MONEY LAUNDERING AND ABUSE OF THE FINANCIAL SYSTEM

Hasmet Sarigul, Mevlana University
MONEY LAUNDERING AND ABUSE OF THE FINANCIAL SYSTEM

Hasmet Sarigul

Mevlana(Rumi) University, Turkey

Every year, huge amounts of funds are obtained by illegal activities. These illegally obtained funds need a process, which is called laundering, in order to appear legitimately obtained and become usable. Although it is not possible to measure the exact volume of money laundering, the International Monetary Fund has stated that the aggregate amount of it in the world could be somewhere between two and five percent of the world’s gross domestic product. The main vehicle for criminals to launder their illicit money is the financial system. Money laundering threatens the credibility of international financial institutions. It undermines the financial system and all of the countries integrated into the international financial system become exposed to the risk. The aim of this paper is to explain the relationship between the money laundering and financial system. It briefly examines money laundering from the perspective of financial system in the case of banks.

Keywords: Money laundering, financial system

Introduction

Every year, huge amounts of funds are obtained by illegal activities such as drugs, racketeering, kidnapping, gambling, procuring women and children, smuggling and armed robbery. These illegally obtained funds need a process, which is called laundering, in order to appear legitimately obtained and become usable. Money laundering is a number of criminal acts to generate a profit for the individual or group that carries out the act. Criminals do this by disguising the sources money, changing the form it or moving the funds from the origin to another place that they will attract less attention. These activities enable the criminal to enjoy these profits without jeopardising their source.

There are multiple transactions used for money laundering. Disguising the origin and ownership of money by placing it in a bank, moving it through multiple transactions, and mixing it with legitimate funds. These steps are known as placing, layering, and integrating the money.

Money laundering which is an international problem has some important implications on economy. It has some systemic effects on financial system and on monetary developments by generating market volatility and instability. Money laundering creates shell organizations and originates unfair business practices which distort competition. The estimated range of money laundering transactions in the world is from 2 to 5 percent of global gross domestic product. But the main negative consequence of money laundering is its impact on the stability of the financial system. It threatens the credibility of international financial institutions and undermines the
financial system and all of the countries integrated into the international financial system become exposed to the risk.

In this paper, we briefly examined money laundering from the perspective of financial system. Our study consists of five sections. In the first section, terms of “black money” and “money laundering” are explained, stages and methods of money laundering are given.

In the second section, the volume of money laundering on global basis examined and its economic implications are examined. Third section indicates financial abuse and money laundering risk of banks and the role of banks in money laundering. In the fourth section, international organizations relating with anti-money laundering are examined, principles and control measures at combating money laundering are discussed. And finally, in the conclusion section, we tried to suggest some solutions for avoiding money laundering. Without an international co-operation, it is almost impossible to fight against money laundering which is also an international problem. It cannot be effectively controlled without the worldwide cooperation of finance ministries, central banks, financial institutions, and financial regulators.

Stages, Methods and Techniques of Money Laundering

The term “money laundering” seems to have been coined in the U.S. in the 1920s when street gangs would seek a seemingly legitimate explanation for the origins of the money their rackets were generating. Their reasons for so doing were varied to hide their material success from corrupt police intent on collecting protection payments, to avoid attracting the attention of envious competitors, or, a little later, to evade the possibility of tax evasion charges, something discovered in the early 1930s to be a powerful weapon against otherwise impregnable criminals. To accomplish these goals, the street gang might take over cash-based, retail service businesses. The most popular choices were clothes-laundries and car-washes–hence, it seems, the origin of the term (www.imolin.org).

The criminals have always tried conceal to the origins of the money obtained from drugs, racketeering, kidnapping, gambling, procuring women and children, smuggling, armed robbery, counterfeiting and bogus invoicing, tax evasion and misappropriation of public funds. Some of these activities are legitimate. But, the tax of this legally earned money isn’t paid and the income isn’t reported to the tax authorities. This wealth, which is also called grey Money, is a criminal offence in most of the countries of the world. But black money, which makes an unofficial economy like grey money, is something different. It is illegally earned, mostly associated with organized crime such as extortion, drug trafficking, arms smuggling, whitecollar crime and e.a. Grey money is generally hidden but black money needs to be appeared legitimately obtained in order to become usable. In other words, black money must be made look legitime or laundered. In this respect, money laundering is described as “the process by which the proceeds of crime and the true ownership of those proceeds are concealed or made opaque so that the proceeds appear to come from a legitimate source” (Johnston and Abbott, 2005:7).

Money laundering is generally defined as “the process by which illegally obtained funds are given the appearance of having been legitimately obtained”. As noted above, by money laundering, illicit funds are conversed to less suspicious forms, the main source is concealed and a legitimate one is created.

Money launderers follow three basic stages to disguise the source of the funds they illegally obtained. So that, those funds may be used without compromising the criminals who are seeking to use them. These stages are called as placement, layering and integration.
• Placement is the first stage of money laundering process that the physical currency enters the financial system. During placement stage, illegal funds are placed into financial institutions through deposits, wire transfers, or other means in order to become more liquid. Placement is generally accomplished by breaking up large amounts of cash into less conspicuous and smaller sums before they are banked.

• Once the placement is complete, the funds must be moved to separate the ultimate destinations to make using the funds more convenient and reduce the possibility of detection. The process of distancing the placed funds from their illegal origins is known as ‘layering’. At layering stage, money launderers use many different techniques to layer the funds. These include using multiple banks and accounts, having professionals act as intermediaries and transacting through corporations and trusts. Funds may be shuttled through a web of many accounts, companies and countries in order to disguise their origins.

Once the funds are successfully layered and distanced from their origins, they become available to be used and controlled as apparently legitimate funds and criminals place those funds back into the economy. By this stage, which is known as integration, illegally obtained funds closely resemble legally generated wealth. The criminal may invest this money further criminal activity.

General Methods and Techniques of Money Laundering

Money laundering can be realized in many ways and criminals are permanently developing their methods. But, there are some typical methods and techniques which are long standing such as smurfing, structuring, currency smuggling, cash conversion, cash intensive businesses, shell companies and casinos. All of these methods and techniques have common features and they are in fact endless variations of the same theme.

• Smurfing: Smurfing is a money laundering method where the cash from illegal sources is divided between deposit specialists or smurfs to make multiple deposits into multiple accounts in various financial institutions. Large and apparently unrelated individuals make the funds difficult to detect any connection between the smurfs, deposits and accounts. In other words, smurfing is done to avoid detection by authorities.

• Structuring: This technique is breaking of one big financial transaction into many smaller ones. That person who is structuring may be acting alone or in conjunction with or on behalf of other persons. He may conduct or attempt one or more transactions in any amount, at one or more financial institutions on one or more days. Structuring involves multiple cash deposits or withdrawals by one person at amounts under reporting currency.

• Currency Smuggling: This is the illegal cross-border movement of currency and monetary instruments physically. The two main methods used for currency smuggling are cash courier and bulk cash smuggling. Cash couriers are the persons physically transporting currency or monetary instruments on themselves or with the luggage accompanying them. And bulk cash smuggling is to conceal currency or monetary instruments in vehicles, commercial shipments, express packages, on private aircraft or boats.

• Cash Conversion: This is the illegal cross-border movement of high value items like diamonds, gold, precious stamps and other collectibles which are relatively easy to reconvert into cash and physically easy to smuggle.

• Cash Intensive Businesses: Money launderers may use some businesses and entities which normally spread out to attract minimal attention like restaurants, retail stores, liquor stores,
cigarette distributors, privately owned automated teller machines, vending machine operators and parking garages to mix proceeds from genuine business with illegitimate income.

- **Shell Companies**: Criminals often set up shell companies, especially in offshore centres, which conduct no real business and have no real operational role. Business turnover and profit are reported untruthfully and financial statements are false in those companies. All kinds of taxes are paid to cover up or conceal the source or nature of the illicit funds. But, since they are offshore, the company records are difficult for law enforcement to access for financial control and audit. Shell companies are used to receive deposits of cash at the placement stage and then the funds are often sent to another country for integration.

- **Casinos**: Casinos are open to all, there are many people inside and it's very difficult to monitor everybody. In addition to this, most of the people playing inside are regular with a lot of money. This makes casinos attractive for money launderers. They place their illicit funds by depositing them with a casino exchange for chips and tokens. After minimal play the chips and tokens are redeemed for a casino cheque and this cheque, representing gaming winnings, is deposited to the bank account.

**Estimated Size and Economic Implications of Money Laundering**

Vuletin (2008), Greenidge (2009), Georgiou (2007), Maurin (2006), Lkhagvajargal (2004), Kauffman and Kaliberda (1996), Frey and Weck-Hanneman (1984), Feige (1979) and Cagan (1958) have suggested different approaches to measure money laundering. Reuter and Edwin go through the macro and microeconomic approaches that try to estimate the amount of money being laundered and they conclude that we simply do not know how much it is.

By its very nature, money laundering is an illegal activity carried out by criminals which occurs outside of the normal range of economic and financial statistics. Yet, it is not possible to measure the amount of money laundering that is occurring world-wide, a reliable estimate is needed to determine the magnitude of the problem. Along with some other aspects of underground economic activity, rough estimates have been put forward to give some sense of the scale of the problem (www.fatf-gafi.org).

The International Monetary Fund (IMF) has estimated the range of money laundering transactions in the world is from 2 to 5 percent of global gross domestic product (GDP) in 1998. The scale of the illicit funds generated by drug trafficking and organised crimes was estimated by the United Nations Office on Drugs and Crime (UNODC) in 2009 as 3.6 percent of global GDP with 2.7 percent being laundered.

Some other estimates are (annual) (Biagioli, 2008: 88):

- OECD countries: $1.1 trillion (Schneider: 2007)

**Economic Implications of Money Laundering**

There are some macroeconomic and microeconomic implications of money laundering which corrupt financial and legal structures. But, it is very difficult to quantify these economical affects. Whereas, IMF indicates that money laundering can undermine the integrity and stability of financial institutions and systems, discourage foreign investment, and distort international
capital flows. They may have negative consequences for a country’s financial stability and macroeconomic performance, resulting in welfare losses, draining resources from more productive economic activities, and even having destabilizing spillover effects on the economies of other countries. In an increasingly interconnected world, the problems presented by these activities are global, as are the links between financial stability and financial integrity.

Also the opinions of some other researchers and experts can be summarized as follows:

- One of the most serious microeconomic effects of money laundering is felt in the private sector. Money launderers often use front companies, which co-mingle the proceeds of illicit activity with legitimate funds, to hide the ill-gotten gains. In some cases, front companies are able to offer products at prices below what it costs the manufacturer to produce. Therefore, front companies have a competitive advantage over legitimate firms that draw capital funds from financial markets. This makes it difficult, if not impossible, for legitimate business to compete against front companies with subsidised funding, a situation that can result in the crowding out of private sector business by criminal organisations. The management principles of these criminal enterprises are not consistent with traditional free market principles of legitimate business, which results in further negative macroeconomic effects (Mc.Dowell and Novis, 2008:7).

- Financial institutions that rely on the proceeds of crime have additional challenges in adequately managing their assets, liabilities and operations. For example, large sums of laundered money may arrive at a financial institution but then disappear suddenly, without notice, through wire transfers in response to non-market factors, such as law enforcement operations. This can result in liquidity problems and runs on banks. In some emerging market countries, illicit proceeds may dwarf government budgets, resulting in a loss of control of economic policy by governments. Indeed, in some cases, the sheer magnitude of the accumulated asset base of laundered proceeds can be used to corner markets or even small economies. Money laundering can also adversely affect currencies and interest rates as launderers reinvest funds where their schemes are less likely to be detected, rather than where rates of return are higher (Mc.Dowell and Novis, 2008:4-7).

- Money laundering can increase the threat of monetary instability due to the misallocation of resources from artificial distortions in asset and commodity prices. The unpredictable nature of money laundering, coupled with the attendant loss of policy control, may make sound economic policy difficult to achieve. It also diminishes government tax revenue and therefore, indirectly harms honest taxpayers. It also makes government tax collection more difficult. This loss of revenue generally means higher tax rates than would normally be the case if the untaxed proceeds of crime were legitimate. Countries cannot afford to have their reputations and financial institutions tarnished by an association with money laundering, especially in today’s global economy. Confidence in markets and in the signalling role of profits is eroded by money laundering. The negative reputation that results from these activities diminishes legitimate global opportunities and sustainable growth while attracting international criminal organisations with undesirable reputations and short-term goals. This can result in diminished development and economic growth. Furthermore, once a country's financial reputation is damaged, reviving it is very difficult and requires significant government resources to rectify a problem that could be prevented with proper anti-money-laundering controls (Mc.Dowell and Novis, 2001:8).

- There is a risk posed to the securities markets, notably the derivatives markets. As a result of the degree of complexity of some derivative products, their liquidity and the daily volume of
transactions, these markets have the ability to disguise cash flows and hence are extremely attractive to the professional money launderer. However, their activities pose huge risks to these markets. Firstly, the brokers used to execute orders on behalf of money laundering clients may be criminally liable for aiding and abetting money launderers. A worrying situation is the money launderers' skilful manipulation of the futures markets. On local futures exchanges, individuals have colluded to take correspondingly short and long positions so as to clean money debts being paid with dirty money, while profits now being clean money. Secondly, another major risk created is through the use of offshore banks which may wash money using derivative markets. As these banks are foreign, they are not required to abide by the same regulations as those of domestic investors as regards overexposure to uncovered risk, they are able to take on huge risk relative to their institutional size. Should losses result from such positions the debts may not be fully paid as the contracts purchased may be only one step in the course of a complex laundering chain that is untraceable. Thus potentially huge loses could be incurred by legitimate investors, causing damage to the derivatives markets (www.tcd.ie).

- In macroeconomic terms, it generates market volatility and instability with systemic effects on the financial system and on monetary developments. Money laundering may also have effects on the formation of asset prices bubbles, due to the fact that informal money becomes available to acquire different types of assets, real estate in particular. On the microeconomic side, it distorts competition, originating unfair business practices and the creation of shell organizations. It also involves higher transaction costs and promotes other illegal activities (Redrado, 2005:1).
- To the extent that money demand appears to shift from one country to another because of money laundering—resulting in misleading monetary data—it will have adverse consequences for interest and exchange rate volatility, particularly in dollarized economies, as the tracking of monetary aggregates becomes more uncertain. The income distribution effects of money laundering must also be considered. Illegal transactions can also deter legal ones by contamination. For example, some transactions involving foreign participants, although perfectly legal, are reported to have become less desirable because of an association with money laundering. More generally, confidence in markets and in the efficiency-signaling role of profits is eroded by widespread insider trading, fraud, and embezzlement (Quirk, 1997:9).

Financial Abuse

Financial abuse has the broadest meaning, encompassing not only illegal activities that may harm financial systems, but also other activities that exploit the tax and regulatory frameworks with undesirable results. When financial abuse involves financial institutions or financial markets, it is sometimes referred to as financial sector abuse. Financial crime, which is a subset of financial abuse, can refer to any non-violent crime that generally results in a financial loss, including financial fraud. It also includes money laundering (Boorman and Ingves, 2001:3). Financial institutions such as banks insurance companies, securities firms and financial investment management firms are particularly vulnerable to the money laundering.

Illegal money must be integrated into the legitimate financial system in order to be laundered. Money laundering can be done with or without the knowledge of the financial institution. Financial institutions may have three roles in money laundering: as a perpetrator, as a victim and knowing or unknowing instrumentality of crime. Money laundering affects financial
institutions in a legal sense because of the obligations placed on them by legislation and financially because of the need for compliance.

With the dismantling of exchange controls and the growing interpenetration of financial markets, access to one country's financial institution allows worldwide mobility of capital. Any country integrated into this global financial system is at risk of money laundering. Because of that, money laundering activities can occur in any country, but they may have a more significant impact on developing countries with relatively small or fragile financial systems or weak economies that are particularly susceptible to disruption as a result of illicit activities. They damage critical financial sector institutions and they may scare away foreign investors and reduce a country’s access to both foreign investments and foreign markets (Humphrey, 2007:7).

Money Laundering Through Banks

The banking system is one of the most important vehicles for money laundering. The complexity and international nature of the banking system allow money launderers to hide their illegal funds. The criminals use the banks to transfer the funds securely, quickly and with the appearance of legitimacy. In this respect, banking system can also provide them to convert funds into various products and move away from predicate offences. But the use of banks has been made more difficult in a number of countries by the introduction of anti-money laundering measures such as suspicious or significant cash reporting requirements and the disallowing of false names or anonymous accounts. These anti-money laundering measures introduced by many countries in recent years have forced money launderers to change their methods to some degree. While in many instances this has resulted in fairly basic changes, such as smurfing or using bank accounts of associates. Money laundering has in other instances become more sophisticated but the banking system remains one of the most important vehicles for money launderers. This can involve, for example, using banking bearer instruments such as bank drafts, telegraphic transfers to transmit funds internationally and the establishment of loan back schemes (McDonell, 1998:4).

Money laundering, whether criminal or corrupt, is carried out through the banks by using various instruments such as electronic payment systems, wire transfer and electronic money transfer, branchless banking, private banking, correspondent banking and offshore banking.

Electronic Payment Systems: Electronic Payment is a financial exchange that takes place between one party and another over electronic media. The instruments of this exchange are encrypted credit card numbers, electronic cheques or digital cash that is backed by banks. Electronic payment systems are characterized by large diversity in terms of access methods, transport methods (access to bank account, to card with electronic chip or to virtual currency account, etc.), charging methods (flat, pay per use, variable fees dependent on volume), and time of the payment settlement (prepaid, post paid, pay now). During payment, the payment systems are characterized by an on-line connection to the system provider who authorizes the transaction (Krzysztof, 2006:36). Choosing an electronic payment system for money laundering depends on the fact that the banks are generally concerned about the credit/fraud risk rather than the source of the funds as an indicator of money laundering. Because of that the criminals can launder their illegal funds by making large payments in excess of the amount due to which creates a large credit balance especially with credit cards and paying in cash. Making an overpayment and then asking for a refund cheque is an other way for laundering. Money deposit cards (smart cards) may also be used as a money laundering vehicle represent electronic cash form, conceptualized and developed as an alternative to the traditional financial instruments.
Smart cards are similar to credit cards, but contain money in the electronic form, which has been previously transferred from the user’s account on a micro chip that holds the value on the card and can be used as regular money in case the value is debited by the financial institution. There are certain factors that may increase the risk of smart card abuse for the purpose of money laundering, which makes these cards very valuable tool for this type of criminal activity, such as: removal or growth of the up-limit, direct money transfer from one card to another without a mediating financial institution (which unable control of the money flow), the utilization of cards outside from the issuer state, etc (Bjelajac, 2011:8).

**Wire Transfer and Electronic Money Transfer** : Wire transfer, also known as telegraphic transfer, is the process of transferring money from one institution or person to another. Wire transfer was elderly used by the telegraph companies that carried the wire transfers of money among their offices. Electronic money transfer is also a wire transferring method. It is the system of transferring money from one bank account directly to another without any paper money changing hands which is used for credit transfers and debit transfers. Wire and electronic money are quick money transfer processes which prevent the hassles of handling the large amount of cash money and ensure maximum security. Money wire transfers are characterized as the easiest and common used transfer methods within the money laundering activities. In other words, wire transactions, which are essentially unregulated, have emerged as the primary method by which high-volume launderers ply their trade. Suspect wire transfers are effectively hidden by the huge volume of legitimate transfers. There are about 700,000 wire transfers a day, of which perhaps from 0.05 percent to 0.1 percent represent money laundering in the U.S.A. The $300 million or less that is estimated to be laundered every day is dwarfed by the more than $2 trillion that is transferred by wire on an average day in the U.S.A. (US Congress, 1995:9).

**Branchless Banking** : Branchless banking is a strategy of distribution channels which are used to provide financial services and seeks to expand the concept of the traditional bank branch. This is done through the growth and development of technology. Although the branchless banking concept can stand alone as a strategy of distribution channel, completely independent and isolated from the traditional branch-based model, it can also be used to complement an existing network of branches, so that clients can be offered a wider variety of channels through which access can be granted to financial services. In general terms, the branchless banking model’s aim is that clients can use banking services regularly (and even during longer times) without the need to physically go to a traditional bank branch. The value of technologies is to support the banking services offering, and are part of the distribution channels which can be used, be them independently, or together to be part of the distribution channel strategy (Deloitte, 2012:4). The main branchless banking devices are the distribution channels such as the internet (home banking), mobile banking and the automatic teller machines (ATMs). The development of these alternative distribution channels has created new opportunities for criminals to misuse such technologies for the purposes of money laundering.

- **Internet (home banking)** : The internet which is used by the majority of the world’s population at work or in home life has become an important banking instrument because of its transaction opportunities including electronic money transfer, direct payment, taking deposits, issuing checks, buying securities, opening and closing accounts. Internet banking offers services to be provided from anywhere in the world. It makes the customers reachable by the banks all over the world without spending money on physical locations and allows customers to check their accounts and make transactions whenever they like. Internet banking instruments can be used both by a directly linked computer or by any computer in an internet cafe or somewhere else. But the nature of internet also makes it attractive criminals
by offering some possibilities for money laundering. That is, the bank can only assume that an account has been accessed by the original holder, routinely confirm the time of the transaction, the amount, or even the user with a name and the account number that has been used for the specific transaction. This implies that a money launderer can concurrently control a large number of accounts by conducting transactions from any place in the world, without drawing attention from the institution or several financial institutions who maintain these accounts (Bjelajac, 2011:14). By only transferring small amounts of money into that account, money launderers are likely to avoid suspicion from the banking authorities and, therefore, they will not question its origins. Once the money is contained within that account, the transferring of that money out into offshore accounts or to somewhere else, out of the control of the authorities involved, is a quick and easy process. Funds can be transferred at the click of a mouse and launderers use this to transfer the money to areas where the laundering of money is not under such strict regulation(Kochan, 2006:278).

- **Mobile Banking (MB)**: Mobile banking is a way for the customers to undertake some of their banking transactions on cell phones or other mobile devices. The customers’ busy and technologically oriented lifestyle makes MB a quite popular method which allows them to bank anytime and anywhere through their cell phones or other mobile devices. The main MB services are financial information, payments and money transfers. Mobile financial information services allow the users to view their personal accounts data and general financial information only and they are disallowed for any financial transaction. Mobile payment services is a more involved type of MB which allows to make payments, check balances, notify the bank of a lost or stolen credit card, stop payment on a check, receive a new PIN, or view a monthly statement, among other transactions besides viewing their personal accounts data and general financial information. And, by mobile money services, users may use their cell phones to transfer money between accounts in addition to information services and payment services. Some banks also send messages to the cell phones of their customers in order to alert them for the activities on their accounts such as deposits, withdrawals, and ATM or credit card uses. Mobile banking present opportunities for criminals to launder money by using wire and electronic transfers methods anywhere and anytime without seeing any bank officer. The World Bank estimates that global wire transfers exceed one quarter of a trillion dollars annually and the share of MB among these transfers is probably increasing together with the grow of mobile banking networks. If the MB services remain unregulated in this proces, it may enable money launderers to bypass regulated banks and their financial reporting requirements and exchange dirty money for digital value in the form of stored value cards or mobile payment credits. Moreover, with digital value instead of cash, they can instantly send—with a touch of a cell phone keypad—their digital value across the country, around the world, or to secret offshore bank accounts(Leyva, 2008:3).

- **Automatic teller machines (ATMs)**: ATM is a computerised machine that enables the customers of banks to perform several banking operations without the help of a teller such as to withdraw cash, make deposits, pay bills, obtain bank statements, effect cash transfers. It permits bank customers to gain access to their accounts with ATM cards/debit cards, credit cards and prepaid cards that permit cash withdrawal upto a certain limit during any time of the day or night. Money launderers using ATMs do not contact face-to-face with a curious teller. It is very difficult to identify the persons performing transactions on ATMs. which are linked networks around the globe. This makes the transactions of illicit funds hidden in an account in a bank around the world easier.
**Private Banking**: Private Banking are the services for the extremely wealthy clients. The big banks charge customers a fee for managing their assets and for providing the specialized services of the private banks. Private Bank services go beyond the routine banking services and include investment guidance, estate planning, tax assistance, off-shore accounts, and complicated schemes designed to secure the confidentiality of financial transactions. The attractiveness of the Private Banks for money laundering is that they sell secrecy to the dirty money clients (Petras, www.rense.com). Abuse of private banking services is one of the highlighted methods of money laundering. In case the basic principles of clients control are not respected within the working framework of the private banking institutions, money laundering and other financial abuses are facilitated. As proposed, this type of services offers individuals and legal entities with immense property, who use the benefits of this type of banking, greater discretion and insufficient legality control of their funds. Therefore, criminals, as well as politically exposed individuals, skillfully use and abuse private banking services, since they provide ideal prerequisites for Money laundering and other financial operations used to conceal and launder illegally acquired funds, and often unconsciously assist the investment and legalization of illegally acquired profits (Bjelajac, 2011:11).

**Correspondent Banking**: Correspondent banking is defined as the provision of banking services by one bank (the correspondent) to an overseas bank (the respondent) to enable the respondent to provide its own customers with cross-border products and services that it cannot provide itself, typically because it lacks an international network. Correspondent banking activity can include establishing accounts, exchanging methods of authenticating instructions and providing payment or other clearing-related services. A correspondent relationship can be based solely on the exchange of test keys, with cover for direct payment instructions being arranged through a third bank for credit to the correspondent’s/respondent’s own account in another jurisdiction. Activity can also encompass trade related business and treasury money market activities, for which the transactions can be settled through the correspondent relationship. A correspondent is effectively an agent for the respondent and executes/processes payments or other transactions for customers of the respondent. The underlying customers may be individuals, corporates or even other financial services firms. Beneficiaries of transactions can be customers of the correspondent, the respondent itself or, in many cases, customers of other banks. The facility for banks to process transactions with speed, accuracy and efficiency via correspondent banking relationships does, however, lead to money laundering risk. The vast numbers of payments being processed through the system, and the speed at which such payments must be made, makes it extremely difficult to identify and intercept suspicious payments. In particular, correspondents often have no direct relationship with the underlying parties to a transaction and are therefore not in a position to verify their identities. In addition, they often have limited information regarding the nature or purpose of the underlying transactions, particularly when processing electronic payments or clearing cheques. It is therefore primarily non-face-to-face business and must be regarded as high risk from a money laundering perspective (www.jmlsg.org.uk).

**Offshore Banking**: Offshore banking business is somewhat different from that conducted onshore. Though, in both cases, banks take deposits and make loans, offshore banks have virtually no checking deposit liabilities. Instead, their deposits are typically made for specific periods of time, yield interest, and are generally in large denominations. Offshore banking arose as a means to avoid a variety of banking regulations (Chrystal, 1984:10). Offshore banks are mostly set up in the countries of low tax jurisdiction. Investment interests paid by offshore banks are usually without tax deduction. There are some other advantages of offshore banks for their
mostly non resident customers such as; heightened privacy of their investments, less restrictive regulatory framework, low or none taxation, protection against local instability, easy access to foreign deposits and investments. Offshore banks are attractive to criminal organizations seeking to launder the proceeds from their illicit activities. They offer opportunities for creating byzantine financial trails and secretion of funds in places where they are relatively safe from identification and seizure by law enforcement. Many of the offshore banks also offer facilities for incorporation that are very attractive for individuals or organizations attempting to protect their anonymity and operate with a high degree of impunity and flexibility. In short, offshore banks are often characterized by “a minimum of transparency and a maximum of autonomy of private action(Blum and et al, www.imolin.org). This makes offshore banks become important and visible vehicles for money laundering.

Combating Money Laundering

International cooperation is neccessary to fight against money laundering which is also an international problem. In this respect, international efforts to combat financial system abuse has started in the late 1980s by recognition that the internationalization of trade and finance and advancements in communication technology may facilitate money laundering. Since then, countering financial crime, and money laundering became an integral part of the agenda of many international agreements.

The main international organization engaged in fighting against money laundering is the Financial Action Task Force (FATF). Some other important international agreements addressing money laundering are the United Nations Vienna Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (the Vienna Convention), the 1990 Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds of Crime. The Basle Committee on Banking Supervision, the European Union and the International Organization of Securities Commissions are also the financial institutions in which have strong roles on preventing and detecting money laundering.

Financial Action Task Force : The FATF was set up by the governments of the G-7 countries at their 1989 Economic Summit. It has representatives from twenty-four OECD countries, Hong Kong, Singapore, the Gulf Cooperation Council, and the European Commission. The Task Force was given the responsibility of examining money laundering techniques and trends, reviewing actions that had already been taken at national or international levels, and setting out measures that still needed to be taken to combat money laundering. Since its creation, the FATF has been at the forefront of measures designed to counter criminal attempts to use the financial system to further criminal purposes. Most notably, in 1990 the FATF established a series of money laundering recommendations. In 2001, they established a series of special recommendations on the prominent threat of terrorist financing, collectively known as the 40+9 recommendations whose aim was to unite anti-money laundering and terrorist financing efforts into one universal instrument (www.anti-moneylaundering.org). The recommendations can be grouped as:

- the criminalization of money laundering,
- the seizure and confiscation of money laundering proceeds,
- suspicious transaction reporting, and
- international cooperation in the investigation, prosecution and extradition of crime suspects.
The Vienna Convention: The Vienna Convention, adopted in December 1988, lays the groundwork for efforts to combat money laundering by creating an obligation for signatory states to criminalize the laundering of money from drug trafficking. It promotes international cooperation in investigations and makes extradition between signatory states applicable to money laundering. And, it establishes the principle that domestic bank secrecy provisions should not interfere with international criminal investigations. It is the first UN convention to define the concept of “money laundering,” even though it does not use that term, and it calls on countries to criminalize the activity (The World Bank and IMF, 2005:208).

European Union Directive: Adopted in November 1990, the Council of Europe Convention establishes a common criminal policy on money laundering. It sets out a common definition of money laundering and common measures for dealing with it. The convention lays down the principles for international cooperation among the contracting parties, which may include states outside the Council of Europe. Its scope is not limited to money from drug trafficking. In June 1991, the Council of the European Communities adopted a directive on the “Prevention of the Use of the Financial System for the Purpose of Money Laundering.” This directive was issued in response to the new opportunities for money laundering opened up by the liberalization of capital movements and crossborder financial services in the European Union. The directive obligates member states to outlaw money laundering.

Basle Committee statement of principles: In December 1988, the G-10’s Basle Committee on Banking Supervision issued a “statement of principles” with which the international banks of member states are expected to comply. These principles cover identifying customers, avoiding suspicious transactions, and cooperating with law enforcement agencies. In issuing these principles, the committee noted the risk to public confidence in banks, and thus to their stability, that can arise if they inadvertently become associated with money laundering. In addition to this, The Core Principles for Effective Banking Supervision, approved by the Basle Committee in September 1997, state that "Banking supervisors must determine that banks have adequate policies, practices and procedures in place, including strict ‘know-your-customer’ rules, that promote high ethical and professional standards in the financial sector and prevent the bank being used, intentionally or unintentionally, by criminal elements(BIS, 1997).

Principles and Control Measures at Combating Money Laundering

Money laundering is a complex economic crime which has many negative effects on the increasingly interconnected growing financial systems of the world. It cannot be effectively controlled without the international cooperation of finance ministries, central banks, financial institutions, and financial regulators. But, the legal enforcement and punishment is the most effective measure against money laundering. In this respect, countries must criminalize all forms of money laundering, and establish efficient mechanisms and institutions capable of enforcing regulations.

Second, in order to prevent them from being used by criminals for money laundering the financial institutions should; (i) know and record the true identity of their customers (know your customer), (ii) record the details of transactions (record keeping), (iii) report suspicious transactions and activities (reporting information), and (iv) respond to information requests from appropriate government authorities.

- Know Your Customer: The objective of doing this is to enable the financial institutions to have positive identification of its customers by collecting some proofs from their customers.
such as; a photograph, a documentary proof of personal identification and address proof. Customer is commonly be defined as: a person or entity that maintains an account and/or has a business relationship with the financial institution; one on whose behalf the account is maintained (i.e. the beneficial owner); beneficiaries of transactions conducted by professional intermediaries permitted under the law, and any person or entity connected with a financial transaction which can pose significant reputational or other risks to the bank, say, a wire transfer or issue of a high value demand draft as a single transaction. A “know your customer policy” helps the financial institutions to prevent from unwittingly used for the transfer of deposit of illegal funds. In other words; identification of customers enables to control financial frauds, identify money laundering and suspicious activities, and monitoring of large value cash transactions. “Know Your Customer” also helps the financial institutions to understand their customers and their financial dealings to be able to serve them better

- **Record Keeping**: This is is a fundamental part of combating money laundering and without it many of the requirements cannot be met (Hopton, 2009:113). In this respect, whenever a bank establishes a business relationship or concludes a transaction with a client, whether the transaction is a single transaction or concluded in the course of a business relationship which that bank has with the client, the bank must keep record of the identity of the client and identity of the persons acting on behalf of the client, the nature of that business relationship or transaction, all accounts at that bank that are involved in and the name of the person who obtained those informations. The records are to be kept at least five years after a business relationship is terminated, or a transaction concluded in order to the FATF regulations.

- **Reporting Information**: This plays an important role in combating money laundering. Financial institutions must, within the prescribed period, report the prescribed particulars concerning a transaction concluded with a client if in terms of the transaction an amount of money in excess of the prescribed amount for their countries. This also includes detailed information about transactions and activities that are or appear to be suspicious. If a financial institution suspects or reasonably ought to have suspected that a transaction has been made for money laundering purposes it must be reported. But the reporting entities must understand the normal activities of their each for each customer and how the transaction differs from those and they should bring together of all relevant factors including knowledge of the person’s or person’s business or background as well as any behavioral factors to decide reporting this transaction.

- **Respond to Information Requests**: All major jurisdictions have agreed to limit their bank secrecy rules to prevent the financial institutions to be laundered the money of criminals through them. In this respect, upon receiving an information request from appropriate government authorities, a financial institution should respond quickly to information requests from appropriate government authorities in money laundering related cases.

Third, governments should establish systems for identifying, tracing, freezing, seizing and forfeiting assets. As a corollary to this principle, governments need to be in a position to cooperate effectively with their international partners to exchange evidence and share seized proceeds of crime.

Finally, as countries have increased regulations and diligence within financial institutions, criminals have learned to use other, less regulated industries to launder their money. Therefore, it is recommended that governments apply these countermeasures and diligence to non-financial
sectors and businesses, as appropriate, and remain vigilant with respect to emerging threats (Myers, 1998:6).

**Conclusion**

The criminals need a process in order to use efficiently the money which is generated from their criminal activities. This process is called “money laundering” by which huge amounts of illegally obtained funds are given the appearance of having originated from a legitimate sources. Money launderers, who are sometimes assisted by financial experts, can use highly sophisticated methods in order to introduce illegally generated money into legal economic flows. Money laundering threatens the credibility and effectiveness of financial systems and it has many negative effects on countries economic structures. It may cause serious macroeconomic distortions and misallocation of resources and capital around the world, and hinder economic growth and reputation.

The banking system is one of the most important vehicles for money laundering. There are certain banking instruments that appear potentially susceptible and exposed to various abuses related to money laundering such as electronic payment systems, wire transfer and electronic money transfer, branchless banking, private banking, correspondent banking and offshore banking. The complexity and international nature of the banking system allow money launderers to hide their illegal funds. The criminals use the banks to transfer the funds securely, quickly and with the appearance of legitimacy. The laundering can happen in every country quickly, easily, with the ability to transferring money through several countries by these banking instruments.

International cooperation is necessary to fight against money laundering which is also an international problem. It cannot be effectively controlled without the international cooperation of finance ministries, central banks, financial institutions, and financial regulators. The legal enforcement and punishment is the most effective measure against money laundering. In this respect, countries must criminalize all forms of money laundering, and establish efficient mechanisms and institutions capable of enforcing regulations. In order to prevent them from being used by criminals for money laundering the financial institutions should; know and record the true identity of their customers, record the details of transactions, report suspicious transactions and activities and respond to information requests from appropriate government authorities.

As a result, finance ministries, central banks, financial institutions, and financial regulators worldwide must continue to focus on money laundering and the efforts to combat financial abuse, including money laundering must be strengthened.

**References**