articles . . . I am not a lawyer and I shouldn't spend my time on reading them instead of taking care of what I am supposed to" [RM9]. Since he is required to identify potential cases of money laundering, the CO should possess some sort of "investigative mind-set" that allows him to distinguish those grey cases that meet the conditions of being reported to the authorities. In several cases though, they may tend to be overzealous and exhibit a certain behaviour that the literature has previously defined as 'defensive' or 'umbrella' reporting, meaning that they would report any suspicion just to be on the safe side (Harvey, 2004; Levi, 2007). In fact, several respondents have mentioned the CO's tendency of overreacting to certain elements that do not pose any threat to the bank's integrity: "Today, their approach is: we assume that the client is a criminal, so he must prove us the contrary. My approach is:

the client is not a criminal, but he must prove that he is 'clean'. These are two totally different things" [RM2].

Whereas they share a common goal – i.e. contribute to the bank's profitability – as members of separate departments, the CO and the RM take a different view regarding the way in which the said goal can be attained. To a certain extent, this can be due to the specific objectives each of them has: safeguarding the bank's reputation versus increasing the bank's client and assets base. In some cases, the compliance department decisions would limit the bank's growing opportunities, even though the commercial department fights to do the opposite. The challenge lies in understanding the thin line between what is deemed to be acceptable from a compliance point of view and what is to be considered suspicious. One problem signalled by the majority of our respondents is the CO's lack of empathy for the business: "99% of them never saw a client and they never take the common sense of life to understand our needs" [RM13]. As the bank's communication interface with the clients, the RM often finds himself forced to manage delicate discussions with the clients; this is especially the case with old clients to whom requesting certain documents/explanations feels like betraying the sort of friendship that has been created over the years.

Beside their different background and objectives, we believe there is yet another element that hinders the collaboration between the two departments: the way in which they perceive *risk*. As banks are financial institutions which profitability depends on their ability to both leverage upon and hedge against risk, we can expect some clashes between the employees attitudes toward this concept. Due to the phenomenon they are supposed to counteract, AML laws have been inevitably designed in such a way as to consider the hazardous aspect of risk. Hence, the CO's actions and decisions are guided by the need of protecting the bank from the risk of being used for criminal purposes. However, risk can also present itself as an opportunity (Demetis and Angell, 2007). Given his growing objectives, the RM will, by default, size any new client as an opportunity.

In Chapter 4 we saw that compliance officers usually face tensioned discussions with their colleagues from the front office (75% of the cases, N=46). As far as the

RM's opinion toward the same matter is concerned, our results show no different picture. In fact, more than 70% of our sample interviewees have experienced a conflict with the compliance colleagues:

- "Ah, some CO are more Catholic than the Pope" [RM13]
- "Yes, there is a conflict. Some compliance officers are really business stoppers that unfriendly dig into things that are not relevant…sometimes they really are a pain in the neck." [RM15]
- "The CO is not the eternal God who came down on Earth" [RM2]
- "Among us we always say that who runs the bank is the compliance department, given that they decide whether 'you can' or 'you cannot'" [RM5].
- "We still live in different worlds and sometimes they really give me the impression that they enjoy nagging us as they hope to find something criminal" [RM10].

Nevertheless, we must emphasise that no single respondent held a categorical view against compliance and that the mentioned conflictual situations regarded specific episodes that the RMs recalled from the personal or other colleagues experience. Overall, we collect a positive general attitude and acceptance of the AML compliant culture as described in the previous section, with some particular cases of conflicts, depending on the CO's and RM's eagerness of defending their assigned professional objectives.

5.5. Conclusions and hints for a smoother collaboration between the relationship manager and the compliance officer

After having described the changes brought by the AML law into the Swiss banking context and the difficulties encountered when coping with compliance requests, this concluding section sets out to document several strategies meant to facilitate the collaboration between the CO and the RM.

As a consequence of FATF's decision to include tax evasion as a predicate offence for money laundering, the majority of its members have adhered to Automatic Exchange of Information agreements that are to become effective in the next couple

of years.[24] Moreover, since the Swiss "White Money Strategy" and the many European tax amnesty programs were implemented, a huge percentage of the offshore funds that were deposited inside Swiss Banks left the country or have been duly declared to the fiscal authorities. The same goes for the American clients, for the supervision of which the Foreign Account Tax Compliance Act (a.k.a. FATCA) has been implemented. In this given picture, the likelihood that somebody who wants to hide criminal/untaxed money will choose Switzerland is very low. As such, we can expect that the compliance controls that have to be run when onboarding new clients will be considerably lighter, at least with regard to tax matters. Consequently, there should be fewer arguments that could possibly trigger a conflict between the RM and the CO.

On the other hand, given the creativity displayed by criminals when exploiting regulatory loopholes it is difficult to believe that by tightening tax controls financial institutions will incur lower money laundering risks. Nowadays, the use of cash has increasingly become unusual – at least in the developed countries – forcing (criminal) people to revert to the use of banking facilities. In fact, the most frequently used instrument by money launderers is banking institution (Ping, 2010) and the vast majority of convicts hold their financial assets in banks (van Duyne, 2003). As such, even though it is true that lately the international fight on money laundering has been (covertly) focusing on tax offences (Davies, 2007), there is still a great deal of controls and supervision to be done by the compliance officers with regard to other types of frauds and economic crimes. Moreover, as banking regulation will continue to become tougher, the RM will struggle searching for growing opportunities while fighting operational limitations. Hence, he will inevitably find himself arguing over certain cases with the compliance department. After surveying the respondents' stories about the conflictual interactions they have had with the compliance colleagues, we were interested in understanding whether there are any strategic operational and communicational moves that could soothe the collaboration between the two departments. Below are summarized our findings regarding both the RM and the CO:

[24] 2017-2019

A: The compliance Officer

▪ Have no religious, political or national prejudices. The CO should evaluate each case objectively and give the right weight to the client's potential risk associated with his country of residence, political association and religious beliefs;

▪ Do not be alarmed by important amounts. Whereas the AML legislation has established that certain thresholds could arouse money laundering suspicions, the CO should always try to see the bigger picture behind a client's financial background: an amount that can be high for an affluent client can be "peanuts" for a wealthy one.

▪ Evaluate a client's case thoroughly before making any questions to the RM and clearly state the information/documents that are to be obtained such that the client is disturbed as less as possible. By requiring all the information at once, the RM will feel more at ease with the client. Moreover, the CO should be aware that certain documents take time to be produced and unless they are vital for reconciling any money laundering suspicion, the business should not be discontinued until the receipt of said documents.

▪ Provide explanations as to why additional information is needed. Unless clearly explained how the missing information affects the bank's integrity, the RM will not understand the necessity of bothering the client with requests that he deems to be superfluous. Furthermore, a detailed explanation should also be given when the compliance decides that certain transactions cannot be undertaken. In both cases, the RM will be better prepared in front of the client and will be able to explain him the bank's decision.

B: The relationship Manager

▪ Take a long term approach when on-boarding risky clients; whereas such clients can seem profitable, their specific financial behavior can later become problematic and complicate the RM's daily business. As such, the incentive of taking responsibility

(in front of the bank and/or of the authorities) for risky cases should always be balanced with respect to the gaining opportunities.

- Do not blame the compliance for the requests addressed to the client. Such conduct not only demonstrates a low commitment toward the bank's internal policies but also endangers the future collaboration with the CO, seen rather as an enemy and not as a partner. As suggested by Edwards and Wolfe (2004) the compliance function is to be recognised within a wider partnership approach, which takes account of good compliance and ethical practice. Ethics are distinguishable from rules as 'rules tell you how to act while ethics tell you how to think before acting'.
- Take a proactive approach and try anticipating what kind of complementary information the CO could ask. This will not only save time for both the RM and the CO but it would also avoid unnecessary communications with the client. Moreover, being thoroughly when collecting the needed information, the RM can better understand the drawbacks that the compliance is likely to identify regarding the client's situation. As such, not only the RM will manage to close ex-ante some information gaps but he will also avoid telling the client that certain transactions can be undertaken whereas later on will be blocked by the CO.
- Do not have a "tick the box" attitude; try to understand why the CO asks for certain documents and how the absence of such documents can put the bank at peril. Once said documents have been provided, run a first check and see if they answer the CO's needs; otherwise, inform the client that the quality of the produced documents is not satisfying.
- Do not take possible conflicts personally and do not leverage on possible friendships with the compliance colleagues. Be aware of the CO's duty of protecting both the RM and the bank against regulatory and reputational risks.

Whereas these lofty recommendations may smooth the interaction between the two professionals, we believe that the different tasks that the two of them must accomplish will always leave room for tension, at least to some degree. The RM will favour risk-taking for growth objectives, while the CO will try to mitigate regulatory

and reputational risks by blocking shady business opportunities; this conceptual gap will inevitably lead to clashes as to where the threshold for risk taking must stand. In conclusion, banks will have to dedicate continuing attention to the RM-CO conflict, encouraging a broader acceptation of the compliance culture inside their institution and putting in place remuneration schemes that can diminish the potential for unnecessary risk taking.

6. Concluding remarks

The main research interest pursued by this thesis was understanding whether the AML compliance duties have been integrated into the banking culture. Over the last three chapters we have been presenting empirical evidence regarding the banks' reactions to such compliance requests, going from the internal due diligence and reporting measures put in place (Chapter 3) to the interaction schemes developed among the interested departments (Chapter 4 and Chapter 5). To the best of our knowledge, this is the first study of this type in Switzerland. In addition, it is the first study that empirically assesses the (conflictual) relationship between the compliance officer and the relationship manager.

As a general conclusion we can say that the banks' financial and socio-cultural efforts in coping with AML requirements have been continuously increasing. Pushed by the desire of protecting their reputation, banks have implemented extensive internal AML policies that are supposed to mitigate money laundering risks by training front line employees on how to monitor clients' financial activity and report potential suspicious transactions. Despite their initial opposition toward these new tasks, relationship managers understood that compliance was key to continuing doing their job and was meant to protect them from potential legal risks. In fact, considering the continuous evolution of AML regulations we can say that banks had a noticeable openness toward disseminating an AML compliant culture among their employees. Nevertheless, we noticed certain compliance aspects that relationship managers refuse to accept and which can lead to internal conflicts.

In the future, banks must continue to invest in the development of a better collaboration between relationship managers and compliance officers, by taking into account their different professional backgrounds, roles and objectives. Moreover, we believe that finding the right balance between reaching growth targets and observing

AML duties will be an important challenge for the banking sector. In this sense, the management will have a key role as an advocate of change. In many cases, compliance is just an advisory function, providing its assessment on the potential risks (reputational and criminal) associated with a client. Especially for a risky client, the final responsibility as to whether on-board him or support him in a certain transaction ultimately lies with the top-management. Hence, designing and enforcing a solid decision-making process, which is proportionate to the bank's risk appetite, facilitates the acceptance of compliance. As relationship managers and compliance officers are on the same hierarchal level, the management has an important role in solving conflicts and differences of opinion among the two. Adopting a top-down approach which is meant to disseminate a compliance-friendly culture can indeed be a solution to many disputes between the relationship manager and the compliance officer, making both parties to accept and respect the other's role.

We believe some of the regulatory updates applicable since the 1st of January 2016 will continue to impact the Swiss banks' investments in compliance knowledge and will intensify the interaction between front employees and compliance officers.

For example, banks are now required to identify the controlling person of a corporate structure and, few exceptions[25] allowed, the controlling person must always be a natural person. A three-stage cascade needs to be used for the identification of controlling persons: (a) natural persons owning more than 25% of the company's voting rights or share capital; (b) if there are no controlling persons according to the first stage, the controlling persons who exercise control over the company by other discernible means need to be indicated; c) if no controlling persons are identified in the first and second stages, the highest managing director (e.g. CEO or similar) must be identified as a substitute. With the exception of small companies for which the owner is almost always the authorized signatory, in the rest of the cases banks will be faced with a knowledge gap, as they are required to run a due-diligence check on an individual

[25] Listed companies, public authorities, banks and other financial intermediaries, companies or associations with an exclusively non-commercial purpose and no relationship to any high-risk countries, simple partnerships, and other collectives such as condominium owner and common ownership collectives.

who has no active role on the account. The relationship managers will often find themselves in a delicate position as they will have to provide the KYC profile of an individual they never met personally, relying exclusively on information provided by the corporate directors/authorized signatories on the account. The mentioned lack of personal contact with the indicated controlling person can lead to resistance on RM's side when it comes to compliance requests for additional investigations.

The introduction of aggravated tax misdemeanor as a predicate offence to money laundering will lead to an increase in the number of SARs filled in by banks; consequently, also the banks' costs associated with reporting activities will increase. However, this is mostly the case for non-European clients as the tax amnesties carried out in various European countries in the latest years pushed many banks to exit undeclared clients already.

Another regulatory novelty in the Swiss AML landscape is the broadening of the definition of "PEP" (politically exposed person) to include domestic PEPs and PEPs belonging to intergovernmental organizations. As PEPs are considered to be the riskiest clients of the bank, multiple controls are put in place to ensure that their transactional activity is properly monitored. For example, each bank must conduct a yearly review of their PEP clients in order to check if (a) there has been any material change in the PEP's financial standing, (b) there is any negative media coverage on the person (reporting him as involved in a scandal/legal case) and (c) the transactions concluded are in line with the pre-announced purpose of the account. The results of the review are typically submitted to the management who must decide whether the relationship with the client can be continued or is to be terminated. In most of the cases, the management's decision will be based on a pre-advice previously issued by the compliance. Beside the yearly review, the RM and the CO are also involved during the year in the strict monitoring of the PEPs' transactions, due to the high risk of corruption associated with these clients. Given all the due-diligence tasks described above, it is clear that the broadening of the definition of PEP will create additional work for both the RM and the compliance officers, increasing thus the likelihood of a dispute between the two.

Beside the local legislation, international initiatives also contribute in adding administrative burden on the Swiss banks' shoulders. For example, the upcoming OECD's Common Reporting Standard (CRS) will enable the governments of adhering countries to automatically exchange financial information with other governments, already starting with 2017. As it was the case for FATCA, banks will need to develop a suitable reporting process, design the specific forms, collect the requested information, hire dedicated specialists and train interested employees accordingly. From an Automatic Exchange of Information perspective, the RM's tasks consist in collecting the client's signature that authorizes the bank to transmit his financial information to his home tax authorities. However, this new transparent context will have consequences also on the CO-RM relationship. On one side, even if bank profits will shrink, the shift to a fully tax-compliant client base is likely to ease the compliance officer's work in certain cases and hence diminish the conflict between himself and the relationship managers. However, the likelihood that RMs will refuse a compliance request to collect additional information or supporting documentation from the client and instead push forward the argument "the funds are declared to the tax authorities, the client has nothing to hide" is very high. Such approach is not to be condemned, given that undeclared assets have been Switzerland's (and other similar offshores centers like Hong Kong and Singapore) main deficiency when it came to recent AML regulation. Indeed, Davies (2007) pointed out that the continuous development of the AML standards by the international organizations are in reality targeting tax evasion and an enrichment of the state's knowledge about its citizens' financial activity. Nevertheless, banks and relationship managers should be aware that tax compliance is just one part of the much bigger anti-money laundering compliance universe. A waiver signed by the client allowing the bank to disclose his financial information to the home country does not offer a complete "protection" for the bank against ultimate beneficial ownership matters, corruption or other potential future frauds.

Professionals in the Swiss banking industry often express disappointment towards the behavior of the Swiss Government, which has too easily gave up in front of the international pressures on banking secrecy and tax evasion, without requesting any

benefit in exchange. For example, the introduction of FATCA has pushed banks to invest significant resources in documenting the US status of each individual and/or corporate client and exchanging the relevant information with the US authorities. However, Switzerland is not automatically notified about Swiss citizens holding US accounts, even though reciprocal exchange of information is possible under certain terms of the Intergovernmental Agreement it signed with the US. Moreover, given the amount of information obtained on US taxpayers through FATCA's standards, the US decided not to adhere to OECD's Common Reporting Standards, avoiding thus any duty of automatically exchanging information with the participating countries. This unilateral flow of information and efforts deployed into complying with FATCA has created a lot of frustration among several OECD jurisdictions. Indeed, the US financial institutions are not obliged to exchange any information on their accountholders. Such collaboration would be particularly important in the international fight against money laundering/tax evasion when considering the millions of shell companies incorporated in Delaware (defined as a "heaven for transnational crime" by Transparency International), Nevada and Wyoming. In these states, lax corporate rules prevent disclosure of the beneficial ownership, encouraging foreign investors in seek of a safe shield against home tax authorities to transfer their (undeclared) assets to the US.

The findings of this thesis regarding the impact of the AML regulation on the banking sector together with the requirements of the recent and upcoming regulatory updates underline the significant costs entailed by compliance. Remains though open the question as to whether the AML burden is proportional to what is expected to be achieved. The lack of consistent and complete data on the number of convictions and amount of assets confiscated as well as the impossibility to quantify the costs of non-compliance, do not allow us to provide a reliable result of AML compliance benefits.

Given the continuous development of IT solutions targeting the financial system, we believe that future research should investigate the effects of the automation of some AML compliance tasks. Even though automation entails important cost savings, it may also create difficulties in those cases in which the interaction between compliance officers and relationship managers is necessary. Moreover, attention should be

given to the impact that the Common Reporting Standard had on the banks' business model, which were the costs associated with its implementation and what benefits (if any) it brought in for the banks.

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Appendix

Survey Structure

Thank you for accepting to take part on this survey.

Please complete this survey only if you are working in the Legal or Compliance Department or you have enough knowledge about the internal AML policy of your bank. Please answer all questions. If for whatever reason, you choose not to answer a particular question, a "No answer" option is always available. You need maximum 20 minutes to answer all questions. Your comments are welcome!

There are 31 questions in this survey.

SECTION A: GENERAL INFORMATION

[A1] Which is your employment position inside your institution?
Please write your answer here:……..

[A2] Approximately what percentage of your time is dedicated to anti money laundering /counter terrorism financing (AML/CTF) matters? Please choose only one of the following:

- o less than 10%
- o 10% to 25%
- o 26% to 50%
- o 51% to 75%
- o 76% to 100%

[A3] For how long have you been working inside this department? Please choose only one of the following:

- o Less than one year
- o One to five years
- o Five to ten years
- o More than ten years

[A4] To which of the following categories does your institution belong? Please choose only one of the following:

- o Cantonal bank
- o Major bank
- o Private bank
- o Trade bank
- o Asset management bank
- o Foreign controlled bank
- o Branch of foreign controlled bank
- o Regional and savings bank
- o Other

[A5] To the best of your knowledge, what is the proportion of foreign assets under management in your institution? Please choose only one of the following:

- o 0 %
- o < 10%
- o 10 to 25%
- o 25 to 50%
- o 50 to 75%
- o >75%
- o Don't Know

SECTION B: AML POLICY INSIDE YOUR BANK

[B1] Does your bank outsource the AML compliance functions? Please choose only one of the following:

- o Yes. Please move to question [C9]
- o No

[B2] During the client acceptance procedure does your institution check the available lists of persons/ special countries or other sources of information to verify the profile of the client? Please choose only one of the following:

- o Always
- o Usually
- o Half of the time
- o Seldom
- o Never

[B3] Does your bank verify the reasons behind a customer`s choice to open an account in a foreign jurisdiction? Please choose only one of the following:

- o Always
- o Usually
- o Half of the time
- o Seldom
- o Never

[B4] Does your bank accept clients that haven`t been personally identified (e.g. via internet or third party introduction)? Please choose only one of the following:

- o Always
- o Usually
- o Half of the time
- o Seldom
- o Never

[B5] Does your institution screen transactions against lists of persons, entities or countries issued by the competent authorities? Please choose one of the following:

- o Always
- o Usually
- o Half of the time
- o Seldom
- o Never

[B6] What are the estimated total costs of AML compliance (including staff, procedures, software) in proportion to the total costs of your bank? Please choose only one of the following:

- o Less than 5%
- o Between 5 and 10%
- o Between 11 and 20%
- o More than 20%
- o Other

[B7] How often do you train relevant employees with regard to the following issues: Please choose the appropriate response for each item:

	Never	Just Once	Every 6 months	Every 1-2 years	Every 5 years
Identification and reporting of transaction that must be reported to Government authorities					
Examples of different forms of money laundering involving the bank`s products and service					
Internal policies to prevent money laundering					
Trade-based money laundering					

[B8] To what extent you consider the Swiss AML Law to be successful in fighting the money laundering phenomenon? Please choose only one of the following:

- o Large extent
- o Certain extent
- o Not sure
- o Limited extent
- o Not at all

SECTION C: ISSUES IN IMPLEMENTING AML/CTF COMPLIANCE

[C1] To what extent do you consider the AML policy of your institution to be stricter than other Swiss banks' AML policies? Please choose only one of the following:

- o Large extent
- o Certain extent
- o Not sure
- o Limited extent
- o Not at all

[C2] To what extent do you find the duty to require documents for customer due dilligence procedures to be: Please choose the appropriate response for each item:

	Large extent	Certain extent	Not sure	Limited extent	Not at all
Intrusive					
A normal business procedure					
An administrative burden					

[C3] To what extent is the information and feedback (technical assistance) provided by MROS (Money Laundering Reporting Office Switzerland) and prosecuting authorities useful in carrying out your AML tasks?
Please choose only one of the following:

- o Large extent
- o Certain extent
- o Not sure
- o Limited extent
- o Not at all

[C4] Through how many layers of decision making a suspicious activity report (SAR) must pass before being transmitted to MROS? Can you mention it/them? Please choose all that apply and provide a comment:

First level: _____
Second level: _____
Third level: _____
Fourth level: _____
Fifth level: _____
Other: _____

[C5] To what extent you consider that you are given enough authority to make day to day decisions on problems that arouse routinely in the course of applying AML law provisions? Please choose only one of the following:

- Large extent
- Certain extent
- Not sure
- Limited extent
- Not at all

[C6] Several studies have proven that the job of a compliance officer is very stressful and that very often he finds himself in a tensioned relation with his colleagues working in the sales department. To what extent do you perceive a contradictory position of AML compliance and the commercial interests of the bank?
Please choose only one of the following:

- Large extent
- Certain extent
- Not sure
- Limited extent
- Not at all

[C7] To what extent do you consider that the requirements stemming from the AML law should prevail when compared to the commercial interests of your institution? Please choose only one of the following:

- Large extent
- Certain extent
- Not sure
- Limited extent
- Not at all

[C8] Did you ever have any tensioned discussion with your colleagues from the sales department? Please choose only one of the following:

- Yes
- No

[C9] To your best knowledge, how many SARs were sent to MROS by your institution during the last year (2011)?
Please choose only one of the following:

- o 0
- o Less than 5
- o Between 5 and 15
- o Between 15 and 50
- o More than 50
- o Other

[C10] To what extent do you think your institution is under or over reporting suspicious activities to MROS? Please choose the appropriate response for each item:

(**1)** Underreporting	→	**(3)** Fair reporting	→	**(5)** Over reporting
O	O	O	O	O

[C11] Has your bank been involved in any regulatory or criminal enforcement action resulting from violations of any AML laws or regulations in the past 5 years? Please choose only one of the following:

- o Yes
- o No

SECTION D: THE COMPLIANCE OFFICER IN THE AML COMPLEX

[D1] To what extent you consider Switzerland to be vulnerable to money laundering transactions? Please choose only one of the following:

- o Large extent
- o Certain extent
- o Not sure
- o Limited extent
- o Not at all

[D2] In your opinion which financial instruments are mostly preferred by money launderers? Please choose all that apply:

- o Checking (current) account
- o Savings Account
- o Certificate of deposit
- o International wire transfers
- o Transactions involving real-estate properties
- o Other:

[D3] How clear (in practical terms) do you consider the Swiss AML Law to be?

Very Unclear				Very Clear
1	2	3	4	5
O	O	O	O	O

[D4] For which reasons should a bank engage in the money laundering fight? Please number each box in order of preference from 1 to 6

	1	2	3	4	5	6
Reputational risks						
Regulatory risks						
Social and moral concerns						
Understand the client`s profile						
Protect the integrity of the banking system						
Avoid criminal liability						

[D5] To what extent do you agree with the following affirmations about the positive and negative impacts that the compliance with the AML law could have on the entire financial institution? Please choose the appropriate response for each item:

	Large extent	Certain extent	Not sure	Limited extent	Not at all
It protects the reputation of the bank					
It increases the awareness of these risks for the financial institution					
It has a proactive involvement in developing new products, services or marketing activities of the bank					
It slows down the business					
It scares clients off					
It is costly					

[D6] As a consequence of the latest FATF-GAFI decisions, Switzerland may be obliged to consider tax evasion as a crime. To what extent do you consider this fact to increase the compliance burden? Please choose only one of the following:

- o Large extent
- o Certain extent
- o Not sure
- o Limited extent
- o Not at all

[D7] Further Comments

Please write your answer here:

_____

_____

Tables – Survey

Table A. 1: Banks' opinion regarding Switzerland's vulnerability to money laundering, the efficiency of AMLA and the rigidity of their internal anti-money laundering policy

Respondents were asked to indicate to what extent they agree with each statement on a scale of -2 (not at all) to +2 (large extent). Panel A reports summary statistics for the responses from all the banks surveyed. Columns (1), (2) and (3) present the number of respondents choosing that particular answer. Column (4) reports the average rating, where higher values correspond to agreement to a larger extent. Column (5) reports the results of a t-test of the null hypothesis that each average response is equal to 0 (neither agree nor disagree) The ***,** and * denote rejection at the 1%, 5% and 10% respectively. Panel B presents a comparison of the average scores for each question when the sample is split according to the banks' and respondents' characteristics reported in Table 3 and Table 4. The "Contradiction" criterion is an indicator for whether or not a firm perceive a contradictory position between AML rule observance and the profit maximization function of the bank. The sample for all comparisons in Panel B varies depending on whether the respondent provided or not the information. ***,** and * denote a statistically significant difference across groups at the 1%, 5% and 10% respectively.

Panel A: Unconditional averages

	Large or Certain extent	*Not sure*	*Limited extent or not at all*	*Average Points*	*H_0: Average rating =0*
(1) Switzerland is vulnerable to money laundering transactions?	36	2	13	0.57	(***)
(2) The Swiss AML Law is successful in fighting the money laundering phenomenon?	39	4	8	0.88	(***)
(3) The AML policy of your institution is stricter than other Swiss banks' AML policies?	27	7	6	0.54	(***)

Panel B: Conditional averages

Column	*(1)*	*(2) Canton*			*(3)Years in dept.*		*(4) AML tasks*		*(5) Size*	
Quest.	*Avg.*	*GE*	*ZH*	*TI*	*<5Y*	*>5Y*	*Full*	*Part*	*Small*	*Large*
(1)	0,57	0,57	0,68	0,22	0,42	0,72	**1,06*** **	**0,34**	**0,36***	**0,75**
(2)	0,88	**0,60**	**0,86**	**1,63***	**0,6** **	**1,20**	**1,27** **	**0,75**	0,80	0,96
(3)	0,54	**0,10***	**0,92**	**0,75**	0,79	0,62	1,00	0,59	0,80	0,63

Contd.	*(6) Ownership*		*(7) AUM*		*(8) Contradiction*		*(9) SARs*		*(10) Sanctioned*	
Avg.	*CH*	*F*	*CH*	*F*	*No*	*Yes*	*No*	*Yes*	*No*	*Yes*
0,57	0,78	0,45	0,50	0,48	0,33	0,72	**0,21 ** **	**0,85**	0,53	1,00
0,88	0,89	0,91	1,00	0,82	1,00	0,87	0,79	0,92	0,92	0,50
0,54	0,53	0,80	0,46	0,75	0,75	0,68	0,71	0,77	0,67	1,00

Table A. 2: Banks motivations for fighting money laundering

Points are assigned as follow: 6 points for a #1 Ranking, 5 points for a #2 Ranking, 4 points for a #3 Ranking, 3 points for #4 Ranking, 2 points for a #5 Ranking and 1 point for a #6 Ranking. See header of Table A.1 for additional table and variable description.

Panel A: Unconditional averages

Reason	*#1 Rank*	*#2 Rank*	*#3 Rank*	*#4 Rank*	*#5 Rank*	*#6 Rank*	*Total Points*	*Average Score*
(1) Reputational risk	22	16	6	2	6	0	254	4.88
(2) Regulatory risk	5	15	15	10	7	0	209	4.02
(3) Social and moral concerns	6	4	4	7	14	17	138	2.65
(4) Understand the client`s profile	4	1	3	10	10	24	115	2.21
(5) Protect the integrity of the banking system	9	8	9	12	9	5	189	3.63
(6) Avoid criminal liability	6	8	15	11	6	6	187	3.60

Panel B: Conditional averages

Column	***(1)***	***(2) Canton***			***(3) Tenure***		***(4) AML tasks***		***(5) Size***	
Reason	***Avg.***	***GE***	***ZH***	***TI***	***< 5Y***	***> 5Y***	***Full***	***Part***	***Small***	***Large***
(1)	4,88	4,93	4,89	4,78	4,92	4,85	4,69	4,97	4,88	4,84
(2)	4,02	4,07	4,14	3,56	3,92	4,12	4,13	3,97	**3,68 ****	**4,24**
(3)	2,65	2,87	2,46	2,89	2,46	2,85	2,81	2,58	2,60	2,68
(4)	2,21	2,20	2,29	2,00	2,23	2,19	2,13	2,25	2,44	1,96
(5)	3,63	3,53	3,50	4,22	3,81	3,46	3,63	3,64	3,76	3,68
(6)	3,60	3,40	3,71	3,56	3,65	3,54	3,63	3,58	3,64	3,60

Contd.		***(6) Ownership***		***(7) AUM***		***(8) Contrad.***		***(9) SAR***	***(10) Sanctioned***		
Reason	***Avg.***	***CH***	***F***	***CH***	***F***	***No***	***Yes***	***No***	***Yes***	***No***	***Yes***
(1)	4.88	5.11	4.76	**5.38***	**4.83**	5.22	4.73	**5.21 ***	**4.70**	4.98	4.50
(2)	4.02	4.22	3.91	4.14	3.82	4.11	3.93	4.00	4.00	3.93	4.00
(3)	2.65	2.33	2.82	2.07	2.65	2.50	2.77	2.26	**2.81**	**2.48***	**3.67**
(4)	2.21	2.00	2.32	2.21	2.09	2.11	2.20	2.53	**2.00**	**2.48****	**1.33**
(5)	3.63	3.39	3.76	3.36	3.29	3.94	3.53	3.57	3.81	3.78	3.17
(6)	3.60	3.94	3.41	3.86	3.35	**3.11**	**3.83***	3.42	3.67	**3.38***	**4.33**

Table A. 3: Banks' opinion regarding the positive and negative impacts of AML compliance on the financial institution

The following table reports the respondents' answer to the question: To what extent do you agree with the following affirmations about the positive and negative impacts that the compliance with the AML law could have on the entire financial institution?
See header of Table A.1 for additional table and variable description.

Panel A: Unconditional averages

Impact	*Large or Certain extent*	*Not sure*	*Limited extent or Not at all*	*Average Points*	*H_0:Average rating =0*
(1) It protects the reputation of the bank	40	0	6	**1.56**	(***)
(2) It increases the awareness of these risks for the bank	45	2	1	**1.38**	(***)
(3) It has a proactive involvement in developing new products, services or marketing activities of the bank	19	15	18	**-0.06**	-
(4) It slows down the business	21	5	26	**-0.21**	-
(5) It scares clients off	14	10	28	**-0.48**	(***)
(6) It is costly	31	5	16	**0.37**	(**)

Panel B: Conditional averages

	(1)	*(2) Canton*			*(3) Tenure*		*(4) AML tasks*		*(5) Size*	
	Avg.	*GE*	*ZH*	*TI*	*<5Y*	*>5Y*	*Full*	*Part*	*Small*	*Large*
(1)	1.56	1.67	1.57	1.33	1.54	1.58	**1.81****	**1.44**	1.52	1.56
(2)	1.37	1.33	1.39	1.40	**1.20****	**1.57**	1.44	1.34	**1.50***	**1.21**
(3)	-0.06	0.13	-0.25	0.22	-0.08	-0.04	-0.31	0.06	**0.16***	**-0.32**
(4)	-0.21	-0.20	-0.11	-0.56	-0.19	-0.04	-0.38	-0.14	**-0.20**	**-0.20**
(5)	-0.48	-0.33	-0.36	-1.11	-0.54	-0.42	-0.75	-0.36	**-0.44**	**-0.52**
(6)	0.36	0.13	0.64	-0.11	0.19	0.54	0.31	0.39	0.36	0.32

		(6) Ownership		*(7) AUM*		*(8) Contradiction*		*(9) SAR*		*(10) Sanctioned*	
	Avg.	*CH*	*F*	*CH*	*F*	*No*	*Yes*	*No*	*Yes*	*No*	*Yes*
(1)	1.56	1.61	1.53	1.54	1.61	1.50	1.60	1.53	1.56	1.57	1.17
(2)	1.37	1.44	1.34	1.17	1.47	**1.64****	**1.23**	1.60	1.33	**1.32***	**1.80**
(3)	-0.06	-0.17	0.00	0.00	-0.09	0.06	0.00	0.05	-0.15	-0.07	-0.17
(4)	-0.21	-0.28	-0.18	-0.23	-0.30	**-0.56****	**0.00**	**-0.58****	**0.11**	**-0.15**	**-0.67**
(5)	-0.48	**-0.94****	**-0.23**	-0.69	-0.57	**-0.89*****	**-0.17**	**-0.89****	**-0.11**	**-0.40**	**-1.00**
(6)	0.36	0.17	0.47	0.23	0.21	0.06	0.47	**0.05****	**0.63**	**-0.25****	**1.17**

Table A. 4: Banks' opinion regarding the duty to require documents for customer due diligence procedures

The following table reports the number of banks answering the question: To what extent do you consider the duty to require documents for customer due diligence procedures to be….

Panel A: Unconditional averages

	Large or Certain extent	***Not sure***	***Limited extent or Not at all***	***Average rating***	***H_0: Average rating = 0***
(1) Intrusive	8	3	36	-0.94	***
(2) A normal business procedure	42	0	5	1.40	***
(3) An administrative burden	21	3	22	-0.17	-

Panel B: Conditional Averages

	(1)	***(2) Canton***			***(3)Time in dept.***		***(4) AML tasks***		***(5) Size***	
	AVG	***GE***	***ZH***	***TI***	***<5Y***	***>5Y***	***Full***	***Part***	***Small***	***Large***
(1)	-0.94	-0.77	-0.93	-1.29	-0.96	-0.91	**-1.31***	**-0.79**	-0.83	-1.05
(2)	1.40	1.15	1.56	1.29	1.44	1.36	**1.79***	**1.24**	**1.61***	**1.17**
(3)	-0.17	**-0.38****	**0.15**	**-1.00**	**-0.50****	**0.17**	-0.15	-0.18	-0.21	-0.18

Contd.	***(6) Ownership***		***(7) AUM***		***(8) Contradiction***		***(9) SAR***		***(10)Sanctioned***	
	AVG	***CH***	***F***	***CH***	***F***	***No***	***Yes***	***No***	***Yes***	***No***	***Yes***
(1)	-0.94	**-1.33***	**-0.75**	-1.14	-0.90	-1.06	-0.86	**-1.26***	**-0.73**	-0.89	-1.5
(2)	1.4	**1.75***	**1.23**	**1.77***	**1.22**	1.63	1.30	1.42	1.45	1.49	1.83
(3)	-0.17	-0.27	-0.13	-0.36	-0.23	**-0.56***	**0.00**	**-0.63****	**0.22**	-0.26	-0.33

Table A. 5: Banks' opinion regarding AMLA's clarity (in practical terms)

	Count	*% of Total*	*GE*	*ZH*	*TI*
(1) Very Unclear	1	2	1	0	0
(2)	1	2	0	1	0
(3)	12	23	4	6	2
(4)	26	50	8	15	3
(5) Very Clear	12	23	2	6	4
Total	52	100	15	28	9
Average rating	3,90		3,67	3,93	4,22