

# **BANKING SECRECY AND FIGHTING MONEY LAUNDERING AROUND THE MEDITERRANEAN SEA: THE CASE OF LEBANON**

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## **How to Fight Money Laundering in a Country that has Enjoyed Banking Secrecy: The Case of Lebanon**

On the Mediterranean Sea a country enjoys an exceptional location with natural beauties and a highly hospitable population whose ancestors were the first to travel around the oceans in order to spread the alphabet and to earn the reputation of successful traders ... the name of the country is Lebanon.

For a very long time Lebanon was not only a preferred tourist destination but also it was attracting the interest of investors and had earned the reputation of being the “Switzerland of the Middle East”. This reputation was mainly built on its free market economy system and the professionalism of its banking sector that gave the country an undisputable competitive advantage in the region.

Switzerland enjoys banking secrecy and Lebanon enjoys banking secrecy, but Switzerland is in Europe and Lebanon is in the Middle East, in a highly unstable and turbulent area. This is an area where the political, economic and recently the military concerns of the world’s biggest nations are directly or indirectly involved.

One of the drawbacks of the above-mentioned advantages is the accusation that the Banking secrecy situation of Lebanon might facilitate or even encourage money laundering practices in the region.

The purpose of this paper is to explain how it is possible to find a balance or a strategic equilibrium between “Banking Secrecy” and the fight against money laundering. The research will cover some legal and banking aspects and will present in a sequential and chronological order the “processes”, laws and regulations that Lebanon adopted in order to successfully remove its name from the

list of “Non-cooperative countries and Territories” (NCCT) in the domain of fighting money laundering (also known as the Black list). After a brief explanation of how money laundering operations are conducted, and whether the banking secrecy system provide a cover for money laundering or not, the following points will be presented:

- What has changed in banking operations following the law against money laundering?
- What is the fate of banking secrecy in Lebanon?
- What are the means to preserve Lebanon’s achievements and keep it away from suspicions and increase its immunity against pressures?

### **What is Money Laundering : Origin and Interpretations**

Money Laundering apparently derives from the ownership of Organized Crime Gangs (MAFIA) in the United States of clothing and laundry factories. These gangs used to generate huge amounts of money from racketing ,prostitution , illegal gambling and illegal trade of alcoholic drinks. The MAFIA was able to merge its illegal profits with its legal ones and money laundering became a worldwide phenomenon with the following characteristics:

- flexibility and ability to adapt
- use of the most advanced technological means
- high qualifications of people performing the operations
- huge resources put at their disposal

Estimates suggest that worldwide money laundering operations involve gigantic amounts that may reach 11.5% of world GDP. This is a consequence of the liberalization of money flows and of the integration of capital markets worldwide, in addition to the advance of computer and telecommunications technologies.

The United States as a consequence of the large size of illegal capital, Canada which represents the “back office” of US based organized crime, Europe , particularly major financial centers such as London, Zurich, Geneva and Paris, tax havens such as

Luxembourg and Liechtenstein, former communist Soviet Block countries such as Ukraine, Georgia etc are all major worldwide money laundering centers.

### **How is Money Laundering Defined or Interpreted by the Law?**

Money laundering is an operation through which the appearance of legality is given to large amounts of money whose source is illegal, resulting from activities such as drug trafficking, terrorist activities or other dangerous crimes.

Article 1 of European Union Directive dated March 1990 defines money laundering as “The concealment or disguise of the true nature of specific funds , their true provenance , their place of residence , their transportation or transfers , their ownership or the rights that are relative to them, while these funds are the result of grave crimes”.

The crime of money laundering is also defined as an act through which the bank’s client seeks to disguise the real source of the funds that have been illegally obtained, either directly or indirectly, whether from criminal acts or other illicit activities and to provide a legal cover for these funds, that become thus difficult to track<sup>1</sup>.

The fight against money laundering has steadily expanded to include combating “terrorist financing” especially with the issuance of Security Council Resolution 1373/2001.

Abdel Aziz Nader in “Money Laundering” (El-Halabi Publications, Beirut 2000) presents in a table the three main phases of money laundering. According to the author, these phases may take place either consecutively in a short period of time or separately extending over a larger period; as can be noticed from phase three of the table the detection of the “concealment act”<sup>2</sup> become very

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<sup>1</sup> Banking secrecy in Lebanon. BBAC. (Bank of Beirut and the Arab Countries s.a.l.) Abbas El-Habbi and Paul Morcos.

<sup>2</sup> Attempts by the client to hide the original crime from which funds have resulted.

difficult since the funds would have been subjected to several levels of circulation.

**Phases of money laundering**

| <b>Money Laundering Phases</b> | <b>Phase ONE</b>                                                                      | <b>Phase TWO</b>                                                                                              | <b>Phase THREE</b>                                                               |
|--------------------------------|---------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------|
|                                |                                                                                       | Placement                                                                                                     | Layering (Laundering)                                                            |
| <b>Objective</b>               | Inject dirty funds into the financial cycle                                           | Conceal funds to be laundered by dissociating them from their suspicious origin and giving them a legal cover | Allow the convenient and easy use of funds                                       |
| <b>Plan</b>                    | Dispose of large amounts of cash through the financial cycle                          | Prevent the possibility of discovering the source of the deposits                                             | Give a legal aspect to illicit funds                                             |
| <b>Mechanisms</b>              | Convert the large amounts of cash into fictitious revenues, profits and bank deposits | Intensify the series of complicated financial operations, most of the times among different countries         | Invest in various economic activities and blend laundered money with legal funds |

**Can the Accusation made against Lebanon of Providing a Cover for Money Laundering and Terrorist Financing be Justified?**

The banking secrecy system was established in Lebanon by virtue of the law of September 3, 1956. This law is indisputably attracting

deposits from abroad. If this law were to disappear, then the amount of capital deposited at Lebanese Banks would be severely affected.

It is important to mention that this system aimed (and still does) at attracting legal funds and at no time was it intended either to protect dirty funds, nor to transform Lebanon into a haven for criminals. The crime of money laundering, committed by recourse to banking operations, has not been common in 1956 when Lebanon adopted the banking secrecy system. Switzerland itself, which is one of the trusted pillars in Western civilization, was also adopting a strict banking secrecy system at the time.

Abbas El Halaby and Paul Morcos argue rightly that the strict banking secrecy in Lebanon, which could have hypothetically granted money launderers cover, has not been the only obstacle to fighting money laundering. There are at least two major indicators showing that banking secrecy does not necessarily create a reason for laundering to take place.

- The countries that rank first as to the volume of money laundering operations taking place on their territories have not been adopting a strict banking secrecy; rather they may not adopt a banking secrecy system at all, a fact that refutes the existence of a definitive link between banking secrecy and money laundering. This becomes more evident when one makes a quick comparison between the huge amount of laundered funds in the U.S.A. and the moderate amount of such funds in Switzerland which unlike the United States, adopts a relatively strict banking secrecy system.
- Money laundering operations around the world, take place outside the Banking system and without the need of recourse to Banking operations. Accordingly money laundering operations are not inherent to banking operations<sup>3</sup>.

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<sup>3</sup> Banking secrecy in Lebanon. Abbas El Halabi and Paul Morcos

Lebanese banks can argue that they derive no benefit from injecting dirty funds into the financial cycle. Needless to say, the origin of the suspected funds that may pass within the Lebanese Banks is external. So, the critical question is: isn't it more appropriate to reinforce efforts in fighting the original crime from which these funds result in the place where the crime was committed?

The Lebanese law No. 318/01 of April 2001 considers illegitimate the funds generated from the following illicit activities:

- Growth of drug related cultures, their manufacturing and marketing.
- Crimes committed by organized gangs defined in Articles 335,336 of the criminal code, internationally recognized as “organized crime”.
- Acts of terrorism defined in Articles 314, 315 and 316 of criminal code.
- Illegal trade of weapons and arms.
- Theft or embezzlement of public or private funds, or illegal acquisition thereof, through fraudulent means, and that are defined as “crimes” by Lebanese Law.
- The counterfeiting of currency or of official documents.
- The financing or the contribution to the financing of terrorism.

Here are in chronological order the steps through which Lebanon fought money laundering.

- In 1995, Lebanon ratified the United Nations' Convention of 1988 on “Fighting Illegal Trade of Narcotics and Psychotropic Drugs” (Known as the Vienna Convention). However it had reservations on a number of its provisions out of precaution of violating banking secrecy.
- At the end of 1996, the Lebanese Banks took the initiative of signing the “Due Diligence Convention on the commitment to fight the laundering of illegal drug trade funds”. This was an agreement concluded between the Association of Banks in Lebanon and member banks.

- In March 1998, the Lebanese Parliament approved the law on “Narcotics, Psychotropic Drugs and their Raw Material”, in implementation of the Vienna Convention. The law perceived severe sanctions on those who violate its provisions. However this law was also confined to money laundering operations resulting essentially from drug trafficking.

In 2000, the Governor of the Central Bank of Lebanon issued a decision requesting “all” Banks operating in Lebanon to comply with the provisions of the Due Diligence Convention.

### **Why fight Money Laundering?**

Taking into consideration the legal framework for money laundering, the next concern is to understand how suspicion of money laundering arises? And how is it traced? And in the case of Lebanon what is the importance of money laundering?

Lebanon is very serious about fighting money laundering because it needs to:

- Maintain the strong reputation of the local financial regulatory system
- Inspire trust in the international capital markets and investors
- Maintain the confidence of the regulatory authorities
- Assess the presence of funds that are of doubtful origin
- Avoid potential dangers on the stability of the banking sector
- Eliminate corruption of the competition within the banking sector
- Evade artificial maintenance of tasks of certain weak institutions
- Prevent the danger of criminal organizations taking partial or full control of the banking sector

Money laundering is characterized by the fact that it is organized on an international level and concealed, and it does not allow the identification of the ultimate beneficiary of the operation or of the rightful economic owner and the “logic” of laundering dictates that the largest possible amount of taxes ought to be paid in order to project an image of legality of funds.

Some indicators:

- Checking the client’s identity.
- A written statement about the identity of the “economic right’s owner”.

Doubts arise in the following instances:

- When a power of attorney is given to a non-professional person and it becomes clear as it appears that there is no relationship to the client and does not justify the proxy operation, or when the business relationship is conducted through nominees or numbered accounts or through umbrella institutions.
- When the financial status of the client intending to conduct the operation is disproportionate to the operation’s value.

It is interesting to mention that in return for the responsibilities laid on their back, the “law” has granted Bank employees an immunity that prevents their being sued.

Needless to say that lack of vigilance, in this context, leads to damage to the name of the Banking institution and to its reputation in financial quarters.

The establishment of the “Special Investigation Commission” (SIC) was the principal characteristic of the law against money laundering. Its work was fruitful. It is now an official reference that has not been previously available; it is entitled to review complaints, incoming particularly by from abroad, about money laundering cases in Lebanon. Neither of the Lebanese Ministries of Foreign affairs nor Justice, nor even the judicial authorities were

able to discredit such international claims as banking secrecy hindered the investigation. As a matter of fact, some international requests reached Lebanon through the Lebanese Ministry of Foreign Affairs, requesting an investigation the accounts of suspected individuals. The requests came either directly from the accusing countries or via Interpol, but they were rejected due to the existence of Banking secrecy<sup>4</sup>.

But since 2000 the SIC has been actively operating, and in fulfilling its duties it is not subject to the authority of the Central Bank of Lebanon, although its chairman is the Central Bank's Governor. The SIC has a special body of auditors to control the implementation of the Bank's obligations. Banking secrecy cannot be a pretext in the face of SIC auditors.

As an example, the SIC's second annual report for 2002 declared that: "Banking secrecy has been lifted from 79 cases out of the 103 investigated cases. 24 other cases have been referred to the relevant judicial authorities, whereas 35 cases remained under investigation"<sup>5</sup>.

The value of the operations classified as "open to suspicion" in Lebanon for 2002 reached around USD 18.8 million. As an indication, in Luxembourg, the value of "suspicious" operations in 2002 exceeded USD 3.5 Billion; in Switzerland three financial institutions were closed in 2002 and 215 sanctions against money laundering were applied according to the first report that the Swiss SIC published in Switzerland in 2003<sup>6</sup>.

The judicious question that comes to mind, at this stage is: what will be the fate of Banking secrecy in Lebanon?

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<sup>4</sup> "Banking secrecy in Lebanon" Abbas Al-Halabi - Paul Morcos.

<sup>5</sup> "Excerpts from the SIC's annual report were published on March 2003 in Lebanese local newspapers in Arabic and French languages.

<sup>6</sup> Fighting money laundering and "terrorist financing", Abbas El-Halabi - Paul Morcos.

The SIC has the exclusive right to lift Banking secrecy from a bank account suspected of hiding money laundering, after investigating the information and deciding on the seriousness of the evidence in raising presumptions of the commission of money laundering. This is done for the benefit of two parties: the specialized judicial authorities and the Higher Banking Commission.

There is no effective violation of Banking secrecy, starting from the client's identity and all the information related to his person, to the transactions of the account, except in case of serious suspicion that he is committing money laundering. The law on money laundering succeeded in harmonizing the requirements of fighting money laundering and the considerations of Banking secrecy effective in Lebanon for almost half a century - with Banking still constituting the principal pillar of an economy that is struggling with the heavy burdens of a post-war situation and the overall dismal economic environment of the region.

All economic and financial analysts agree that Lebanon needs the large amounts of money deposited in its Banking sector whether by local or foreign investors and that Lebanon through its legal authorities and relevant institutions has reached the equilibrium state where Banking secrecy constitutes a "comparative" advantage of its economy while totally complying with the rules and standards of international authorities that are trying to control world-wide crimes: "money laundering" and "terrorist financing". The slogan of "combating terrorism" has taken a new dimension manifested in the international efforts in general and American efforts in particular to target the sources financing organizations classified as "terrorist".

Resolution 1373 issued by the International Security Council<sup>7</sup>, aims at least apparently at prohibiting "terrorism" from using the

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<sup>7</sup> The Resolution was issued on Sept. 28<sup>th</sup> 2001, at the end of the night session number 4385. It assures the council's determination to "criminalize the willful provision or collection by any means, directly or indirectly, of funds by their nationals or in their territories with the intention that the funds should be used or in the knowledge that they are to be used in order to carry out terrorist acts".

techniques and tools of the financial system. The Resolution that falls under Chapter 7 of the Charter of the United Nations makes it immediately obligatory on all 187 members of the international organization and it imposes on them the obligation of bringing their internal law into line with its texts.

What is required of Lebanon? The Resolution dealt with requirements that are closely related to Lebanon's action to fight money laundering. Examples of requirements:

- Extending local legislation to cover "terrorist acts": The Lebanese law appropriates special provision pertaining to "terrorism" in Article 314 and the following articles of the penal code, in addition to Articles 316 bis that was added pursuant to the previously mentioned new amendment of the penal code<sup>8</sup>.
- International cooperation in the domain of combating "terrorism" - Lebanon has ratified several related treaties.
- Guaranteeing that refugees would not perform "terrorist acts". The matter that the Lebanese have not been able to resolve for a relatively long time remains without promise of a solution: the issue of the Palestinian refugees in Lebanon.

Last but not least, many of the BASEL committee recommendations are listed in the law on fighting money laundering in Lebanon and it is now fulfilling the requirements of the BASEL Committee in this regard. The BASEL Committee was established at the end of 1974 by the central bank Governors of the Group of Ten countries amongst which are the U.S.A and European Countries. It formulates broad supervisory standards and guidelines and recommends statements of best practice in the expectation that individual authorities will take steps to implement them through detailed arrangements. The BASEL Committee focused heavily on

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<sup>8</sup> "Fighting money laundering and terrorist Financing" Abbal El-Halabi, Paul Morcos.

the principle of Know your customer (KYC); it has issued guidance to banks on Customer Due Diligence (CDD) processes and on account-opening and Customer Identification.

In conclusion, we can add that due to the above-mentioned information Lebanon has succeeded in having its name removed from the list of Non-Cooperative Countries and Territories (NCCT) in the domain of fighting money laundering (also known as the Black List) issued by the Financial Action Task Force (FATF) on money laundering (Lebanon's name was included in the list in June, 2000 and removed in June 2002).

In legislation as well as in practice, it is argued, Lebanon's readiness to fight money laundering has been demonstrated, especially if we take into consideration two factors:

- Lebanon's ratification of the international treaties relating to the principal crimes that could form a source of money laundering.
- Lebanon's persistent efforts to adapt its legislation to these international regulations.

However, the removal of its name from the "Black List" does not mean that Lebanon can be complacent, for:

- Lebanon remains within a sphere of general political turbulence.
- Lebanon still enjoys a "stringent" banking secrecy system despite the new exception introduced in order to fight money laundering.
- Until recently, the striking headline was "fighting laundering operations". Today it has become combating "terrorism" and stifling its sources of financing - Tomorrow who knows what the headlines might become? Fighting against corruption or any other headline.

The means to preserve Lebanon's achievements, keep it above suspicions and increase its immunity against pressures are filtered

through the special equilibrium between Banking secrecy and the rules and regulations for effectively fighting money laundering.

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