МЕЃУНАРОДНА НАУЧНА КОНФЕРЕНЦИЈА БЕЗБЕДНОСТА И ЕВРОАТЛАНТСКИТЕ ПЕРСПЕКТИВИ НА БАЛКАНОТ

ПОЛИЦИСКИТЕ НАУКИ И ПОЛИЦИСКАТА ПРОФЕСИЈА (СОСТОЈБИ И ПЕРСПЕКТИВИ)

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POLICE SCIENCE AND POLICE PROFESSION (STATES AND PERSPECTIVES)

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MONEY LAUNDERING ON FINANCIAL MARKETS

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Abstract

According to global statistic there are 1.5 trillion dollars laundered annually. This remarkable figure and the fact that money laundering directly affect the integrity and functioning of financial systems, financial stability, general economic and social of the entire development show why the concerns about this phenomenon are growing on global level. The purpose of this paper is to show the role of financial markets in the occurrence of money laundering. According to the analysis of the typology of the FATF on money laundering in the financial markets, 7 criteria of the structure of the typology are given. Typology of financial markets may be considered according to: financial products, methods of payment, professional intermediaries, clients, and types of accounts, setting values and neglectful financial officers.

This paper, except analysis of the use of certain forms of money laundering in the financial markets, will provide guidelines to improve existing measures to prevent money laundering in the financial markets. Also new measure instruments will be proposed, which will be summarized in the paper from the comparative analysis, and will be able to accommodate and implement in the region. Basic normative for undertaking any serious social engagements for the reduction and combat with this phenomenon remain for a unified system which will provide collecting and update the available data-bank on money laundering at national level.

Lack of knowledge of functioning of financial markets is one of the main problems for detecting the phenomena money laundering and one of future directions is to organize knowledge training for appropriate authorities (financial investigators) to understand the roots of functioning of financial markets, financial institutions, financial processes, changes and events.

Keywords: Financial markets, money laundering, the structure of typology, financial stability, social development, finance officers, etc.

Role of the Financial Markets

Financial markets as complex financial institutions represent peculiar bodies which channel the blood stream (finance) in the economy. To understand the movement and fluctuations in financial markets is necessary to see the changes not only in the economy, but, even more, in all segments of social life. Within the global finance, money laundering is one of the activities that is hardest to be recognized and understood.

Financial markets are transmission mechanism or place where exchange occurs or redistribution of excess funds to those who need or have lack of funds. Movement of funds from those who need to those who have surplus of funds occurs in two ways:

1. Credit-deposit mechanism through the banking sector, and
2. Issue of securities by those who need funds.

According to the U.S. Congress[1] financial market has several basic functions such as:

1. Method of collecting funds by corporations and governments
2. Providing a good allocation of capital to companies and various projects
3. Increase of savings by the population
4. Opportunity for investors for potential profit in the markets
5. To generate increased rate of returns and employment

Development of the financial markets opened the opportunity to develop types of financial instruments. The financial market is a specific market because it deals with specific goods (money, capital short and long term securities, currencies and foreign currency), in a specific manner and under specific conditions. The most famous proprietary instruments are stocks and bonds with the longest term. Beside them other types of instruments such as derivatives have developed, and they contribute to increase profits and the risk. Financial market serves also to finance investments, including: direct, indirect and internal funding. Financial market consists of three segments (each with specific functions):

1. Money market:
   - short-term securities and
   - short-term bank loans
2. Capital market
   - short-term securities (stocks and bonds) and

[1] Frank Fabozzi and others, Capital markets, Institutions and Instruments, Prenoce and Hall, 1996, p.16.

- long-term crediting of investments (loan capital)

Foreign currency exchange

- short-term demands in foreign currency

The modern form of financial market exists since the late XIX century, when central banks in the market countries established and organized first, national and later, international financial markets. Earliest beginnings of organized market transactions have existed for more than 2,000 years in the Roman Empire. Following the fall of the Roman Empire financial market didn't exist for almost tens of centuries. Even at the late XIII and early XIV century, with the development of Italian cities Venice, Genoa and Florence financial markets began to be established and operate again. At the end of XV and early XVI century national financial markets were established in London and Paris. At the end of the XVI century, the financial market established in Amsterdam gets characteristics of an international financial market. Today, the most significant financial markets are in London, New York, Frankfurt, Tokyo and other towns.

Money Laundering on Financial Markets

Financial markets globally are characterized by diversity and ease of trading (via electronic trading for example), and the ability to do transactions in markets with strong investor protection. These characteristics make the financial market attractive for a common investor who has an interest and looks for a good profit of its funds. Also the size or the volume of transactions which could be made in many markets at the same time make this market to be a potential mechanism for money laundering coming from criminal sources. Speaking in general, this type of market allows criminals on the one hand concealing the illegal funds, and on the other hand once they enter them in the market, to also generate income from them.

Use of the financial markets has several advantages for money launderers because the electronic way of trading reduces the risk to be detected or at least, provides dislocation of the alternative market platforms:

• The risk comes from the easy access to the market;
• Customers are anonymous;
• Connection is provided to all markets in the world;
• Participation in the financial markets is cheap;
• Transactions are made on the basis of the consolidated accounts "day trading", so that they often represent a "black box" for the financial investigators;

• The small number of proven cases of money laundering points to the fact that the secondary market is particularly suitable soil for trading;

• High concentration of money in one place, greater frequency of transactions, fast flow, a large number of instruments and positions available to the participants and a global presence.

Money laundering in the financial markets must be considered from two aspects, namely:

1. Money laundering on the financial market (participants are there only to convert their illegal money into legal and they become legitimate investors) and,

2. Manipulation of the financial market (participants are in this market for manipulation which can, but needn't be necessarily money laundering). According to the FATF typology of money laundering in the financial markets, the structure of typology is divided into seven criteria including:[2]

1. Financial markets;
2. Financial products;
3. Methods of payment;
4. Professional intermediaries;
5. Customers and accounts;
6. Price transparency;
7. Unscrupulous employees.

1. Financial markets

Trading or transmission of transactions can be conducted in the traditional way through *the traditional market* and/or over-the-counter (OTC) market. The first market is well organized with less room for criminals with a history list of transactions and so on, while the second is more speculative and leaves more room for money laundering. The lack of transparency is considered as the main reason that allows money laundering. In some cases, transfer may take place even the individual does not own account in the financial institution, for example, through breach in the data security of the financial institution, or through transfer of an instrument similar to the holder of the funds. Payment for transferable securities may also be made in cash and there is no trace of the transfer made for such an order. In another case fraud can be made through transfer of securities with special orders that are not numbered in the general statements, and thus at the end of the year, banks do not include them in their bank balance sheets.

[2] Money laundering in security sector, FATF, 2009, p.14.

2. Money laundering through financial instruments

Diversity of the financial instruments provides an opportunity for money laundering through them and the opportunity is really huge. According to FATF basic division of financial instruments is as follows: 1) transferable securities (stocks, bonds, certificates of deposit and promissory notes), (2) shares in investment funds (open, closed and mixed funds), and (3) derivatives (options, futures, forward, swaps, commodity derivatives and foreign exchange derivatives). The attractiveness of financial instruments is great for the speed and because there is no risk in the dematerialization of securities. Furthermore they are easily transmitted and through them the illegal money can easily pass through the first two phases: investing and piling up. Possible indicators for this type of money laundering are:

1. Depositing of large amounts of securities, followed by a quick sale on the open market;
2. Request for payment in cash of securities without depositing, frequent depositing of securities of a bearer to an account through financial intermediaries (especially if the amounts are below the legal threshold in terms of control of money laundering);
3. Depositing of securities on an account of other parties through financial intermediaries (on an account on behalf of another person or depositor different from the name of security, if there are any and registered);
4. Payment of proceeds from the sale of securities on behalf of third parties;
5. Unclear or incoherent reasoning and method of acquiring the securities;
6. Securities of a person who is the actual representative of the safety mechanisms.

3. Methods of payment

The risks are practically identical, as in other spheres of trade in goods and services. Methods of payment can be divided into:

1. Payments in cash;
2. Payments or transfers of value of unexplained origin of money.

Just the specifics of trading in financial markets contribute to the speed and simplicity in favor of money laundering. Upon accumulation the funds quickly and easily are used for buying and selling securities and money are transferred to other accounts.

4. Financial Intermediaries

Financial intermediaries are licensed, legitimate participants in the financial markets. These include brokers, dealers, financial advisors, banks, investment funds, and insurance companies and so on. They consciously or unconsciously may participate in the chain of money laundering. Also, some of them offer anonymity for customers or do not disclose information and they do not implement the obligatory activities associated with "know your customer". Many of the intermediaries do not receive cash payments for transactions and most investors have to open accounts with their intermediaries. New internet opportunities for opening an account represent a way, through direct access to investors, to enable transactions in financial markets, which complicates the monitoring or identification of suspicious transactions. This only underlines once again that financial intermediaries are key partners in cases of detecting money laundering.

5. Customers and accounts

Typical representatives of this group of participants in the financial markets are trusts, humanitarian and nongovernmental organizations, fictitious funds, shell companies and hedge funds. This typology of money laundering is most often recognized in the stages of accumulation and integration. Some financial markets require information about the clients and accounts, but in some of them, users who benefit from the accounts are unknown and with masked identities. Clients use these financial markets because under normal conditions their access or participation in the financial system would be restricted or prohibited.

Some of suspicious transactions relating to our clients and their accounts under the FATF are:

• At the time of opening an account, the person refuses to provide information to do CDR / KYS procedure (for example, employment, previous financial relations, etc.), especially in terms of end owners;

• A person opening an account does not want to provide complete information on the nature and objective of the client's business, on the previous financial relations, on the activity of the account, about managers of the company or business location; and

• Trust or the end owner of the account is located in an area with high risk.

6. Transparency of prices

Always when trading in the financial markets there must be transparency in prices. Also "short sale" can be one of the abuses in the financial markets, and related to the transparency of prices. Prices in the financial markets can be used for money laundering, especially in the financial markets which are not regulated or the markets where there are no traditional pricing mechanisms. According to FATF, there are two possible states indicated for money laundering through prices as follows:

- Transactions in illiquid securities, for which it is difficult to determine the market value;
- Transactions in which the established price significantly deviates from the previously established trend of prices.

These clues are intertwined also with certain categories of frauds as market manipulation and therefore create confusion and misunderstanding among researchers in the financial markets, and those institutions dealing with the prevention of money laundering.

7. Unscrupulous employees

Basically people are main factor for making fraud and money laundering in the financial markets. Unscrupulous individuals are essential for detecting money laundering in the financial market. According to FATF, indications of money laundering by employees in financial markets are as follows:

1). Excessive enthusiasm in making transactions for individual clients;

2). Desire to work unsupervised and avoid communication with colleagues;

3). Focus on achieving fulfillment of the regulatory or business standards;

4). Excessive pressure on fulfillment of the objectives;

5). Standard of living and way of life are with higher costs than the annual income;

6). Avoidance to take annual leave;

7). Known “mended life” situation, etc.

According to APG member countries, common indicators to detect suspicious transactions in the financial markets can be grouped as follows:

• Change of ownership share in order to transfer wealth across borders;

• Purchase of long-term investment in a short term period;

• Opening several accounts;

• Use of brokerage accounts as long-term depositary of accounts for funds;

• Realization of transactions involving third parties or nominated persons;

• Engaging in market manipulation, for example, "pump and dump" schemes, and

• Engaging in "boiler room" operations.

Measures and Guidelines to Combat Money Laundering on Financial Markets

One of the goals of this paper is to raise awareness of the opportunity offered by the financial market for money laundering. One of the future directions to fight against this phenomenon on the financial markets is raising awareness among the financial intermediaries (banks, investment funds and pension insurance funds, leasing companies) of money laundering and globally through the exchange of experiences through case study analysis. Basic scale of norms for taking any serious social engagements for the reduction and eradication of this phenomenon is creating a system that will provide uniform collectivizing and updating of the available data-bank on money laundering at the national level.

As one of the important measures in the context of data collection, is the proper implementation of financial analysis, which requires acceptance of data, information, comparison, identification of inconsistencies, reconstruction of the event and identification of money launderers, as well as preparation of a report and verification of suspiciousness of an analyzed transaction.

Ignorance of the functioning of financial markets is one of the major shortages to timely detect the phenomenon of money laundering and one of future directions is to organize and provide training for the competent authorities, stakeholders and financial investigators for basic and comprehensive knowledge about functioning of the financial markets, financial institutions, financial processes, changes and occurrences.

Conclusion

The appearance of money laundering through financial markets really is a global threat. Complexity of the financial markets facilitates the process of money laundering for the benefit of criminals. In a word, money laundering has already been adopted in the financial markets, both as a primary activity and a secondary activity of criminals through the market manipulations. According to the typology of the FATF, money laundering is

articulated through the financial markets, financial products, methods of payment, professional intermediaries, customers and the types of profiles, prices, unscrupulous employees, etc., and implies strong distortions on efficient functioning of the financial markets, economic system, security system, macroeconomic policies and, in general, on the social existence. Financial markets are complex structures with complex infrastructure and a large number of financial instruments and participants which is cohesive with the nature of money laundering: a way of distractions of the attention of the financial investigators in favor of the money launderers. Basic shortage in case of monitoring and reducing the phenomenon of money laundering is ignorance of the way of functioning and the nature of financial markets in order to underline and detect the opportunities of money laundering. Of utmost importance is to turn the focus of attention to small countries with poorly developed financial markets (such as the Republic of Macedonia and the region), where there is poor flow of information for the participants in the market or imprecise detection of clients and such markets, and because of poor development, there is space for putting any customers, just because of the existence of any movement on it.

Proving the money laundering in financial markets is extremely difficult because most of the conclusions are drawn based on the statements of the participants (appropriate information) or the conclusions drawn based on the amount of information (manipulation). Finally, money laundering in the financial markets is very important to be studied in order to influence the reduction of this phenomenon, as it generates negative effects on the economy by creating a short-term unstableness and long-term distrust among economic agents toward the market.

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