PREVENTION OF MONEY LAUNDERING - THE PROBLEM OF CONTEMPORARY BANKING

Prof. Dr. Kostadin Pušara
Doc. Dr. Aleksandra Pušara, FORKUP

Abstract: *The author presents a system of money laundering prevention and terrorism financing. Basic notions are defined and principles and fundamentals of international regulations are analyzed.*
Infiltration of dirty money is a serious problem for the national economy. Buying stocks, real estate, establishing of "dirty investment funds" and usage of the banking system for depositing such funds endangers credibility of the entire country, especially for the safety of the financial and banking system. Money launderers constantly find new ways, using new, non-financial channels and expand their activities to real estate, art, and insurance. It is therefore necessary to keep up European solutions and recommendations, to strive for further improvement and modernization of laws and enact new regulations harmonized with international standards, particularly with the 2005/60 EC Directive.

Keywords: *money laundering, terrorism financing, prevention, harmonization with international standards, the implementation of in-depth analysis, information on the suspicious transactions*

INTRODUCTION

The concept of money laundering

Money laundering is a process that aims to cover traces of the real source of illegally acquired money, taking advantage of financially, but more often, and non-financial sector and the profession. In accordance to 2005/60 EZ Directive, this process includes covering up of real source of the money, converting, and transfer of assets in terms of its unlawful origin i.e. acquisition, possession, or use of property derived from criminal acts or complicity, connection, helping, encouraging, and enabling of performing any such act. Dirty money is the money acquired through criminal acts and all property derived from that money. This means that money laundering do not exist without such criminal activities.

Money laundering is the process of disguising the illegal source of income generated through criminal activity, to include such income in the flow of legitimate financial business. The issue of money laundering is integrally linked with corruption, organized crime, financial fraud, smuggling, and other criminal acts aimed at making profit. This problem causes serious consequences if not resolved properly. The ability of criminals to collect and legitimize the gains can lead to the undermining of democratic institutions and the abuse of economic systems. Illegally earned income allows criminals to develop its political and economic power at the expense of honest citizens and legitimate business. Countries that are not adequately addressed the issue of money laundering have established that officials are also susceptible to corruption, and that therefore there comes to a complete interruption of legitimate international investments. Thus, programs to combat money laundering are more than a simple means of implementing the law, which is used in case of incomes derived from criminal activities. They are essential in the process of protection of democratic institutions and economic freedom of each country. Money laundering is also becoming international activity on a global scale. For this reason, many international organizations have established standards, procedures, and recommendations to solve this phenomenon. Today, money laundering, in most countries is consider as serious crime, and that the authorities are at risk of coming into a situation where they undermine organized crime and corruption is the generally accepted opinion, if you do not have adequate laws and procedures aimed at resolving issues related to prevention, detect, investigate and take legal measures in cases of money laundering. It is also believed that financial trading is a matter of international character, so the implementation of these laws should be consistent. Council of Europe, the European Union, and the Financial Action Task Force (FATF) established by the member countries of G-7, and the United Nations, defined guidelines for the implementation of effective programs to combat against money laundering for its Member States.

What is money?

Money is the idea. The idea that value of an object can be determined and that can be used in trading is very old, but universal. Money is a very old tool, but the notion that it is believed that is reliable artifact, something that one can accept without question and without checking, but something that appeared in history of money only occasionally; in fact, such a viewpoint was created during the last century.
Everyone sees the money in a different way and it is not at all surprising that these opinions differ, especially in a world of diverse cultures.

Clear understanding of money laundering as such requires an understanding of the nature and role of the money. The money is usually seen as cash. How really one convertible mark, dollar, or euro worth? Perhaps a better definition would be that the money is “all that is widely accepted as a way to settle the costs.”

Money appeared thousands of years before the paper and coins, but it is impossible to know who came up with the idea that an object determines the value and assigning it such an important place in the business.

Money is, therefore, the idea that a particular item has a value that is accepted in all kinds of exchanges. As a concept, the money can have any shape. At different times in different places, the money can be almost anything you can imagine.

Why is all this so important for the prevention of money laundering? We must be aware that although most of the money laundering process involves some form of money, everything can be used in the process of money laundering: diamonds, gold, credit cards, stock, warranty, rare coins, insurance, and many other different forms of money. These kinds of transfer of money in various forms are limited only by the imagination of people, not the form in which money appears.

The process of money laundering

U.S. Office for the prevention of money laundering (FinCEN) has described the process of money laundering through three stages: placement, refinement, and integration.

Investment Stage

Phase of investment in which money or cash came directly from criminal activities inserted into the financial mainstream. This money enters the financial system in the way that is designed to avoid detection of origin by the bank or the legislature. Money launderers usually invest large amounts of money in a number of smaller banks or companies. In the phase of the investment, funds from criminal activities are invested in the financial system or in real estate and movables. The main goal is to put money in financial flows and transfer it abroad. Doing that, money launderers expose their earnings, so this is the most important phase, due to possibility of detection of dirty money. No matter whether money that comes from criminal activities appears in the form of cash or not, investment is the most dangerous phase for the criminals. At that time, a direct link between money and criminal still exist. From that moment, the money is not cash but is converted into numbers on paper or on the display screen.

Concealment phase

Concealment phase is known as the *refining*, but is also called swamping or mixing. During the refining stage, money launderers start to cover traces of the real source of with numerous money transactions. Using legal transactions they transfer money to accounts in the country and abroad, and changing its shape, to increase inability to do any monitoring of its route. At this stage, all existing offshore banking centers may be used as suitable means. The ultimate goal of transferring money is the dispersal of money and obtains as many paper traces in order to disrupt the supervision of an ongoing or future investigation, and eventually collected a false origin or source of money. This is precisely the reason why the laws, regulations, and changes of the authorized persons and officials who work directly with clients, should be based on taking thorough analysis of the diligence and data-acquisition of the purpose and intended nature of the business, as well as constant monitoring business relations and transactions. Furthermore, it is important to establish the identity of the beneficial owner, and take all necessary measures based on risk and the type of customers, business relationships, products, or transactions. The very nature of the invention allows finding of certain characteristics that indicate possible money laundering. These are financial transactions having no logical justification, created exclusively for the transaction itself and for the frequent buying and selling goods, especially with the fees and commissions to advisers. That may be accounts created from many smaller accounts, the accounts of which there is no connection, and a lack of interest in investment losses, costs, bank charges, or counsel fee. Money launderers are interested only in profit as a secondary objective - the concealment of the real source of money is the only motive.

Integration phase

Integration phase, money launderers integrate its resources into the economy and financial system and can interfere with its full resources, which make it difficult to detect the real source of money. The final phase of the money laundering process is actually the integration of illegal funds that have become legitimate and which were successfully embedded in the financial system. This phase is called phase drying or centrifuging. Money laundering is a developing complex system, implementing new techniques, and money launderers are improving constantly. Criminals are hiding behind complex transactions involving international transfers, cut transaction into smaller amounts, or transformed into the accounts of a number of people, changing the shape of money, using the advices of top banking executives, brokers, investment bankers, accountants, consulting firms, civil servants, and lawyers. The money laundering process never stops no matter in what phase dirty money went and how many forms of illegal means changed, such funds will never be clean in the eyes of the law.

DEFINITION OF MONEY LAUNDERING

It is by accident that just in the U.S. in 1986, “legislative premiere occur”. In Washington State the law on money laundering, which strictly punish any failure to report cash transactions above $10,000 was adopted. Otherwise, the literature mentions that the term “money laundering” promoted “The Guardian” from London thirty years ago in connection with the famous Nixon's Watergate scandal, and it was the amount of $200,000 meant to fund the Republican election campaign. In the early 1980, the term was included in the documents the Council of Europe (Giunio, 1998:40).

Considering the fact that money laundering usually happens in three phases and often extends across international borders, which involved small or large groups of people established an ad hoc or permanent effect, and that different of criminal acts precede it, it is clear that the process of money laundering is very complex.

Precisely for this reason in the literature different definitions of money laundering appear, some of which we quote:

1. Money laundering is any technique aimed at converting unfairly and illegally acquired income, so it seems a fair and lawful wage (Heršak, 1992:741).
2. Money laundering is an activity aimed at collecting unfairly or illegally acquired income through legal businesses (Vukelic, 1994:29).
3. Money laundering can be defined as the transformation of illegally obtained income into illusory legitimate (Novoselec, 1996:41).
4. Money laundering include new actions aimed at concealing the proceeds obtained by crime work, inclusion, disposal, and other disposition of this products (money,

securities, jewels, etc.) creating the illusion of legal acquirement of these products, 1998:40).
5. Money laundering is a financial transaction made to hide illegal activities or to conceal profits from illegal activities (DeGabrielle, 2001:192).
6. The term money laundering applies to change of the shape of illegally obtained money so that it is legal. In addition, it is covering up illegal sources of income or its use (Claessens, 2000:22).
7. Traditionally, money laundering is (among other things) the cleaning of dirty money derived from illegal activities that are probably related to drug trafficking in the collective consciousness is (Lilley, 2000:1).

Return effects of money laundering

Money laundering has a wide range of feedback effects on economic, political, and social structures of each country. The most significant consequences of money laundering are decline of business legal private sector, the impact on exchange rates and interest rates, economic disturbances and instability, reducing state revenues and loss of control of economic policy, jeopardizing the reform program and privatization, declining reputation of the country.

PREVENTION OF MONEY LAUNDERING PROCESS

The most important is to prevent that financial system is used for washing dirty money by appropriate measures. The central bank needs to establish regulations and supervise the banks to prevent and detect money laundering. This regulation is necessary to prescribe measures for banks and financial institutions that include the obligation of reporting supervisory body if there is doubt about the origin of money, prepares appropriate sanctions, strict rules for issuing licenses to banks and financial institutions. Together with the association of banks, central banks should set the rules of banking practices against money laundering, measures to assess, monitor and control clients, determine limits on the amount of transactions in foreign currency by individuals; bank's obligation to determine those responsible for supervision in relation to money laundering and provide staff training on the techniques of money laundering. For the banking sector is important that risk management system and corporate governance structure are well organized and adapted to enable the prevention and fight against the entry of dirty money into the financial system. In addition to local cooperation between central banks and the banking sector, it is important to develop international cooperation in the fight against money laundering.
The roles of the main factors in determining cases of illegal transactions have the financial institutions because of their unique role in the payment system in the collection and transfer of funds. It is very difficult (perhaps impossible) to make comprehensive recommendations to banks for a fully successful against money laundering.
William C. Gilmore (1995), professor of public international law from the University of Edinburgh, Scotland, lists several recommendations:

- Know your party: banks should try to learn the identity of their parties and to have a proper investigation of the origin of their funds.

- Operate in accordance with regulations: bank management should ensure that business is conducted in accordance with high moral standards, to respect the laws and regulations not to realize service if there are good reasons to doubt about case of money laundering.
- Cooperate with relevant authorities to prevent illegal actions: bank in all suspected cases of money laundering should cooperate fully with the relevant authorities and take appropriate measures required by law.

- Pay attention to training and informing employees:

  - All bank employees should be well informed about the adopted policies of the bank,
  - Consistently implement decisions on the mandatory establishment of legal identity of the parties, and
  - Keep proper records of accounts, at least five years, to successfully determine the sequence of individual transactions.

Grown problems present in the world do not recognize national borders and require global solutions. Although money laundering is a global problem, there are significant differences between countries. This is especially evident in countries in transition. The countries that are more involved in world economic developments and which are quite advanced in transition (Hungary, Poland, and Slovenia) have considerably smaller problems in adjusting its monetary market and banking institutions than countries that are late in transition (Albania, Romania, and Russia) where these problems are more pronounced. Prevention of money laundering process is not only a fight against crime, but also an attempt to preserve the integrity of financial institutions and financial system as a whole. International money laundering is based on the differences between financial and banking provisions in the legislation of individual countries.[65] It is therefore necessary to minimize these differences, if they cannot be completely eliminated. Also important is the finding of new laws to combat money laundering, the creation, and development of new specialized services. The successful prevention of money laundering is probably the most important development of international co-operation with the use of modern and successful methods. Otherwise, all the individual efforts will bring poor results and cause high costs.[66]

[65] United Nations 1992: „*Money Laudering and Associated Issues: The Need for International Cooperation*“, Doc. E/CN. 15/1992/4.
[66] Support to the Special Department for Organised Crime, Economic Crime and Corruption, www.registrarbih.gov

RESUME

Corruption, organized crime, financial fraud, smuggling, and bribery are alternative ways of acquiring illegal income that after legalization and laundering of so accumulated capital directly enable criminalized people to achieve economic power and strong influence on politics at the expense of society and the legitimate operation of most businesses. Money laundering means activities aimed at the legalization of money earned from criminal activities. Participants in the money laundering use many different types of financial transactions to disguise the true origin of money, and so transform it into legal means of transport in the money market, which enables them to use it normally in business relations in which they place their capital.[67]

The phenomenon of money laundering is a threatening phenomenon of criminal activities and is present in developed countries, countries in transition, and developing countries. It is manifested in different forms and performed in a variety of ways. Participants in the process of money laundering continuously improves and invent new methods and ways, so that the forms of money laundering improve along with progress in technique and technology with the development of financial and economic relations at the international level. One of the most widespread forms of money laundering is done as part of organized crime, where strong relationships between state institutions and state bodies and the criminal organization are established. State institutions - their employees deliberately abuse their position, function, power, and prestige with high reimbursement in order to legalize illegally acquired cash. Simultaneously, criminal organizations seeking to, through rapid maneuver transactions, legalize dirty money.

Under the term money laundering, we assume all settlement activities, converting or cleaning criminal money, and its transformation into a regular cash flow or assets.

Eliminating and preventing money laundering is not only a fight against organs of direct crime but efforts to preserve the integrity of the financial system, financial institutions in general, and the legality of business undertakings.

[67] Dr M. Kulić 2001. „*Pranje novca, Privredni kapital i korupcija“,* Institut za kriminološka i sociološka istraživanja, Beograd

REFERENCES

1. Dautbašić, Ismet 2001., *Finansije i finansijsko pravo*, Sarajevo, Univerzitet u Sarajevu
2. Gilmore, C. W. 1995: *Dirty money, The evolution of money laundering counter – measures*, Council of Europe Press, Council of Europe, Strasbourg.
3. Giunio, M., 1998. "*Mjere za sprečavanje pranja novca*". *Slobodno preduzetništvo*
4. Kulić. M., 2001, *Pranje novca, Privredni kapital i korupcija*, Beograd, Institut za kriminološka i sociološka istraživanja
5. Milojević, Aleksa i Milivoje Trkulja, 2000, *Javne finansije*, Srpsko Sarajevo, Ekonomski fakultet
6. Novoselec, P., 1996. *Kriminalno-političko značenje i pravno uređenje pranja novca*
7. Raković, Milena, 2007, *Finansije i finansijsko pravo*, Banja Luka
8. World Bank 2009. *Diagnostic Study of Institutional Integrity and Goverance in Colombia*