

## AN EXAMINATION OF THE CONCEPT OF CUSTOMER DUE DILIGENCE UNDER THE NIGERIAN MONEY LAUNDERING (Prohibition) ACT, 2011 (As amended).

Ibrahim Abdu Abubakar<sup>1</sup>,

<sup>1</sup> PhD Candidate, Dept. of Public Law, Ahmadu Bello University, Zaria, Nigeria. P.O Box 618 Zaria, Kaduna State, Nigeria.

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### **ABSTRACT**

The key steps financial and designated – non financial institutions are required to perform to prevent illicit funds from entering their system is Customer Due Diligence (CDD), to find out who their customer is, where his funds have come from and the beneficiary of such funds. While it is important that financial institutions develop their own effective CDD policies, leaving them to do it on their own without regulatory oversight will not work, because the avoidance of illicit funds, inevitably involves turning down potential business, and not all financial institutions are willing to do this. The current system of customer due diligence entrenched in Nigerians Money Laundering (Prohibition) Act, 2011 (As amended), is full of loopholes. The result is that financial and designated-non financial institutions are complicit in helping to perpetrate money laundering and terrorist financing. It is the aim of this paper to explore the provisions of Nigeria's Money Laundering (Prohibition) Act, 2011 with a view to identifying vulnerabilities where Nigeria's response to customer due diligence may need to be strengthened.

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## INTRODUCTION

By doing business with dubious customers financial and designated non-financial institutions are facilitating corruption and state lootings, which denies the nation the chance to lift them out of poverty and leave them dependent on aid. This is happening despite a raft of anti-money Laundering Laws that require them to do due diligence to identify their customers and turn down illicitly acquired funds. But the current laws are ambiguous about how far banks must go to identify the real person behind series of front companies. Also, if a bank has filed a report on a suspicious customer as required by the law, but the authority and the law permit the transaction to go ahead<sup>1</sup> the bank can take dirty money. So it may be possible for a bank to fulfil the letter of its legal obligations, yet still do business with these dubious customers. By accepting these customers, financial institutions are directly or indirectly-assisting those who are using the assets of the state to enrich themselves or brutalise their own people. The key steps financial institutions are required to perform to prevent dirty funds entering the system is due diligence to find out who their customer is and where his or her funds have come from. But the current system is full of loopholes, whether in the anti-money laundering laws or the way they are enforced.<sup>2</sup>

In accordance with international standards set by the Basel Committee on Banking Supervision (Basel Committee), FATF<sup>3</sup> countries must ensure that their financial institutions have appropriate customer identification and due diligence procedures in place. The procedure applies to financial institutions, individuals and corporate customers alike. These rules and procedures ensure that financial institutions maintain adequate knowledge about their customers and their customers' financial

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<sup>1</sup> Section 6 of the Nigerian Money Laundering (Prohibition) Act, 2011, (As amended)

<sup>2</sup> Undue Diligence – How Banks Do Business with Corrupt Regimes. A Report by Global Witness, (2009)

<sup>3</sup>FATF recommendation 5.

activities. Customer identification requirements are also known as “know Your Customer” (KYC) rules,<sup>4</sup>a term employed by the Basel Committee. KYC Procedures not only help financial institutions detect, deter, and prevent money laundering and terrorist financing, they also confer tangible benefits on the financial institutions, its law abiding customers and the financial system as a whole.

### **CONCEPTUAL CLARIFICATION OF KEY TERMS**

#### **Who is a Customer?**

The Basel Committee on Banking Supervision defines a customer as:

A person or entity who maintains an account with a financial institution or on whose behalf an account is maintained (i.e, beneficial owners); Beneficiaries of transactions conducted by professional intermediaries (eg, agents, accountants, lawyers); and A person or country connected with a financial transaction who can pose a significant role to bank<sup>5</sup>

#### **What is Customer Due Diligence?**

Customer Due Diligence means taking steps to identify your customers and checking they are who they say they are. In practice this means obtaining the following from a customer:

Their photograph on an official document which confirms their identity, their residential address or date of birth.<sup>6</sup>

The best way to do this is to ask for a government issued document like a passport along with utility bills, bank statements and other official documents. In situations where it is relevant, you also need to identify the (beneficial owner). This may be because someone else is acting on behalf of another person in a particular transaction. Or it may be because you need to establish the ownership structure of a company, partnership or trust.<sup>7</sup>

#### **When do you need to apply Customer due Diligence Measures?**

You must establish customer due diligence measures:

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<sup>4</sup>Basel Customer Due Diligence for Banks.

<sup>5</sup> Basel Customer Due Diligence for Banks. See also FATF Recommendation 10

<sup>6</sup> [www.hmrc.gov.uk/mir/](http://www.hmrc.gov.uk/mir/)... Responsibilities Accessed on the 9<sup>th</sup> of October at about 8.00hrs.

<sup>7</sup> Ibid

When you establish a business relationship, when you suspect money laundering or terrorist financing, when you have doubt about a customer's identification information that you obtained previously, And when the circumstances of existing customers change.<sup>8</sup>

### **Customer Due Diligence When you are establishing a business relationship**

A business relationship is one that you enter into with a customer where both of you expect that the relationship will be ongoing. It can be a formal or informal arrangement. When you establish a new customer relationship you need to obtain information on:

- (a) The purpose of the relationship
- (b) The intended nature of the relationship – for example where funds will come from the purpose of transactions, and so on.<sup>9</sup>

The type of information that you need to obtain may include:

- Details of your customer's business or employment
- The source and origin of funds that your customer will be using in the relationship.
- Copies of recent and current financial standings.
- Details of the relationship between signatories and any underlying beneficial owners.
- The expected level and type of activity that will take place in your relationship.<sup>10</sup>

### **Financial Institutions**

Financial institutions include banks, body corporate, associations or group of persons, whether corporate or incorporate which carries on the business of investment and securities, a discount house, insurance institution, debt factorization and conversion firm, bureau de change, finance company, money brokerage firm, whose principal business include factoring, project financing, equipment leasing, debt administration, fund management,

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<sup>8</sup> See Section 3 of the Nigerian Money Laundering (Prohibition) Act, 2011 (as amended)

<sup>9</sup> Ibid

<sup>10</sup> See Basel committee on Banking Supervision and FATF Recommendation.

private ledger service, investment management, local purchase order financing, export finance, project consultancy, financial consultancy, pension fund management, and such other business as the Central Bank or other regulatory authorities may from time to time designate.<sup>11</sup> Most, if not all the crimes of money laundering are committed with the help of financial institutions. The crime of money laundering is done in stages, namely placement, layering and integration. Placement occurs when the launderer first introduce the fund to the financial institution. The launderer seeks the assistance of an insider who will assist him in the laundering process. Next, is the layering stage, where the launderer create complex layers of transactions, moving money from one account to another within the same bank or from one bank to another.. the final stage is integration, where the launderer take over an ailing business and revive it, making it difficult for law enforcement to unravel.

#### **Designated Non Financial Institutions**

“Designated Non Financial Institutions” include dealers in jewelry, cars and luxury goods, chartered accountants, audit firms, tax consultants, clearing and settlement companies, legal practitioners, hotels, casinos, super markets, and such other businesses as the Federal Ministry of industry may from time to time designate.<sup>12</sup> These businesses and professions are used by launderers and those who finance terrorism as shams or mask to avoid recognition by law enforcement agencies. To check the crimes perpetrated by these businesses and professions, the Federal Government established the Special Control Unit on Money Laundering (SCUML), operating under the Ministry of Commerce, to regularly conduct inspections.

#### **Politically Exposed Persons**

While, “Politically Exposed Persons (PEPs)” includes-

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<sup>11</sup> Ibid

<sup>12</sup> Ibid.

- (a) individuals who are or have been entrusted with prominent public function by a foreign country, for example Head of state or government, senior politicians, senior government, judicial or military officials, senior executives of State owned Corporations and important political party officials;
- (b) individuals who are or have been entrusted domestically with prominent public functions, for example Heads of State or of Government, senior politicians, senior government, judicial or military officials, senior executives of State owned Corporations and important political party officials; and
- (c) Persons who are or have been entrusted with a prominent function by an international organization and includes members of senior management such as directors, deputy directors and members of the board or equivalent functions other than middle ranking or more junior individuals.<sup>13</sup>

### **DEVELOPMENT OF THE CONCEPT OF CUSTOMER DUE DILIGENCE**

In 1988, when the Basel Committee of Banking Supervision (BCBS) wrote the Basel statement of Principles<sup>14</sup> and introduced the concept of Know Your Customer (KYC) as a fundamental principle in banking supervision, the aim was far broader than “catching criminals.” The principle sought first to facilitate credible risk management by financial institutions and secondly to reduce the risk of uncontrolled flows worldwide. The KYC principle was later upgraded to “Customer Due Diligence (CDD) for banks.” Beyond combating money laundering and terrorism financing, these obligations on customer acceptance and their continuous monitoring are part of an attempt to harmonizing standards in banking

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<sup>13</sup> Ibid.

<sup>14</sup> Winer, J. (2002) “Globalization and Global Conflict-Time for a White List?” 4 European Journal of Law Reform.

supervision as a reaction to the demise of national control by using elements of global governance for financial centres.<sup>15</sup> Concurrently, and not unrelated to the process, 13 major international banks and NGO “Transparency International” decided to develop a private code of conduct, the “Wolsberg Principles.”<sup>16</sup> Their most significant effect was to spur regulators, who had already started work on new rules of CDD within the BCBS into adopting a more rigorous approach. The CDD paper of the BCBS influenced the Financial Action Task Force (FATF) to issue the 40 Recommendations on money laundering and terrorism financing.

### **INTERNATIONAL STANDARD ON CUSTOMER DUE DILIGENCE**

The Financial Action Task Force (FATF) created by the G7 summit issued a set of 40 Recommendations designed to “provide an enhanced, comprehensive and consistent framework of measures for combating money laundering and terrorist financing.” These Recommendations among other things, cover the criminalization of money laundering and terrorism financing, the freezing and seizing of criminal proceeds and of terrorism funds, key preventive measures against laundering and terrorism financing for financial institutions and other institutions, financial intelligence units and international co-operation.<sup>17</sup>

FATF Recommendation 10 requires that if, during the establishment or course of the customer relationship or when conducting occasional

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<sup>15</sup> Ibid.

<sup>16</sup> [www.wolsberg.principles.com](http://www.wolsberg.principles.com). Accessed on the 30<sup>th</sup> of September, 2014 at about 100 hours.

<sup>17</sup> The FATF 40 Recommendations are broken into four groups. These are Group A: Legal systems, and include the scope of the criminal offence of money laundering (1 and 2) and provisional measures and confiscation (3). Group B: Measures to be taken by financial institutions and (certain) Non-financial Business and professions to prevent money laundering and terrorist financing, and include prohibition on shell Banks (4) Customer Due Diligence and recordkeeping. (5-12) reporting of suspicious transactions and compliance. (13-16), other measures to deter money laundering and terrorist financing etc. For the purpose of this paper we will concentrate on measures to be taken for Customer Due Diligence.

transaction, a financial institution suspects that transaction relate to money laundering or terrorist financing, then the institution should:

Normally seek to identify and verify the identity of the customer and the beneficial owner, whether permanent or occasional, and irrespective of any exemption or any designated threshold that might otherwise apply; and make a suspicious transaction report (STR) to the financial intelligence unit (FIU) in accordance with Recommendation 20.<sup>18</sup> When performing customer due diligence (CDD) under Recommendation 10, financial institutions are also required to verify that any person purporting to act on behalf of the customer is so authorised, and should identify and verify the identity of the person. Also, when performing CDD measures in relation to customers that are legal persons or legal arrangements,<sup>19</sup> financial institutions should be required to identify and verify the customer and understand the nature of its business, and its ownership and control structure. The purpose of the requirement is twofold: firsts, to prevent the unlawful use of legal persons and arrangements, by gaining a sufficient understanding of the customer to be able to properly assess the potential money laundering and terrorist financing risks associated with the business relationship; and second, to take appropriate steps to mitigate the risks.

The type of information needed to perform due diligence is:

Name, Legal form and proof of existence – verification could be obtained through certificate of incorporation, a certificate of good standing, a partnership agreement, a deed of trust, or other documentation from a reliable independent source providing the name, form and current existence of the customer. The powers that regulate and bind the legal

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<sup>18</sup> In determining the reasonableness of the identity verification measures, regard should be led to the money laundering and terrorist financing risks posed by the customer and business relationship.

<sup>19</sup> In these recommendations references to legal arrangements such as trusts, being a customer of a financial institution or DNFBPP or carrying out a transaction, refers to a situation where a natural or legal person that is the trustee establishes the business relationship or carries out the transaction on behalf of the beneficiaries or according to the terms of the trust. The normal CDD requirements for customers that are natural or legal persons would continue to apply.



person or arrangement (eg senior managing directors in a company, trustee(s) of a trust). The address of the registered office, and, if different, a principal place of business.

Recommendation 10 also requires financial institutions to identify beneficial owners of a customer's account, which in the case of legal persons includes "taking reasonable measures" to identify the physical persons who own or control the legal person.

For life or other investments- related insurance business, financial institutions in addition to CDD measures required for the customer and the beneficial owners, conduct CDD measures in accordance with the International Association of Insurance Supervision (IAIS) guidelines.

A key development in the 2012 Recommendations was the adoption of an optional risk based approach for certain preventive measures. The adoption of risk sensitivity "involves identifying and categorizing money laundering risks and establishing reasonable controls based on risks identified."<sup>20</sup> Where the risks are lower, financial institutions could be allowed to conduct simplified CDD measures.

Another innovation brought by the 2012 FATF Recommendation<sup>21</sup> is the conduct of CDD on Politically Exposed Persons. Financial institutions should take reasonable measures to determine whether the beneficiaries of a life insurance policy are Politically Exposed Persons. Whether there are higher risks identified, in addition to performing normal CDD measures, financial institutions are required to inform senior management before the pay out of the policy proceeds, and conduct enhanced scrutiny on the whole business relationship with the policy holder and consider making a suspicious transaction report.

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<sup>20</sup> See FATF Guideline on the Risk Based Approach to Combating Money Laundering and Terrorist Financing.

<sup>21</sup> FATF Recommendation 12

## **CUSTOMER DUE DILIGENCE UNDER THE NIGERIAN MONEY LAUNDERING (Prohibition) ACT, 2011 (As amended).**

### **Identification of Customers for financial and designated non-Financial Institutions**

The *Money Laundering (prohibition) Act 2011* (As amended) makes it mandatory for financial institutions and designated non-financial to verify the identity and update all relevant information on the customer<sup>22</sup> before opening an account for, issuing a passbook to, entering into financing transaction with, renting a safe deposit box to or establishing any other business relation with the customer,<sup>23</sup> and during the course of the relationship with the customer.<sup>24</sup> Financial institutions must also scrutinize all ongoing transactions undertaken throughout the duration of the relationship in order to ensure that the customer's transaction is consistent with the business and risk profile.<sup>25</sup>

The use of the word "shall" in the section presupposes mandatory. However, what is not clear from the provision is the use of the term "its customers" as this raises the question at what stage will a person be referred to as a customer? For example, for a person to be considered as a customer of a bank, it is essential and indispensable that the person should have opened an account in the bank<sup>26</sup> or the person is conducting transaction on behalf of another person who has an account.<sup>27</sup>

It is submitted that the phrase: 'its customers' ought to have been qualified to include its customers or prospective customers so as to cover both the existing and potential customers. The identity of a customer is verified, in the case of an individual, by the customer presenting a valid

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<sup>22</sup> Section 3(1)(a).

<sup>23</sup> Section 3(1)(a)(i).

<sup>24</sup> Section 3(1)(a)(ii).

<sup>25</sup> Section 3(1)(b).

<sup>26</sup> *Great Western Railways Company v. London and Country Banking Co.* (1902) AC, 424; *Ademuliyi and Damuye v. A.C.B.* (1964) N.M.L.R. 137.

<sup>27</sup> *New Nigerian Bank v. Odiase*, (1993) 8 N.W.,L.R. 235, at pp.243-4.

original copy of an official document bearing his or her name and photograph. For example, utility bills, such as water bill and power holding corporation bills etc<sup>28</sup> within the previous three months.

The address of an individual customer is also verified by the customer presenting to the financial institution the original of receipts issued within the previous three months by public utilities or any other documents as the relevant regulatory authorities may from time to time approve.<sup>29</sup> What is not clear is whether the receipts must necessarily bear the name of the customer or of any other person's name. The likely effect of the utility bill bearing the name of the customer is that it may foreclose tenants, dependents, squatters and such others, who will find it difficult to have utility bills in their names. To achieve the objective of the law, it is necessary to expand the scope to include utility receipt issued in favour of a guardian, guarantor, or any such similar person among others.

Public utilities connote services provided for the public, for example, an electricity, water or gas supply.<sup>30</sup> In Nigeria today, it is an onerous task to demand receipt of public utilities from even those who own residential accommodation let alone squatters. Today, the fixed line telephone line is almost extinct and the common telephone facilities are GSM<sup>31</sup> and fixed wireless<sup>32</sup> which are substantially pay-as-you-go with no issuable receipt to establish evidence of particular residential address. The electricity bills are now replaced with pre-paid metering system where electricity consumer will only buy credit units and receipts are no longer necessary. Water bill receipts are similarly not a common instrument among the citizenry, because substantial reliance for water supply is through personalized boreholes and water vendors who issue no receipt.

Nonetheless, the purpose of the above requirement is if an institution has only the basic details of a customer, it will lack information

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<sup>28</sup>Section 3(3).

<sup>29</sup> Section 3(2)(b).

<sup>30</sup>Oxford Advanced Learners Dictionary, sixth Edition.

<sup>31</sup> For example MTN, Airtel, GLO, Etisalat, et cetera.

<sup>32</sup> For example multi links, starcomms etcetra.

that could be used to profile the specific client and to correctly identify a suspicious and unusual transaction that may be concluded by the client.<sup>33</sup> Customer Due Diligence violation is yet to be tested in Nigerian Courts. But in the South African case of *Kwamashu Bakery Ltd v. Standard Bank of South Africa Ltd*,<sup>34</sup> the court held that banks are required in terms of common law to identify and verify prospective clients before opening an account. See also *Powell V. ABSA Ltd*.<sup>35</sup>

A body corporate is required to provide proof of its identity by presenting its certificate of incorporation and other valid official documents attesting its existence.<sup>36</sup> It is submitted that though the certificate of incorporation is a proof of identity for corporate body, evidence of filing annual returns with corporate Affairs Commission suffices.

Also, the manager, employee or assignee delegated by a body corporate to open account shall be required to produce not only documents mentioned in sub section (2), but also proof of the power of attorney granted to him in that behalf.<sup>37</sup>

A casual customer shall comply with the provisions of subsection (2) for any manner of transaction involving a sum exceeding \$1,000 or its equivalent if the total amount is known at the commencement of the transaction or as soon as it is known to exceed \$1,000 or its equivalent.<sup>38</sup>

Financial institutions or designated non-financial institutions shall seek from the customer information as to the true identity of the principal if it appears that the customer is not acting on his own account. Where the customer is a body corporate, the financial institution shall:

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<sup>33</sup>Dekoker, L. "Money Laundering Control: The South African Model," *Journal of Money Laundering Control* (2001).

<sup>34</sup>(1995)2 S.A. 377.

<sup>35</sup>(1998), 2 SA 807.

<sup>36</sup>Section 3(3).

<sup>37</sup>Section 3(4).

<sup>38</sup>Section 3(5).

take reasonable measures to understand the ownership and control structure of the customer; and determine the natural person who truly own or control the customer.<sup>39</sup> Where the customer is a public officer or Politically Exposed Person (PEP), the Financial Institution or Designated non-financial institution shall in addition to the requirements of subsection (1) and (2) put in place appropriate risk management systems; and Obtain senior management approval before establishing and doing any business relationship with the public officer.<sup>40</sup>

Section 3 sub section (4) of the Act provided for management of risks by financial and designated non financial institutions. Enhanced measures are taken to manage and mitigate high risks<sup>41</sup>. While simplified measures are taken to manage and mitigate lower risks<sup>42</sup>. In the case of cross-border correspondent banking and other similar relationships, sufficient information is gathered about a respondent institution<sup>43</sup>. Also the respondent institutions anti money laundering and combating the financing of terrorisms control shall be assessed<sup>44</sup>. Respective responsibility of each institution in this regard must be documented<sup>45</sup>. Also, management approval must be obtained before establishing new correspondent relationships<sup>46</sup>. Former sub section (8) which provided for putting in place appropriate risk management systems and obtaining senior management approval before establishing and during any business relationship with the public officer is now replaced with a new sub section 7. The new sub section replaced “public officer” with “politically exposed person.”

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<sup>39</sup> See Section 3(7)(a) and (b).

<sup>40</sup>Section 3(8(a) and (b).

<sup>41</sup> Subsection (4) (a)

<sup>42</sup> Subsection 4 (b)

<sup>43</sup> Subsection (4) (C) (i)

<sup>44</sup> Subsection (4) (C) (ii)

<sup>45</sup> Subsection (4) (C) (iii)

<sup>46</sup> Subsection (4) (C) (iv)

## **Due Diligence for Designated Non- financial Institutions.**

### **Due Diligence for Casinos**

In addition to the customer due diligence requirement in section 3 of the Act, the law made it incumbent upon casinos to verify the identity of their customers. Anybody carrying out financial transactions with a casino is required to present a valid original document bearing his name and address<sup>47</sup>. The due diligence required of a casino includes recording of all transactions in chronological order, including the nature and amount involved in each transaction;<sup>48</sup> and each customer's surname, forenames and address, in a register forwarded to the Ministry of Industry for the purpose.<sup>49</sup>

### **Due Diligence for Occasional Cash Transactions by Designated Non-financial Institutions**

Designated Non-financial Institutions include dealers in jewellery, cars and luxury goods, chartered accounts audit firms, tax consultants, clearing and settlement companies, legal practitioners, hotels, supermarkets and such other business as the Federal Ministry of Industry, Trade and Investment or appropriate regulatory authorities may from time to time designate.<sup>50</sup> The due diligence required from a designated non-financial institution for occasional cash transactions is as follows: before the commencement of any new business and in the case of existing business operated within 3 months from the commencement, must submit a declaration of its activities to the Ministry of Commerce, Trade and Industry.<sup>51</sup> A specialised unit from the Ministry of Commerce known as Special Control Unit on Money Laundering (SCUML) coordinates the

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<sup>47</sup> Section 4 (1)(a)

<sup>48</sup> Section 4 (1)(b)(i)

<sup>49</sup> Section 4 (1)(b)(ii)

<sup>50</sup> Section 25 of the Money Laundering (Prohibition) Act, 2011

<sup>51</sup> Section 5(1) (i) (ii)

activities of designated non financial institutions, business and professions (DNFIBPs).<sup>52</sup>

DNFIBPs whose business involves cash transaction shall prior to any transaction involving a sum exceeding US\$1, 000 or its equivalent, identify the customer by requiring him to fill a standard data form and present his international passport, driving license, national identity card or such other document bearing his photograph as may be prescribed by the Ministry of Commerce.<sup>53</sup>

Also, the DNFIBPs must record all transactions in chronological order, indicating each customer's surname, forenames and address in a register numbered and forwarded to the Ministry of Commerce and Industry.<sup>54</sup> Upon receipt of the transactions, the Ministry of Commerce, then forwards the information received to the Economic and Financial Crimes Commission within 7 days of receipt.<sup>55</sup> It is also required that the register be kept and preserved for a period of 5 years after the last transaction recorded.<sup>56</sup> The penalty for DNFIBPs that fails to comply with the requirement of customer due diligence and the submission of returns of such transactions is a fine of ₦250, 000 for each day during which the offence continues and suspension, revocation or withdrawal of license by the appropriate licensing authority as the circumstances may demand.<sup>57</sup> Complying with the above due diligence requirement protects financial and designated non-financial institutions from legal risk, operational and reputational risks.

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<sup>52</sup> The SCUML is a specialized unit of the Ministry of Commerce and Industry responsible for regulating, supervising and monitoring of designated non-financial institutions, business and professions against money laundering in compliance with FATF 40 Recommendations.

<sup>53</sup> Section 5 (1) (b)

<sup>54</sup> Section 5 (1) (c) of the Money Laundering (Prohibition) Act, 2011

<sup>55</sup> Subsection (2) Ibid

<sup>56</sup> Subsection (3) Ibid

<sup>57</sup> Subsection (6) Ibid

## THE ROLE OF FINANCIAL SECTOR REGULATORS IN PROMOTING CUSTOMER DUE DILIGENCE.

### The Central Bank of Nigeria Act, 2007.<sup>58</sup>

The *CBN Act*,<sup>59</sup> established a body known as the Central Bank of Nigeria, (referred to as “the Bank”) and charged it with the responsibility of administering the *Banks and Other Financial Institutions Act (BOFIA) of 1991*(as amended), the bank discharges its principal functions of ensuring high standards of banking practice and financial stability through its surveillance activities, as well as the promotion of an efficient payment system. In its role towards combating money laundering, the CBN issued the Know Your Customer (KYC) directives as expounded by circular on Anti Money Laundering/Counter Terrorism Financing (AML/CFT).<sup>60</sup> The circular reminds the financial institutions of the requirement to implement the various provisions of the Money Laundering Guidance notes and to observe the code of ethics and professionalism issued by the Bankers’ Committee.<sup>61</sup> The KYC directive requires financial institutions to develop policies, practices and procedures that will ensure a rigorous customer due diligence in order to protect their institutions from being used for financial crimes. The prudential guideline 2010 reiterated the compulsion of compliance with the Money Laundering Act and other directives related thereto by the CBN.<sup>62</sup>The KYC principles require financial institutions to; *inter alia* observe the following customer identification and record keeping rules in spirit of Money Laundering (prohibition) Act:

1. Avoiding keeping anonymous accounts or accounts in fictitious names;

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<sup>58</sup> Cap. C4, LFN, 2004.

<sup>59</sup> Ibid.

<sup>60</sup> CBN Annual Report 2009, p.43.

<sup>61</sup> BSD/DIR/GEN/CR/O2/0275.

<sup>62</sup> [www.centralbank.org/publication-circulars,17/09/2010](http://www.centralbank.org/publication-circulars,17/09/2010). Accessed on the 26/02/13, at 11.00 p.m.



2. Verifying with the Corporate Affairs Commission the proof of incorporation of the corporate customers, their structure, address, directors, memorandum and articles of association and the customers' business activities;
3. Subject to strict safeguards, detecting or monitoring physical cross-border transportation of cash and bearer negotiable instruments.<sup>63</sup>
4. Having clear procedures on and communicate to all their personnel how they should promptly report suspicious transactions to the money laundering reporting officers and to other competent authorities;
5. Investigating the sources of funds before accepting as a customer, a Politically Exposed Person (PEP), and the decision to open such account should be taken at the senior management level;<sup>64</sup>
6. Applying effective customer identification procedure and on-going monitoring standard for telephone and electronic banking customers and proactively assess various issues posed by emerging technologies;<sup>65</sup>
7. Undertaking regular reviews of existing records of customers, especially when there is material change in the way the account is operated.<sup>66</sup>

It is submitted that the KYC Guidelines and the prudential guidelines have provided a comprehensive guide for banks and other financial institutions, within the regulatory purview of the CBN, on the uniform procedure to be adopted for obtaining adequate information for the banks to minimize the

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<sup>63</sup>This is to be done without impeding the freedom of capital movements.

<sup>64</sup> See also section 3(8)(a) and (b) of the *Money Laundering (Prohibition) Act 2011*.

<sup>65</sup>Ibid.

<sup>66</sup>CBN Annual Report 2008.

risk of illicit activities, protect themselves against fraud and reputational risks.<sup>67</sup>

### **Investments and Securities Act, 2007.**<sup>68</sup>

The Act established a body to be known as The Securities and Exchange Commission<sup>69</sup> vested with the power to regulate and develop the Nigerian capital market, in addition to setting the basis of allotment of securities by the *Securities and Investments Act, 2007*.<sup>70</sup> It also has power to register and regulate Securities Exchange; Capital Trade Points; Options and Derivative Exchanges; commodity Exchanges and any other recognizes Exchange.

The Commission in March 2003 issued Know Your Customer (KYC) guidelines which are also in line with the FATF Recommendations. The fundamental objective of KYC framework is to determine the true identity of all customers seeking to utilize the capital market services. The scope of identification stretches to include the beneficial owner of all accounts and custodial facilities. The framework seeks to make capital market operators aware of activities that are unusual or inconsistent with normal market activity.<sup>71</sup> To satisfy these requirements, market operators need to have mechanism that will facilitate the establishment of customer transaction profile. Internal systems therefore need to be developed or put in place by every capital market operator to determine such profiles and to identify trends or activities with established profile.<sup>72</sup>

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<sup>67</sup> [www.centralbank.org](http://www.centralbank.org)/accessed on the 26/2/13 at 10.00 p.m.

<sup>68</sup> Cap. 124, LFN, 2004.

<sup>69</sup> Ibid.

<sup>70</sup> Section 1 of the Investments and Securities Act, 2007.

<sup>71</sup> [www.sec.gov.ng/laws/2009](http://www.sec.gov.ng/laws/2009), accessed on 28/03/13 at 2.00.

<sup>72</sup> Ibid.

Within the regulatory framework, the Commission pursuant to its powers<sup>73</sup> issued the Anti-Money Laundering/Combating the Financing of Terrorism Manual for Market Operators 2010.<sup>74</sup> The manual intended to guide capital market operators in the implementation of the KYC and Customer Due Diligence (CDD) requirements for the capital market. Compliance with the Manual is mandatory and violation attracts prescribed sanctions.<sup>75</sup>

In exercise of the powers conferred on the Securities and Exchange Commission (SEC), by section 13(a), (aa) and (dd), and section 313 of the *Investments and Securities Act, 2007*, and all other powers enabling it in that behalf, SEC made Regulations<sup>76</sup> that provides protection against fraud, reputational and other financial market risks. These Regulations are known as “Securities and Exchange Commission (Capital Market Operators Anti-money Laundering and Combating the Financing of Terrorism) Regulations, 2013. The Regulation also minimise the risks faced by the capital markets from the proceeds of crime; guide capital market operators in the implementation of Know Your Customer (KYC) and Customer Due Diligence (CDD) requirements for the capital market<sup>77</sup>; and protect the integrity of the securities market against all forms of abuse, fraudulent and unfair trade practices.<sup>78</sup>

### **National Insurance Act, 2003<sup>79</sup>**

The Insurance Act, 2003<sup>80</sup> established a body to be known as the National Insurance Commission (NAICOM). Similar to the SEC, the role of the Commission in combating money laundering and terrorist financing may be viewed from two perspectives. Firstly, as goalkeeper and secondly, as

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<sup>73</sup> Section 13 (n) of the Investment and Securities Act, 2007.

<sup>74</sup> Effective from 28<sup>th</sup> July, 2010.

<sup>75</sup> Section 29 of the Manual

<sup>76</sup> No 63 of 2<sup>nd</sup> September: - Official Gazette of the Federal Republic of Nigeria vol. 100

<sup>77</sup> Regulation 1 (b)

<sup>78</sup> Regulation 1 ©.

<sup>79</sup> Cap.N.53, LFN, 2004.

<sup>80</sup> Ibid.

supervisor. As goalkeeper, the Commission discharges the function of making appropriate rules and regulations that will ensure ethical practice of insurance business and also determine who is a fit and proper person to be licensed to engage in insurance business in Nigeria.<sup>81</sup>

In order to strengthen the provisions of the Money Laundering (Prohibition) Act, 2011 especially as it relates to necessary disclosures and statutory reporting, the Commission issued the KYC guideline. The scope of the identification within the KYC principles stretches to include the policy holders and beneficiaries of insurance policy. The framework seeks to make underwriters aware of and report activity that is unusual or inconsistent with the normal insurance transactions. To satisfy these requirements, insurance operators need to have mechanism that will facilitate the establishment of customer transaction profile. In ensuring compliance, the Commission appoints high-ranking officers as Compliance Officers who shall not be below the rank of Assistant General Manager.<sup>82</sup>

In addition to above, the National Insurance Commission in exercise of the powers conferred on it by section 101 of *the Insurance Act, 2003*<sup>83</sup> and all other powers enabling it in that behalf made Regulations<sup>84</sup> with the approval of the Honourable Minister of Finance. These Regulations are known as “National Insurance Commission (Anti-money Laundering and Countering the Financing of Terrorism) Regulations, 2013. The objective of the Regulations is to promote, enhance and ensure compliance with subsisting legislation on Anti-money Laundering and Countering the Financing of Terrorism by the Insurance Industry in Nigeria.<sup>85</sup>

### CHALLENGES OF IMPLEMENTATION

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<sup>81</sup> See section 1 & 2 of the Insurance Regulation 2003.

<sup>82</sup> Section 25, 2005 Operational Guidelines, National Insurance Commission

<sup>83</sup> Cap. N53, LFN, 2004.

<sup>84</sup> No. 62 of 9<sup>th</sup> September, 2013: - Official gazette of the Federal Republic of Nigeria Vol.

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<sup>85</sup> Regulation 1

In a number of developing countries, the way people are identified makes full compliance with the law requirement a burdensome and costly process. Those financially vulnerable people, who form a significant part of the potential clientele of financial institutions, often lack proper identification documents. A survey of some banks situated in some countries highlighted a number of practical problems<sup>86</sup>:

1. Obligation to get information on the occupation of the customers and on the use of the funds leads to a heavy procedure for each of the transactions;
2. Lack of proper identification documents (ID, Passport);
3. Lack of official proof of income and residence address. For instance, self employed rural farmers would not be able to produce proof of income while poor living in rural areas and informal accommodation will not be able to justify their residence address;
4. Lack of appreciation by the unbanked of the need to supply the compliance information;
5. Customers do have the requisite documentation, but due to lack of information they do not have them on their person when going to the bank to open accounts and would necessarily not be served. These prospective customers might be coming from places quite distant from the branches, and would obviously find it costly in terms of time and money to go back to the bank to open accounts.

Consequently, Banks may also face reputational risks resulting into commercial challenge, since these CDD requirements are conflicting with their mandate to serve unbanked and under-banked people.

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<sup>86</sup> As reported for example by the HFC Bank Ltd, Ghana; *Caisse d'Eppargne de Madagascar*; Bank Simpanan Nasional, Malaysia; Philippine Postal Savings Bank; PostBank Uganda; PostBank South Africa or Lesotho PosBank

Customer due diligence also include the Know Your Customer Principles (KYC) and the Know Your Customer Business (KYB). As operators move to embrace the KYC and KYB principles more comprehensively, they will be challenged to implement these principles in respect of their existing customers. While a system for the implementation of the principles in respect of new businesses can be put in place without difficulty, the task of implementing the principles in respect of existing business is far more challenging. Apart from the sheer volume of the work involved, the question may arise of the legal opinion available to the operator that discovers that an existing customer does not satisfy the KYC/KYB test applied.

Based on available data, the KYC enables banks to minimize risk of illicit activities, protect themselves against fraud and reputational risks.<sup>87</sup> In order to ensure compliance, the regulators conduct examination of financial institutions on anti-money laundering/combating the financing of terrorism (AML/CFT). During the examination carried out in 2008, some of the problems observed include difficulty in obtaining information on Politically Exposed Persons (PEPS), lack of transparency by operators and lack of continuous training for staff.<sup>88</sup> It is recommended that appropriate regulatory guidelines should be evolved to deal specifically with the PEPs.

## CONCLUSION

Financial and designated non financial institutions must be properly regulated to force them to-do their customer due diligence properly, so that if they cannot identify the ultimate beneficial owner of the funds, they must not accept the customer as a client. Anti-money laundering laws must be absolutely explicit, and consistent across different jurisdictions, that financial and designated non financial institutions must identify the

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<sup>87</sup> [www.cbn.org](http://www.cbn.org). Accessed on the 16/4/13.

<sup>88</sup> CBN Annual Report, 2008, pp.24-28.

natural person behind the funds, investigate the source and refuse the customer if he presents a risk. Regulators must ensure that this is enforced, and should treat the prevention of illicit money flows as a priority.

Secondly, the requirement for presenting original receipts of public utilities to verify the address of a customer is not clear under the Money laundering (Prohibition) Act, 2011. What is not clear is whether the receipt must bear the name of the customer or any other persons name. Insisting that the receipt must bear the name of the customer forecloses tenants, dependents and squatters from becoming customers of the financial or designated non financial institution. In Nigeria today, it is difficult to demand receipt of public utility from even those who own residential accommodation let alone a squatter, tenant or dependent. The apt thing to do in the circumstances is to introduce a liberal interpretation of customer identification and verification to give everybody the opportunity of enjoying the services of financial and designated non financial institutions. It has also been found that the issue of verification of a customer's identity by financial institutions raises the question at what stage will a person be referred to as a customer? For example, to be a customer of a bank, it is essential that a prospective customer opens an account in the bank, or a person is conducting a transaction on behalf of another person who has an account. It is recommended that the phrase "its customers" ought to have been qualified to include its customers or such other persons in circumstances wherein a contract may arise. Financial institutions must scrutinize all ongoing transactions undertaken throughout the duration of the relationship with its clients in order to ensure that the customers' transaction is consistent with the business and risk profile.

Thirdly, in conducting CDD, financial institutions should determine the extent of such measures on a risk sensitive basis depending on the type of customer, business relationship or transaction.. In certain circumstances, where there are low risks the financial institution could

apply reduced or simplified measures. The measures that are to be taken should also be consistent with guidelines issued by competent authorities. For higher risk categories, financial institutions should perform enhanced due diligence. In certain circumstances where there are low risks simplified measures should be conducted.

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