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Know Your Customer (KYC) Principles Relates to Bank Confidentiality as an Effort to Prevent Money Laundering Crimes

Benedictus Renny See*, Ahmadi Miru, Muhadar, Hasbir Paserangi
Faculty of Law, Hasanuddin University, Makassar, Indonesia
* Corresponding author

Abstract

Anti-money laundering laws also create a major dilemma for banks, the banks also could be held liable as constructive trustee for the rightful owner of the corrupted funds. Hence, this study aims to find out and explain the essences of know your customer principles relates to bank confidentiality in accordance with the Indonesian Anti-Money Laundering Laws. Type of the research was an empirical legal research. The research was conducted in the Province of Yogyakarta, Indonesia, precisely in several public and private-owned banks. The results show that the know your customer principle is carried out in the context of applying prudential banking to protect banks from various risks in dealing with customers and counter-parties. For this reason, it is necessary to have a common perception and understanding between the Bank and the costumers regarding the urgency of applying the KYC principles. In supporting the application of the principle of knowing customers, it is necessary to support adequate technology and information systems that can monitor each customer transaction that is tailored to the character and profile of the customer. For instance, support for systems and information technology like this is certainly very necessary even though it requires a large investment or cost. The application of the principle of knowing customers is part of the implementation of bank risk management in general.

Keywords: Bank; Know Your Customer Principles; Money Laundering

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1. Introduction

Money laundering has been described by many as the lifeblood of crime and is a major threat to the economic and social well-being of societies.[1] In recent years a number of countries have implemented laws to fight against money laundering and Indonesia is no exception. In the same way, there is no denying that banking institutions as one of the financial institutions have strategic value in the economic life of a country. Banking is engaged in various services provided such as credit activities, as well as serving financing needs and launching a payment system mechanism for all sectors of the economy. The institution is intended as an intermediary for parties who have surplus funds with those who lack of funds.[2]

In fact, banks are required to put in place effective anti-money laundering measures to guard against the flow of ‘dirty money’ into the financial system. As a consequence, banks are considered to be an important source of valuable information for law enforcement agencies to detect money laundering and more importantly to follow the money trail of criminal organization which thereby would lead to the prosecution of the perpetrator who has enjoyed their illicit profits for a long time.

As comparison with other financial institutions, bank financial institutions are financial institutions that provide the most complete financial services. The bank provides special services that are very beneficial to the community. No modern society can achieve rapid progress or can maintain its growth rate without a bank. According to Compton,[3] it is impossible to give an idea of a national economy that runs efficiently, grows steadily or survives for a period of time without the support of a strong banking system.

One of the main factors in increasing public trust in a bank in particular and banking in general is the bank's compliance with the bank's secret obligations. The purpose is concerning whether or not the bank is trusted

[1] Aspalella, A. R. (2010). *An Analysis of the Malaysian Anti-Money Laundering Laws and Their Impact on Banking Institutions*. The University of Western Australia, VDM Publishing, p. 1.

[2] Kasmir. (2015). *Bank Dan Lembaga Keuangan Lainnya.* Jakarta: PT. Raja Grafindo Persada, p. 5-6

[3] Eric N. Compton. (1991). *Principle of Banking* (translated by: Alexander Oey, Jakarta: Akamedia Pressindo, p. 330

by customers who save their funds. In other words, it depends on the bank's ability to uphold and firmly adhere to bank secrets.[1] There are several factors that affect the level of public trust in a bank, these factors are: Management integrity, knowledge and ability of the management in the form of knowledge of managerial skills and banking knowledge and technical capabilities, the health of the bank concerned, and bank compliance with bank confidential obligations.[2]

Above all, the confidentiality of a bank is very important because the bank needs the trust of the people who keep their money in the bank. Customers only entrust their money to banks or use bank services if the bank provides a guarantee that the bank's knowledge of deposits and financial conditions will not be misused. The guarantee of bank secrecy over all community data in relation to the bank, the community will trust the bank, then they entrust their money to the bank or use the services of the bank.[3]

Historically, bank secrecy is as old as the development of banking itself. Even the bank's secrets have existed since 4000 years ago in Babylon as stated in the Code of Hamourabi. The secrets of this bank in its development are recognized as a part of human rights to protect their personal secrets (rights of privacy), especially with regard to their secrets or financial privacy.[4]

Even though it is not yet known exactly how much money is washed every year through money laundering activities, but the estimated amount is very large. The former IMF Managing Director, Michel Candessus, estimates the volume of cross-border money laundering between 2-5% of the world's gross domestic product (GDP). In fact, according to him, the lower limit of the range, namely the amount generated from narcotics trafficking activities, arms trafficking, fraud banks, securities fraud, counterfeiting and similar crimes that are washed around the world each year reaching almost US $ 600 billion.[5]

Nowadays, the rise of money laundering cases occurring in Indonesia and in other countries is the main indicator that money laundering is a serious threat to the economy of a country. Examples of several money laundering cases that occurred during 2018, as reported by the National Narcotics Agency (BNN) have revealed the crime of money laundering from drug trafficking cases with a total transaction reaching Rp. 6.4 trillion.[6] In another case, money laundering by using the accounts of other parties to collect proceeds of crime also occurred in South Sulawesi, as reported by Fajar news, which was published on Friday, September 14 2018 with the head line "Corruption Receipt Student Account" in which PPATK sniff out 6000 suspicious transactions in South Sulawesi. Deputy for Prevention of PPATK Muhammad Sigit revealed many cases, students have high financial transactions. This is certainly very suspicious. Why did it happen? That's because his bank account is also used by perpetrators of corruption.[7]

In a simple sense, money laundering can be explained as an act of 'turning dirty money into net money'. A common feature in defining money laundering is alihan transfer of illegal assets into the economic system. Another definition of money laundering is the process by which a person conceals the existence of a source of illegal income or illegal use of income, and then disguises the income so that it appears legally.[8]

As a fiduciary financial institution, banks are faced with two conflicting obligations and often cannot be negotiated. On the one hand, the bank has an obligation to keep the situation confidential and its customers' financial records (duty of confidentiality) because these obligations arise on the basis of trust (fiduciary duty). On the other hand, the bank is also obliged to disclose the circumstances and financial records of its customers in certain circumstances. This is where conflicts of interest often arise (conflict of interest) both from the point of application of law and from business (economic) interests.[9]

Provisions on bank confidentiality are needed because banks must protect their customers. Banks that divulge information categorized as bank secrets should be subject to severe sanctions. However, this provision cannot be rigid and rigorous without exception. This provision can be ruled out when the public interest seems to be harmed by certain people. As an entry for the entry of proceeds of crime, banks or

[1] Sutedi, A. (2016). *Hukum Perbankan Suatu Tinjauan Pencucian Uang, Merger, Likuidasi, dan Kepailitan.* Jakarta: Sinar Grafika, p. 2
[2] Rachmadi Usman, (2001). *Aspek-Aspek Hukum Perbankan di Indonesia*. Jakarta : PT. Gramedia Pustaka Utama, p. 14
[3] Rani Sri Agustina, *op cit*, p. 3
[4] Rachmadi Usman, (2010). *Hukum Perbankan*, Jakarta: Grafika, p. 487
[5] Remi Syahdaeni, *Money Laundering*, Materi Kuliah Hukum Perbankan, Post-graduate School, Universitas Indonesia, without year, p. 3
[6] Source: https://nasional.sindonews.com/read/1286139/13/pencucian-uang.
[7] "FAJAR" news, Jumat, 14 September 2018, p 1.
[8] Hanafi Amrani. (2015). *Hukum Pidana Pencucian Uang,* Yogyakarta: UII Press, p. 6
[9] Muhamad Djumhana. (2008). *Asas-Asas Hukum Perbankan Indonesia*, Bandung: PT. Citra Aditya Bakti, p 271.

other financial service companies must reduce the risk of being used as a means of money laundering by knowing and knowing the identity of customers, monitoring transactions and maintaining customer profiles, and reporting suspicious transactions) carried out by parties using the services of banks or other financial services companies. The application of the Know Your Customer Principle or more commonly known with the Know Your Customer Principle (KYC Principle) is based on the consideration that KYC is not only important in eradicating money laundering, but also in the implementation of prudential banking to protect banks or other financial service companies from various risks in dealing with customers and counter-parties.

However, from the banks' perspective, they exist to make as much profits as possible. Hence, their cultural and commercial interests are totally distinct from the interests of the law enforcement authorities. It is widely accepted that the anti-money laundering laws create a major dilemma for banks as they produce a significant shift in the way banks interact with their customers as well as other banks. Furthermore, the implementation of the laws not only creates significant compliance problems for banks, but also has the potential to adversely affect the internal operations of banks.

2. Method of the Research

Type of the research was an empirical legal research. The research was conducted in the Province of Yogyakarta, precisely in several public and private-owned banks. Then, the data obtained in this research is described in accordance with the problems studied in descriptive qualitative. The primary and secondary legal materials that have been collected are inventoried, processed and studied in depth so as to obtain a description of the legal issues.

3. Know Your Customer Principles and Bank Liability to Prevent Money Laundering Crimes

Know Your Customer (KYC) principles is basically an inseparable part of the bank's risk control system as an effort to prevent the banking industry from being used as a means or target of crime, especially in the prevention and eradication of money laundering. Since the Government issued Law Number 8 of 2010 concerning Prevention and Eradication of Money Laundering Crimes, Bank Indonesia as the monetary authority and bank supervision has also issued a regulation on money laundering which refers to the law on money laundering, namely Bank Indonesia Regulation Number 14/27/PBI/2012 concerning the Application of Anti-money Laundering and Prevention of Terrorism Funding Programs for Commercial Banks; which directly replaces previous regulations which are considered to be no longer compatible with national, regional and global dynamics and the increasingly complex products, activities and information technology of banks, which have a higher risk of utilizing banks in money laundering and terrorist funding.

Obviously, the manipulation of the banking systems is vital for a successful money laundering operation. As such, for criminals, the best method of laundering is to own a bank. Then, in implementing anti-money laundering and prevention of terrorism funding programs, banks remain guided by the application of risk management related to anti-money laundering and prevention of terrorism funding and international standards issued by the Financial Action Task Force on Money Laundering (FATF) which establishes policies and steps to protect the global financial system from money laundering and terrorism financing, known as FATF recommendations. The recommendation is also used as a reference for the international community to assess a country's compliance with the implementation of anti-money laundering and prevention of terrorism funding programs.[1]

As is known since Bank Indonesia issued Bank Indonesia Regulation No. 3/10/PBI/2001 concerning the Application of the Know Your Customer Principles, which is one of the efforts to prevent the banking system from being used as a means of money laundering crimes, whether committed directly or indirectly by the perpetrators of crime. In the BI Regulation, banks are required to apply the Know Your Customer Principle which consists of policies and procedures for receiving and identifying customers, monitoring customer accounts, monitoring customer transactions and risk management policies and procedures.

The implementation of these policies and procedures is intended to enable the Bank to recognize the customer's profile and characteristics of each customer transaction so that in turn the bank can identify suspicious transactions and subsequently report to Bank Indonesia. By applying the Know Your Customer Principle means that the Bank can also minimize the possibility of possible risks, namely operational risk,

[1] See, General Explanation of the Bank Indonesia Regulation No. 14/27/PBI/2012 concerning the Application of Anti Money Laundering and Prevention of Terrorism Funding Programs for Commercial Banks.

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legal risk, concentration risk and reputational risk. One of the obligations that must be fulfilled by the Bank with the issuance of the Bank Indonesia Regulation is to make a policy and procedure for implementing the Know Your Customer Principles.

In essence, the application of the principle of knowing customers (Know Your Customer Principle) carried out by Bank institutions is not only important in the context of prevention and eradication of money laundering, but also in the framework of applying prudential banking to protect banks from various risk in dealing with customers. Banks are required to apply the Know Your Customer Principle which consists of customer acceptance and identity policies and procedures, monitoring customer accounts, monitoring customer transactions and risk management policies and procedures.

The lack of public knowledge of bank service users in understanding the significance of the application of the principles of knowing customers, is one of the obstacles faced by the Bank, especially concerning information and openness in providing important data relating to the process of opening accounts at the Bank. The tendency of some prospective customers not to be transparent in providing data on sources of funds and income will make it difficult for banks to mitigate risk, which will later harm themselves from the customers themselves.

The obligation of the Bank in implementing the principle of knowing customers, will not reduce the compliance of the Bank in carrying out its obligations, namely maintaining the confidentiality of customers and deposits, because both are regulated in bank procedures and policies issued and supervised by Bank Indonesia as the monetary authority. The existence of strict sanctions in the form of fines and sanctions in the form of a decrease in the bank's soundness and the many regulations issued by Bank Indonesia, the Financial Services Authority (OJK) which regulates bank operations, is one way for authorities to always oversee the Bank as an institution trusted by the community (fiduciary financial institution).

The confidentiality of a bank is one of fulfilling the needs of depositors, customers need a sense of security to save money and connect with bank financial institutions. Customers only entrust their money to banks or use bank services if the bank provides a guarantee that the bank's knowledge of deposits and financial conditions will not be misused. Nevertheless, the provisions of bank secrets can be excluded in certain cases as stipulated in the Banking Act or there are greater interests concerning the public interest and the interests of the bank itself from the actions of irresponsible individuals.

In implementing anti-money laundering and prevention of terrorism programs, banks remain guided by the application of risk management related to anti-money laundering programs and prevention of terrorism funding and international standards issued by the Financial Action Task Force on Money Laundering (FATF) which establishes policies and steps to protect the global financial system from money laundering and financing of terrorism, known as FATF Recommendations. The recommendation is also used as a reference for the international community to assess a country's compliance with the implementation of anti-money laundering and prevention of terrorism funding programs.[1]

From the results of the questionnaire and interviews with officials and employees in several branch offices of commercial banks which were the object of research, it can be seen that the role of Human Resources (HR) in the Bank is the main key to the successful implementation of the principle of recognizing customers. recognize the customer's profile and characteristics of each customer transaction so that in turn the bank can identify suspicious transactions and subsequently report to Bank Indonesia.

Implementing the ideal principle of knowing your customer principles is a form of principle to know customers who are able to detect early and prevent the bank being made as an entry point for money from proceeds of crime; either through cash transactions, book transfers and online transfers. The Bank is obliged to monitor each customer transaction that is tailored to the characteristics and profile of the customer. Besides that, the information system that is owned must be able to enable banks to trace each individual transaction. Thus, support for systems and information technology like this is certainly very necessary even though it requires a large investment or cost. The application of the principle of knowing customers is part of the implementation of bank risk management in general.

4. The Obligations and Responsibilities of the Bank in Applying the Know Your Customer Principles

[1] Johnson, J., & Desmond Lim, Y. C. (2003). Money laundering: has the financial action task force made a difference?. *Journal of Financial Crime*, *10*(1), 7-22.

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Risk management policies and procedures which include; supervision by bank management (management oversight); delegation of authority; separation of duties; internal supervision system including internal audits; and employee training programs regarding the application of know your customer principles; including the appointment of special officers who are responsible for handling customers who are considered to have high risks need to get attention from the Bank's management in its implementation.

Customer due diligence procedures is vital for obtaining satisfactory evidence as regards to the identity and the legal existence of the customer.[1] It may be defined as a process to identify and verify the customer; identify and verify beneficial ownership and control of the transaction; obtain information on the purpose and intended nature of the banking relationship; and conduct on-going due diligence and scrutiny in ensuring the information provided is updated and relevant.

Banks in carrying out their business activities face various business risks, so that to reduce the business risk, banks are required to apply the precautionary principle. One of the bank's efforts in implementing the principle of prudence is the application of the principle of knowing customers. Understanding the principle of knowing customers as regulated in Bank Indonesia Regulation Number 3/10/PBI/2001 concerning the Application of Know Your Customer Principles states that the Know Your Customer Principle is a principle applied by banks to identify the customer's identity, monitor customer transaction activities including reporting suspicious transactions.[2]

The goal to be achieved in the application of the principle of knowing customers is to increase the role of financial institutions with various policies to support the practice of financial institutions, avoiding the possibility of suspicious transactions, where banks as financial institutions are used as an arena of crime and illegal activities by customers and protect the reputation and reputation of financial institutions. The application of the principle of recognizing or more commonly known with the Know Your Customer Principle (KYC Principle) is based on the consideration that KYC is not only important in eradicating money laundering, but also in the context of implementing prudential banking to protect banks or other financial service companies from various risks related with customers and counter parties.[3]

In applying the principle of knowing customers, banks do not distinguish between depositing customers and borrowing customers. Between depositors and borrowing customers, a clear identity is needed to provide protection to the bank itself in carrying out its business activities in order to maintain the existence and prevent the occurrence of banking crime events and defaults. The bank is obliged to serve customers or prospective customers. For this reason, complete and accurate data is needed, so that the bank can meet customer needs in accordance with bank promises or offers.

Especially for customers, banks or other financial service companies must recognize customers, so that banks or other financial service companies are not caught in money laundering crimes. This principle of knowing customers is a FATF recommendation, which is the fifteenth principle of twenty-five Core Principles for Effective Banking Supervision. Recognition of customers must be carried out starting from the customer's identity, customer acceptance procedures, continuous customer monitoring, and then reporting to the authorities. Bank Indonesia has been requiring banking institutions to recognize their customers.

In addition, a recommendation from the Basel Committee on Banking Supervision which, in its subsequent presentation, is called the Basel Committee, in the Core Principles for Effective Banking, stating that the application of the principle of knowing customers in each banking transaction is an important factor in protecting the health of the bank. The same thing was also explained in Bank Indonesia Regulation concerning the Application of Know Your Customer Principles.

Even though Bank Indonesia Regulation Number 3/10 / PBI / 2001 does not explicitly aim to prevent money laundering, the main purpose of the Bank Indonesia Regulation was to prevent Indonesian banking institutions from becoming money laundering, because for a long time It is said that banking institutions in Indonesia are a convenient place for money laundering. This is due to the strict provisions of bank secrets.

[1] *The Standard Guidelines on Anti-Money Laundering and Counter Financing of Terrorism,* para 5.1.3; Aspalella, A. R. (2010). *Op.Cit.,* p. 197

[2] Bank Indonesia Regulation No. 3/10/PBI/2001 concerning Know Your Customer Principles.

[3] Adrian Sutedi, *Op Cit*, p. 73

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The Bank Indonesia Regulation (was actually to fill the legal vacuum, because at that time there was no money laundering law.[1]

In order for the application of the Know Your Customer Principles to work effectively, the bank directors must form a special work unit or appoint an official responsible for that and based on the Bank Indonesia Regulation, before conducting a relationship with a bank customer, they must request information about:

1. Identity of prospective customers;
2. The purpose and objectives of the business relationship that the customer will make with the bank;
3. Other information to find out the profile of prospective customers;
4. Identity of another party if the prospective customer acts for and on behalf of another party.

The identity of the prospective customer must be proven by supporting documents and the bank must examine the validity of the supporting documents. If needed, the bank can conduct interviews with prospective customers to examine and believe the validity and correctness of documents supporting the customer's identity. In this case the prospective customer acts as an intermediary and/or the power of the other party (benefit owner) to open an account so that the bank must obtain supporting documents on identity and legal relations, assignments, and the authority to act as an intermediary.

This provision also applies to banks that have used electronic media in providing their services. Such banks are required to meet with prospective customers at least at the time of account opening. Banks are prohibited from conducting business relations with prospective customers who do not meet the requirements or the bank doubts or cannot believe the identity of the prospective customer. After a person or entity is accepted as a customer, the bank is required to monitor the customer's account and transaction in question. Therefore, banks must have an information system that can identify, analyze, monitor, and provide reports effectively on the characteristics of transactions carried out by customers.

However, in practice, if there is a suspicious transaction, the bank must report it to Bank Indonesia no later than 7 (seven) working days after the bank becomes aware. Thus, banks must be careful and selective in accepting someone or entity to become a prospective customer. Banks are also required to recognize the pattern of customer financial transactions so that they can immediately identify if there are suspicious transactions.

With the increasingly widespread crime of money laundering and terrorist funding that utilizes financial institutions, cooperation and attention from various parties is needed in the prevention and eradication of the intended crime. Meanwhile, the increasingly complex development of products, activities and information technology of banks increases the opportunity for criminals to misuse banking facilities and products in assisting their crimes.[2] For this reason, the role and cooperation of banks are needed in helping law enforcement in carrying out anti-money laundering and prevention of terrorism funding programs.

In implementing anti-money laundering and prevention of terrorism funding programs, banks refer to international standards to prevent and combat money laundering and / or terrorism funding by the Financial Action Task Force on Money Laundering (FATF), known as Recommendation 40 + 9 FATF. The recommendation is also a reference used by the international community in assessing a country's compliance with the implementation of anti-money laundering programs and preventing terrorism funding.[3]

Bank Indonesia Provisions concerning the Application of Know Your Customer Principles that have been implemented so far, are deemed necessary to be adjusted to refer to more comprehensive international standards in supporting efforts to prevent money laundering and prevention of terrorism funding. Adjustments to these arrangements include:

a) Use of the term Customer Due Diligence in the identification, verification and monitoring of customers;
b) Application of Risk Based Approach;
c) Arrangements regarding prevention of terrorist funding;
d) Arrangements regarding Cross Border Correspondent Banking; and
e) Arrangements regarding fund transfers.

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[1] Gema Swadarma, *"Mari Mengenal Nasabah",* Edisi No. 028/III, September 2001, p. 10

[2] The Financial Action Task Force (FATF) recommendation is a standard recommendation for the prevention and eradication of money laundering and terrorism funding issued by the FATF.

[3] CDD Customer Due Diligence is an activity in the form of identification, verification and monitoring conducted by the Bank to ensure that the transaction is in accordance with the customer's profile.

With the effective implementation of anti-money laundering and prevention of terrorism funding programs by banks, banks are expected to operate in a healthy manner so that in the end it will increase financial system resilience and stability. The existence of national and global dynamics accompanied by recent technological developments, it has the potential to increase opportunities for perpetrators of crime to misuse banking facilities and products as a means of money laundering and terrorism financing, with a more sophisticated modus operandi. Increased risks faced by banks need to be balanced with improving the quality of the application of risk management related to anti-money laundering and prevention of terrorism funding programs.

Based on Research findings, banks face difficulties in asking for complete data on existing customers and prospective customers. This is because there are many customers who feel that the completeness of the data, especially income data and the purpose of using the account is just a formality so they are dishonest and transparent in providing actual data. Moreover, they assume that banks are trust institutions that will protect customers' and savings data.

As a result, it can be understood that the application of the know your customer principle is very important in the banking industry in order to maintain the stability of the bank's health. Along with the development of technology and information, the more complex banking products and activities, the risks faced by banks will also increase. This increase in risk must be balanced with improving the quality of risk management. The arrangement of applying the principle of knowing customers is also refined based on international standards by using new customer due diligence terms and enhanced due diligence. This indicates how important the application of this principle is in banking in order to avoid increasingly sophisticated risks which in the end are expected to create a healthy trust from customers and banks.

5. Conclusion

The Know Your Customer Principle is carried out in the context of applying prudential banking to protect banks from various risks in dealing with customers and counter-parties. The principle of getting to know customers is a recommendation from the Financial Action Task Force on Money Laundering (FATF), which sets out the policies and steps needed to protect the global financial system. In implementing the principle of knowing customers, the Bank is still obliged to maintain the trust of its customers by upholding the bank's confidential provisions. For this reason, it is necessary to have a common perception and understanding between the Bank and the costumers regarding the urgency of applying the KYC principles.

In supporting the application of the principle of knowing customers, it is necessary to support adequate technology and information systems that can monitor each customer transaction that is tailored to the character and profile of the customer. Besides that the information system that is owned must be able to enable banks to trace each individual transaction, if necessary. Thus, support for systems and information technology like this is certainly very necessary even though it requires a large investment or cost. The application of the principle of knowing customers is part of the implementation of bank risk management in general.

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