



Source of funds and source of wealth are vital in battling money laundering and terrorist financing.

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“ Money Laundering is a sophisticated crime, and we must be equally sophisticated.

~ Janet Reno

Money laundering has emerged as a critical concern in today's global financial system. It enables criminals to conceal the origins of illicitly obtained funds, posing significant threats to financial integrity and security. To combat this pervasive issue, it is crucial for Financial Institutions (FIs) to identify and scrutinize the source of funds and the source of wealth of its customers. By doing so, FIs and businesses can prevent money laundering, safeguard their integrity, and contribute to the overall security of the financial system.

Verification of source of funds and source of wealth is a core element in most laws and regulations regarding anti-money laundering and counter-terrorism financing. This helps to prevent illicit activities such as money laundering, terrorist financing and other criminal activities that can be detrimental to the financial system of any country. Additionally, verification of sources of funds and sources of wealth helps to protect FIs from legal and

reputational risks that could arise from involvement in these activities. However, in practice, scrutinizing source of funds and source of wealth can sometimes be challenging and difficult to apply. But exactly what are these checks and how do they differ from one another?

In the realm of anti-money laundering, source of funds refer to the origins or provenance of the money used in financial transactions. It encompasses the various channels through which funds enter the financial system. Determining the legitimacy of these sources is vital in preventing money laundering. On the other hand, the source of wealth pertains to the overall accumulation of assets and wealth by an individual or entity over time. It involves examining the entire financial history of a person or entity to understand how they acquired and generated their wealth.

Many financial transactions involve funds that originate from legitimate sources. These sources are often encountered in everyday financial activities and typically do not raise significant concerns related to anti-money laundering. Examples of legal sources of funds include employment income, business profits, investments, inheritances, and loans obtained from reputable financial institutions. These funds are earned or acquired through legal means and are essential for the functioning of the economy.

To effectively combat money laundering, it is crucial to be aware of red flags that may indicate the involvement of illicit activities. These red flags act as indicators for suspicious transactions that require further scrutiny. Some common red flags include cash deposits or withdrawals in large amounts without a clear explanation, frequent transfers to offshore accounts, and funds originating from high-risk jurisdictions. Additionally, sudden, and unexplained changes in transaction patterns or a client's behavior can also raise suspicions.

While it is important to determine both the source of funds and source of wealth of a customer prior to conducting any transaction, as per the Financial Action Task Force (FATF) Recommendations and the Financial Intelligence And Anti-Money Laundering Regulations 2018 (Mauritius), it is obligatory to ascertain the source of funds and source of wealth for all higher risk customers (including higher risk domestic Politically Exposed Persons (PEPs)) and all foreign PEPs and all other relationships where the type of product or service being offered makes it appropriate to do so because of the risk profile. For example, cash-intensive businesses, such as casinos, money service businesses, or jewelry stores, are susceptible to money laundering due to the ease of integrating illicit funds into their operations. Shell companies, which lack substantial business activities and serve as vehicles for illicit transactions, can be used to obscure the true origins of funds. Politically exposed persons, individuals who hold prominent public positions, can be exploited for illicit purposes due to

their influence and access to significant resources. Non-profit organizations, while generally legitimate, can be exploited by criminals to disguise illicit funds under the guise of charitable contributions. Hence, it is vital for FIs to verify the source of funds and source of wealth of such customers to comply with the regulatory requirements.

With the purpose to effectively identify and verify the source of funds and source of wealth, FIs should apply robust customer due diligence (CDD) processes. CDD involves obtaining relevant information about customers, understanding their business activities, and assessing the risks they pose. Know Your Customer (KYC) procedures, enhanced due diligence (EDD), and ongoing monitoring play vital roles in identifying and verifying the source of funds and source of wealth. KYC procedures involve gathering and verifying customer information, such as identification documents, business records, and proof of address. EDD goes a step further by conducting more comprehensive checks for high-risk customers, such as PEPs or clients from high-risk jurisdictions. Ongoing monitoring enables financial institutions to detect suspicious activities or changes in transaction patterns and behavior, allowing for timely intervention.

While the terms "source of funds" and "source of wealth" are related, they have distinct meanings in the context of anti-money laundering. Source of funds focuses on the specific origins or provenance of the money used in a particular transaction, aiming to determine whether the funds are legitimate, derived from legal sources, and not connected to criminal activities. On the other hand, the source of wealth analysis takes a broader and more comprehensive view of an individual or entity's financial activities, examining the entire financial history to understand how wealth has been accumulated and generated over time.

Here is an example that illustrates how source of funds differs from source of wealth:

A wealthy businessman inherited a large sum of money from his father, which he invested in various assets such as real estate, stocks, and a small business. Over time, his investments grew, and he became a multimillionaire. In this case, the sources of his wealth is the inheritance, and the assets he owns represent his overall net worth.

Now suppose that the businessman wants to purchase a new yacht. He decides to take out a loan from a bank to finance the purchase. In this case, the source of funds used in the transaction, i.e., the loan, is the bank. The sources of wealth, which is the businessman's inheritance and investment portfolio, is not relevant in this particular transaction.

With the evolving technologies, money launderers are now tech-savvy and are constantly seeking new and sophisticated methodologies to conceal their source of illegal money to avoid detection by regulatory authorities. Criminals engaged in money laundering employ various techniques to disguise the illicit origins of their funds, making it difficult for financial institutions and businesses to identify and prevent such activities. Here are some key challenges:

01 Complexity of Financial Transactions: Money laundering schemes often involve intricate networks of transactions and financial structures. Funds may pass through multiple intermediaries, jurisdictions, or layers of complex corporate structures, making it challenging to trace their origins accurately.

02 Mixing Legitimate and Illegitimate Funds: Money launderers often mix illicit funds with legitimate funds to create the appearance of legality. This commingling makes it difficult to separate legal and illegal funds, further complicating the verification process.

03 Global Nature of Money Laundering: Money laundering is a transnational issue that operates across borders, taking advantage of jurisdictional differences and regulatory gaps. Tracking funds across multiple jurisdictions and coordinating efforts among international authorities present significant challenges.

04 Emerging Technologies: The rapid advancement of technology introduces new challenges in verifying the source of funds. Cryptocurrencies, online payment systems, and digital assets provide additional avenues for money laundering, requiring specialized knowledge and tools to effectively trace the flow of funds.

05 Limited Information and False Documentation: Criminals often provide false or misleading documentation to support the legitimacy of their funds. This includes falsified invoices, contracts, or bank statements. Verifying the authenticity and accuracy of such documents can be a daunting task.

06 Time and Resource Constraints: Conducting thorough due diligence to verify the source of funds requires significant time, expertise, and resources. Financial institutions and businesses face challenges in allocating sufficient resources to perform comprehensive investigations on every customer or transaction.

Addressing these challenges requires a multi-faceted approach involving regulatory frameworks, technological advancements, international cooperation, and ongoing education and training for professionals in the field of anti-money laundering. Insofar, FIs must work harder than ever to establish the source of funds and source of wealth of their customers by implementing an array of Know Your Customer (KYC) measures and controls. Under the risk-based approach to AML compliance recommended by the FATF, KYC measures including establishing source of funds and source of wealth should be proportionate to the risk that different customers present. This means that higher-risk customers should trigger enhanced compliance measures, while lower-risk customers may warrant simplified measures.

Notwithstanding the above, there may be exceptional cases where FIs are unable to gather information on the source of funds and source of wealth of its customers. In such situations, FIs can conduct a thorough background check which includes scrutinizing public records, online resources and social media accounts, or seek assistance from regulatory agencies such as financial crime enforcement authorities or anti-money laundering units to see if they have any information about the individual's financial activities. In some situations, depending on the risk appetite of the FI, it might be best to refuse to proceed with the transaction or business relationship until the matter has been resolved.

From a local regulatory perspective, during regulatory inspections, the Financial Services Commission (Mauritius) verifies on how FIs establish the source of funds and source of wealth for all customers. Failure to comply with this requirement entails regulatory sanctions and might also be subject to the enforcement committee. Hence, it is essential for FIs to comply with this regulatory obligation to prevent any regulatory sanctions and to safeguard their reputation and licence.

From an international perspective, we can see this in

the case of “The 1MDB Scandal” on how failure to verify the source of funds and source of wealth of customers proved to be detrimental. The scandal was a case of money laundering where billions of dollars were allegedly siphoned off from a Malaysian state-owned fund, leading to a global scandal. The scandal arose due to the failure of those involved to ascertain the source of funds and source of wealth. Another common example is the “Panama Papers”. The Panama Papers leaked a set of 11.5m documents that exposed allegedly how wealthy individuals used offshore companies to evade tax and launder money.

Understanding the source of funds and source of wealth is crucial in combating money laundering effectively. Since money launderers use an array of sophisticated methods to conceal their illicit money, verification of source of funds and source of wealth poses significant challenges. Overcoming these challenges requires a coordinated effort from financial institutions, regulatory bodies, and law enforcement agencies to ensure the integrity and security of the global financial system. By implementing a robust customer due diligence process and remaining vigilant in identifying red flags, stakeholders can strengthen their defense against money laundering and contribute to a safer financial environment for all.



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