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Compliance in International Logistics' Finance – Anti-Money Laundering and Know-Your-Customer

By Dorle Katharina Oldenburg* and Thomas Ostendorf**

Summary

Approximately sixty percent of German goods exports are transported via sea freight. The international shipping industry is dominated by firms registered in offshore centers with little transparency. Criminals feel invited to abuse these opaque constructions for laundering their illegally acquired income or to also circumvent sanctions imposed on certain countries or goods. Banks and other financial enterprises thus need risk management and mitigation processes to stop illegal money laundering and other illegal financial transactions. At the core of these measures is the Know-Your-Customer process. Apart from watching and controlling money flows it is important to identify the owner of both money and firms employed in transactions. However, many offshore centers lack adequate registers that transparently document who is the owner. These registers are therefore not easily accessible resources for banks fighting money laundering. This paper discusses the current state of the art in anti-money laundering, mandatory know-your-customer screenings and its challenges in German banks involved in international trade finance.

Zusammenfassung

Ca. 60 Prozent der deutschen Exporte werden per Schiff getätigt. Die internationale Schifffahrtsbranche wird von Unternehmen dominiert, die ihr Domizil in sogenannten Offshore-Zentren haben, die durch geringe Transparenz gekennzeichnet sind. Kriminelle fühlen sich dadurch eingeladen die undurchsichtigen Strukturen zu nutzen, um illegale Geldströme zu verbergen oder Sanktionen zu umgehen, die gegen bestimmte Länder oder Waren verhängt wurden. Banken und andere Finanzinstitute müssen daher Risikomanagementprozesse installieren, um diese illegalen Geldwäschetransaktionen aufzudecken und zu stoppen. Im Zentrum dieser Mitigationsmaßnahmen steht der sogenannte Know-Your-Customer Prozess. Neben der Beobachtung und Kontrolle der Geldströme gilt es im Rahmen dessen die berechtigten Parteien, sowohl des Geldes als auch der involvierten Unternehmen, zu identifizieren. Allerdings fehlen in vielen Offshore-Zentren angemessene Register, die einen transparenten Überblick über die Eigentümerstrukturen

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gewährleisten. Darum bilden diese Register für Banken, die Geldwäsche bekämpfen, keine leicht zugänglichen Quellen. Der vorliegende Artikel zeigt die gegenwärtigen Maßnahmen der Geldwäschebekämpfung sowie der obligatorischen Know-Your-Customer Prüfungen in Finanzinstituten auf und diskutiert die Herausforderungen für deutsche Banken, die in der internationalen Handelsfinanzierung tätig sind.

JEL classification: F1, F3, G15, G21, G28

Keywords: money laundering, know-your-customer, compliance, fraud, sanctions, shipping industry, logistics finance, risk management, ultimate beneficial owner, politically exposed person, offshore company, Panama Papers, Paradise Papers

1. Introduction

Behind the shiny facades of the financial world, where business is conducted at rapid speed and billions shift hands with a simple mouse click,¹ an invisible web of concealed transactions and manipulated business structures weaves itself.² Money laundering is not a practice of the last century, but still a relevant component of organised crime today.³ Reported global events of economic crime include eleven percent that are associated with money laundering.⁴ The term money laundering covers the injection of illegal assets into the legal economy in order to subsequently be able to reinvest these legally in other places.⁵ The issue posed by money laundering lies in its ability to obscure its criminal origins and legitimise assets without leaving any trace of illicit activity.⁶ The implications extend from supporting terrorist activities to funding drug cartels⁷ and mafia clans.⁸

While creative criminals and corrupt networks try to cover their money laundering tracks from public sight,⁹ regulators, experts, and banks are working to identify those responsible and hold them accountable.¹⁰ Similarly, state and private actors trying to circumvent sanctions need to disguise the illegal flow of financial assets. To prevent or uncover this, financial institutions are legally obliged to enforce anti-money laundering (AML) compliance measures im-

¹ Cf. Idzikowski, L., Transactions in banking, 2021, p. 49.

² Cf. Iosifidis, A., Jensen, R. I. T., Money laundering, 2023, p. 8889.

³ Cf. Sullivan, K., Money laundering, 2015, p. 1.

⁴ Cf. PwC, Global Economic Crime and Fraud Survey, 2020, p. 4.

⁵ Cf. Teichmann, F. M. J., Money laundering purposes, 2018, p. 372.

⁶ Cf. Naheem, M. A., Money laundering techniques, 2016, p. 136.

⁷ Cf. Sullivan, K., Money laundering, 2015, p. 2.

⁸ Cf. The New York Times, Gambling parlours as mafia's money laundering model, 2022, n. pag.

⁹ Cf. Barone, R. et al., Money laundering, 2022, p. 320.

¹⁰ Cf. Iosifidis, A., Jensen, R. I. T., Money laundering, 2023, p. 8889.

posed by investigative authorities to monitor their clients.¹¹ In the global finance industry, 29 percent of fraud incidents in 2022 resulted from failed so-called know-your-customer reviews, which display the core AML measure.¹² In case of non-compliance with the legal regulations on money laundering prevention, banks are not only exposed to reputational damage, but also to penalties. For instance, in 2021, HSBC was fined GBP 63.9 million because the UK's Financial Conduct Authority revealed that they had not fulfilled their due diligence obligations.¹³ As another example, in 2024 the German online bank N26 was fined EUR 9.2 million for AML failures.¹⁴

Globalisation has made international payments for globally transported goods and trading operations common practice.¹⁵ Germany as a maritime exporting nation transports approximately sixty percent of its export goods by sea.¹⁶ Establishing offshore company structures is a legal tax saving model.¹⁷ Their lack of transparency complicates the clear distinction between legality and illegality.¹⁸ This results in challenges for banks in screening their logistics customers for AML purposes.¹⁹ The number of Suspicious Activity Reports filed by German financial institutions is steadily increasing annually.²⁰ In this context the following research question will be addressed in this paper:²¹

What approaches do German banks employ to enforce legally required anti-money laundering compliance measures monitoring their logistics customers and what obstacles do they face? What are possible solutions for shortcomings?

2. International Ownership Structures in Maritime Shipping

In the globalised world, cargo is transported all over continents and seas, involving numerous logistics companies.²² Especially in maritime shipping as part of the logistics industry, certain varieties of ownership structures like ship-own-

¹¹ Cf. Barone, R. et al., Money laundering, 2022, p. 320.

¹² Cf. PwC, Global Economic Crime and Fraud Survey, 2022, p. 6.

¹³ Cf. The Guardian, Millions in fines for HSBC's AML failings, 2021, n. pag.

¹⁴ Cf. Bundesanstalt für Finanzdienstleistungsaufsicht, Millions in AML fines for N26, 2024, n. pag.

¹⁵ Cf. Ndizera, V., International trade, 2023, p. 329.

¹⁶ Cf. Drumm, L., Zhang, P., German maritime industry, 2020, p. 470.

¹⁷ Cf. Polsky, S., Offshore companies, 2022, p. 74.

¹⁸ Cf. Cox, D., Money laundering, 2014, p. 11.

¹⁹ Cf. Iosifidis, A., Jensen, R. I. T., Money laundering, 2023, p. 8899.

²⁰ Cf. Financial Intelligence Unit, German Suspicious Activity Reports, 2021, p. 17.

²¹ This paper is based on a research project conducted at FOM University of Applied Science in 2023.

²² Cf. Paun, C., Topan, V., Maritime ownership structures, 2016, p. 360.

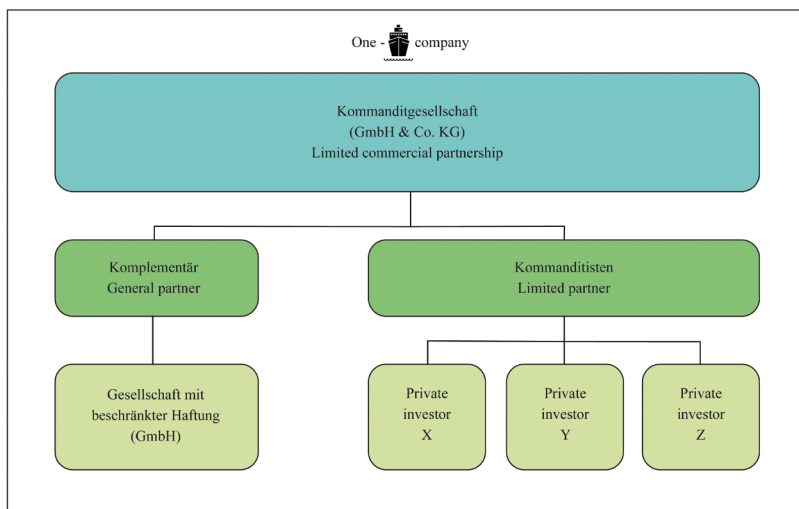


Figure 1: Shareholding structure of a common German one-ship company

Source: Based on Verband Deutscher Reeder, Zentralverband Deutscher Schiffsmakler, Seafreight, 2013, p. 282.

ing companies, partnerships, foundations, trusts, and holding companies are commonly used to facilitate investments and operations, each providing specific advantages in terms of liability and taxation.²³

Figure 1 above illustrates the corporate structure of the so-called ship-owning company, also known as a one-ship company (in German: *Einschiffsgesellschaft*) which is commonly used by German shipping companies which own a ship. This is a special type of limited commercial partnership, whose investments are held by a general partner (in German: *Komplementär*) and limited partners (in German: *Kommanditisten*). Various investors can act as limited partners, both legal entities and individuals who do not cover an active management role. The liability of the limited partner is limited only to the amount of the asset contribution. The general partner in this construct, in contrast, is a limited liability company (in German: *Gesellschaft mit beschränkter Haftung*, abbreviated to *GmbH*). Generally, the so-called general partner is liable with all his private assets, but this is limited to the business assets of the so-called *GmbH*.²⁴

This set-up of one-ship companies is specifically established to own and operate only one asset which is the vessel registered under its name. It is common to establish these kinds of companies even for several separate vessels of a whole

²³ Cf. Harlaftis, G., *Maritime ownership structures*, 2019, p. 238.

²⁴ Cf. Verband Deutscher Reeder, Zentralverband Deutscher Schiffsmakler, *Seafreight*, 2013, p. 281.

fleet.²⁵ These limited commercial partnerships offer flexibility in terms of capital contributions and management responsibilities, making them attractive for investors seeking to participate in the maritime industry without assuming excessive risks or liabilities. Due to the significant volume of equity required for building or purchasing a vessel, which usually sums up to several million euros, one-ship companies enable the owner of the vessel to attract private investors that intend to bear only limited liabilities.²⁶

As another common maritime ownership structure holding companies play a significant role in the maritime industry. They are established to hold ownership interests in various maritime companies or assets, providing centralised control and management of investments.²⁷

As a further legal form, foundations are used in shareholding structures of companies in the maritime sector. They hold and manage assets for specific beneficiaries or charitable causes, and in the maritime context, they may manage vessel ownership and operations, ensuring long-term asset preservation and goal fulfilment.²⁸ As another common legal form, a trust, established by a trustor, and managed by a trustee as a legal entity, serves to manage assets and wealth on behalf of individuals or entities, ensuring effective management, protection, and strategic growth of entrusted resources.²⁹

The process of transporting goods from the producer to the end customer by sea involves not only logistics companies, but also financial institutions, in particular banks, which provide financing support and management of the transport.³⁰

3. Compliance

This chapter introduces compliance as the paramount topic encompassing AML measures. As a part of it, in the first sub-chapter the principle of money laundering and the financial scandals Panama Papers and Paradise Papers are displayed. Moreover, the second sub-chapter introduces different compliance measures and their purposes. The third subchapter presents the vocabulary commonly encountered in banks for the conduct of compliance measures to be

²⁵ Cf. Hathi, B., Hathi, S., One-ship company, 2019, p. 344.

²⁶ Cf. Verband Deutscher Reeder, Zentralverband Deutscher Schiffsmakler, Seafreight, 2013, p. 282.

²⁷ Cf. Panayides, P., Maritime holding companies, 2019, p. 331.

²⁸ Cf. Hartley, C., Maritime foundations, 2023, p. 360.

²⁹ Cf. Etmann, B. et al., Banking, 2015, p. 78.

³⁰ Cf. Heilig, L. et al., Relationship between logistics companies and banks, 2018, p. 1188.

applied to corporate clients. Subsequently, the fourth sub-chapter delves into the legal framework for compliance measures in German banks.

3.1 *Money Laundering as Economic Crime*

To transfer funds from criminal businesses into the legal economy, the principle of money laundering has been used for decades.³¹

The term money laundering was formed in the 1920s³² by the criminal Al Capone in Chicago. He built up his fortune with criminal business from gambling, prostitution, and illegal alcohol trade during prohibition. In order to transfer these illicit funds into the legal economic cycle, he invested his fortune in laundrettes. At that time, the use of laundry machines in the respective salons was paid by coins. Thus, it was not traceable how often the machine ran daily, how many coins were inserted, and where the money originated from. Illegal earnings were taxed just like legal ones, hence recorded as seemingly legitimate revenue for the laundrettes. The term money laundering is also still used today to figuratively represent the procedure of laundering illicit money from criminal operations into untainted, freely usable money.³³

There are three phases of the money laundering process, as illustrated in the Figure 2 below.³⁴ In the following, the stages of money laundering are explained in more detail using the below diagram.

In the first phase of the money laundering process, known as placement, the money launderer introduces cash from illegal sources into the legal money circuit, e.g., by depositing small sums of cash into bank accounts which is called smurfing.³⁵ Subsequently, in the second phase, layering, the concealment of the source of the illicitly obtained money, is enforced. A common technique is to transfer the money to an international bank account of a foreign bank.³⁶ Ultimately, the third and last phase of money laundering is integration, whereby the laundered money is utilised to acquire legitimate assets, such as e.g., real estate, shares in legal businesses³⁷ and luxury goods³⁸. This process serves to legalise the laundered money within the economic cycle while also covering up its trail.³⁹

³¹ Cf. Fiedler, I. et al., History of money laundering, 2017, p. 3.

³² Cf. Sullivan, K., Money laundering, 2015, p. 1.

³³ Cf. Bausch, O., Voller, T., History of money laundering, 2020, p. 1.

³⁴ Cf. Ghazanfari, F. et al., Techniques for Anti-Money Laundering, 2017, p. 10085.

³⁵ Cf. Alkhalili, M. et al., Watch list for AML, 2021, p. 18482.

³⁶ Cf. Ghazanfari, F. et al., Techniques for Anti-Money Laundering, 2017, p. 10085.

³⁷ Cf. Reuter, P., Trumann, E., Anti-Money Laundering measures, 2004, p. 3.

³⁸ Cf. Moody's, International money laundering, 2024, n. pag.

³⁹ Cf. Reuter, P., Trumann, E., Anti-Money Laundering measures, 2004, p. 3.

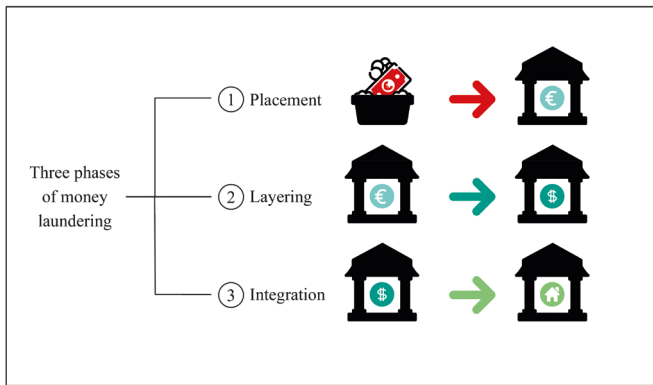


Figure 2: Three phases of money laundering

Source: Based on Ghazanfari, F. et al., Techniques for Anti-Money Laundering, 2017, p. 10085.

In the Panama Papers and Paradise Papers⁴⁰ financial scandals exposed an intricate web of offshore corporate structures exploited for economic crimes such as money laundering and tax evasion.⁴¹

The so-called Panama Papers were uncovered and published in 2016⁴² by the International Consortium of Investigative Journalists (ICIJ) in cooperation with the German newspaper Sueddeutsche Zeitung⁴³ and more than 100 additional media firms.⁴⁴ It exposed the operations of the Panamanian law firm Mossack Fonseca,⁴⁵ revealing the involvement of narcotics cartels, mafia clans,⁴⁶ but also high-profile individuals such as political representatives⁴⁷ and international corporations in tax evasion and the concealment of assets.⁴⁸ The 11.5 million leaked documents⁴⁹ revealed the activities of 214,000 offshore companies which are connected to the services of the law firm. The firm Mossack Fonseca set up off-

⁴⁰ Cf. Berglez, P., Gearing, A., Paradise Papers, 2018, p. 4574.

⁴¹ Cf. Obermaier, F., Obermayer, B., Publication of the Panama Papers, n.d., n.pag.

⁴² Cf. Ibid.

⁴³ Cf. International Consortium of Investigative Journalists, Panama Papers, 2016, n.pag.

⁴⁴ Cf. Leyendecker, H. et al., Sueddeutsche Zeitung about Panama Papers, n.d., n.pag.

⁴⁵ Cf. Bernstein, J., Panama Papers, 2017, p. 23.

⁴⁶ Cf. Leyendecker, H. et al., Sueddeutsche Zeitung about Panama Papers, n.d., n.pag.

⁴⁷ Cf. International Consortium of Investigative Journalists, Involved politicians, n.d., n.pag.

⁴⁸ Cf. Bernstein, J., Panama Papers, 2017, p. 23.

⁴⁹ Cf. Statista, Leaked files of Panama Papers, 2016, n.pag.

shore jurisdictions⁵⁰ and illegal shell companies with engaged sham directors for the purpose of tax evasion, asset concealment, and money laundering.⁵¹ In this context, so-called bearer shares were also mentioned,⁵² where the holder of the physical share certificate is automatically considered the owner of the company, which complicates the identification of the actual ownership.⁵³

Subsequent to the Panama Papers, the so-called Paradise Papers were published in 2017⁵⁴ based on information gathered from 21 different sources. These revealed the offshore investments and financial activities of numerous celebrities, multinational corporations, and wealthy individuals worldwide.⁵⁵ The 13.4 million leaked documents revealed offshore structures and accounts in various countries, including prominent tax havens such as Bermuda, the Cayman Islands,⁵⁶ the Cook Islands, Malta, and others.⁵⁷ The Paradise Papers also uncovered Donald Trump's then trade secretary as a business partner of Vladimir Putin's family in connection with his shares in the shipping company Navigator Holdings.⁵⁸

The revelations of both leaks have caused concerns about the integrity of international shipping companies that were involved⁵⁹ and exposed vulnerabilities in the global financial system. Since then, the topic of the so-called Russian shadow fleet that is supposedly used to circumvent sanctions has added further concern in the international shipping industry. This has led to calls for regulatory reforms to combat illicit activities⁶⁰ disguised by complex ownership structures⁶¹ and offshore tax havens.⁶² Global efforts to increase regulations, transparency and the fight against financial crime have highlighted the necessity and importance of due diligence, compliance measures and risk assessments in the

⁵⁰ Cf. International Consortium of Investigative Journalists, Panama Papers, 2016, n. pag.

⁵¹ Cf. Leyendecker, H. et al., Sueddeutsche Zeitung about Panama Papers, n.d., n. pag.

⁵² Cf. Fischer, H.-D., Bearer shares, 2023, p. 198.

⁵³ Cf. Roach, L., Bearer shares, 2022, p. 458.

⁵⁴ Cf. Berglez, P., Gearing, A., Paradise Papers, 2018, p. 4584.

⁵⁵ Cf. Sueddeutsche Zeitung, Paradise Papers leak, 2017, n. pag.

⁵⁶ Cf. International Consortium of Investigative Journalists, Paradise Papers release, 2017, n. pag.

⁵⁷ Cf. Sueddeutsche Zeitung, Paradise Papers leak, 2017, n. pag.

⁵⁸ Cf. International Consortium of Investigative Journalists, Paradise Papers, 2017, n. pag.

⁵⁹ Cf. *ibid.*

⁶⁰ Cf. Sylle, F., Increased regulatory requirements due to Panama Papers, 2019, p. 285.

⁶¹ Cf. Rapp, M. S., Trinchera, O., Offshore ownership structures, 2017, p. 30.

⁶² Cf. Meunier, D., Offshore ownership structures, 2018, p. 2.

logistics and, in particular, the international maritime sector.⁶³ Regulatory reforms are aimed at the protection of the global financial system's integrity and the promotion of ethical business practices.⁶⁴

3.2 Purposes and Types of Compliance Measures

Compliance measures are essential to protect companies and the economic cycle from various risks.⁶⁵ In the following, typical types of compliance measures and the reasons for compliance needs are introduced:

Firstly, legal compliance is crucial for companies to ensure adherence to laws and regulations, safeguarding companies from potential legal consequences such as fines, liability, and reputational damage. Compliance efforts involve understanding and implementing applicable laws and regulations to ensure adherence.⁶⁶ In particular, compliance measures play a vital role in protecting corporate reputation. By upholding ethical and legal standards and building a positive reputation, companies maintain the trust and confidence of diverse stakeholders, e. g., customers, investors, and the public.⁶⁷

Moreover, risk management is a key focus of compliance measures. Companies need to systematically identify, assess, and control risks to minimise or avoid issues such as fraud, corruption, money laundering, and violations of competition laws. Compliance programs help establish internal controls and protocols to address these risks effectively.⁶⁸

Besides, compliance measures function in mitigating financial losses, resulting from fraud, misconduct, or legal disputes.⁶⁹ By implementing internal controls, companies ensure financial integrity and stability, safeguarding the company's assets and financial well-being.⁷⁰

Another reason for implementing compliance measures is to encourage fair competition. Companies must operate within the boundaries of competition law and adhere to fair business practices. In this way, they contribute to a level play-

⁶³ Cf. Klein, N., Regulations for maritime companies, 2022, p. 185.

⁶⁴ Cf. Kern, A., Banking regulation, 2019, p. xvii.

⁶⁵ Cf. Brown, R. et al., Banking compliance measures, 2020, p. 110.

⁶⁶ Cf. Andersen Hill, J., Reputational risk, 2020, p. 535.

⁶⁷ Cf. Mahaputra, R., Saputra, F., Business ethics and stakeholder trust, 2021, p. 116.

⁶⁸ Cf. Leo, M. et al., Risk management in banking, 2019, p. 517.

⁶⁹ Cf. Wronka, C., Deloitte's compliance approach to financial crime prevention, 2023, p. 100.

⁷⁰ Cf. Manning, L., Compliance, 2020, p. 995.

ing field in the economic system and prevent unfair competitive advantages obtained by illegal practices.⁷¹

Substantially, compliance measures enable companies to fulfil their legal obligations, minimise risks, safeguard their reputation, and contribute to building a responsible and sustainable business culture. There are various types of compliance measures that can be implemented in companies, e.g., legal, regulatory, financial, and ethical compliance.

3.3 Compliance Measures for Screening Corporate Banking Customers

The essential core compliance measure for money laundering prevention in German banks is the so-called know-your-customer (KYC) process, involving regular reviews of customer activities and their profile by several internal bank units.⁷² The KYC process serves to shield banks from engaging in transactions with illicit business counterparts. Before an account is opened, the so-called KYC process must be conducted, involving the screening of interested parties.⁷³ Furthermore, after account opening KYC reviews at regular intervals are conducted for existing customers, and additional event-driven reviews can occur, triggered by management changes or sanctions imposed with new countries. The due diligence process examines risk factors.⁷⁴

The so-called three lines of defence model is part of the KYC process.⁷⁵ It establishes the three distinct lines of responsibility within a bank's risk management.⁷⁶ The first line includes the business units responsible for day-to-day operations and the customer relationship.⁷⁷ The second line consists of compliance and risk management functions that monitor the first line's activities. The third line comprises the internal audit, which independently evaluates and provides assurance on the effectiveness of the first and second lines.⁷⁸ It requires critical compliance decisions to be validated by at least two units, ensuring multiple checks to prevent errors and enhance accuracy in German banks as well as regulatory adherence.⁷⁹

⁷¹ Cf. Falzon, J. et al., *Compliance*, 2021, p. 378.

⁷² Cf. Wohlschlägl-Aschberger, D., *KYC as core of AML compliance measures*, 2018, p. 5.

⁷³ Cf. Duggal, R., Soni, A., *KYC*, 2014, p. 49.

⁷⁴ Cf. Alkhalili, M. et al., *Watch list for AML*, 2021, p. 18485.

⁷⁵ Cf. Meissner, M., *Three lines of defence*, 2018, p. 132.

⁷⁶ Cf. Hasan, R., Kruse, O., *Three lines of defence*, 2023, p. 10.

⁷⁷ Cf. Davies, H., Zhivitskayam M., *Three Lines of Defence*, 2018, p. 37.

⁷⁸ Cf. Luburic, R., Perovic Milan, S. R., *Three lines of defence*, 2015, p. 244.

⁷⁹ Cf. Meissner, M., *Three lines of defence*, 2018, p. 132.

The KYC process further involves identifying the origin of deposited balances and transactions, as well as the account owners.⁸⁰ In this context, the so-called source of funds, which refers to the origin of the funds for business operations, and the so-called source of wealth, which pertains the origin of the initial Euro, must be determined.⁸¹ In order to prevent money laundering, suspicious transactions are thoroughly investigated⁸² and the companies and associated persons are also verified through identity checks.⁸³ The KYC review ought to safeguard banks against reputational risks and prevent the infiltration of illicit funds into the economic cycle.⁸⁴

Among the three possible KYC review occasions within a bank, the shareholding structure of the client's company is examined. As part of the ownership structure review in German banks, the ultimate beneficial owner (UBO) must be identified and his background checked.⁸⁵ The UBO is defined as the natural person who directly or indirectly holds at least 25 percent of the shares in a company, thereby exercising control and voting rights over the company.⁸⁶ If there is no UBO, e. g., due to free float shares, one or more directors of the company are appointed as the fictitious UBO.⁸⁷ It also needs to be analysed whether the (fictitious) UBO is a politically exposed person (PEP). A PEP is a person who currently occupies or previously has occupied a high-ranking public office with the federal or state government, encompassing government officials, politicians, military leaders, and prosecutors,⁸⁸ along with their spouses and family members. By recognising these connections, potential risks of undue influence can be proactively identified.⁸⁹

3.4 Regulatory Law Framework for German Banking Compliance

The regulatory framework governing compliance measures in German banks is determined by the Federal Financial Supervisory Authority,⁹⁰ commonly

⁸⁰ Cf. Goldsworth, J. et al., *International law and practice*, 2007, p. 115.

⁸¹ Cf. Chatain, P.-L. et al., *Preventing money laundering*, 2009, p. 246.

⁸² Cf. Kumar, V. A., *Source of funds and source wealth*, 2012, p. 114.

⁸³ Cf. Teichmann, F. M. J., *Beneficial owners, and their funds*, 2022, p. 118.

⁸⁴ Cf. Duggal, R., Soni, A., *KYC*, 2014, p. 49.

⁸⁵ Cf. Daudrikh, Y., *Beneficial ownership*, 2019, p. 5.

⁸⁶ Cf. Knobel, A., *Beneficial ownership*, 2019, p. 5.

⁸⁷ Cf. Holthaus, J., Lehnhoff, D., *Fictitious UBO*, 2019, p. 10.

⁸⁸ Cf. Financial Action Task Force Guidance, *Politically exposed persons*, 2013, p. 5.

⁸⁹ Cf. Raymond Choo, K.-K., *Definition of PEP*, 2008, p. 372.

⁹⁰ Cf. Grieser, S., Heemann, M., *BaFin*, 2020, p. 412.

known as BaFin (Bundesanstalt für Finanzdienstleistungsaufsicht).⁹¹ In 2002, BaFin was established by merging three existing supervisory bodies: the Federal Banking Supervisory Office, the Federal Supervisory Office for Securities Trading, and the Federal Insurance Supervisory Office. This consolidation united oversight for banking, securities, and insurance sectors under one regulatory body. Since then, BaFin has continuously adapted to the changing financial landscape, strengthening its supervisory framework to ensure the stability and soundness of the German financial system.⁹² BaFin plays a crucial role in combating money laundering and supervising financial institutions in Germany and ensures that they fulfil legal and regulatory requirements.⁹³

German banks are obliged to comply with the so-called German Money Laundering Act (MLA), in German Geldwäschegesetz (GwG),⁹⁴ and to conduct KYC reviews to ensure funds' legitimacy. In order to prove that the funds transferred through the bank's accounts do not originate from illegal sources, each bank has established internal control systems.⁹⁵ These KYC reviews must be carried out not only when accounts are opened, but also on a regular basis for all existing clients.⁹⁶ The MLA was originally introduced in 1993 and has subsequently been further evolved and revised several times.⁹⁷ Adjustments were enacted to encompass various sectors and align with the latest international requirements of the Financial Action Task Force (FATF), an intergovernmental organisation⁹⁸ focused on anti-money laundering and combating terrorist financing globally.⁹⁹ Another legal framework for money laundering is the EU Money Laundering Directive, which is issued by the European Union and must be enforced by EU Member States.¹⁰⁰ To address developments, several more recent EU Money Laundering Directives have been adopted since the first one in 1991.¹⁰¹ In order to facilitate the identification of potential AML cases, specialised institutions known as Financial Intelligence Units (FIU) have been established in various

⁹¹ Cf. Grieser, S., Heemann, M., BaFin, 2020, p. 994.

⁹² Cf. Bundesanstalt für Finanzdienstleistungsaufsicht, BaFin's history, 2020, n. pag.

⁹³ Cf. Grieser, S., Heemann, M., BaFin, 2020, p. 123.

⁹⁴ Cf. Bundesanstalt für Finanzdienstleistungsaufsicht, BaFin's role in AML, 2017, n. pag.

⁹⁵ Cf. Le Nguyen, C., Preventing the use of banks for money laundering, 2018, p. 48.

⁹⁶ Cf. PwC, KYC reviews, n.d., n. pag.

⁹⁷ Cf. Liebich-Frels, M., The German Money Laundering Act, 2006, p. 96.

⁹⁸ Cf. Kefßler, D., Zerres, C., Economic crime, and its preventive measures, 2020, p. 2.

⁹⁹ Cf. Financial Action Task Force, AML and combating terrorist financing, 2022, n. pag.

¹⁰⁰ Cf. European Union, EU legal framework, 2013, n. pag.

¹⁰¹ Cf. Hlavica, C. et al., EU Money Laundering Directives, 2011, p. 296.

countries.¹⁰² These entities analyse so-called Suspicious Activity Reports (SAR) which include suspicious financial transactions on a national scale according to the MLA¹⁰³ and pass on information cross-border to law enforcement authorities.¹⁰⁴

4. Utilisation of the Three Lines of Defence Model in the KYC Process

Banks usually implement the so-called six eyes principle, better known as the above mentioned three lines of defence model. The first line of defence in banks consists of the relationship manager and the KYC analyst. The second line of defence could be a separate AML or compliance department. The third line of defence is usually a back-office function that does not deal directly with the client or the internal audit department.¹⁰⁵

Primarily, as KYC key information, the company's ownership structures are investigated in detail and the UBO or, if not applicable, a fictitious UBO is determined.¹⁰⁶ For this purpose, the complete company documents are inspected. Depending on the country of domicile and the legal form, various documents of the audited company itself and of all companies holding shares are required, in some cases with apostille. Generally, the following public documents are requested for the verification of customer information: certificate of good standing, certificate of incumbency, extract from the register, list of directors, list of shareholders and organisation chart.¹⁰⁷

The UBO, typically all authorised representatives and the managing directors of the firm, are identified by an identity card or passport or proof of residence. And these are often additionally verified by the relationship manager in person,¹⁰⁸ notary, lawyer¹⁰⁹ or via video.¹¹⁰

In connection with the screening of the company structure and the UBO, numerous risk points are investigated: UBO or fictitious UBO, expected transactions, product type (credit or payment), origin of business partners, business purpose of the company itself, type of the business relationship. Additionally,

¹⁰² Cf. German Customs, Definition of FIU, n.d., n. pag.

¹⁰³ Cf. Financial Intelligence Unit, German Suspicious Activity Reports, 2021, p. 15.

¹⁰⁴ Cf. European Parliament, FIU, 2023, n. pag.

¹⁰⁵ Cf. Metzger, V., Täuber, N., Three lines of defence according to KPMG, 2022, n. pag.

¹⁰⁶ Cf. Deloitte, UBO and fictitious UBO, 2018, n. pag.

¹⁰⁷ Cf. BNP Paribas, KYC documents required by legal entities, 2023, p. 2.

¹⁰⁸ Cf. IDnow, MLA data to be recorded, n.d., n. pag.

¹⁰⁹ Cf. Bheemaiah, K., Authentication of KYC documents, 2017, p. 71.

¹¹⁰ Cf. IDnow, KYC identity verification via video, n.d., n. pag.

the transactions of the last twelve months as well as the expected compatibility of product usage and business purpose could be examined.¹¹¹

More in-depth reviews would include: Sector, legal form, fiduciary relationships, bearer shares, trusts,¹¹² foundations, relation to sanctioned countries, source of funds and source of wealth of the company itself as well as adverse media.¹¹³

Databases used to screen the companies and individuals involved are as follows: Worldwide public registers (shareholding structure),¹¹⁴ Bloomberg (shareholding structure),¹¹⁵ WorldCompliance LexisNexis (adverse media, serious crime arrests, money laundering, tax fraud, PEP),¹¹⁶ ICIJ (International Consortium of Investigative Journalists which displays companies involved in data leaks from offshore regions),¹¹⁷ IHS (shipping routes and data on evasion of sanctioned countries).¹¹⁸

Further possible risk factors are country risks due to foreign interconnections, worldwide navigation of shipping routes, ship registrations abroad, and the threat to relations with sanctioned countries because of national borders at sea. The country of origin of the business partners must also be examined to prevent sanctions. Furthermore, shipping company clients encounter industry risk due to the dynamic nature of international routes and the transportation of various shipped commodities.¹¹⁹

There is a dependence on documentation requirements for shipped cargo and, for example, on container ships, the commodity of each container is not inspected but only on a sample basis.¹²⁰

This also includes an examination of the origin of the company's transactions for the business purpose and the involved business partners. It is essential to ensure that no payment transactions occur with countries that may be sanctioned

¹¹¹ Cf. Makhija, D., Sirur, S., Risk impacting KYC factors, 2024, p. 167.

¹¹² Cf. Financial Action Task Force, In-depth KYC factors, 2018, p. 5.

¹¹³ Cf. Bundesanstalt für Finanzdienstleistungsaufsicht, Money Laundering Act, 2018, n. pag.

¹¹⁴ Cf. BNP Paribas, KYC documents required by legal entities, 2023, p. 2.

¹¹⁵ Cf. Bloomberg, Shareholding disclosure, 2024, n. pag.

¹¹⁶ Cf. LexisNexis Risk Solutions, Compliance database, n.d., n. pag.

¹¹⁷ Cf. International Consortium of Investigative Journalists, ICIJ database; 2017, n. pag.

¹¹⁸ Cf. IHS Maritime & Trade, Vessel data provider, 2016, p. 21.

¹¹⁹ Cf. Verband Deutscher Reeder, Zentralverband Deutscher Schiffsmakler, Foreign flags, 2013, p. 357.

¹²⁰ Cf. Verband Deutscher Reeder, Zentralverband Deutscher Schiffsmakler, Said to contain, 2013, p. 299.

because, beside the country risk, there is also a product risk and economic risk.¹²¹

Country risk also includes foreign corporate offices and relations to offshore firms (e.g., Cayman Islands) with a negative reputation. In this context it is crucial to review the trustworthiness of the business partners and negative media to avoid a reputational risk and to guarantee that the firm engages in tax-saving with assets, but not in tax fraud or tax scam with shell companies. It is also more complex to maintain customer relations and proximity when the company is based abroad, which is why banks consider customer visits as particularly relevant. Also, there is a legal form risk in foreign companies. It is common that the location of the shipping company's registered office is in an offshore country and its operational headquarter in an EU country.¹²²

Due to lower legal and regulatory standards for corporate customers abroad (e.g., employment contracts, incorporation, etc.) obtaining information may be more difficult, and the audits of foreign companies are more complex. Therefore, banks often rely on third-party providers to provide the necessary data. Additionally, foreign companies often have complex ownership structures (e.g., fiduciary accounts).¹²³ Further risk involves the concealment of ownership through so-called bearer shares. There is a risk that the persons involved are not discovered and may already have been convicted of tax fraud or money laundering without being detected. In order to ensure that both the company and the UBO are not involved in international crime related to tax havens and foreign companies, the entire ownership structure as well as the UBO are thoroughly investigated after identification.¹²⁴

The aim of the supervisory authority is to prevent money laundering. However, it is probably impossible to prevent money laundering completely as long as business and transactions are handled.¹²⁵

Banks strictly implement the legal requirements in order to detect criminal offences and to satisfy the regulatory demands of the supervisory authority. At the same time, they do not seek to restrict clients, but to rather expand their business with them. Banks thus serve as a buffer between a high demand for information from the supervisory authorities and the corporate clients who try to disclose as little data as necessary, e.g. for cost reasons. However, in the end, the customers have a duty to cooperate and lack the possibility to express their

¹²¹ Cf. Swift, Risk factors, n.d, n. pag.

¹²² Cf. Financial Action Task Force, In-depth KYC factors, 2018, p. 152.

¹²³ Cf. Moody's, KYC solution, n.d., n. pag.

¹²⁴ Cf. Fischer, H.-D., Bearer shares, 2023, p. 193.

¹²⁵ Cf. United Nations Office on Drugs and Crime, Money laundering cycle, n.d., n. pag.

wishes regarding the state regulations. In summary, various interests of the stakeholders must be considered by the banks.¹²⁶

5. Obstacles in Enforcing Mandatory Compliance Measures

Regarding the legally obliged KYC review of corporate maritime customers as part of the account opening process and the regular screening, German banks encounter numerous challenges, e.g. accessing documents (i.e. identity documents, extracts from registers) and investigating foreign companies as major issues. The problem occurs because in German banks, companies are assessed according to German law, although in other countries, especially tax havens (e.g., Seychelles, Marshall Islands, etc.), less strict laws apply to the firms based there. In some countries, the document standards are lower than in Germany. Furthermore, a higher research workload arises from foreign companies, as there are fewer publication regulations. Generally, there are greater difficulties in accessing registers abroad as these are often either not accessible or do not even exist. The lack of transparency of international firms in offshore areas leads to a dependence on customer information. Often, banks use third party providers in order to verify the information received from customers. Another obstacle can be language barriers for some offshore customers when conducting video verification with third-party providers in Germany.¹²⁷

At times challenging can be the determination of the ultimate beneficial owner in complex ownership structures. An increase of the non-transparency and complexity of the structures as well as that of KYC screenings in the last decades complicate the determination of the UBO. Nowadays, most banks review all corporate levels in the ownership structure down to the smallest detail and the results are usually reviewed internally by at least three departments. Since BaFin set-up a particular examination framework without specifying detailed requirements for the collection of documents and information, banks are using different approaches to interpreting the identification of the UBO. The discrepancies in document requirements among different banks frequently lead to confusion among clients. They occasionally raise complaints with banks, pointing out instances where they had to provide varying or less comprehensive information to other banks. This disparity demands extra resource expenditure from them.¹²⁸

During the UBO's KYC assessment, databases are employed to ascertain whether an individual holds a politically exposed person (PEP) status. This results in extra effort for customers and the bank when an event driven review (EDR) is activated, e.g., by a change of managing director. Thus, up-to-date

¹²⁶ Cf. Odak, D., *Balancing conflict of interests*, 2020, p. 73.

¹²⁷ Cf. PwC, *Global Economic Crime Survey*, 2024, p. 12.

¹²⁸ Cf. LSEG, *Different in-house screening guidelines*, 2023, p. 9.

quality of the data is a main challenge, as proactive notifications from customers on changes in their ownership structure are rarely submitted to the bank despite the client's obligation to provide information on changes.¹²⁹ Another challenge can be the verification of the source of funds and source of wealth as shipping companies are often traditionally managed over several generations so that the family wealth dates sometimes far back in history.¹³⁰

6. Proposals for Solutions

The exchange between banks is perceived as useful and valuable because recurring KYC screenings are required in each bank. There are already service providers offering the digital generation of a KYC profiling (e.g., third-party providers SWIFT,¹³¹ Moody's¹³²) as well as the utilisation of artificial intelligence for analysing document content. By linking public registers, KYC EDRs are triggered upon changes, enabling increased data quality (Sinpex).¹³³ For a potential future system, it is relevant that there is a customisable scope of use for all banks. In this context, two options are regarded as feasible. The first option is outsourcing the KYC process of all German banks to designated external service providers.¹³⁴ The second approach is to assign competence for conducting KYC screenings for clients to certain banks and subsequently their profiling results might be transferred to all banks nationally or in the EU. Thus, each bank does not have to conduct similar KYC checks itself, but can rely on the results of the other responsible banks. The cooperation and coordination of the banks for the integration of a functioning cross-bank process is the precondition.

An improved information exchange, reduced review expenses, an increase in the efficiency of the KYC process as well as faster compliance processing of priority transactions would benefit all three stakeholders, i.e. customers, banks, and regulatory supervision.

Customers benefit from a reduced workload due to identical, unified KYC requirements from different banks (common standard for all information and documents). Shortened waiting times for account opening are made possible. BaFin benefits from an improvement in data quality. And banks save costs by sharing the effort to fulfil regulatory requirements.

¹²⁹ Cf. Sinpex, AI-driven monitoring, n.d., n. pag.

¹³⁰ Cf. Financial Action Task Force, In-depth KYC factors, 2018, p. 108.

¹³¹ Cf. Swift, KYC registry, n.d., n. pag.

¹³² Cf. Moody's, KYC solution, n.d., n. pag.

¹³³ Cf. Sinpex, AI-driven monitoring, n.d., n. pag.

¹³⁴ Cf. Swift, KYC registry, n.d., n. pag.

Additionally, establishing a global register would help to improve and alleviate data collection. Such a centralised global register ought to provide information on all companies worldwide. Thus, it provides access to the shareholding structures of all banks' corporate customers. Documents which are required by banks in context of KYC screenings are accessible without waiting for customer responses. By giving banks access to all necessary data in a global register, the transmission of information might be automated and standardised. The documents of the global register should be filed in English in order to reduce language barriers and make the files comprehensible for all banks worldwide. Within this framework, the implementation of a standardised minimum document requirement is requested for offshore corporations, given the current lack of substantial regulations for these. The realisation of such a registry might not only mitigate the costs incurred in verifying translators or lawyers but also enhance the efficiency of the overall procedure. The data that remains unavailable through the global registry or databases ought to be transmitted by the customer.

7. Conclusion

The focus of this paper has been the legally mandatory monitoring of logistics' customers by German banks to prevent money laundering and other illegal international financial transactions. For this purpose, the status quo of the applied anti-money laundering compliance measures for account openings and existing customers has been investigated and the resulting challenges for German banks have been identified. In addition, a future scenario for an ideal anti-money laundering compliance process has been developed.

The know-your-customer process is the central anti-money laundering compliance measure, involving several departments in each bank. There is a need, however, for a simplified access to foreign registers. The implementation of a cross-bank standardised anti-money laundering process has pros and cons. On the one hand, it can be assumed that a cross-bank process would generate synergy effects such as less effort and an acceleration of processes. On the other hand, a possible vulnerability for data insecurity is a problem that needs to be addressed when banks should share customer data with each other or with external partners to perform KYC-checks.

Further research and discussions among the relevant stakeholders, i.e. the shipping industry, banks, and supervisory bodies, are necessary to improve the current shortcomings of global compliance AML practices.

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