

**ANTI LAUNDERING MONEY POLICIES IN THE
E-CONTRACTS USED BY THE ELECTRONIC TRADING
PLATFORMS**



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1 INTRODUCTION

Thanks to technology, the frontiers that used to impose limitations on us have been eliminated, and a person from anywhere in the world can make transactions with people from other countries without the need to travel. This has enabled business that doesn't need written contracts, thanks to advances such as electronic contracts, which are being used with increasing frequency. E-commerce has been in recent years one of the most lucrative activities and e-banking have enabled clients to replace offices with computers to carry out their transactions. This implies that our paradigms have changed, and this reflects on our way of thinking about technology.

However, technology has also nurtured new illegal modalities. Terrorist and criminal groups find a new refuge that makes their activities simpler. Cybercrime paved the way for the establishment of new criminal typologies—of which the typical example is hacking—but in turn it ended up being a decisive element for countries to pressure their governmental entities to catch up with the new technological advances.

This is why it is necessary for the legal systems in each country to be thoroughly complete and for its institutions to be prepared to face these threats. One of the biggest problems with globalization is the fact that criminal organizations may transfer their misbegotten resources to any place in the world.

In the last decades, thanks to the enormous dividends generated by financial markets, these organizations have invested large sums with the aim of turning illegal money into legal money. Therefore, it is necessary for the entities susceptible to these risks to be able to minimize them from a corporate perspective with help from a zero-tolerance government towards these activities.

The scopes of this work are the policies adopted by brokers in Europe, United States, and Switzerland in relation to ML/FT that enable access to Internet-based electronic trading platforms, and a legal problem is formulated in the following question which it is the aim of this work to resolve: Are the Anti-Money Laundering policies used by the electronic platforms efficient enough and applied in accordance with that established by the law in their e-contracting phase, or is a legislative reform necessary to enable these ML/FT laws to go hand in hand with technological advancements?

The methodology use in the work will compromise the selection of three brokers firms that has a recognize electronic trading platform and their contracts will be analyzed according to their jurisdiction, governing law and anti-laundering money policies and comparing within the three of them: one country of the European Union (Denmark), United States and Switzerland.

The work will be divided into three segments; the first one (Chapter 2) explains in general terms the working of the electronic platforms and e-contracts that may be derived from financial activities; the second one (Chapter 3) is focused on explaining ML/FT laws and policies, focusing primarily on United States, Europe and Switzerland, after that one broker from each country mention before will be selected to be analyzed; and the third one (Chapter 4, Conclusion) proposes a series of criticisms and possible solutions, trying to solve the problem posed above.

That's why the research is based on a discussion on the operation of policies against money laundering and financing of terrorism (ML/FT), from the viewpoint of how these activities have been influenced by technology. The methods used to combat these activities have changed through the years, but always aiming at the same goal of keeping capital from flowing illegally into a country's economy with its ill effects on the macro economy, the paying of taxes and with ill consequences for the citizens.

2 ELECTRONIC PLATFORMS

In this chapter, it will be discussed what an Electronic Trading Platform (ETP) is and will be focused on the role that this one play in the marketplaces and their function within the securities market. This chapter will be further divided into three parts; the first one will define what marketplaces are and their function in relation to e-commerce; the second part examines the Electronic trading platforms in the financial world and how they work; and the third part will discuss and analyze the contracts in this field.

2.1 MARKETPLACES

Thanks to e-commerce many industries went from being physical entities to being virtual entities (with marketplaces being the electronic business centers). This brought along new commerce dynamics between the different web participants. The most common and used of this is the sale of goods and services, which pose a special interest for legislators around the world due to the volume of transactions, carried out every day.

This leads to question what is a marketplace and how it works: The definition of an e-marketplace is inherent within e-commerce and the activities that are carried out, where the Internet is one of the determinant factors for its success, allowing users to have global access, immediate real-time access, virtually infinite space, multimedia, interactivity, database driven information and data mining user interface¹, which allows the establishment of a scalable business structure anywhere in the world without restrictions, and only with one computer.

E-marketplaces are defined as: “[the] logical extension of the ability of large e-business companies to place the procurement process online, and of all e-commerce companies

¹ Nordlund (2000) p.14

to place their goods and services online, including payment and logistics”². Or, in a simpler way, they could be defined as "web-based systems that link multiple businesses together for the purposes of trading or collaboration"³.

Using both definitions, e-marketplaces may be considered as those spaces in which transactions of all types are made, involving a virtual intermediation and negotiation ecosystem, which generates operations of offer or demand of contracts, or any other type involving goods and services.⁴.

The main functions of marketplaces are divided into three areas:

“Matching buyers and sellers; facilitating the exchange of information, goods, services and payments associated with market transactions; and providing an institutional infrastructure, such as a legal and regulatory framework, that enables the efficient operation of the market”⁵.

Those in charge of the first two functions are the market intermediaries, whether in offers between buyers and sellers or the exchange of information; the third function is only attributed to governments as these are in charge of creating laws and enforcing their application.

There are many classifications of the functioning of e-marketplaces, and the most appropriate is the following, which distinguishes three kinds of participants within this milieu: The first ones are the operators for third parties independent of the company to which they offer their services; the second ones are consortiums, which belong whether to the buyers or the suppliers within the marketplace; and the private operators who

2 Telecoms InfoTech Forum (2001) p. 3

3 White (2007) p.3

4 Nordlund op. cit p.14

5 Bakos (1998) p.5

create their own marketplace to negotiate directly with their users without any kind of mediation⁶.

The importance of e-marketplaces for the financial markets has its origin in the structure, functioning and agility, they provide to their different participants, whether in selling or buying stock or any other trade instrument offered on the market. ETP allows this kind of operations, as they are the materialization of one or many classes of marketplaces from our classification, and they can act as independent third parties or by offering their clients all services without the need for an intermediary.

2.2 ELECTRONIC TRADING PLATFORMS

This part is dedicated to Electronic Trading Platforms (ETP) in the financial sector and how they function. The purpose of these platforms is to work as a “communications system facilitating transmission of pre- and post-trade information, order routing, matching, execution, trade clearing, settlement, and custody”⁷, and that means that any users can access through the Internet to these communication systems and to perform any one of the activities described above.

The financial market is the market where sellers and buyers interact with each other to buy any kind of financial instrument (commodities, securities, forex or derivatives), the most important and well known is the capital market⁸ that consists of the stock market and bond market. The Financial market is divided into two marketplaces known as the primary and secondary market; the primary marketplace is that in which any financial instrument may be bought directly from the issuer; whereas the secondary marketplace is an indirect negotiation model where speculation and mediation play a significant role,

⁶ White op. cit p.4

⁷ Hendershott (2003) p.11

⁸ Howells, Bain (2007) p. 17

where the issuer of the tradable instrument does not play any relevant role in its negotiation. The ETP negotiates at the secondary market, as these mediate the negotiation of different financial instruments, acting automatically when the user wishes to accept any order.

The financial market performs four kinds of transactions; the first one is the direct search market, where the traders look for offerors or buyers on their own, in other words, it is a market where all transactions are performed directly between the parties; the second kind is the brokered market, where the trader contracts agents to carry out these tasks; the third is the dealer market, where the traders complete the transactions negotiating with the sellers, who have their own business portfolios and are willing to buy or sell at any moment; and the fourth is the auction market, where the traders negotiate directly against the orders from other traders who communicate through a unique centralized intermediation system⁹.

ETP may be used for these kinds of transactions, but the most common one is the auction market, which is characterized for being a blind market, meanings that there is no information on which the parties are, there is only the assurance that the offers of tradable instruments are sent and subject to luck of the draw, where if the offered price is compatible with the sell price, the instrument will be traded between those two parties. What makes this market structure attractive is that it “provides centralized procedures for the exposure of purchase and sale orders to all market participants simultaneously. By doing so, they virtually eliminate the need for middlemen to locate compatible partners and to bargain for a favorable deal”¹⁰.

⁹ Lee (1996) p.398

¹⁰ Ibid p.398

The difference between e-brokerage and e-auctioning is centered on the market perspective. The former is there to "help customers compare offerings from many vendors in order to find a good match for their specific needs with regard to product attributes, service, price, and other factors". The latter is there to "formulate contracts by discovering the market price of goods. Traders electronically expose their bids and offers to multiple potential trading partners, and computer-based market systems create transactions by discovering market prices of goods based on those demands and supplies"¹¹. Both are necessary for financial markets.

ETP was born as a consequence of the boom of the internet in the 1990's, Many internet websites began to offer services through electronic communications networks (ECN) which allowed the users to negotiate securities without the need of intervention from the banks. Websites such as dealt4free or Charles Schwab offered these services making it much cheaper to participate in the financial market. Without the banks, there was a boom in the financial market and, particularly in currency exchange, these ETP offered real time prices and allowed users to form prices.

Therefore, the ETP is defined as a computer system designed for the user to be able to close or open orders through a network by a financial intermediary, usually the financial instruments that are offered by these platforms are all kinds of securities (bonds, stocks, currencies, commodities and derivatives). The platforms are composed of live stream prices, tools such as financial charters of the instruments and financial news.

The advantage of ETP is the ease with which users can follow second by second any tradable instrument, allowing the creation of prices depending on the quantity of offers and the demand, creating a transparent market. A trading system must not be confused

¹¹ Ibid p.400

with ETP. Those are methods created by the market players in order to gain information on the instruments and are defined thus: “programming instantiates specific rules regarding allowable messages that participants can send and receive and the type of information displayed. The system transmits pre- and post-trade data about quotes and trades to market participants”¹².

The e-marketplaces brought the development of the electronic financial market, thanks to technology and its influence it has created new practices in the negotiation of financial instruments providing a more rapid, fair, accessible and transparent financial world. ETP plays a significant role in this respect, creating a more attractive and simpler sector for Internet users with the necessary knowledge on investments, to download the platform and start to trade.

2.3 ELECTRONIC TRADING PLATFORM CONTRACTS

This chapter focuses on contracts (both electronic and classic ones) and their pre-contractual phases, from the financial viewpoint and more specifically those performed by online brokers. It will analyze e-contracts and their features, also explores the contracts used in the financial market, and finally dedicate to examine those contracts performed in the opening and negotiation in ETP.

ELECTRONIC CONTRACTS

Electronic contracts were born as a response to transactions carried out through the Internet, bringing about the dematerialization of law institutions. The Internet allowed the globalization of the world and brought together millions of people to offer their goods or services without the need to negotiate a contract personally. Nowadays, one of the parties simply sends a contract via e-mail, and the other one attaches their digital

¹² Hendershott op. cit p.11

signature to a copy of the contract and thus, without the need for additional requirements. A consensual agreement is made.

With the adoption of e-contracts other problems emerged in relation to the interpretation and adoption of different legal systems; each country, depending on the legal family to which it belongs, has elements within the contracts that are not used by other countries. An example of these is the rules applied for offering; English laws demand different requirements than French laws. In response to the above, model laws were created that could solve these problems trying to homogenize electronic contracts¹³.

An e-contract is a bilateral manifestation of will be aimed at producing legal effects, and in this case, the medium of negotiation to be used will be either the Internet or any other electronic means. For the existence of an e-contract, the same formalities are necessary to any other contract. This means an accepted offer, and the requirements demanded by the laws of each country¹⁴. In conformity with the above it is understood that e-contracts comply with the same requirements as any other types of contract, but also that they are executed and dealt with via electronic media, with respect to their different stages.

FINANCIAL CONTRACTS

The contracts used in the financial market depends of the type of investor, the most common one is the “Portfolio management” that means “managing portfolios in accordance with mandates given by clients on a discretionary client-by-client basis

13 1996 UNCITRAL Model Law on Electronic Commerce (MLEC); •Within the EU: 1999 Electronic Signatures Directive: –2000 EU Electronic Commerce Directive :•2005 UN Convention on the Use of Electronic Communications in International Contracts (ECC)

14 Article 9 of Directive 2000/31/EC, “on electronic commerce, requires EU member states to ensure both that contracts can be concluded by electronic means and that the law does not create any barriers against using such contracts or which deprive such contracts of their validity”.

where such portfolios include one or more financial instruments ' ' (Directive 2004/39/EC art. 3).

Usually broker firm offer three kind of generic contracts depending in the needs of the investor and his knowledge of the market; in the first one the investor buys financial instruments on their own and the broker only complies with those orders (execution dealing); in the second one a broker is appointed to act as the client's representative, and it is the broker who is in charge of buying or selling specific instruments (discretionary dealing); and in the third one the broker advises the client on the state of the market and offers counseling on the best options to earn money, but it is the client who decides what to buy or sell (advisory dealing)¹⁵.

The evolution of the Internet has enabled users to act as investors in the easiest and most accessible manner from anywhere: right now an investor in China may contract the services of a Danish company to buy shares from a German company. The ETP implied that the financial market is transformed into a universe where the users can act directly without the need to know the broker, but this brought along the need to create specialized contracts in the rendering of these services that are agile and, which comply with the requirements demanded by the laws of public order.

Charles Schwab introduced the first negotiation system in the American financial market using a Virtual Private Network (VPN), where users who had access to the World Wide Web could have their resources at their disposal and acquire securities that they considered potentially successful; while brokerage firms managed and supplied the necessary services to be able to buy or sell any financial instrument as if they were in the same stock exchange. The main role played by the companies rendering these

¹⁵ Emmanuel (2010) p. 54, 55

services, is that of being in charge of supplying the securities that may be bought or sold, guaranteeing the effective performance of the operations.

The activity of online brokers comprises the following steps: "The first activity involves an electronic agreement between a buyer and a broker (and similarly between a seller and an agent). The second activity encompasses an electronic agreement between agents representing the buyer and the seller to transfer stocks from the seller to the buyer at a mutually acceptable price. The third activity is the execution of the contract, in which the order completion information is relayed back to the buyer and the seller"¹⁶.

In other words, first an e-contract or physical contract is created between the user and the broker, and this stage determines the conditions of the opening of an account that will allow access to the ETP and upon compliance of the requirements, the broker may operate it from home. The constitution of the contract with respect to the opening of an operation account is formalized and executed in the application form.

The application form itself is the contract between the parties, and it establishes the broker as the investor's agent. The following text defines the abovementioned relationship: "The process of online stock trading starts with the investor signing up with an online brokerage house. The form is a contract which allows the firm to trade as an agent for the investor at a preset trading price. After the successful completion of the application process, the client may start trading. When the investor places a trade using the online system, the investor is effectively signing an electronic contract with the agent (their broker) to buy (or sell) a certain number of stock a market price (called a market order) or at a client-given price (called a limit order)".¹⁷.

¹⁶ DASGUPTA S (2010) p.21

¹⁷ Ibid p.21

Among the elements of this e-contract, the consent is express to the instant that the user decides to “fill the application form”, and the offer elements are gathered when the broker accepts the application. The perfection of the contract will be manifest at the moment that the broker allows access and let the user deposit the money to start trade. It is here that institutions fighting against ML/FT play a decisive role in creating policies that must be implemented by the brokers in order to fight these activities (concern that will be discussed in the next chapters). Having said the above, e-contracting only is executed when the user can begin to negotiate securities on the financial market by obtaining access to the ETP, that is, when money is deposited in the account.

Below analyzing the requirements demanded by brokers in order to open accounts and obtain access to their ETP. Two types of contract must be distinguished in the use of these services. There is the one that comprises the opening of the account and there are the contracts that exist in each operation, further discussion.

Summarizing this chapter, the Internet has allowed the financial market to become decentralized and demonopolized, but among the problems that aroused there is ML/FT along with other illegal practices. The main purpose of the financial market and the ETP is to be accessible, sophisticated, safe, and to avoid by all means possible being used for illegal activities.

3 MONEY LAUNDERING AND FINANCING TERRORISM

This chapter is entirely dedicated to explaining money laundering and financing terrorism (ML/FT), and is divided into three parts: First is dedicating to answer see what is it, and look at their development around the history; second the discussion will describe the different international legal instruments and the main institutions fighting against it; and the third section will explain some typologies.

3.1 MONEY LAUNDERING AND FINANCING TERRORISM BACKGROUND

Money laundering and financing terrorism is defined as: “[a] method by which all proceeds of crime are integrated into the banking systems and business environments of the world: black money is washed so it ends up whiter than white”¹⁸. Money laundering brings together all the activities used by criminal organizations in order to legalize their resources by means of different modalities ranging from Shell bank deposits (A bank that has no physical presence in any country) to the purchase of securities with the purpose of evading illegal resource monitoring and control systems.

The complexity of the strategies used by criminals dedicated to ML/FT has been met by authorities sufficiently specialized in identifying and tracking down money movement patterns, creating a series of increasingly efficient policies on fighting and preventing this activity.

The Financial Action Task Force institution to establish the standards in this field describes the process used by these organizations to laundering money “firstly, cash enters into the domestic financial system formally or informally; secondly, it is sent abroad to be integrated into the financial systems of regulatory havens; and, thirdly, it is

¹⁸ Lilley (2006) p.6

repatriated in the form of transfers of legitimate appearance”¹⁹, that’s the main reason why the fight against this illicit activity has attracted the attention of almost all the institutions around the banking and financial system.

Governments and international organizations simply saw ML/FT as “ more the underlying crime that was looked at than what was done with the proceeds of that crime ”²⁰, that is, simply as a crime-derived activity. Criminals such as Al Capone could only be taken to court in the 1930’s for tax evasion, not for the crime of ML. One of the biggest problems at that time was the birth of secret bank accounts in Switzerland in the same period, which did not appear as an evasion response in order to promote ML, but instead:

“More with the aim of helping people hide away money in fear of the Nazi regime than for other reasons came into the view of people who wanted to hide money for all kinds of legitimate and less legitimate reasons at that time”²¹.

However, this new bank institution allowed people from all over the world to abuse it, using it as a means of tax evasion, in addition to the lack of control on the part of the Swiss government at that time. Offshore financial centers are in operation since the 19th century as a solution for arbitration in tax payment, as people paid taxes in places that offered lower rates, or usually they were exempted.

The movement of capital will be destined for those zones of a country that offer the lowest rates. The first example of this was in New Jersey where the tax rate was so low that it established one of the most famous offshore financial centers. In Bahamas and Curacao a boom of these financial centers took place, thanks to Dutch companies that

19 Financial havens, banking secrecy and money laundering (1998) p.4

20 Kälin, Goldsmith (2007) p.3

21 Ibid p.3

moved to the Dutch Antilles running away from the Nazi regime and giving rise to the period of the Eurodollar during the Marshall Plan.

With the advent of illegal drug trade in the 1970's and 1980's, the policies of the nations focused on trying to stop drug trade and the financing of terrorism (because many terrorist groups finance their wars with the illegal resource coming from the drugs). Among the activities to be stopped there was the selling of illegal weapons, but events took an unexpected turn because the established norms and policies were not being enforced, as the following text relates:

“ Until the mid- to late-1980s, the traditional emphasis on fighting criminal organizations had been to disrupt the supply of the products (drugs) and to arrest ... The logic of this new approach appears sound: the criminal organization's incentive is to make money, so seizing the money removes the incentive to continue the illicit business”²².

Banks, other financial institutions, securities brokers, wire-transfer businesses, money remitters, casinos and the stock market are now the focus of illegal activity supervision, as these have the highest risk of receiving resources coming from illegal activities. The main purpose was to be able to identify the patterns of activity of these organizations, It is necessary take into account that the stock market could be the easiest way of laundering money in that time, but now with ETP the chance to trade from your home can create an easier way to launder money unless the broker has strong policies against this risk.

Bringing about an end to these illegal activities is the aim of many countries, as these resources are used for financing of these cartels, terrorism and the purchase of weapons.

²² Richards (1999) p.65

As a consequence of the above the economy of a state is affected by the income of these resources, as they are used to finance the activities and the sustenance of the criminal organizations.

The role of combating ML/FT was concentrated on the international community and the legislation of the states, but also on the bank associations and regulators of the financial system who worked on the matter, producing a wave of legislation.

3.2 ANTI MONEY LAUNDERING LEGISLATION

This section is focusing on the legislation and its different approaches to the problem of money laundering and financing terrorism. The creation of norms that fought against this phenomenon came about as a response to the problem of capital movement between the different jurisdictions. In trying to search for a solution to the lack of agreement between the different countries to regulate these monies, the international community created international treaties, with the purpose of building a common strength that could put a stop to ML as stated in the following text in reference to the world financial system and the Internet: “The liberalized global financial system has taken on characteristics that are as conducive to money laundering as to any other form of money movement. The Internet, has radically affected many areas of commerce. It allows the maintenance of a bank account in jurisdiction A by a person in jurisdiction B so as to buy goods in jurisdiction C with the currency of jurisdiction D for delivery anywhere in the world”²³.

23 ALLDRIDGE (2003) p.92

THE VIENNA CONVENTION (1988).

The “Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances”²⁴ of 1988 (Vienna Convention) was the first response from the international community created by the United Nations to fight ML and the legislation of those states that harbored those who perpetrated these deeds. On December 20, 1988 the Vienna convention entered into operation, complementing the “1961 Single Convention on Narcotic Drugs” and the “1971 Convention on Psychotropic Substances”. This convention requires that the member states enforce within their jurisdictions the “criminalize Money according (Art. 3)”, “to provide for asset forfeiture (Art. 5)” and “allow for extradition and mutual legal assistance (Art. 6 and 7)”.

This initiative would complement the treaties already in place on the issue, but their focus was on the legal treatment that should be given to the monies raised and destined for the financing of organizations dedicated to selling of drugs, terrorism or selling weapons. The Vienna Convention was an exemplary model of the policies provided by the international community aimed at using the tools of “immobilization and forfeiture of assets as a means to combat drug trafficking and the accompanying money laundering” (Art. 5 Vienna Convention).

One of the most important tools used in relation to this convention is the cooperation between several states and the use of legal instruments such as extradition (Art. 6 of the convention). The aim of this treaty is to promote cooperation and the creation of bilateral treaties between the member states in order to contribute to the common good. It should be noted that this convention as well as many public international law treaties

²⁴ The main aspect in this convention was the creation of a criminal law that is capable of fighting the drug trade, with the forfeiture of ill-gotten gains, criminalization of money launderers, as well as mutual legal assistance and extradition.

need for the countries ratifying it to create a legislation of a national nature and implement the guidelines set forth in the convention (Art 2(1) Convention of Vienna 1988). Article 5 of the convention is dedicated to promoting in national legislations the tools that would allow the forfeiture of assets related to criminal activities. Furthermore, it establishes in its article 7 that banking secrets cannot be an impediment for legal assistance with other states.

One of the main problems in that time was the lack of cooperation between the states. The purpose of this legislation couldn't fulfill the requirement that needed the fight against drugs in that time, as the problem was beginning none will be realized what would happen in the later years, and as always, legislator never formulated the laws to be capable of endure during the time, and in a field like this that is mutating every time to be more specialized and trick every government and institution around the world.

THE PALERMO CONVENTION

The Palermo Convention Decreed in the year 2000, and titled "The International Convention against Transnational Organized Crime" (Palermo Convention), was adopted by the United Nations with the purpose to complement the existing laws in the struggle against organized crime and its activities. In relation to money laundering the countries that ratified this convention undertook to:

'Criminalize money laundering and include all serious crimes as predicate offenses of money laundering, whether committed in or outside of the country, and permit the required criminal knowledge or intent to be inferred from objective facts (art 6); Establish regulatory regimes to deter and detect all forms of money laundering, including customer identification, record-keeping and reporting of suspicious transactions (art 7(1)); Authorize the cooperation and exchange of information among

administrative, regulatory, law enforcement and other authorities, both domestically and internationally, and consider the establishment of a financial intelligence unit to collect, analyze and disseminate information (art 7(b)); and international cooperation”.

It was adopted by 147 states but ratified only by 82 states. As is the case with many of the conventions and laws on the issue of AML, it was based on principles established by the FATF and its 40 recommendations.

INTERNATIONAL CONVENTION FOR THE SUPPRESSION OF THE FINANCING OF TERRORISM

This convention was created in 1999 by the United Nations, but had not been signed and ratified until the 9-11 attacks, on April 10, 2002, by 112 countries. Its aim is to criminalize and forbid the use of resources to finance terrorist activities. Additionally, any financial entity that knows the destination of the funds must freeze them so that they cannot arrive to these organizations²⁵. This convention is part of the proposal of the United States that became alive after the attacks of 9-11 calling the “The Patriot Act”, could be really difficult to apply when there is still some offshore financial hubs, where the money can be untraceable, with this act few years later U.S. try to pressure Switzerland to reveal the names of the American citizens who have accounts there.

BASLE STATEMENT OF PRINCIPLES.

Basle statement of Principles was born in 1988 as a response from the banks and regulatory agencies, stating that the “main purpose of bank supervisory authorities is to maintain the financial stability of banks, and not to ensure the legitimacy of individual banking transactions, these authorities “cannot be indifferent to the use made of banks

²⁵ Security Council, United Nations, (2002).

by criminals. Such indifference may cause banks to suffer losses through fraud or to erode public confidence and undermine the stability of the banking system”²⁶.

These principles developed by these entities were the first tool to safeguard the financial institutions from ML/FT, complying with the required standards in order to adopt policies that would impede this activity, establishing the need for the banks and governments to operate jointly. Likewise, the banks must follow the guidelines set forth by the laws of each country allowing a harmony in the prevention of money laundering. As guidelines this principles do not have any enforcement by the government, but the banks at least in Switzerland are committed to use them.

FINANCIAL INFORMATION EXCHANGE AGREEMENTS (FIEAS)

Financial Information Exchange Agreements (FIEAS) were established in the year 1995, and their main objective “are bilateral Executive Agreements designed to facilitate the Exchange of currency transaction information between governments. They provide a mechanism for the exchange of such information between the Treasury Department, through Fin CEN, and the other government’s finance ministry”²⁷. Currently it is operating in countries such as Colombia, Ecuador, Panama, Peru, Venezuela and Mexico, they function as obligatory agreements between the countries that’s signs it.

MUTUAL LEGAL ASSISTANCE TREATIES (MLATS)

Mutual Legal Assistance Treaties deals with treaties with the US Department of State, in which the main objective is the cooperation between “U.S. officials and foreign governments in international criminal matters, including money laundering and asset

²⁶ Savona (2000) p.41

²⁷ Richards op. cit p. 258

forfeiture. In this area, the mutual assistance is often in the form of expediting the flow of information from foreign-based banks”²⁸. Currently there are 22 treaties in operation, which have effectively allowed the freezing and forfeiting of accounts from drug trading cartels.

3.3 ANTI MONEY LAUNDERING INSTITUTIONS

THE FINANCIAL ACTION TASK FORCE (FATF)

Financial Action Task Force was Created in July 1989 by the group of 7 (G7) at the Heads of State and Finance Ministers Economic Summit in Paris, the main objective is to combat ML/FT and to commit its members (Represented by 26 countries, the most important financial centers around the world) to the creation of unilateral, bilateral and multilateral agreements that apply in accordance with the 40 recommendations issued by this institution. The 40 recommendations²⁹ are a guideline for the struggle against ML/FT, and its applicability is of a universal nature.

The recommendations are divided in three groups. Recommendations 1 to 7 develop the role that financial systems should have; Recommendations 8 to 29 state how the different members should cooperate among themselves; And finally, recommendations 30 to 40 set forth the guidelines in the application of the recommendations and how these must be adapted to each one of the legal systems.

One of the most relevant aspects in this field is the fact that each and every member must commit annually to comply with these principles and allow it to be supervised by international bodies³⁰. In the year 1996 the recommendations were updated by 9 new principles (so the principles are known as 40+9) and mention of e-payments was

28 Ibid p.259

29 For a more detailed discussion of the recommendations refer to FATF, The 40 Recommendations, http://www.fatf-gafi.org/document/28/0,3746,en_32250379_32236920_33658140_1_1_1_1,00.html. [Visited 10 of September 2011]

30 ALLDRIDGE op. cit p.105

included among them, as an effort to combat these activities in agreement with technological advances. It is important to stress that the 40 recommendations are not binding for the members.

THE CAREBEAN FINANTIAL ACTION TASK FORCE (CFATF)

The Caribbean Financial Action Task Force (CFATF) has the same functions as the FATF, and plays an important role among Caribbean and Latin American countries. One of its major achievements was the conference that took place in 1996 with the aim of regulating casinos. It uses the nineteen Aruba recommendations, based on the 40 recommendations of its counterpart in Paris, but plays an independent role.

THE BASLE COMMITTEE.

The Basle Committee is the biggest international agency charged with regulating and supervising financial institutions. Adopted In 1998 within its discourse to combat money laundering and safeguard the integrity of the banks, producing “ 29 recommendations as to the effectiveness of the supervision of banks operating (as had BCCI) outside their national boundaries”³¹. Within its main interventions within the banking system is the development of the principle of Consumer Due Diligence (CDD) that must be carried out by banking institutions³². It is represented by the central banks and the regulatory authorities of the G-20 major economies countries as Hong Kong and Singapore.

ORGANIZATION OF AMERICAN STATES (OAS)

It was established in the year 1890 as a group of 18 nations dedicated to creating commerce rules amongst themselves. When the treaty of Rio (Reciprocal Assistance)

³¹ Ibid p.107

³² For more on AML Basel Committee, Money laundering and terrorist financing, http://www.bis.org/list/bcbs/tid_32/index.htm [Visited 15 of September 2011]

entered into operation in 1947, several safety measures were also included (regional security pact), but as was the case in the Bogotá treaty of 1948, it was formalized in the OAS Charter. The efforts of this organization have been focused not just on the safety of the member states and dispute resolution, but also in the fight against ML/FT with the creation of the Inter-American Drug Abuse Control Commission (CICAD). It has been charged with creating and improving the banking systems of the member states and their policies.

FINANCIAL INTELLIGENCE UNITS (FIUS)

These are private or public agencies, charged with combating money laundering. They may be of an international nature. The FATF has defined them as “serving as a central point for the receipt, and as permitted by domestic law, analysis and dissemination to competent authorities of suspicious activity report information and data”³³. They include:

- Fin CEN in the U.S.
- Great Britain (Financial Intelligence Unit of the National Criminal Intelligence Service, or NCIS).
- France (“TRACFIN” — “traitement du renseignement et action contre les circuits financiers clandestins,” or treatment of information and action against illicit financial circuits).
- Belgium (“CTIF” — French for “cellule de traitement des informations financières,” or bureau of treatment of financial information, or the Flemish “CFI” — “cel voor financiële informatie-verwerking”).

³³ Richards op. cit p.255

- Mexico (created with the assistance, and funded through, FinCEN, and opened in April 1997)³⁴;

THE WOLFSBERG GROUP

The Wolfsberg Group represents association of eleven global banks, which aims to develop financial services industry standards, Anti-Money Laundering and Counter Terrorist Financing policies. The Wolfsberg Anti-Money Laundering Principles were published in November 2002.

INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONERS (IOSCO).

International Organization of Securities Commissioners (IOSCO) is charged with regulating the financial markets around the world. There are currently 105 regulatory agencies around the world. It may also be comprised due to lack of governmental entities by the regulatory agencies. It operates under three principles;

The protection of investors; Ensuring that markets are fair, efficient and transparent; and the reduction of systematic risk³⁵.

The way IOSCO works in the regulation against AML is based in the 7 steps:

1. The extent to which customer identifying information is gathered and recorded by financial institutions under its supervision, with a view to enhancing the ability of relevant authorities to identify and prosecute money launderers;
2. The extent and adequacy of record-keeping requirements, from the perspective of providing tools to reconstruct financial transactions in the securities and future markets;

³⁴ Ibid p.256

³⁵ IOSCO, (2003)

3. Together with their national regulators charged with prosecuting money laundering offenses, the appropriate manner in which to address the identification and reporting of suspicious transactions;
4. The procedures in place to prevent criminals from obtaining control of securities and futures businesses, with a view to working together with foreign counterparts to share such information as needed;
5. The appropriate means to ensure that securities and futures firms maintain monitoring and compliance procedures designed to deter and detect money laundering;
6. The use of cash and cash equivalents in securities and futures transactions, including the adequacy of documentation and the ability to reconstruct any such transactions;
7. The most appropriate means, given their particular national authorities and powers, to share information in order to combat money laundering³⁶.

These are in short the most important ones, with the collaboration of the Interpol, the International Monetary Fund and the World Bank.

3.4. MONEY LAUNDERING AND FINANCING TERRORISM TYPOLOGIES

In this chapter, the discussion will focus in the most common typologies used by the experts to laundering the money, but to understand them almost all experts define a series of steps that normally are used to perform this activity always divided by three general steps describe below:

1. ‘ ’ The placement. Involves placement of illegally derived funds into the financial system, usually through a financial institution. This can be accomplished by depositing cash into a bank account. Large amounts of cash are broken into smaller, less

³⁶ "Initiatives by the BCBS, IAIS and IOSCO to combat money laundering and the financing of terrorism", (2003).

conspicuous amounts and deposited over time in different offices of a single financial institution or in multiple financial institutions”³⁷.

2. ‘ ’ Layering. after the ill-gotten gains have entered the financial system, at which point the funds, securities or insurance contracts are converted or moved to other institutions, further separating them from their criminal source”³⁸.
3. ‘ ’ Integration. “ integration of funds into the legitimate economy. This is accomplished through the purchase of assets, such as real estate, securities or other financial assets, or luxury goods”³⁹.

This is how the money can be laundered, but the criminals develop so many diverse ways to structure the same steps in a different economic sector of the society, only few typologies will mention to give a general idea, of how they do it:

- a. Structuring: It consists of trying to evade bank policies, structuring a model in which the person deposits less than 10,000 USD in different accounts, not raising suspicion and being able to transform a large sum of money into small but legal ones.
- b. The Use of Front Companies: A legal business is simply used as a cover, with the lack of control the authorities cannot know how much is bought or sold. One of the most common ways is through “Money-Service Businesses” (MSBs). Money-service businesses, or MSBs, include money transmitters, check-cashing businesses, traveler’ s-check and money-order issuers, currency exchangers, and issuers of stored-value cards. They are notorious as fronts for money laundering” .

³⁷ The World Bank (2006) p.22

³⁸ Ibid p.23

³⁹ Ibid p. 24

- c. Bank Draft: By withdrawing money from one country into another, or through international remittance intermediaries.
- d. Use of foreign Banks: The use of foreign banks of a suspicious provenance or otherwise, which are in a jurisdiction that has not ratified any treaties on the matter.
- e. Investment in capital markets. It's the procedure of buying tradable financial instruments to hide their origin.
- f. Trade-based money laundering: Usually involves invoice manipulation and uses trade finance routes and commodities to avoid financial transparency laws and regulations.
- g. Structuring of deposits at multiple bank branches to avoid Bank Secrecy Act requirements⁴⁰.

As a matter of fact, the using of these schemes not always will be successful because they are the common ones, professionals in this illegal activity always change their modus operandi, and don't let authorities catch them so easily, with the new technology's access to securities market could be more affordable to criminal to try to clean their money, but that's the place where authorities and companies are starting to take care more of their policies trying to avoid these resources.

3.5 ANTI MONEY LAUNDERING IN EUROPE UNITED STATES, SWITZERLAND

In these chapter is going to be examining the legislation of the United States, the European Union and Switzerland, considering that these represent the most important financial systems in the world. Most of the transactions in the financial market take

⁴⁰ Richards op. cit. and O'Sullivan (2008)

place either at the European Union (England, France or Germany), or in the United States market (at the Chicago commodities stock exchange), and in Switzerland they represent an important market due to the economic stability and the conditions offered to investors.

EUROPEAN UNION

The first Directive from the European Union regarding the fight against ML/FT was issued in the year 1991. Although it was not the only legislation dealing with these matters, it was indeed one of the most complete in fighting the surge produced at the end of the 1980's. It is known as "the directive on prevention of the use of the financial system for money laundering" on the Council Directive 91/308/EEC. Subsequently, two other Directives followed which complemented the first one and intervened in new aspects, such as regulating the profession of lawyers.

The Directive 91/308/EEC was focused on avoiding the use of financial and credit systems for ML. When a single market was implemented the free flow of capitals and persons between the countries would be one of the main risks suffered by these institutions, and taken advantage of by criminal organizations. With the purpose of combating them, a series of preventive measures was created in order to minimize the risk.

Among them is "customer/client identification, record-keeping and central methods of reporting suspicious transactions"⁴¹. But this Directive still does not completely respond to the problems presented. It simply "provides that member States shall ensure that laundering is prohibited, but without specifying the mechanism by which the

⁴¹ Directive 91/308/EEC

prohibition is to be achieved”⁴². Another problem was the definition of ML. It was simply focused on activities related with drug trafficking (The Parliament of Europe extends the provision of drugs and goes beyond to all the profession of the organized drugs)⁴³.

Directive 2001/97/EC is the second Directive charged with updating its predecessor on this matter. It incorporates the 40 recommendations of the FATF, and it establishes new rules applicable to the jurisdiction and its manner of implementation in the different member nations in relation to suspicious transactions. The problem came when a financial institution had many branches in different member countries, and the laws had validity only in the country where they had been established, with some countries being more flexible than others. In the face of this, the new Directive ensured that corruption-related activities had to be regulated in order to prevent the risk of susceptibility to ML.

It also created a list of possible institutions that may run this risk, and included “currency exchange offices, money transmitters and investment firms”. Another one of these particularities is the use of new tools to combat this activity, such as the power enjoyed by the authority to “identify, trace, freeze, seize and confiscate any property and proceeds linked to criminal activities”⁴⁴.

The third 2006/70/EC Directive is the one currently in force. It incorporates the new FATF recommendations and policies for combating terrorism in accordance with the standards of the year 2003. Within its scope of application the Directive focused on establishing the susceptibility to risk of non-financial institutions and certain professions. One of its most important developments was the regime applicable to “

42 ALLDRIDGE op. cit p.97

43 Ibid p.97

44 Directive 2001/97/EC

lawyers, notaries, accountants, real estate agents, casinos and encompassing trust and company services, exceeding €15,000”⁴⁵. This Directive had to be transposed by all its members by a final deadline of December 15, 2007, since then is been applying by all members.

UNITED STATES

The history of the United States on money laundering begins in the time of the prohibition, when Al Capone was trying to evade taxes and use the resources accrued from illegal trade of alcohol. But the first AML policies that fought this problem directly were created through the Bank Secrecy Act (1970), creating rules binding the banks:

“Established requirements for recordkeeping and reporting by private individuals, banks and other financial institutions; Designed to help identify the source, volume, and movement of currency and other monetary instruments transported or transmitted into or out of the United States or deposited in financial institutions; Required banks to (1) report cash transactions over \$10,000 using the Currency Transaction Report; (2) properly identify persons conducting transactions; and (3) maintain a paper trail by keeping appropriate records of financial transactions”⁴⁶.

In the year 1986 a law was issued to combat ML, known as the “Money Laundering Control Act”, complementing the abovementioned law. It established that ML is a federal crime. Among the measures introduced by the authorities there was “the civil and criminal forfeiture for the violation of the BSA”.

⁴⁵ Directive 2006/70/EC

⁴⁶ Bank Secrecy Act (1970)

In the following years came the “Anti-Drug Abuse Act of 1988”, “the Annunzio-Wylie Anti-Money Laundering Act 1992” and “Money Laundering Suppression Act 1994“, imposing stricter controls on how the banks should act and included non-financial institutions to impose stricter methods with relation to the use of financial resources and the prevention of ML.

In the year 1998 the Money Laundering and Financial Crimes Strategy Act made proposals on how the AML policies should be created and enforced for banks and, at the national level, that they should be created by governmental agencies (Department of the Treasury), and intensified the struggle with the creation of an agency charged with investigating financial crimes (HIFCA) “Task Forces to concentrate law enforcement efforts at the federal, state and local levels in zones where money laundering is prevalent”⁴⁷.

As stated in previous chapters, after the 9-11 attacks the Patriot Act was signed into law, and it toughened the existing laws to “require that financial institutions know their customers, including their identities, their business, and the source of their funds; and require the filing of reports if a transaction, or a structured set of transactions, involves \$10000 or more in currency, or monetary instruments”⁴⁸.

It is important to stress this provision vis-à-vis the others, as it establishes not just for banks, but also for brokers, that the identity of the investor should be known, as well as the provenance of the resources, topics that will be discuss later. It complemented the previous Intelligence Reform & Terrorism Prevention Act of 2004 which deals with

47 Ibid

48 Money Laundering and Financial Crimes Strategy Act (1998)

matters related to capital flows through electronic and paper systems, which it is the role Secretary of the Treasury to regulate⁴⁹.

SWITZERLAND

Switzerland is one of the most important countries in the financial sector, and the proof of this is the 11.6% that the financial sector represents in its GDP⁵⁰. Its banking system has its origins in the 13th and 14th centuries, which generates trust for investors due to its strict policies. Likewise, Switzerland is perceived as a safeguard for investments due to the stability of its currency and its large gold stocks. One of the most important elements characterizing the Swiss banking industry, and which implies a high risk of money laundering is the establishment of bank secrecy.

Bank secrecy is defined as: “in essence – the confidentiality due by a bank to its clients and is frequently associated with Switzerland on an international level”⁵¹. It is necessary to clarify that since 1990 with the new criminal code, Switzerland came to lift the veto of confidentiality in money laundering and tax evasion pursuant to the provisions of Art. 47 of the Bank Act, and Art. 305 of the Swiss criminal code.

The fight against money laundering is designed in several fields of law: In the Swiss Criminal Code; in the creation of financial units known as MLRO in 1998; from the administrative field of law; and “in the financial sector uniform rules of due diligence was made in 1998 for all financial intermediaries in the banking and the non-banking sector”⁵².

49 FinCEN (Look 28 of September 2011)

50 SWISSBANKING (2010)

51 Pieth, Aiolfi (2004) p.118

52 Ibid p.127

It is worth noting that the Swiss legal system combats money laundering in a preventive manner and subsequently uses penal code tools. Likewise, the self-regulation laws for banks strengthen this struggle. Among them is the agreement on the code of conduct regarding the exercise of due diligence (CDB 1977) and its subsequent revision in the year 2008, the regulatory authority is the Swiss financial market supervisory authority (FINMA).

3.6. ELECTRONIC TRADING PLATFORMS POLICIES

Previously have been explained the operation of the ETP and how the laws against ML/FT worked. The analyses will center in the policies of a series of brokers who offer ETP to clients around the world. Looking at their e-contract, establishing the applicable jurisdiction and the AML laws of the relevant country in which the firm has its main headquarters.

PLATFORMS

Three platforms were choosing, considering the important role that they play in the financial sector. Each of them belongs to one of the countries mention in the previous chapter. The study of A.M.L policies will be focused on three stages; the first analyzes the contract (what type of e-contract (see chapter 2)); the second determines the jurisdiction and governing law according to A.M.L laws; and the third will explain the policies implemented by these ETP.

The main objective in this part is focusing on the contracts that natural persons sign with the broker firm, because exist a greater risk to be susceptible to receive illegal resources from this kind of contracts due to the amounts are not so large and are also less regulated than legal persons because the latter's activities are supervised in their respective countries.

3.6.1 SAXO BANK⁵³

HEADQUARTERS: Copenhagen, Denmark

ESTABLISHED: 1992

PRODUCTS: Investment Bank

REGULATE: F.S.A. (Finanstilsynet)

AML POLICIES E-CONTRACT: CDD

PLATFORM: Saxo Trader

TYPE OF CONTRACT: Automated Execution Dealing

One of the largest brokerage firms that provides services since 1992, it has developed one of the most leading and comprehensive ETPs in the financial sector and offers different negotiation instruments, either by stocks, forex or commodities among other. It is noteworthy that it has always been recognized as an investment bank that uses technology as main tool and complies with all standards required by the European Union. Their headquarters are located in Denmark but they also have commercial agencies in London and Switzerland, regulated by the respective organisms of each country⁵⁴.

The accounts to operate the platform can be opened by natural or juridical persons. The accounts that can be opened by natural persons are divided according to the amount but the procedures for each of the accounts are the same.

CONTRACT

The first step to be able to start operating with this broker is to choose what type of account is wished to be opened, there are three types divided by the amount that the

53 "Saxo Bank classifies its Clients in three main categories: Eligible Counterparties (ECPs), Professional clients and Retail Clients" "different levels of regulatory protection to each category and hence to Clients Within each category. In particular, Retail Clients are afforded the most regulatory protection; professional Clients and ECPs are considered to be more experienced, knowledgeable and sophisticated and able to assess their own risk and are thus afforded fewer regulatory protections" (legal business terms).

54 Saxo bank, [http://www. Saxo Bank.com/about-us/saxo-bank](http://www.Saxo Bank.com/about-us/saxo-bank) [Visited 18 of September 2011]

natural person would like to invest. The two first ones are the Classic (USD 10000) and the Premium (USD 100000), these have similar characteristics, nonetheless, the Premium offers the user more leveraging and more negotiation instruments; the third option is the Platinum (USD 500000) besides receiving the benefits from the other two accounts, this account has personalized counseling from a specialized member of the firm. In this case, before the two first accounts there will be an execution dealing⁵⁵ contract, while the third is named advisory dealing and execution dealing⁵⁶ at the same time. The procedure to open the account is same for all three cases:

1. Choose your account & submit application.
2. Send us supportive documentation.
3. Fund your account and start trading.

In the previous chapter was mentioned, there are two types of e-contracts, the first ones allow for opening an account, depositing some funds and accessing the ETP, and the second ones are composed by the openings or closings of each operation (in other words, there is a contract every time it is wished to negotiate in the platform).

The first contract is an offer and its acceptance will depend on the broker's acceptance. It is divided in two instants, the first is the pre-contractual stage, the offer is constituted by the "application form" which is completed and sent by electronic means while the physical required documentation is mailed, thus it is necessary for the offerer to previously know the risk that this market represents: "Trading in financial products always involves a risk".

⁵⁵ Broker only buys stocks and other financial instruments on the behalf of the client.

⁵⁶ Broker advises the client about the market, but still he is the one who decides where to invest the money.

As a general rule, you should therefore only trade in financial products if you understand the products and the risks associated with them”⁵⁷. The second instant, when the contract is perfected and the user acquires access to the platform as long as all documents were in order and correct according to the mentioned in the application form. In these stages the ML/FT policies are implemented according to the set forth by law.

The other contracts are those in which the client invests in a financial product. These would be purchases or sales of some security, but it may only work with previously deposited money⁵⁸. The purchases or sales will be reflected on losses or earnings on the total balance of his/her account when opening or closing positions. The analysis only focuses on the first ones.

The aforementioned contracts are derived from the main contract which allows us to have access to the ETP; the client must understand what are his/her rights and obligations besides the risks incurred by negotiating in this system. The contract’s terms for the opening and functioning are regulated in the following documents: General Business Terms (including the Risk Disclosure Statement), the Business Terms for Securities Trading, and the Business Terms for Custody Management, the Business Terms for International Transfer of Funds as well as the Conflict of Interest Policy and the Best Execution Policy”⁵⁹. (All these terms are according to the Directive 2002/65/C that regulates the distance marketing of financial products).

The responsibility of Saxo Bank’s obligations will cover only the predictability spectrum as they mention it in the following clause: “Saxo Bank shall not be liable to

⁵⁷ Client application form Saxo Bank.

⁵⁸ Margin contract means that the client only operates with the money he previously deposited in his account.

⁵⁹ Saxo Bank, Legal documents <http://uk.saxobank.com/about-us/legal-documentation>. [Visited 17 of September 2011]

the Client for any failure, hindrance or delay in performing its obligations under the Terms where such failure, hindrance or delay arises directly or indirectly from circumstances beyond its reasonable control.” Such force majeure events shall include without limitation any technical difficulties such as telecommunications failures or disruptions...”⁶⁰

GOVERNING LAW AND JURISDICTION IN AML

In this second section studies the jurisdiction and the applicable law according to the terms set forth in the contract from Saxo Bank, the perspective only examines what is based on the established A.M.L laws and that will enable, in the third point, to analyze the policies that have been adapted by that firm and if what is mentioned in the norms is complied with according the procedures for the account opening.

The law that governs the contract and the applicable jurisdiction are stipulated in the “General Business Terms” on clause 29 titled ‘GOVERNING LAW AND CHOICE OF JURISDICTION’, divided in paragraphs that refer to the law governing the contract which is the applicable jurisdiction to the contract and the applicability of clause 29 under any circumstance.

It is not to debate for practical effects the nature of the clauses according to the commercial relation between the client and the bank and what is establish in the “distance marketing of financial services Directive” the Brussels convention regarding jurisdiction (1960) and Rome’s convention (1980): considering there are two different relations regarding the applicable jurisdiction and the relationships with clients.

⁶⁰ Saxo Bank, General business terms clause 30.2.

http://www.saxobank.com/Documents/legal_documents/General_Business_Terms_ENG_Oct2011.pdf, [Visited 18 September 2011]

For this paper, the laws that govern in connection to the legal responsibility that the bank has on managing AML policies will be ruled by the laws set forth in the contract where the bank determines it's their headquarters and where it's regulated by national authorities of the corresponding country, without the need of the contractual relationship that the client, and the bank have. It is impossible for a financial entity to comply with the A.M.L laws of their clients, which is why in this field, national standards and institutions such as FATF have a harmonization role between the various countries in order fulfill some minimum law compliance requirements.

Regarding jurisdiction, the same case mentioned above occurs and thus, for the purpose of this work, and with the considerations previously expounded, the law that governs the contract regarding A.M.L will be covered by clause 29.1 which states:

“The Client relationship and Terms are subject to and shall be construed in accordance with Danish law as the sole and exclusive governing law”⁶¹, and the jurisdiction regarding any ML/FT legal matter shall be subject to clause 29.2 “The Client and Saxo Bank have agreed that the Maritime & Commercial Court of Copenhagen shall have exclusive jurisdiction and be the sole and exclusive venue in disputes regarding the client relationship and the Terms and any and all dealings between the Client and Saxo Bank”.

However, Saxo Bank reserves the right to commence proceedings in any competent court and jurisdiction that it may find suitable, including but not limited to jurisdictions in which the Client is a citizen or resident and jurisdictions in which the Client possesses assets.

⁶¹ Ibid

Although the jurisdiction issue may be handled by the bank from any of the perspectives of its clause, it implies to sue anywhere from which the client is a citizen or owns assets. For the purpose of ML/FT laws, the applicable jurisdiction is that of Denmark, given that the offense is done through the use of a bank that is headquartered in this country, being the means used to complete this activity no matter where the client is located.

Denmark's A.M.L legal system is composed by the transposition of A.M.L Directives, being of vital importance the implementation of the third Directive regarding money laundering and the fight against financing of terrorism. That is how "Act no. 117 of 27 February 2006" and its consolidation "Act no. 442 of 11 May 2007" known as 'Danish Act on Measures to Prevent Money Laundering and Financing of Terrorism', states that the fight against any of the activities described in these norms and therefore the measures that must be taken by entities or professionals that might be susceptible to this risk.

Criminal law handles money laundering from two perspectives, the first one is aimed at fighting the person(s) who receive earnings from the offense related to drug sales contained in the section criminal code S 191 (a); and the second covers all other criminal activities that allow for generating resources susceptible to be used for laundering, an example would be kidnapping or extortion is contained in S 284 of that same code. A.M.L policies must comply with the requirements set forth in the norms mentioned above and with other agreements to which the country belongs to and with the ones from the European Union.

Art 1 (1) from Act no. 442 of 11 May 2007, establishes the applicable to bank institutions (1) and institutions dedicated to investment (3). Norms that will regulate

ML/FT being applied indirectly to the clients who wish to invest in Saxo Bank, it is important to highlight that financial activities are under supervision of the Financial Supervisory Authority (Finanstilsyne).

POLICIES OF AML IN THE PLATFORM

In this third stage will focus on the applicability that the platform has given to ML/FT prevention policies. In this case Saxo Bank must meet the requirements by Denmark's law. According to M.L.A, anonymous accounts destined to earn profits in the stock market are not allowed, therefore, it is necessary to comply with the prevention policy "Consumer Due Diligence" also known as CDD, implemented in almost all legislations and recommendations. This rule is aimed at promoting knowledge of the client as the best preventive measure to avoid falling into money laundering. FATF points that:

"Financial institutions should undertake customer due diligence measures, including identifying and verifying the identity of their customers, when: establishing business relations"⁶²

With the aim of establishing the client:

- a) Identifying the customer and verifying that customer's identity using reliable, independent source documents, data or information"⁶³.

In article 11 from Act. No. 442 of 11 May 2007: "The undertakings and persons covered by this Act shall always require that customers identify themselves, if they suspect that a transaction is associated with financing of terrorism or money laundering covered by the reporting obligation under section".

⁶² FATF, The 40 recommendations, <http://www.fatf-gafi.org/dataoecd/7/40/34849567.PDF>, 2003. [Visited 12 of September 2011]

⁶³ Ibid

Within the client's identification process, other series of procedures related with "keeping the records of the clients" are taken, and in suspicious transactions any activity that is considered to be related to ML/FT is informed. How is it possible to identify suspicious transactions within the ETPs if everything is liquidated in money and it is necessary for the client to have previously deposited a certain amount to be able to operate? This means that it is only possible to monitor in cases where the client was able to successfully open an account.

Saxo Bank demands the user, in its pre-contractual stage within the application form, to send the following documents:

"PROOF OF IDENTITY

Types of acceptable documents:

- Valid Passport (Identification & signature page required)
- Valid Driver's License
- Valid National Identity Card

Identity documents must be current and valid, issued by official

Government authority and include:

- Full name
- Unique personal identification number
- Date and place of birth
- Clear visible picture which identifies the person
- Signature

PROOF OF RESIDENTIAL ADDRESS

This document must be valid and include the current permanent address of the holder and be issued by an official government authority.

Types of acceptable documents:

- Valid National Identity Card
- Valid Government issued insurance or medical card
- Tax Statement (issued within the last 6 months)⁶⁴

The CDD process only allows the user who is able to verify its identity with the bank to open an account. The idea of using this tool is to identify, beforehand, the client with whom an agent relationship will be initiated and who will receive funds; one of the problems that arise from opening these accounts is that the contract is not perfected by electronic means due to public order regulations that require physical documents. Nonetheless, there is a debate about whether these documents allow ensuring the broker its authenticity knowing there are means such as electronic signatures that may be more veracious than physical documents.

As the FATF has described it, in order to identify the client, it is necessary to use “reliable, independent source documents, data or information”. What countries could demonstrate the veracity of these documents? And, to whom must these rules be applied, considering that each country belongs to a completely different context this policy must be used with much care depending on the country it is applied to. It is pertinent to see that the FATF within its recommendations invites banks to use electronic means if these are capable of being trustworthy and independent.

⁶⁴ Saxo Bank, Application form, <http://uk.saxobank.com/en/accounts/Documents/Client%20App%20Form%20NEW.pdf> [Visited 15of september 2011]

The bank, within its efforts, takes Politically Exposed Persons (P.E.P)⁶⁵ and Immediate Family and Closed Associates cautiously due to the risk that these funds represent (an example is money obtained by corruption), the bank has taken as special measure that those persons who are in these categories should declare their status with the aim of preparing necessary procedures.

The CDD⁶⁶ measure is a preventive one which allows banks, in this case Saxo Bank, to minimize the risk of being exposed to money that comes from illegal activities. Regarding this aspect, the problem about knowing the client is to be able to determine the certainty and reliability of the submitted documentation given that there might be citizens from different nationalities and others outside the European Union who belong to a country that does not cooperate in this matter. According to the contract's legal clauses, Saxo Bank will inform about all suspicious activities they consider might be ML/FT to the Finanstilsynet. Such activities can be monitored only when an account has been opened.

One of the most problematic aspects in this case is the opening of the account, it only requires a statement from the client mentioning that the resources are his/her own; no further documentation is required in order to verify the procedure.

Earlier was explained, when it is about natural persons, many countries have the policy of simply reporting amounts higher to a determinate sum in relation to money transactions or through other means (wire transfer). Denmark opted to only report sums superior to 100,000.00 DKK (13,427.09 EUR)⁶⁷; one person may open a Classic account without any trouble and without the need of declaring the procedure of the

65 A Politically Exposed Persons (P.E.P) is a person who has been in charge of a notorious public function.

66 Such measures are on a risk sensitive basis depending on the type of customer, business relationship or transaction (FATF, http://www.fatf-gafi.org/document/58/0,3746,en_32250379_32236920_43642938_1_1_1_1,00.html, [Visited 18 of September 2011])

67 www.xe.com Tuesday, 20 of September 2011

resources given that he/she only needs USD 10000 (54.311 DKK)⁶⁸, that is half of what is required by Danish authorities to report operations; the issue is that these accounts may represent a problem and a regulation void that might be used for transferring resources in small amounts.

The analyses of the previous aspects before the platform are aimed to examine the e-contract that the client, and the bank establish when opening the account in order to access the platform. In this case, the law that governs the contract and its jurisdiction regarding A.M.L norms, looking into which policies are adopted in the respective contract. To finalize, in 2010, Saxo Bank standardized a new A.M.L suite that uses a series of filters and monitoring for the following tasks “transaction monitoring, watch list filtering, sanctions monitoring and know your customer / customer due diligence”⁶⁹.

3.6.2 MIG BANK⁷⁰

HEADQUARTERS: Neuchâtel, Switzerland

ESTABLISHED: 2003

PRODUCTS: Investment Bank (forex and products related)

REGULATE: Swiss Financial Market Supervisory Authority (FINMA).

AML POLICIES E-CONTRACT: CDD

PLATFORM: MetaTrader 4

TYPE OF CONTRACT: Automated Execution Dealing

Mig Bank is the largest Swiss bank specialized in FOREX services (Foreign Exchange), offering from foreign currency purchases and sales to CFDs⁷¹. Created in August 2003,

68 Ibid

69 NICE Actimize, , Saxo Bank Implemented Nice Software (23 of June 2010), <http://www.actimize.com/index.aspx?page=news302> [Visited 12 of September 2011]

70 Mig Bank, <http://www.migbank.com> [Visited 20 of September 2011]

it was known as MIG Investment and then changed its name in December 2008. It currently has clients in at least 120 countries; it is regulated by the financial authority of Switzerland's market and offers its clients different account types to access the platform.

CONTRACT⁷²

For accessing the platform it is necessary to choose from any of the accounts offered by this firm. The accounts are divided in four categories which are: Mini, Classic, Advanced or Prime, accounts may be opened by natural persons or juridical persons; there is also a third category that allows for opening an account known as joint account (association of natural persons that may use the same account).

Accounts are divided according to the amount deposited by the client. The Mini is for deposits from USD 2000 to USD 10000, the Classic is for deposits from USD 10000 to USD 50000, the Advance is for deposits from USD 50000 and up, the Prime is not specified but they mention is for large amounts of money. What is particular about this broker is that it offers the same services for all accounts, the difference lies in the foreign currency purchase and sale spreads, the better the account the lower the spread⁷³.

The contract signed with the broker is an execution dealing contract, it is necessary for the client to decide what does he/she wants to sell or buy. By using these platforms all orders will be automatic (it has the same characteristics as the execution dealing, but you don't need to call the broker to execute an order). Steps for opening an account with this broker:

“1. Select your account agreement type from the three options above

71 Contract for difference: in simple words this contract is used by a seller and buyer stipulating a Price in the future, and depends on the Price one part will pay the other.

72 Mig Bank, Legal Documents, <http://www.migbank.com/fileadmin/download/documents/en/D-SETCLI-01-EN.pdf> [Visited 22 of September 2011]

73 Spread is the difference that exists between the prices when buying and selling a financial instrument.

2. Enter your information into the selected agreement form
3. Save a copy and print a copy
4. Sign the printed copy
5. Include all the required additional documents with your application as listed on page 2 of the agreement form*
6. Place the signed copy in an envelope and send it to:

*In conformity with Swiss law we do not accept faxed, scanned or electronically mailed documents. Agreements applications and required forms must therefore be sent via post to our physical address”⁷⁴

Pursuant to the above, all documents must be sent by mail in order to accept the offer although there are pre-contractual negotiations where the client submits the application online when all documents are sent. All negotiation clauses and necessary documents to be sent are found in the “individual form”. Regarding the point above it is necessary to consider there is a negotiation between the parties through electronic means, although the contract cannot be perfected given that there are public order norms that must be completed, as stated in the last clause.

The contract’s terms are very similar to those described in Saxo Bank’s contract; they are exempt from risks associated to negotiations in this financial market or due to technological failures and of any other type. There are secondary contracts, derived from the main contract, that are signed as the client opens and closes operations. Regarding the client’s obligations, these will only depend on the money deposited in the account and in cases where there are no more funds. Mig Bank, unilaterally, may close the operation according to clause 2.1.7 “DEFAULT. Without prior notice to, or

⁷⁴ Mig Bank, How to open an account, <http://www.migbank.com/trading/open-an-account/> [Visited 22 of September 2011]

receiving further authority from the Client, the Bank shall have the right to close out all or any part of any transaction, and realize any assets of the Client held by the Bank, upon or at any time”.

One of the most important aspects that governs the contract and the user, for being in a bank based in Switzerland, is that bank secrecy will be applied with its respective limitations as stated in clause 2.1.10 “BANKING SECRECY. In its capacity as a bank pursuant to the Federal Law on Banks and Savings Banks, the Bank is subject to banking secrecy.” The Bank is therefore obliged to observe the strictest discretion regarding all business relations with the Client, even after the Client’s relationship with the Bank is ceased. Swiss banking secrecy does, however, only apply to data located in Switzerland.

However, by entering into this agreement the Client authorizes the Bank to disclose such information relating to the Client as may be required by any law, rule or regulatory authority, including any applicable Market Rules, without prior notice to the Client”.

GOVERNING LAW AND JURISDICTION IN AML

Based on our considerations on the analysis of Saxo Bank, it is not necessary to enter into a debate about what are the jurisdiction and the applicable law to this case, the clause 9 states: “These General Business Conditions and Safe Custody Regulations shall be governed by Swiss law”. All law matters related to ML/FT are subject to Swiss law; being understood, that the bank is regulated under the authorities from this country and it is them who can have strict control over the activities carried out.

Regarding jurisdiction in matters related to ML/FT, the same clause states: “The place of performance and the place of jurisdiction for any proceedings whatsoever, including for the Client domiciled abroad, is NEUCHÂTEL, Switzerland. However, the Bank

retains the right to file an action in the country of domicile of the Client or before any other competent court, in which case Swiss law will still apply” .

The Swiss government reserves their right to apply jurisdiction and laws that will govern the contract when talking about activities such as Money laundering. In this case, any attempt by the client to use this bank as a means for money laundering shall incur in an offense before the laws of the Swiss government.

Switzerland has one of the most important regulation bodies in connection to this issue (see this chapter regarding Switzerland), in the Swiss Criminal Code (Schweizerisches Strafgesetzbuch; Code penal suisse) articles: Art. 305bis (money laundering), Art.305ter (insufficient diligence in financial transactions), Art. 260ter (criminal organization), Art. 260quinquies (financing terrorism) specifies the terms in which this activity is criminalized and what are the punishments when incurring in it.

It also allows the Swiss government to criminalize those perpetrators that commit this activity in other countries whenever there is a relation with the offenses committed in Switzerland. As a result of the above the client assumes responsibility of possibly being judged by Swiss courts and laws in case of incurring in any of these activities by opening an account with the purpose of incurring in money laundering whatever their purpose.

The main tool used to fight against money laundering from a regulatory and preventive perspective is found on the Federal Act on the Prevention of Money Laundering in the Financial Sector (AntiMoney Laundering Act, AMLA; Bundesgesetz zur Bekämpfung der Geldwascherei im Finanzsektor (Geldwaschereigesetz, GwG); Loi fédérale concernant la lutte contre le blanchiment d'argent dans le secteur financier (Loi sur le blanchiment d'argent, LBA)), among the main objectives of this application law from

the CDD principle and pursuant to the guidelines established by the auto bank regulative organism (Swiss Banks' Code of Conduct with Regard to the Exercise of Due Diligence (Due Diligence Agreement)). In its Art. 2, the A.M.L describes institutions that must follow this law, with banks being highlighted ⁷⁵.

POLICIES OF AML IN THE PLATFORM

Art. 3 from AMLA explains which must be the policies adopted by entities when receiving deposits. The purpose of this it to demand fulfillment of the CDD measure, it also establishes these are the requisites to be followed:

“Verification of the identity of the customer:

When establishing a business relationship, the financial intermediary must verify the identity of the customer on the basis of a document of evidentiary value. Where the customer is a legal entity, the financial intermediary must acknowledge the provisions regulating the power to bind the legal entity, and verify the identity of the persons who enter into the business relationship on behalf of the legal entity”⁷⁶.

In clause 2.1.11 which governs for the opening of the account, explicit reference is made to the CDD policy from the A.M.L which this broker will perform: “As the Client is aware that the Bank has to comply with the Swiss Federal Money Laundering Act the Client agrees to provide the Bank, as per separate document, with full and accurate information regarding, among others, the identification of the contracting partner, the identification of the beneficial owner and the origin of the assets...”.

Required documents for the opening of the account, in agreement with what is stated in the contract, are:

⁷⁵ Switzerland has a special control authority that is known as the Anti-Money Laundering Control Authority

⁷⁶ Federal Act on Combating Money Laundering and Terrorist Financing in the Financial Sector, <http://www.admin.ch/ch/e/rs/9/955.0.en.pdf>, 1997,

[Visited 23 of September 2011]

“Notarized copy of passport or identity card (with photo and signature).

The copy must be fully legible and the photograph clear and identifiable.

Authentication of signature by a public notary (if not features on the Passport or Identity card).

Utility Bill (ex. electricity, telephone, etc.) or a notarized proof of residence”

The scope of this CDD and how should it be implemented pursuant to the established by the FATF will be applying the same concepts from the section 3.6.1. The scope of the documents required by Mig Bank should seek to comply with the obligation of identifying the client.

One of the most interesting clauses and one of the points that Swiss legislation has tried to develop is to determine who is the real beneficiary of the account as described in the following text: “The need to properly identify the customer as well as the beneficial owner of an account (or the person on whose behalf a transaction is conducted) is a fundamental part of any anti-money laundering system, because information is obtained that is absolutely necessary to later make use of mutual legal assistance or to effectuate asset seizures in the context of national legal proceedings”⁷⁷.

The measures adopted by Mig Bank during an account opening in order to have access to the electronic platform, are based on the CDD. They try to implement it from the perspective of knowing the real account beneficiary. Although Saxo Bank has the same problem that was mention in the previous section, it is necessary to consider their supervision norms to be stricter because they include an explicit clause and also, their ML/MF risk minimization policy is based on a management system that enables cooperation with banks around the world.

⁷⁷ Pieth, Aiolfi (2004) p.185

Problems arise when opening an account is that in order to offer the opportunity of making such small deposits in the mini accounts can be a risk factor, that of using several people in order to have these resources available in the ETP.

Swiss law only demands to report suspicious activities that sum more than CHF 20000 (approx. USD 22.235⁷⁸), such amounts of money would not be used by perpetrators of these activities because they represent a high risk for the funds transfer even within their own countries. This broker offers two accounts that may be operated without being reported to the financial authority. The preventive measure from the CDD implies a lot of efforts from Mig Bank, not only in the compliance of laws and its auto regulation, but also in the establishment of sufficient relations to have an electronic contract that enables users to hire their services in an expedite manner besides complying with A.M.L procedures.

3.6.3 E*Trade Securities, Inc⁷⁹

HEADQUARTERS: New York City, New York U.S.

ESTABLISHED: 1991

PRODUCTS: Financial Services

REGULATE: Security Exchange Commission (5 Self-Regulatory Authorities)⁸⁰

AML POLICY E-CONTRACT: CDD

TYPE OF CONTRACT: Automated Execution Dealing

PLATFORM: E*TRADE Pro

⁷⁸ www.xe.com 21 of September 2011

⁷⁹ E trade, <https://us.etrade.com> [Visited 25 of September 2011]

⁸⁰ NFA, FINRA, Chicago Board Option Exchange, NYEX Arca, NASDAQ Stock Exchange

E-TRADE was created in 1991 as renovation of a company formerly known as TradePlus. As Charles Schwab Corporation did, this company focused on doing brokerage activities at very low costs for users. One of the pioneers in providing online services through American Online and Computer Server services, it created a platform that would allow users to buy or sell stock. Thanks to the expansion of the 90s with regard to computers, the portion of the online investments' market started to grow until positioning this company as number one in this sector.

The company is defined as “an innovative financial services company offering a full suite of easy-to-use online brokerage, investing and related banking solutions, delivered at a competitive price” We empower individuals to take control of their financial futures by providing the products, tools and services they need to meet their near- and long-term investing goals” . It is regulated by the Securities Exchange Commission and 5 auto regulating authorities (Finra, NFA are among them).

CONTRACT⁸¹

Having access to this platform is more complex compared to the other two because American brokers not only act as online brokers, they also offer a portfolio of financial services such as loans, mortgages, account openings and they also function as an investment and a commercial bank. The only account that will focus in this paper is the one that enables to operate online investments and access the ETP. There are four types of accounts depending on the client's characteristics divided as follows: Individual account, Joint account, Custodial account and Retirement account.

⁸¹ E Trade, How to open an account, https://content.etrade.com/etrade/customer/invest/portfolio_margin_application.pdf [Visited 28 of september 2011]

The emphasize will be only on the individual account, this in turn is divided in three other classes depending on the activity to be performed by the investor which are the following: “Margin Account: Allows you to borrow and purchase additional securities using your current holdings as collateral. A \$2000 balance must be maintained if you wish to borrow funds on Margin.

Margin Account with Options Trading: “options give the buyer the right, but not the obligation, to buy (call) or sell (put) an underlying asset at an agreed-upon price during a specific period of date.

Cash Account Only: An account which requires full payment for each trade placed in the account”⁸².

A "margin account" will be analyzed. To open this type of account, the broker classifies necessary requirements between US and Non US residents. A US resident simply has to fill the application online and after a series of steps he/she will be able to start operations in the market without trouble, the contract is perfected instantly without requiring the documents demanded by other operators. For nonresidents, a series of steps must be completed; such steps are similar to those seen in previous platforms although this one does not inquire about the precedence of funds.

GOVERNING LAW AND JURISDICTION IN AML

This contract is very interesting to discuss from the consumer’ s point of view regarding the terms used. Speaking of which law governs the contract and the applicable jurisdiction, referring to that set forth in clause 12 (M) of legal terms of the contract which establish the following: “ Choice of Law I understand that this Agreement will be deemed to have been made in the State of New York and will be

⁸² E trade, Open account, <https://express.etrade.com/app/brokerage/page1B-1-2-accttype> [Visited 29 of september 2011]

construed, and the rights and liabilities of the parties determined, in accordance with the internal laws of the State of New York” . All matters dealing with ML/FT issues, either the law that governs the contract or its jurisdiction shall correspond to the state of New York

The applicable law in the United States is based on the Patriot Act as well as on the guidelines from auto regulating entities where the broker is subscribed. Contemplating the above regarding criminal law, it will be that of the state of New York and its A.M.L policies must follow the established by the Patriot Act.

POLICIES OF AML IN THE PLATFORM.

The Patriot Act establishes that all entities that provide financial services must follow a series of measures to prevent and detect cases in which ML/FT is incurred; here the CDD demands compliance of the following requisites:

“(2) MINIMUM REQUIREMENTS.—the regulations shall, at a minimum, require financial institutions to implement, and customers (after being given adequate notice) to comply with, reasonable procedures for—

(A) Verifying the identity of any person seeking to open an account to the extent reasonable and practicable;

(B) Maintaining records of the information used to verify a person’s identity, including name, address, and other identifying information; and

(C) Consulting lists of known or suspected terrorists or terrorist organizations provided to the financial institution by any government agency to determine whether a person seeking to open an account appears on any such list.”

But financial institutions such as brokers and, in this case, E*Trade must also comply with other provisions as stated in the same section, fourth point: “ CERTAIN

FINANCIAL INSTITUTIONS.—In the case of any financial institution the business of which is engaging in financial activities described in section 4(k) of the Bank Holding Company Act of 1956 (including financial activities subject to the jurisdiction of the Commodity Futures Trading Commission), the regulations prescribed by the Secretary under paragraph (1) shall be prescribed jointly with each Federal functional regulator (as defined in section 509 of the Gramm-Leach Bliley Act, including the Commodity Futures Trading Commission) appropriate for such financial institution”.

Verification is done by E*Trade and is divided between residents and nonresidents. They demand different requirements for opening an account according to this division; residents only need their social security number and their driver’s license and the account is verified without the need of sending further documentation; nonresidents need to send a copy of the contract, the passport and a receipt issued where the person lives. Between both categories the difference lies in the need for certain users to send a physical copy of the documentation in order to have access, while for the rest everything is done online.

There is a series of voids regarding the treatment given to the contract; any of its negotiation stages and clauses makes reference to the ML/FT, a person can access instantly with their social security number and the entity simply verifies their criminal record. Never, during the opening of the account, it is known if it complies with the CDD measure, neither if it is necessary to prove the funds’ origin.

3.6.4 Summary

In some contracts studied before, the procedures and applicable ML/FT laws are mentioned, but some of them don’t establish anything. A broker which offers its services to clients around the world must establish all contract conditions (essential

element for both parties to sign a contract), and how are laws going to be applied pursuant to the established in the contract as well as what will the jurisdiction and obligations be when the user executes this offer.

From the analysis of Mig Bank and Saxo Bank's cases, it is established that the law that governs the contract and the applicable jurisdiction are those from the country where the broker is headquartered. E*Trade never mentions the applicable law and the jurisdiction; it simply recognizes that in the event of conflict, the case will be subject to an arbitration court for resolution. In other of its clauses they mention the state of New York, under which the contract is governed.

The first criticism to this aspect is the determinability of the law and jurisdiction applicable to contracts regarding ML/FT. there is necessary to divide two scenarios that imply different interpretation. If the transfer was made through a mechanism that does not allow determining the origin of the money (cash, wire transfer in Shell Banks' jurisdictions or a bank check), applying the law and jurisdiction of the destination bank or broker. While in cases where the money is transferred by an account to the broker, there will be two jurisdiction and laws applicable to the infraction, one from the bank of origin and the consignee according to the criminal activity undertaken in both normative dispositions.

One of the most effective mechanisms to fight ML/FT is to use clauses that are clear enough for the contract. This will allow dissuading those persons who want to carry out this activity and know about the consequences of depositing funds to this broker. The contracts intended for individuals from other countries, where the relationship with the broker is simply subject to what is set forth in agreement between the parties, must have sufficiently clear rules for both parties either on their rights, obligations and legal

consequences if the law were to be breached in the country where the broker is (only one of the three contracts explained above had a clause that resembled this).

The policies implemented by the brokers regarding account openings must comply with the requirements demanded by law and the 40+9 principles from FATF. These brokers increase the risk of receiving illegal money, the first risk is that they allow any person to open an account without determining the risk of the fund's origin (countries with armed conflict, drug exporters, gun vendors or high corruption indexes are more vulnerable to ML/FT than others), the client needs to know that there is a series of variables that determine which funds are susceptible to come from illegal activities, also, these brokers must consider the list of noncooperation country, which is updated by FATF⁸³ each year (any broker uses it because it doesn't restrict countries from opening accounts).

The main tools used by financial institutions are CDD/KYC, although not mention the second one a lot, it refers to "Know Your Costumer" and it covers monitoring situations and the place where the information of transactions done by the client is kept when he/she is believed to be doing suspicious activities. The Consumer Due Diligence can be in the same account opening as manifested by FATF:

"A particularly attractive feature (in some jurisdictions) to persons who wish to abuse this service for ML purposes is its lack of transparency. In some instances, a transfer can be effected without the individual having an account with the financial institution, for example through a breach in the financial institution's data security, or through the transfer of an instrument similar to a bearer security. Payment for the transferred

83 FATF, Non-Cooperative Countries and Territories (http://www.fatf-gafi.org/document/4/0,2340,en_32250379_32236992_33916420_1_1_1_1,00.html) [Visited 30 of September 2011]

securities can also be made in cash. As such, account statements may not reflect the fact that a share transfer has taken place. In some cases investigated, transfers of securities were confirmed to the customer by separate statements that were not consecutively numbered. Moreover, such statements were not included as part of the year-end bank reconciliation effort”⁸⁴.

The CDD measure applied by all three brokers has to agree to the transparency principle effected by these entities. These contracts represent big challenges; it is the brokers, the government and the legislators who should adopt laws that are sufficiently strict and capable of fighting ML/FT, and at the same time, the policy of knowing the client, which is find on recommendations and laws, must generate mechanisms that are bound to an e-contracting model that speeds up the origin and process of both the funds and the account opening.

The transparency principle and the CDD allow both parties of the contract to know the how the process is done, and it also allows different banks of the world to know the person who wants to open the account and the origin of the resources. Thus, the bank of origin and the addressee broker are responsible for obtaining information; each one plays an important role in knowing the client. The adopted measures by ETPs seek to identify the user and know the origin of funds deposited. If the contract establishes clear rules about what are the criteria used, it would be possible to have joint cooperation between the banks of origin and the addressees.

These brokers’ main problem lays on the CDD implementation; is it possible to identify a user with the documents requested? When can the broker recognize that funds come from an illegal activity? When can the authorities apply criminal laws (the deposit must

84 FATF, Report 29 Oct. 2009 <http://www.fatf-gafi.org/dataoecd/32/31/43948586.pdf> [Visited 28 of September 2011]

be completed or by trying to open an account), are brokers sufficiently careful about knowing both the client and the bank of origin? Are resources identified by any efficient means which verifies its legality? And lastly, does the broker accept other means of payment for the opening of an account (for example PayPal)?

Let's begin with Saxo Bank, within their application form, they demand a series of documents and make a series of questions related with the user and his/her or her family. Are requested documents from the user enough? In order to answer this question it would be pertinent to explain that one of the main deficiencies on opening an account with this broker is demonstrating the legality of resources, the user is never required to send physical or electronic documents that prove its legality. Funds may be transferred through a bank correspondent without the need for demanding them to be deposited from an account used by the client.

The application form can be sent by electronic media and only the documents that identify the nationality of the offered are required in order to validate the information. The national or financial authority is not required to confirm the legality of resources. The CDD policy seeks to prevent resources from being deposited, and this is why such policy is not completely executed; besides, many times due to the amount, as for this case, it is not necessary to report it to the Danish authority.

One of the criticisms from FATF to the brokers and those entities who receive funds is the CDD delegation to the banks of origin when there is not a homologation, and a verification method of the policies enforced by banks in other countries. From the three platforms, only one demands demonstration of the funds' origin while the others would only use this mechanism after believing there is a suspicious activity. Basically is found that brokers, except one, consider that only with the requested documents it is not

necessary to demand legality of the money (what would happen if a legal sum is transferred this way but the illegal one is transferred by other means?).

Mig Bank complies with the strictest measures at requesting the origin of funds no matter which policy has been effected by the bank where funds are originated. On the other hand, E*Trade constitutes two types of contracts depending if the user is a resident or not of the United States; such criterion is not valid enough given that sanctions appealed to this broker demonstrate compliance with the Patriot Act and the CDD is not fully diligent⁸⁵.

The problem lies in the type of contracting; it is necessary to return to physical contracts or is it possible to execute measures to prevent ML/FT efficiently by e-contracts, without the need of physical documents? Account's opening has been dematerializing contracts and “lack of face to face interaction” between brokers and persons who wish to open accounts, demanding the broker to generate policies that enable to create a client's profile with more certainty and ultimately identifying the resources (the real solution lies not only in the identification of the client but also in the legality of resources).

The potential risk that exists in opening an account is that many people comply with all requisites demanded; but what happens with resources and what happens if the account is shared among several people? Electronic contracts may expedite and transform the previous financial intermediation relationship. The ETPs can change the model and the lack of interaction between the broker and the client; the possibilities are infinite in order to use them as a means for ML/FT from buying utilities from other users up to the

⁸⁵FINRA, E*Trade Units Fined \$1 Million for Inadequate Anti-Money Laundering Program,

<http://www.finra.org/newsroom/newsreleases/2009/p117667> [Visited 30 of september 2011], <http://www.sec.gov/news/press/2008/2008-156.htm>

[Visited 1 October 2011]

creation of fictitious companies that obtain little earnings but demonstrate the money went from illegal to legal.

4. CONCLUSION

As the conclusion fighting these activities is a challenge for brokers, especially when the Internet has changed the paradigms in this sector. The solutions to be found must stem from technology itself and the cooperation between countries. The legal systems need to appraise non-conventional contracting mechanisms in the financial systems, among them the ETP, for both types of contracts mentioned in the second chapter.

These laws must be capable of combating this activity with clarity, precision and adequateness in relation to the new securities negotiation schemes (demanding that mechanisms such as derivatives are included in the lists of financial instruments and are regulated by these laws). The law in relation to ML/FT has been renewed, thanks to the different institutions intervening, but its application is restricted only to the countries that create them. The laws regulating the financial system have not been strict enough with respect to the necessary requirements for obtaining licenses to operate in these markets and render intermediation services.

Likewise, there are huge gaps in the regulation of suspicious deposits, which elicits the question, whether it is necessary to know about the client or to know about the legality of the resources, or a combination of both criteria.

The technology allows the clients to contract intermediation services with the purpose of gaining access to the ETP without the need to find these places physically. The laws were created based on the principle that a measurement of CDD should be performed in those cases when a user profile could be created. Nowadays, it is impossible to determine whether the person sending the documents corresponds to the person that

operates the accounts. Likewise, the lack of information available from other countries impedes knowledge of the legal or financial information on the solicitor.

One of the possible solutions for electronic contracts and the procedures that are carried out, is to create a more unified financial and cooperative system between the countries creating unified databases that may allow any banking or intermediary institution to access information from the solicitor's country and to establish the risk level they represent, this can only be possible if the countries interested sign a cooperative treaty that will establish the rules for the signature countries.

Another mechanism is to create an international normative body. One that not only allows combating these activities but also projects being a regulator of financial activity around the world, i.e., has a sufficient facultative power to gain access to the database from each country and also distributes information, issues guidelines and recommendations, and analyzes the financial systems from each of the member countries; thus, it could homologate and validate the legality of the resources, and the countries are not given their power. They are creating an international cooperation between the states as an informative tool to let the countries know where the sources is coming and trying to avoid the illegality of the money.

The institutions that overview, regulate and self-regulate must make a distinction between intermediation through the Internet and regular intermediation. The mechanisms adopted to need to identify the risk from different perspectives (one of them is the lack of face-to-face interaction). The necessary criteria for identification of funds must be created.

One response is to create an international transfer system that identifies the origin of the resources and their legality. In other words, each electronic transfer performed from one

country to another will have a fund's legality certificate, which makes CDD processing easier for the addressee broker or bank.

The creation of an international normative body that delimitates the scope of action concerning fund's transfer activity from one country to another and allows access to the databases of the subscribed countries, will make it possible for CDD/KYC policies to be applied in a more effective manner. It will also allow the contracts, whether they be from brokerage or to open any type of accounts, to be more expedite and totally electronic, without the need for any document proof.

Nowadays, there are suites offering companies dedicated to minimizing risks such as the one contracted by Saxo Bank. These companies offer a series of applications to minimize ML/FT risks. This is one of the options, but is necessary to consider, regarding the analysis found in this work, that in the first stage, these companies are only capable of verifying the client with respect to the information that is destined to them, without prior knowledge of their financial movements or the legality of the funds. This is one of the possible preventative measures, but knowing the client implies a myriad of variables to which only the authorities of each country have access. Therefore, a database that is capable of calculating the risk, updated by the financial and regulating entities of each enrolled country, managed by the international financial institution, speeds up the procedures for e-contracting policy, in addition to the deployment of AML policy.

In response to the question formulated at the introduction, e-contracts have made negotiations easier, but in turn they have made manifest the lack of necessary requirements on the art of the brokers to further policy to prevent ML/FT. The problem stems from the change to online trading without the creation of laws sufficiently able to regulate this field and institutions prepared to combat these activities in a virtual world.

The difference between first world and third-world countries in the field of technology is one of many factors that should be identified.

Although this is the true, policy is not adopted in a precise manner by the brokers, and oftentimes illegal money enters the ETP. This has taken place because there are no clear criteria with regard to policies such as CDD. In some countries, it is necessary to know about the legality of the funds, while in others it isn't. More often than not, the banks delegate this function to the addressee and vice versa.

Therefore, technology will allow the authorities to fight with ever increasing efficacy against this activity, but in order to achieve this. It is necessary to establish not just an international cooperation, but a body that allows supervision of the institutions from an international perspective.

In conformity with the above, the ETP has revolutionized the world of investments, but the brokers and governments must be stricter, not just in the granting of licenses, but as well in the supervision and application of laws concerning AML.

5 REFERENCE TABLE

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LEGISLATION

EUROPE

Directive 91/308/EEC of the Council of the European Communities 10 June 1991 on prevention of the use of the financial system for the purpose of money laundering.

Directive 2000/31/EC of the European Parliament and of the Council 8 June 2000 on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market (Directive on electronic commerce).

Directive 2001/97/EC of the European Parliament and of the Council 4 December 2001 amending Council Directive 91/308/EEC on prevention of the use of the financial system for the purpose of money laundering.

Directive 2006/70/EC of the European Parliament and of the Council 26 October 2005 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing.

Directive 2004/39/EC of the European Parliament and of the Council 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European parliament and of the Council and repealing Council Directive 93/22/EEC.

UNITED STATES

Bank Secrecy Act (BSA), codified at 31 USC. §5311 (1970)

Money Laundering Control Act of 1986, Pub. L. No. 99–570, 100 Stat. 3207.

Annunzio-Wylie Anti-Money Laundering Act of 1992, Pub. L. No. 102–550, 106 Stat. 4044.

Uniting and Strengthening America by Providing Appropriate Tools to Intercept and Obstruct Terrorism (US PATRIOT) Act of 2001, Pub L. No. 107–56, 115 Stat. 272.

DENMARK

Money Laundering Act Danish Act No. 806 of 6 August 2009 amended by Act No. 579 of 1 June 2010 and Act No. 1553 and Act No. 1556 both of 21 December 2010.

SWITZERLAND

MLA; SR 955.0) Swiss Federal Act of 10 October 1997 on Money Laundering.

6 ANNEX

ABREVIATIONS

AML: ANTI MONEY LAUNDERING

AMLA: ANTIMONEY LAUNDERING ACT (Switzerland)

CDD: CONSUMER DUE DILIGENCE

E-BANKING: ELECTRONIC BANKING

ECN: ELECTRONIC COMMUNICATIONS NETWORKS

E-COMMERCE: ELECTRONIC COMMERCE

E-PAYMENT: ELECTRONIC PAYMENT

ETP: ELECTRONIC TRADING PLATFORMS

FATF: FINANCIAL ACTION TASK FORCE

GDP: GROSS DOMESTIC PRODUCT

KYC: KNOW YOUR COSTUMER

M.L.A.: MONEY LAUNDERING ACT (Denmark)

ML/FT: MONEY LAUNDERING AND FINANCING TERRORISM

ML: MONEY LAUNDERING

NYSE: NEW YORK STOCK EXCHANGE

VPN: VIRTUAL PRIVATE NETWORK