Role of Islamic Banks in Anti-Money Laundering in Yemen

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Abstract: *Money laundering and terrorist financing are considered among the most dangerous financial issues. Accordingly, all countries around the world prioritize combating these crimes. Islamic banks, in particular, have a significant role to play.Since the unrest in Yemen, the country has shown great interest in addressing these crimes and has begun taking measures to curb them. This study employs an analytical regression approach. A questionnaire distributed to a sample of 129 participants examines the role of Yemen Islamic banks in anti-money laundering (AML) efforts. The findings suggest that Islamic banks are committed to AML, and their role has a positive impact on these efforts*

Keywords: Islamic banks, anti-money laundering

INTRODUCTION

Banking systems are considered the essential lifeblood of other sectors and any country's economy (Al-Magharem et al., 2020). They are vulnerable to money laundering, which can lead to closure, dissolution, and loss of reputation. To mitigate these risks, banks are required to comply with anti-money laundering (AML) laws and regulations (Kumar, 2020). The banking sector is a cornerstone of the financial industry in any economy. Therefore, supervising bank activities is essential to combat money laundering and ensure adherence to central bank standards (Zyadat, 2022). The complexity of bank operations is considered one of the main factors facilitating money laundering (Hassan et al., 2022). The global criminal funds are estimated at $3

trillion annually, posing a significant threat to financial and business institutions (Pol, 2020). While efforts to establish a collective international approach against money laundering have been ongoing, success remains elusive. Perhaps the most prominent initiative is the Financial Action Task Force (FATF), which issues decisions, agreements, and recommendations urging countries to implement appropriate legal, regulatory, and institutional frameworks to combat money laundering (Pol, 2020). Its primary objective is to protect the organization from financial crimes and ensure full compliance with relevant laws and regulations. The internal policies and risk management standards of the financial institution must be given consideration (Chau & Nemcsik, 2020).

The Central Bank of Yemen has developed the anti-money laundering law and issued several circulars on the topic (Central Bank of Yemen, 2012, 2023). Having become prominent players in the economies of the Arab World and Islamic countries, Islamic banks play a crucial role in the financial sector within the framework of the profit-sharing principle. The program aims to ensure the existence of policies, procedures, internal controls (IC), compliance functions (CF), a continuous training (CT) program , Independent audit (IA) functions, and know-your-customer (KYC) procedures to combat money laundering and terrorist financing operations in Yemen Islamic banks.

Islamic Banks in Yemen
The idea of founding Islamic banks in Yemen emerged from the very beginning of the incorporation of Islamic banks, at the end of the 20th century. The year 1995 witnessed the first try to issue an Islamic banking license via the Yemeni Islamic Bank for Finance and Investment. Established as a Yemeni joint stock company in Sana'a in 1995, the bank operated under the license of the Central Bank of Yemen in 1995, before the issuance of the Islamic Banking Law, which was still in the House of Representatives for approval. The bank started practicing its actual operations as of mid-1996 (Central Bank of Yemen, 2013).

Following this, Tadhamon Bank and Saba Islamic Bank were established in 1996.
Shamil Bank of Yemen and Bahrain was founded as a closed Yemeni joint stock company, and began banking activity with a permit issued by the Central Bank of Yemen in 2002. Cooperative & Agricultural Credit Bank "CAC Islamic" and Al-Kuraimi Islamic Microfinance Bank were established later in 2010 (Central Bank of Yemen, 2013).

Additionally, four Islamic microfinance banks were established in recent years: Al-Kuraimi Islamic Bank (2020), Al-Qutaibi Islamic Bank (2021), Bin Dowal Islamic Microfinance Bank (2022), and Alinma Islamic Microfinance Bank (2022).

Literature Review and Hypotheses Development
Internal controls (IC)

Banks have to adopt good policies, procedures, and internal controls (IC) for anti-money laundering (AML) to comply with international standards and best practices. Effective AML programs should be supported by a well-documented policy and clear procedures that define compliance principles. The IC have to reflect the directions of the board of directors and management to be verified and approved by the board. of directors (Al-Zoheri & Al-Khazali, 2016; Gaviyau & Sibindi, 2023).

Accordingly, IC must be aligned with the laws, regulations, and anti-money laundering/counter-financing of terrorism (AML/CFT) policies of the banks. Verification is necessary to ensure the policies and procedures are written in a clear and concise manner, and distributed to all employees (Al-Zoheri & Al-Khazali, 2016; Kumar, 2020).

Research by Jayasuriya (2009) suggests that compliance with AML regulations can lead to sound banking growth. Similarly, Mohammad et al. (2016) found that reducing money laundering boosts the banking sector. A 2023 study by Al-Numimi highlights how money laundering jeopardizes the financial system and the security and profitability of the banking sector. Therefore, this study aims to examine the following hypothesis:

H1:IC have a significant positive impact on AML efforts.

Compliance functions *(CF)*

The compliance functions (CF) are responsible for supervising business controls and activities. Top executives of the banks are responsible for developing, implementing, and overseeing the compliance policy. The CF should have a formal charter approved by the board of directors, which establishes its independence and continuity within the bank (Sultan, 2019).

One of the duties and responsibilities of the compliance officer is to manage all aspects of AML/CFT compliance programs, including but not limited to program design and implementation, making necessary changes and updates. Al-Numimi (2023) said that AML laws might affect the expansion of the banking system in any country. Hence, this study investigates the hypothesis:

H2: CF have a significant positive impact on AML efforts.

Continuous Training *(CT) Programs*

Effective AML/CFT training programs are crucial for employee compliance (Everhardt, 2003). To achieve this, banks must ensure a program effectively trains employees on both AML and CFT procedures. This training should cover legal requirements regarding the bank's and employees' obligations, fostering awareness of their responsibilities (Karima, 2014).

Therefore, most AML/CFT regulations require banks to train relevant personnel, including contractors, consultants, agents, and subsidiaries, as part of a formal AML/CFT compliance program. The training methods should be effective and up-to-date, tailored to the bank's specific needs and risk profile, while considering available time and resources (Al-Zoheri & Al-Khazali, 2016).

A successful training program can significantly enhance an organization's AML culture, particularly when senior management demonstrates its commitment to the process (Mbwayo, 2005).

Failure to conduct effective AML training can lead to fines by regulators. A case in point is the coordinated enforcement action taken by the Financial Crimes Enforcement Network (FinCEN) and the Office of the Comptroller of the Currency (OCC) against Gibraltar Private Bank and Trust in Coral Gables, Florida, on February 25, 2016. The bank's failure to properly train compliance officers was cited as a violation, resulting in a total civil penalty of $6.5 million ($2.5 million from OCC and $4 million from FinCEN). From 2009 to 2014, Gibraltar's AML training program was inadequate and did not meet the needs of various functions, departments, board members, or other employees (AML Expert, 2016).This study suggests following hypothesis:

H3:CT has a significant positive impact on AML efforts.

Independent Audit *(IA) Functions*
The bank must have an effective IA department that develops and implements detailed audit test programs for each area and function. This department must take into account all recommendations made in independent audit reports, identifying the date and staff responsible for implementing the corrections. Additionally, the bank must be verified to have an independent auditing body that regularly audits the AML program to ensure its effectiveness. This independent audit should also verify the adequacy of customer due diligence procedures and policies and whether they meet the internal requirements (Al-Zoheri & Al-Khazali, 2016).

Failure to properly handle audit issues exposes banks to fines from regulators. On June 15, 2015, the FinCEN announced that it had imposed a civil monetary fine of $4.5 million on Mingo Bank of Williamson, West Virginia, for violating the Bank Secrecy Act and citing serious and systemic deficiencies in several aspects of the AML and Financing Program. The bank's independent test failed to determine whether adequate controls were in place to detect, monitor, and report suspicious activity and large cash transactions (AML Expert, 2016). As a result, this study investigates the hypothesis:

H4: *IA has a significant positive impact on AML efforts.*

Know your customer *(KYC)*
Know Your Customer (KYC) refers to AML policies and procedures used to determine a customer's true identity, typical activity patterns, and detect unusual transactions. KYC regulations require banks to develop customer policies and programs at different risk levels. Customer Due Diligence (CDD), considered one of the best ways to prevent money laundering and other financial crimes, is the tenth recommendation in the Financial Action Task Force (FATF) recommendations updated in February 2012. Therefore, financial institutions are required to conduct CDD and may utilize KYC software to streamline the process. (Everhardt, 2003)**.** In addition, FATF notes in its explanatory note to recommendation 10 that there are circumstances where the risk of money laundering or terrorist financing is higher and enhanced customer due diligence (EDD) measures should be taken. Additionally, risk factors necessitate an EDD procedure (AML Expert, 2016). This research aims to examine the following hypothesis:

H5: KYC has a significant positive impact on AML efforts

Anti- money laundering (AML)
Money laundering efforts are on the increase globally due to the rise in operations of organized criminal groups in many fields (Al-Numimi, 2023). Therefore, this phenomenon has placed great challenges on the world and global policy agenda. In Yemen, weaknesses in AML persist, and money laundering crimes continue to rise. This is due to factors such as corruption, wars, and a lack of adoption of recent technologies for combating money laundering (Al-Rahoumi, 2017). It is essential for banks' compliance departments and boards of directors to ensure that the bank implements AML/CFT programs. Ofoeda et al. (2022) found that AML regulations can enhance financial system development in developing countries.

Sample Selection and Methodology
Sample Selection
The population of this study consisted of compliance, risk, and internal audit officers in five Yemeni Islamic microfinance banks: Al-Kuraimi Islamic Microfinance Bank, Al-Kuraimi Islamic Bank, Al-Qutaibi Islamic Bank for Microfinance, BinDowal Islamic Microfinance Bank, and Alinma Islamic Microfinance Bank. The total population was 242 officers.

A sample of 150 participants was selected for the study. The researchers distributed questionnaires to 150 individuals, of whom 129 responded, representing a response rate of 53%.

Methodology
This study utilized the Statistical Package for the Social Sciences (SPSS) software to analyze the data,. an analytical regression approach was employed to investigate the

role of Islamic banks in combating AML The initial analysis, descriptive statistics, and multiple regression analysis was conducted.

This study examines the effects of internal controls (IC), compliance functions (CF), continuous training (CT), independent audit (IA), and Know Your Customer (KYC) practices on anti-money laundering (AML) effectiveness. The following regression model is used to analyze these relationships:

$$AML = \beta 0 + \beta 1 IC + \beta 2 CF + \beta 3 CT + \beta 4 IA + \beta 5 KYC + \varepsilon \qquad (1)$$

Where:

AML is anti-money laundering which is considered a dependent variable.

$\beta 0$ is beta-nought (representing the predicted value of AML when all the independent variables are zero).

ε represents the error term, which accounts for any unexplained variance in the dependent variable.

Empirical Analyses

The descriptive statistics of the study are tabulated in Table 1. The results show that the dependent variable AML has the mean value (4.59). Independent variables IC have the high mean values (4.60), while IA has the lowest mean value (4.42).

Table 1: *Descriptive Analysis*

No.	Dimension	Mean	Std. Deviation	Verbal Evaluation
1	Anti-Money Laundering (AML)	4.59	0.43	Agree
2	Internal Controls (IC)	4.60	0.38	Strongly Agree
3	Compliance Functions (CF)	4.53	0.45	Strongly Agree
4	Continuous Training (CT)	4.44	0.57	Strongly Agree
5	Independent Audit (IA)	4.42	0.58	Strongly Agree
6	Know Your Customer (KYC)	4.44	0.49	Strongly Agree

Source: Authors' calculation

Multiple regression analysis is used to test the direct effect of the independent variables (IC, CF, CT, IA, and KYC) on AML (the dependent variable). Table 2 indicated that the R square = .655 and this means that the percentage of variability of AML is 65.5% that is explained to be a good influence by independent variables. In another context, IC, CF, CT, IA, and KYC explain AML with a percentage of 65.5%.

It appears from the Multiple Regression Table 2 below that IC have a positive and significant impact on AML at 0.01 level. Thus, hypothesis H1 is supported and broadly consistent with prior studies which indicated a positive effect on AML (Al-Numimi, 2023; Jayasuriya, 2009; Mohammad et al., 2016). This finding could be explained by the fact that Islamic Banks have IC that lead to the decrease of money laundering. Likewise, CF have a positive and significant impact on AML at 0.01 level. Hence, hypothesis H_2 is supported. Also, CT has a positive impact on AML at 0.05 level, which supports the third hypothesis is H3. Additionally, IA has a positive impact on AML at 0.05 level, which supports the fourth hypothesis (H4). Finally, KYC has a positive impact on AML at 0.01 level, which supports the fifth hypothesis (H5).

Table 2: Multiple Regression

Model	Unstandardized Coefficients		Standardized Coefficients	T	Sig.
	B	Std. Error	Beta		
(Constant)	.798	.278		2.874	.005
Internal controls (IC)	.304	.102	.272	2.977	.004
Compliance functions (CF)	.245	.101	.261	2.423	.017
Continuous training (CT)	.131	.064	-.176	-2.030	.045
Independent audit (IA)	.139	.069	.181	2.011	.047
Know your customer (KYC)	.282	.088	.323	3.191	.002
Number of Obs.	129				
R^2 sq.	.655				

Dependent Variable: Anti- Money Laundering (AML)

Table 3: Summary of Hypotheses Testing Results

Hypothesis	Statement	Result
H1	IC have a significant positive impact on AML efforts	Supported
H2	CF have a significant positive impact on AML efforts.	Supported
H3	CT has a significant positive impact on AML efforts.	Supported
H4	IA has a significant positive impact on AML efforts.	Supported
H5	KYC has a significant positive impact on AML efforts.	Supported

CONCLUSION

This research examines the impact of internal controls (IC), compliance functions (CF), continuous training (CT), independent audit (IA), and know your customer (KYC) practices on anti-money laundering (AML) efforts in Yemen Islamic banks. The findings from this paper suggest that IC, CF, CT, IA, and KYC all have significant and positive impacts on AML.

The novel contribution of this research is that it examines the most important issue AML/CFT in the financial institutions and takes into account whether Islamic banks in Yemen have implemented the necessary IC, CF, adequate CT, effective IA, and due diligence KYC practices to combat money laundering in Yemen.

This study is not without limitations. The study only focuses on five Islamic banks. Future research should cover both Islamic and conventional banks in the Yemen banking system.

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