Banks Battle Terror Financing with Software

Money laundering has thrust itself to the top of the agenda for bank management.

Adam Rombel

Attention Wall Street bankers: William Catucci is trying to keep you out of the nasty headlines that so often grace today's financial newspapers and television networks. In this case, it's headlines indicating that bank regulators and law enforcement officials are breathing down your neck because a terrorist laundered money through your vaults.

Catucci heads Regulatory DataCorp, a new software database company started by Goldman Sachs and some of the biggest global financial services companies to help them ferret out prospects and clients that might be involved with money laundering, terrorist financing, organized crime, fraud and corruption.

Between $590 billion and $1.5 trillion is laundered globally each year, according to the Financial Action Task Force on Money Laundering, which is under the Organization for Economic Co-operation and Development. "This is a need and an imperative that these financial institutions have today. Imagine them waking up one day and finding their name in the paper about terrorist financing or fraud or corruption that they should have identified or prevented," Catucci says.

RDC's flagship product is the Global Regulatory Information Database, or GRID system. GRID compiles public information from national and local regulatory and law enforcement agencies in more than 50 countries, court proceedings, 10,000 newspapers and other news sources to raise red flags about potential new customers and existing clients. Banks and brokerages can then close accounts, pass the information along to the appropriate government agencies to meet regulatory obligations to report suspicious customers, and avoid doing business with people that may land them in regulatory hot water and tarnish the financial institution's reputation through bad publicity.

"Firms are concerned that if they're constantly hitting the pages of The Wall Street Journal because they're dragged into some investigation involving money laundering, their stock gets hit and customers may leave," says Don Temple, a money-laundering expert at Mantas, a Fairfax, Virginia-based security software firm. Temple spent 26 years as an Internal Revenue Service special agent.

The Impact of 9/11
Although the idea for RDC and its GRID system was hatched about two years ago, it is emblematic of the current times. The terrorist attacks on the United States on September 11 of last year, which may have partly been financed through US-based bank accounts, have led to unprecedented regulatory, law enforcement and intelligence agency scrutiny of bank, securities and other financial accounts for potential links to terrorism and money laundering.

"[RDC is] an idea whose time has come," says Catucci. "It wasn't conceived after 9/11. It was a financial imperative that the financial community realized a couple years ago—the idea that they must manage their regulatory risk. As we've learned, they were very prescient."

Last October the US Congress passed the USA Patriot Act, which required US banks, brokerages, asset managers and other financial firms to set up systems to detect money laundering by last April. Accounts with foreign "shell" banks also had to be closed.

The Patriot Act and resulting government agency rules unveiled in the past few months also mandate that financial companies check their customers more closely and share suspicions with regulators and each other. Specifically, the US Treasury Department issued rules in July that require securities firms to file suspicious-activity reports with the federal government for transactions greater than $5,000 that the firms suspect may involve the proceeds of criminal activities—or even legitimate funds that could be headed for terrorists or other criminals. Against industry objections, the treasury will require firms to report transactions that could be connected to violations not only of US federal law but also of state and even foreign laws.

Banks already had to report a lot of this under the Bank Secrecy Act and anti-money-laundering regulations passed in the mid-1990s, but now Wall Street brokerages, mutual fund companies, money transfer businesses such as Western Union, and check cashing firms are being brought to task to do the same. As a result, financial services firms have been scrambling to implement software technology to help them comply with these more stringent rules.

The TowerGroup, a Needham, Massachusetts-based research firm focusing on the financial services industry, projects that the industry will spend about $120 million on compliance software this year, or triple what was spent in 2001.

RDC's database software works like this: In a hypothetical example, a bank would give RDC a list of names of new customers it wants to check. Say one of those is "John Smith." RDC will run it through GRID's database of several million names of individuals and organizations with various levels of ties to terrorism, crime or alleged wrongdoing. Let's say it finds that John Smith was sanctioned and disciplined by the Prague Stock Exchange for insider trading a decade ago. But what if the system turns up 12 John Smiths? How do you as a brokerage know if this is the same guy trying to open an account with you? That's where RDC's staff, called Alerters, comes into play. They will conduct more extensive manual searches to weed down the list and then send a final report, or Alert, to the brokerage.

"The bank would then know we have to be careful with this person. What they do with it is up to them," says Catucci. "If you're to look at a forest of trees, we're identifying the trees that you should look at carefully."

The GRID system also continually updates to make sure that a client that came up clean in August is still clean in December, for example.

"At any particular given moment you can wake up to new facts about a customer. The challenges are significant because of the pace and volume of business on a global basis," says David Lawrence, associate general counsel at Goldman Sachs and a former federal prosecutor, who helped develop RDC.

Goldman Sachs' financial firm partners in RDC include Allianz, American Express, Citigroup, Deutsche Bank and UBS. Its board members include Judge William Webster, formerly director of the Central Intelligence Agency and Federal Bureau of Investigation.

David Leppan, chief executive of Global Objectives, which runs World-Check [see box below], a competing online database of about 55,000 high-risk individuals, claims the GRID model may be too broad. By including people who have been through bankruptcy and forfeiture proceedings, the system may act more like existing credit bureaus than a tool for filtering out truly risky criminals and terrorists, Leppan says. And banks have to send their customer lists to the RDC for matching; that makes it impossible to use it as a tool for monitoring suspect transactions, says Leppan.

Goldman Sachs' Lawrence defends the use of forfeiture records as necessary. He concedes that GRID is not set up to track individual transactions but instead focuses on suspicious individuals and organizations that could potentially initiate those transactions. "There are other products by some terrific vendors that focus on money flow. We are looking at the people, the organizations and companies. It's the other side of the equation," Lawrence says.

One vendor that's experienced an upsurge in business is Mantas, which builds data mining software that uncovers suspicious patterns in a customer's transactional behavior. Red flags include unusual wire transfer activity, sudden transaction activity to high-risk countries and organizations, rapid movement of funds and a series of innocent looking, separate transactions that may be linked to one shady entity. Mantas has experienced a tripling in demand for its software since passage of the Patriot Act and 9/11, says Temple.

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Do You Really Know Who You Are Doing Business With?

A database might help you sidestep the bad guys.

James Bond it isn't, says David Leppan, the head of World-Check, a company that describes itself as "the intelligence service to the financial community." Set up in London in October 2000, World-Check compiles lists of people around the globe who may carry risks for banks doing business with them. That's not just your regular criminals, arms dealers or money launderers, but also politicians, their friends and families.

Banks around the world are increasingly required by law to "know their customers," and World-Check helps them meet this need, says Leppan: "It's an early warning system for what you legally need to know."

But if you have a freewheeling private-sector secret service in mind, think again. World-Check is effectively an automated, highly specialized news clipping service. A team of some 24 researchers around the globe identify potential subjects; their names are fed into a search engine with software provided by Autonomy, a Cambridge, UK-based company. This trawls through 7,000 Web sites and 800 printed sources to identify, for example, business associates of politicians in a particular country. Armed with that knowledge, a bank can decide whether or not to do business with a potential client. Because the system is real-time, it can also monitor transaction flows, says Leppan.

Late-night rendezvous and rifling through trash cans are out, says Leppan. Data privacy laws in key jurisdictions such as the United Kingdom mean banks can use only publicly available information in making these business decisions.