Raising Awareness and Sensibility in the Anti-Money Laundering and Countering the Financing of Terrorism Network

by

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To

My beloved Father, Mother,

Spouse and Children

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CERTIFICATION PAGE

I, Sharipov Mirzosharif (student ID: 51215600) hereby declare that the contents of this Master's Thesis/Research Report are original and true, and have not been submitted at any other university or educational institution for the award of degree or diploma. All the information derived from other published or unpublished sources has been cited and acknowledged appropriately.

SHARIPOV Mirzosharif, September 1, 2017

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LIST OF ABBREVIATIONS

ABA-American Bar Association;

AML-Anti-Money Laundering;

AML/CFT-Anti-Money Laundering and Countering the Financing of Terrorism;

AUSTRAC-Australian Transaction Reports and Analysis Centre;

BGFRS-Board of Governors of the Federal Reserve System;

BSA-Bank Secrecy Act;

CD-Compact Disc;

CDD-Customer Due Diligence;

CDB-Bankers Code of Conduct;

CFATF-Caribbean FATF;

CI-Criminal Investigation;

CMIRs-Reports of International Transportation of Currency or Monetary Instruments;

CPA-Certified Public Accountant;

CPS-Crown Prosecution Service;

CTR-Currency Transaction Report;

DBA-Drug Enforcement Agency;

DNFBPs-Designated Non-Financial Businesses and Professions;

ESAAMLG-Eastern and South Africa Anti-Money Laundering Group;

EU-European Union;

FATF-Financial Action Task Force;

FBARs-Foreign Bank and Financial Account Reports;

FBI-Federal Bureau of Investigation;

FDIC-Federal Deposit Insurance Corporation;

FIU-Financial Intelligence Unit;

FinCEN-Financial Crimes Enforcement Network;

FIs-Financial Institutions;

FSA-Financial Services Authority;

FSRB-FATF Style Regional Body;

FY-Fiscal Year;

GBP-Great Britain Pound;

HM-Her Majesty;

ICE-HSI-Immigration and Customs Enforcement - Homeland Security Investigations;

ICRG-International Co-operation Review Group;

IMF-International Monetary Fund;

IRS-Internal Revenue Service;

JMLIT-Joint Money Laundering Intelligence Taskforce;

LEAs-Law Enforcement Agencies;

MENAFATF-Middle East and North Africa FATF;

MLRO-Money Laundering Reporting Officer;

ML-Money Laundering;

MLA-Mutual Legal Assistance;

MONEYVAL-Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism within the Council of Europe;

MSBs-Money Service Businesses;

NAMLS-National Anti-Money Laundering Strategy;

NCA-National Crime Agency;

NCIS-National Crime Intelligence Service;

NCUA-National Credit Union Administration;

NRA-National Risk Assessment;

NTFIU-National Terrorist Finance Investigation Unit;

OECD-Organization for Economic Co-operation and Development;

OCC-Office of Comptroller of the Currency;

POCA-Proceeds of Crime Act;

PPP-Purchasing Power Parity;

RBA-Risk-Based Approach;

RCPO-Revenue and Customs Prosecution Office;

RECS-Recommendations;

RMLOs-Residential Mortgage Loan Originators;

SAR-Suspicious Activity Report;

SBA-Swiss Bankers Association;

SFO-Serious Fraud Office;

SOCA-Serious Organized Crime Agency;

STR-Suspicious Transactions Report;

SWIFT-Society for Worldwide Interbank Financial Telecommunication;

TF-Terrorism Financing;

UK-United Kingdom;

UN-United Nations;

UNSCR-United Nations Security Council Resolution;

US-United States;

WGEI-Working Group on Evaluations and Implementation;

WGTYP-Working Group on Typologies;

WGTM-Working Group on Money Laundering and Terrorism Financing;

8 300 Reports-Reporting Cash Payments of over USD 10 000;

18 USC 1956-Laundering of Monetary Instruments.

ABSTRACT

The purpose of this research was to analyze the interaction between the Financial Intelligence Unit and financial institutions when detecting and preventing the promotion of money laundering actions. More specifically, the study aimed at exploring tacit nature of relationships between these entities. With the aim to match the goals of this study three major tasks were pursued: (i) a historical account of the issue; (ii) a detailed examination of documents from the Financial Action Task Force; and analytical framework, the agency theory, was used when conducting analysis. The study found that there is a lack of sensibility on how Financial Intelligence Unit and financial institutions treat the Financial Action Task Force's standards. On the basis of these analyzes a set of recommendations that could help to promote awareness and sensibility in the anti-money laundering and countering the financing of terrorism network, were developed.

Key terms: money laundering, terrorist financing, sensibility, Financial Action Task Force, awareness, Financial Intelligence Unit, financial institutions.

CHAPTER 1

INTRODUCTION

1.1. Introduction

Financial crimes are as old as organized economies themselves. The need to hide income is inherent in criminals. Nevertheless, offenders prefer to use their illegal proceeds at any time and how they like. In the last three decades of the 20th century, accumulation of enormous capital movements from illegal markets, in particular the drug trade, were one of the many factors driving legitimate economies into danger.

Illegal activities of empowered criminal groups represent a threat to society so weighty they could destabilize not only one country's order, but also that of the whole world (Pieth & Aiolfi, 2004). Seizure and forfeiture mechanisms for dealing with the problem of ill-gotten gains have not been sufficient for tackling the problem. Therefore, the emerging threats to the integrity of the international financial environment were an impetus for members of global society to, by the end of the 20th century, initiate countermeasures for stopping the problem of using the global financial framework for illegal purposes.

This raises a question as to why the above-mentioned efforts had not been considered until the late 20th century. One possible answer is that deregulation and globalization of financial markets at that time worked both for illicit and licit operators (Pieth & Aiolfi, 2004). Additionally, considerable growth in the amount of international money transactions and the availability of high-tech solutions provided a platform not only for legitimate business operators, but also for illegitimate ones.

However, the measures developed at the national level to manage illegal aspects of financial deregulation and globalization of financial markets has impeded countries in their efforts to keep pace with liberalization of the financial environment. Thus, the

traditional crime-solving methods suggested for financial supervisors and law enforcement authorities were less efficient (Pieth & Aiolfi, 2004). Likewise, territorial factors and cumbersome cooperation procedures between countries caused additional difficulties when transnational illegal activities represented a concern.

The exponential growth in dirty dealings, especially drug dealings, posed many concerns for countries, especially the United States (US), which was the first country to initiate a "War on Drugs," in 1971 (Lilley, 2006). The initiative, introduced by US President Richard Nixon, sought to find alternative methods of coping with the illicit drug trade. The growing number of drug users in the country in the aftermath of the Vietnam War gave rise to this sentiment (Pieth & Aiolfi, 2004).

The idea of "follow the money," suggested by Western countries, to cut off drug dealers at the head with the use of forfeiture mechanisms was just the beginning of dealing with illegal drug-related activity. The next step was to enforce that financial institutions (FIs) establish and maintain a proper "paper trail" regarding the transactions they carried out, especially if they were conducted in cash. According to Pieth and Aiolfi (2004), owing to the realities of that time, it was recognized that the above methods would constitute a coherent policy if they could beapplied worldwide.

Considering the differences of each country's legal framework, the only way to impel other states to accept similar policies to those established in the US was by creating a platform in which all countries could be members. To this end, the United Nations (UN) was the only venue in which gatherings to treat illegal drug-related problems could find practical solutions, whereas the body was not regarded by strategists in the North s a place to enforce implementation of worldwide policies on drug-related offenses (Pieth & Aiolfi, 2004).

While UN regulations dealing with narcotics were already in place, no emphasis was given to the proceeds from drug-related crimes (Pieth & Aiolfi, 2004). In other

words, attention needed to move from illicit drug dealing to the profits it generated. Eventually, it shifted toward techniques used to transform illegal proceeds from drug-related offenses into legally obtained funds. While the UN was taking actions against drug-related offenses, no actions were yet developed toward illegally obtained funds. This made the US the only country that sought counteractive measures against what eventually came to be known as money laundering (ML).

Members of international society considered legalization of illegal proceeds (i.e., ML) a key issue because it could lead to long-lasting consequences, such as establishment of a platform for disguising assets and the ways in which they were generated. ML could also fuel illegal undertakings and allow these to operate and expand their activities. Thus, left unchecked, ML could erode the integrity of the national and global financial environments (Pieth & Aiolfi, 2004).

This chapter begins with a brief introduction of the research topic, followed by a number of subsections to describe the concept of ML, provide a brief account of the Financial Action Task Force (FATF), establish background knowledge with regard to interaction between the Financial Intelligence Unit (FIU) and FIs, shed light on the history of the FIU, and discuss the dilemma inside the anti-money laundering and countering the financing of terrorism (AML/CFT) network. The chapter then continues with a statement of the research problem and a description of the background and need for additional research in this field. The following section gives an account of the research questions and presents an overview of the methodologies used in the present study. The last section summarizes the chapter.

1.1.1. Concept of money laundering

Lilley (2006) argued that ML, which was used as a technique to disguise assets from illegal drug trading, now represents a complicated scheme that could help conceal

funds generated from a variety of illegal undertakings apart from drug dealing. Zubkov and Osipov (2008) pointed out that ML can be explained as the transformation of illegal proceeds into legally obtained funds. The term ML thus describes the process by which illegal proceeds are cleaned so they are, or at least appear to be, legitimate money with no signs of criminal origins (Booth et al., 2011).

1.1.2. Financial Action Task Force

Considerable efforts have been implemented with the aim of tackling the ML phenomenon. All the initiatives countries had taken over the years spilled over in creation of a unique ad-hoc body, which was to remain permanent and establish itself as the agenda-setter for preventing ML and correlated offenses (Pieth & Aiolfi, 2004). Today, this organization is known as the FATF. Its foundation was vitally important in setting up a comprehensive and consistent framework of measures that countries should implement to combat ML and other threats to the integrity of the international financial environment.

The FATF is an intergovernmental body established in 1989 by the G7 member countries. Its objectives are to set standards and promote effective implementation of legal, regulatory and operational measures for combating ML, terrorist financing (TF) and other such threats that have potential to manipulate the international financial environment for illegal purposes. The FATF is a policy-making body that works to generate necessary political will to bring about national legislative and regulatory reforms in these areas.

It has developed a series of recommendations, which United Nations Security Council Resolution (UNSCR) 1617 in 2005 recognized as international standards in the AML/CFT field. These recommendations form the basis for coordinated response against misuse of the international financial system. First issued in 1990, the FATF's 40

Recommendations were revised in 1996, 2001, 2003 and most recently in 2012 to ensure they remain up to date and relevant.

The FATF monitors its members' progress in implementing necessary measures, reviews ML and TF techniques, and develops countermeasures against misuse of the international financial framework. In collaboration with other international institutions, it works to identify national-level vulnerabilities, in seeking to guard against such misuse. These days, the FATF's 40 Recommendations are recognized and endorsed by nearly 200 jurisdictions (FATF, 2017) as international standards in the AML/CFT area. As noted by Hopton (2009), almost all jurisdictions introduced the FATF standards into their national legislations, as these recommendations represented a comprehensive and consistent approach countries could implement for AML/CFT objectives.

1.1.3. Financial Intelligence Unit and FIs

Considering the context of the present study, this research was, among other tasks, carried out to illustrate how cooperation is established among the members of the AML/CFT network, which were referred to the FATF, national governments, competent authorities and FIs. The FATF's task in this network is to establish a comprehensive framework guarding against misuse of the international financial system, and which should be implemented through its recommendations. Subsequently, national governments should bring their legislation in line with the FATF standards, and ensure all the measures indicated in the recommendations are effectively implemented.

Competent authorities in each country are tasked with putting all the FATF's 40 Recommendations, and national regulations drawn on those standards, into practice. Meanwhile, FIs are regarded as gatekeepers in the fight against ML and associated offenses (Lilley, 2006). In other words, they should stay at the forefront for a legitimate

financial sector not to be misused, and support the competent authorities in fulfilling their duties.

More specifically, this study was conducted for establishing discussion on the interaction between the FIU and FIs. The term “financial institutions” herein refers to banks, which are qualified as FIs in the glossary of the FATF’s 40 Recommendations (2012). The present study does not take into account other financial activities not qualified as banking ones. FIs in particular cases are referred to as “reporting entities” because of the nature of the tasks they perform. The term “competent authorities” refers to all authorities in charge with the AML/CFT.

A look at the context of the FATF standards may help illustrate the body’s goals. The recommendations require countries to bring their legislations in line with FATF standards and ensure a high degree of cooperation among the competent authorities and FIs. Among other tasks, as Pieth and Aiolfi (2004) noted, countries should ensure FIs were subject to adequate regulation and supervision for AML/CFT purposes. The recommendations needed countries to ensure FIs were legally obligated to submit suspicious transaction reports (STRs) to the FIU upon suspicion that funds were either illegal proceeds or related to TF.

The exchanges of intelligence and mutual legal assistance for AML/CFT purposes were regarded as an additional requirement of the FATF standards. This was driven by the fact that productive exchange of intelligence could help consolidate international efforts toward better understanding and implementation of the standards.

As Ryder (2012) stated, countries’ national AML/CFT systems should be driven by a succession of competent authorities divided into three categories: primary, secondary and tertiary. Primary authorities are countries’ finance departments, which oversee the national AML/CFT policies and its implementation; their departments of justice, which carry out the enforcement procedures for violation of AML/CFT

regulations; and their foreign ministries, which deal with international obligations regarding implementation of the FATF standards.

These primary authorities need to be supported by secondary ones, such as law enforcement bodies, financial regulators, and countries' FIUs, and with the tertiary authorities represented by members of professions under potential threat from illegal transactions. These include banks, all other FIs, nonprofit organizations, and designated non-financial businesses and professions (DNFBPs). According to the glossary of the FATF's 40 Recommendations (2012), these are casinos, real estate agents, precious metal dealers, lawyers, notaries, and other independent legal professionals and accountants.

1.1.4. History of the FIU

As the FIU is one of the target subjects of this study, this section presents a detailed account of the history behind its foundation. The idea of establishing the FIU, as reported by the International Monetary Fund (IMF) and World Bank (2004), was initiated when countries developed their strategies for combating ML, and identified that law enforcement bodies had insufficient access to FI intelligence. As a result, considering the conditions, there was need for FIs to be actively involved in combating ML; this could help in handling their activities. This suggested a body should be established to cooperate with and supervise FIs, as well as receive and manage STRs (Pieth & Aiolfi, 2004).

The FATF's 40 Recommendations released in 1996 left the need to choose the recipients of STRs to member countries, which should decide whether to establish an FIU or report suspicious transactions to law enforcement bodies. In some countries, STRs were sent directly to prosecution bodies. This had not brought positive results

because of the lack of analyzing capacities (Pieth and Aiolfi, 2004). This was another reason why the FIU was brought into existence.

The first FIUs were established in the early 1990s, while after the following decades their number had significantly increased. There are now around 152 units (Egmont Group, 2017). Motivation for establish the FIU also emerged when the FATF's 40 Recommendations 2003 were adopted, and gradually the unit has received much wider recognition. As reported by the IMF and World Bank (2004), the FIU is an independent body that undertakes the role of buffer between other competent authorities and FIs to support them accordingly. The FATF's 40 Recommendations establish the need for the FIU to have access to the widest range of financial, administrative and law enforcement intelligence, which can assist its properly undertaking its functions.

There are different models of the FIU as administrative, law enforcement, prosecutorial and hybrid types, and the FATF's 40 Recommendations are applicable to all of them (Ryder, 2012). The FIU and FIs should cooperate in a way that corresponds to the goals of the FATF standards (Lilley, 2006). The present study demonstrates how this cooperation is supposed to be formulated. It also emphasizes what kinds of obstacles are inhibiting productive dialogue from coming into existence among the above-mentioned institutions.

As explained, the FIs are legally obligated to file STRs to the FIU upon suspicion that funds were either illegal proceeds or related to TF. When STRs are sent to the FIU, the body should receive, analyze and disseminate the results of analysis at will or upon the request of a competent authority to proceed for further inspection, and to FIs are to be used as guidance when applying AML/CFT measures (Booth et al., 2011).

Considering the FIU's independence, the free dissemination of this intelligence to competent authorities can be carried out only in cases where in the FIU has

reasonable grounds to suspect ML, predicate offenses or TF. Moreover, the dissemination of intelligence should be selective, and therefore requiring the FIU to conduct precise analysis of the intelligence before it is sent to a competent authority. Accordingly, the FIU needs informative and precise STRs from FIs before such items are sent to the body. This must be a mechanism of cooperation between the FIU and FIs, as per the FATF standards.

Despite this, a considerable number of publications in the AML/CFT area have demonstrated that the actual performance of national governments does not correspond with the FATF's established goals. The FIU conducts analysis of intelligence based on STRs submitted by reporting entities. Therefore, the reporting entities must be meticulous in their understanding of what could and count not be regarded as suspicious, and work using a list of red flags (Lilley, 2001), which could help denote suspicion (see Appendix C). If reporting entities do not submit STRs to the FIU, the body could fine an institution (Lilley, 2006). Therefore, FIs, triggered by possible fines, intentionally submit a considerable amount of STRs to the FIU merely to demonstrate their deceptive tolerance with the AML/CFT standards (Demetis, 2010).

As can be seen, the reporting entities could, hypothetically, pay less attention to precise analysis of the information before it is sent to the FIU. This circumstance burdens the FIU with a need to conduct analysis of the intelligence itself. Eventually, when the number of STRs submitted by a particular FI continues to increase, the FIU may pay less attention to those reports, considering them meaningless. In the literature this phenomenon is called "crying wolf". In other words, there are false alarms emphasizing existence of excessive reporting that may dilute the reports' value.

As a result, when ML, TF and associated predicate offenses occur, the FIU may not consider such related reports to be actual cases, and may not pay sufficient attention to such intelligence. Accordingly, when it becomes obvious the financial environment

has been misused because of a fault of the reporting entity, which provided a low-quality report, the FIU penalizes the responsible institution.

In fact, the above situation could cause difficulties with management of efforts for AML/CFT purposes, and lead to possible sanctions from the FATF applied regarding jurisdictions with strategic AML/CFT deficiencies. If a country maintains the same attitude toward implementation of the FATF standards, it can eventually be blacklisted.

1.1.5. Dilemma inside the AML/CFT network

The IMF has estimated around $2 trillion was laundered annually (Lilley, 2006). Statistics in the AML/CFT field illustrate the number of STRs sent to the FIU exceeds the amount of actual prosecutions. In this regard, Demetis (2010) conducted a case study over a 3-year period in a financial institution in the European Union (EU) to analyze a bank's internal reporting system concerning the increased number of STRs and the influences of various information systems on AML/CFT measures.

Figure 3 shows part of the findings from that study, which incorporated interviews with the national banking association, central bank, ministry of finance and FIU. The results of the study were, thus, extremely useful in disclosing certain details regarding issues in the relationships between the FIU and reporting entities. The figure consolidates the amount of disclosures made to the national FIU in the form of STRs submitted by the FIs in the country (left column) and the number of prosecutions for each corresponding year (respective right column).

As can be seen, the number of STRs continually increased while the number of prosecutions remained relatively unchanged. Moreover, the country's FIU reported that the amount of prosecutions remained stationary in 2002-2009, whereas the number of STRs continued to increase each year (Demetis, 2010).

Additional statistics in the field illustrated that this situation with regard to the number of STRs was prevalent in other countries. For instance, some FIUs, such as the Australian Transaction Reports and Analysis Centre (AUSTRAC), proudly proclaimed an increase in the number of STRs, as if such a change implied effectiveness of the national AML/CFT system. In Australia, 10.7 million STRs in 2005 led to 1743 investigations (though not prosecutions). Japan is another possibly illustrative example, where 98,935 STRs led to only 18 prosecutions.

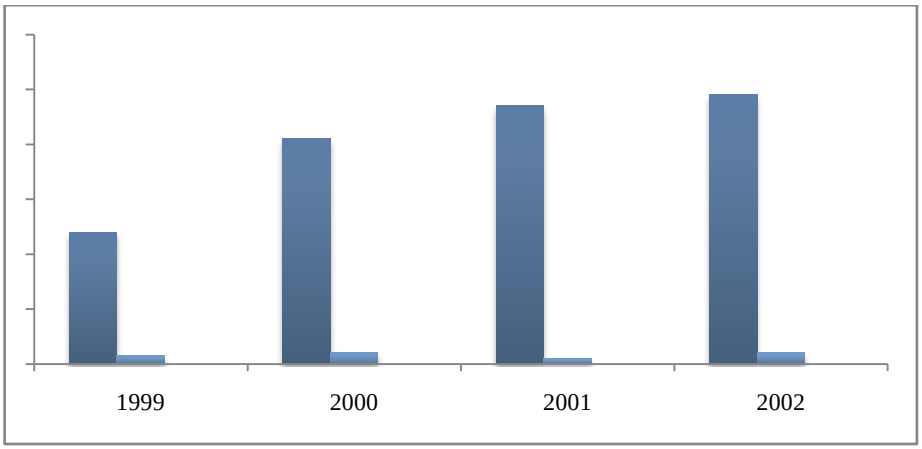

Figure 1. Disclosures and prosecutions for the national AML/CFT system. Adapted from *Technology and Anti-Money Laundering. A systems theory and a Risk-Based Approach.* London, United Kingdom: Edward Edgar Publishing Limited.

The above situation demonstrates that in some countries AML/CFT regimes are less likely to be in line with FATF standards. A possible explanation for this problem is the lack of sensibility in treatment of the FATF standards by the FIU and FIs, as they as they play a crucial role in detecting and preventing illicit funds at an early stage. It appears the FIU does not receive well-conducted and analyzed reports from FIs. Meanwhile FIs, in their aims of growing and fulfilling their endeavors, appear to not be paying sufficient attention to these reports, and performing this activity mechanically, leading to unfavorable outcomes. As a result, efforts aimed at combating ML and corresponding offenses, in particular those coming from the FATF, are not being implemented as expected by these two participants in the AML/CFT network.

A dilemma arises concerning the two participants, on which this research is focused, as to whether they understand and know how to implement the FATF standards. The problem this research seeks to demonstrate is not connected with a number of reports sent to the FIU per se, rather than with a degree of commitment of those institutions when understanding and implementing the standards.

Raising the level of sensibility toward the treatment of a subject as delicate as combating illegal use of the financial system, which concerns every nation, may generate effective results in detecting and further combating ML, TF and other threats to the international financial environment's integrity. For this reason, a number of suggested recommendations on how consensus could be reached to overcome the challenges between the FIU and FIs are offered herein for the purpose of minimizing the problem.

1.2. Statement of the problem

The information presented above shows a potential lack of sensibility in treatment of the FATF standards by the FIU and FIs. The sensibility in this particular case refers to the degree of commitment among the FIU and FIs toward this treatment. In other words, the need for sensibility in treating and employing these standards implies making decisions about what is good and valuable in relation to understanding and implementing the AML/CFT regulations.

However, the lack of sensibility on how the FIU and FIs treat the FATF standards does not simply come from these entities, but rather from how the standards were presented and developed. Therefore, the root cause of the problem between the FIU and FIs might have come from irrational and unaffordable nature of the FATF standards.

From a theoretical perspective, the FIU and FIs should be aware of the standards in the AML/CFT area. However, as can be expected, practice and theory are not always similar. The research problem mentioned in the previous section is connected with the idea that if implementation of the FATF standards continues without the FIU's and FIs' proper attention to understanding of the international regulations in the field, it will not help to reach the goals the FATF initially intended.

That is, the lack of sensibility in treatment of the standards by those entities could lead to the consequences introduced and discussed here. Therefore, this study, besides disclosing tacit ideas behind the interaction between the FIU and FIs as they play a key role in the detection and prevention of illicit funds at early stages, aimed at exploring how the FATF standards influence their dialogue.

Additionally notable is that the term "sensibility" is unique in addressing the interaction between the FIU and FIs. K. Stroligo and I. Deleanu contended that the term, which was used in this study in referring to the problem in the AML/CFT network, represents a crucial point when discussing relationships between the FIU and FIs (personal communication, May 25, 2017; May 9, 2017).

1.3. Background and need

The literature widely reports those countries with a high commitment to implementing the FATF standards can obtain a higher position in the Basel AML Index. This index, among other tasks, conducts assessments of countries' ML and TF risks (Basel Institute on Governance, 2017). Therefore, countries that are careless in understanding and implementing the FATF's instruments eventually may lead themselves into negative consequences, while also leading themselves to blacklisting.

While understanding and implementation of the FATF standards may generate unexpected costs for FIs, there is also recognition when reporting entities effectively

implement the FATF recommendations, as per the Basel AML Index, which could positively rank a country if its financial sector performs well. Ultimately, the AML/CFT network participants with a high level of sensibility in treating this problem could generate positive outcomes that will benefit all participants in the network, while at the same time leading them toward effective control of this problem.

While a considerable amount of studies have been conducted to illustrate problems among AML/CFT network participants, the problems persist. Among those studies, Előd Takáts in 2007 shed light on the problem of excessive reporting, which occurs when FIs continue filing meaningless reports with the FIU, from the standpoint of crying wolf theory, as discussed in Chapter 3. In general, the study reflected his thoughts with regard to those mechanisms, which could help reduce the number of meaningless STRs and increase productivity of the AML/CFT regime through decreasing fines and introducing reporting fees.

Considering an important feature of previous studies, it could be argued that additional efforts should be taken in consideration for providing suggested recommendations. These could positively impact the problem and have a profound impact in this field. Finding and establishing a comprehensive approach that generates productive dialogue between the members of the AML/CFT network, especially the FIU and FIs, may help alleviate the existent but unspoken problem of communication among these participants, and instead promote effective discourse.

It is important to stress that addressing this problem effectively will bring immeasurable benefits to all of global society. Conducting and promoting studies addressing the issue discussed here represents a continuation of the constant fight carried out by FIs and other relevant authorities worldwide regarding misuse of the financial environment. Research and relevant contributions of any size in this field represents progressive steps to counteract the problem.

1.4. Objectives and methodology

1.4.1. Objectives

The objectives of this particular study are to respond to the following research questions:

1. **What kinds of factors brought the lack of sensibility in the treatment of the FATF standards?**

   The aim of this research question is to examine a sequence of past events related to formulation of the ML phenomenon, disclose why this concept became a global concern, view what kinds of countermeasures were taken, and deconstruct possible reasons that may have brought the research problem into existence.

2. **How are the FATF standards being implemented in different countries?**

   The purpose of this question is to understand how the FATF standards are being implemented in different jurisdictions, as this could help in checking the relevance of the research problem in selected countries and verifying the validity of the speculations herein regarding potential underlying reasons mentioned above.

3. **What suggested recommendations are there for promoting awareness and sensibility in treatment of the FATF standards?**

   This question was developed to substantiate a need for additional measures when combating ML, and draw a set of suggested recommendations for promoting awareness and sensibility in the FIU's and FIs' treatment of the FATF standards.

1.4.2. Methodology

Owing to the nature of the study, a qualitative approach was chosen, as the main concern herein is to analyze a particular phenomenon in institutional behavior, which

was categorized as the need for sensibility in treatment of the FATF standards by the entities appointed for this particular task.

Additionally, the present research was considered as descriptive, as it describes the procedures, participants and characteristics of the AML/CFT regulations. This study also has some elements of exploratory study in that it examines primary and secondary sources of information with the aim of expanding understanding of the phenomenon under investigation. Considering the importance of the text's structure, the research question order was used as an organizational style for this study.

This study drew on a number of sources, such as booksin the research field, newspaper and journal articles, online materials, and IMF and World Bank reports. A number of relevant documents from the FATF webpage, in particular, Mutual Evaluation Reports (MERs) on AML/CFT regimes in the US and UK, and the UK's national risk assessment report on its AML/CFT regime, were also reviewed.

It should be noted that use of materials from the FATF webpage required prior written permission of the FATF Secretariat. For this purpose, a letter was sent to the FATF's Secretariat for receiving its permission in order to use materials from MERs on AML/CFT systems those of the US and the UK (see Appendix F). The FATF Secretariat kindly responded and granted use of the data (see Appendix G).

Along with the above-mentioned sources, a number of structured interviews were carried out with people versed in the area to obtain first-hand evidence on the topic under investigation. Interviewees were also solicited for necessary assistance in interpreting some of the FATF's 40 Recommendations. Receiving detailed interpretation on specific recommendations helped enhance the analysis when drawing conclusions on legal aspects of AML/CFT policies.

Interviewees were selected from a list of relevant people working in the field of inquiry, as well as personal contacts of the researcher. The selected interviewees

possessed ample expertise and experience in the research field. In light of the potential secrecy of the topic, only six people agreed to respond to questioning.

Before conducting interviews, a letter was sent to each potential interviewee, requesting permission (see Appendix D). After receiving permission, a second email was sent to each interviewee with details such as interview location, equipment to be used (IC recorder), duration of the interview, and a list of possible questions (see Appendix E). The questions were formulated based on each interviewee's profile. Emails were sent to their personal email addresses through the researcher's personal Gmail account.

A number of established research methods, such as analysis of historical records and document analysis, were used for soliciting answers to the research questions. The analysis of historical records was conducted to obtain background knowledge with regard to development of the ML phenomenon, disclose why the concept became a global concern, find what kinds of countermeasures were taken, and deconstruct possible reasons behind the research problem's emergence.

Meanwhile, the document analysis was applied for a number of documents as a method of reviewing and evaluating selected materials with the aim of understanding how the FATF standards are being implemented in the US and UK. These countries were selected because of the abundance of publicly available information with respect to the AML/CFT regimes therein.

With the aim of matching the goals of the third research question, the findings generated from historical and document analyses, as well as interviews, were reviewed through the implications of agency theory. It must be emphasized that a number of techniques, such as content analysis, diligent note taking, triangulation of multiple data sources and categorization, were apart of selected research methods in data analysis.

1.5. Summary of the chapter

This chapter presented an overview of the study to facilitate understanding of the context of the research in terms of the issues it addresses; in particular, the importance, special terminology and research problem. It provided a description of broad issues related to the study, as well as the reasons why economic crimes occur, and which factors triggered the initial US-initiated "War on Drugs."

Background knowledge about the concept of ML, as a technique for legalizing illegal proceeds, and a theoretical basis for the concept of the phenomenon, was also discussed by citing information regarding the concept's origins. An introduction of the agenda-setter in the AML/CFT field was also provided. The historical context of the need to create a body was also illustrated, which indicated the FATF was established to set comprehensive policies in the AML/CFT area. A brief account regarding the FATF's 40 Recommendations was also presented.

Subsequently, the chapter introduces the main factors that impelled the research presented herein, and examined the interaction mechanisms between the FIU and FIs. A possible problem between these entities was later introduced by considering the lack of sensibility in treatment of the FATF standards as the main factor affecting the performance expected by the body. Moreover, a dilemma was raised as to whether countries' authorized bodies should understand and implement these standards. Emphasis was placed on the possibility of being blacklisted in the case of non-fulfillment of the standards, and being labeled as a non-cooperative jurisdiction.

The chapter has also introduced the research problem and indicated aspects that needed addressing. Specifically, it mentioned that inefficiency in the coordination of efforts for AML/CFT objectives among countries' competent authorities; in particular the FIU and FIs, could lead to the possibility of being sanctioned by the FATF when a country is regarded as a jurisdiction with strategic AML/CFT deficiencies.

The background for the research problem is provided and need for more research asserted, while a subsequent section presents a list of research questions with their justifications. This is followed by a description of the methodologies applied in the present research.

CHAPTER 2

LITERATURE REVIEW

2.1. Introduction

Money laundering has long been recognized as a phenomenon that could cause long-lasting consequences for a certain society and eventually the entire world. Increased illegal activities incur significant damage, such as deterioration of FIs, and political and financial instability. Therefore, ML is still considered a challenging and problematic area that affects not only developed nations, but also developing ones.

A few institutions have been organizing responses targeting ML, and these efforts have intensified the fight against ML over the past two decades. After the 9/11 terrorism events in New York City, which underscored the connection between the financing of terrorism and ML, the topic garnered much wider interest within the broader agenda of dealing with security issues.

Considering the continuous efforts against ML and associated offenses, encouraging results have seldom been witnessed; prosecutions are scarce and convictions even scarcer (Ryder, 2012). Although the AML/CFT network has expanded because of the wide range of regulatory initiatives, such expansion has come with a number of practical difficulties for the network, including dealing with professions such as lawyers and accountants. Nevertheless, FIs role at the forefront of the fight against misuse of the legitimate financial environment is difficult to refute. Ultimately, FIs have an important role in every modern society; therefore, studying and preserving them should be mandatory pursuits in every government.

As FIs are one of the focuses of this study, this chapter presents a detailed account of the history behind ML and its effect on FIs. Understanding the nature of ML and the continuing efforts to counteract it is of paramount importance to visualizing and

present additional solutions to the problem. Therefore, this chapter discusses a comprehensive literature review on the pertaining concepts and participants of the AML/CFT network.

This chapter begins with a brief account of relevant sources in the AML/CFT field, followed by a description of ML, where money targeted for laundering comes from, and why this phenomenon became such a global concern. The subsequent section provides a list of international initiatives that have been implemented for AML/CFT purposes. The penultimate section provides an overview of AML/CFT regimes of the US and UK and describes how these countries have fared in implementing the FATF standards. The last section summarizes the chapter.

2.2. Review of the AML/CFT literature

A considerable number of materials in the AML/CFT area were studied and reviewed in conducting this study. These sources, to be listed in subsequent section, provided relevant information to illustrate and define the so-called ML phenomenon, explained why the concept became a global concern, described what kinds of initiatives have been implemented to counter illegal use of the financial environment, and fostered understanding of how the research problem came to be. Moreover they also gave a detailed account of how the FATF standards are being implemented in different jurisdictions.

Taking the limitations of this study into account, only materials that could contribute when conducting the research, and assist the expertise of the researcher in the AML/CFT field, were considered. As these sources were considered the most relevant for this study, other sources were also cited and included in this research.

This section gives a brief account of the relevant sources in the AML/CFT field. Among the most important sources, this study focused on a number of key books (Pieth

& Aiolfi, 2004; Lilley, 2006; Zubkov V.A. and Osipov S.K., 2007; Demetis, 2010; Booth et al., 2011; Ryder, 2012).

2.2.1. *A Comparative Guide to Anti-Money Laundering: A Critical Analysis of Systems in Singapore, Switzerland, the UK and the USA*

A Comparative Guide to Anti-Money Laundering gave a detailed account of the history of the ML phenomenon and provided groundbreaking evidence on the establishment of the FATF as an agenda-setter in the AML/CFT field. It presented critical analysis of how the FATF standards were being implemented in Singapore, Switzerland, the UK and the US.

Mark Pieth and Gemma Aiolfi are highly experienced professionals in the AML/CFT field; therefore, their perspectives incorporated in the corresponding book provided useful and informative insight toward revealing key aspects of compliance with the FATF standards in selected jurisdictions.

2.2.2. *Dirty Dealing: The Untold Truth about Global Money Laundering, International Crime and Terrorism*

Dirty Dealing was one of the major informational sources in conducting this study as it helped in forming perceptions about the ML concept and obtaining knowledge the phenomenon at the early stages of the research process. Its author, Peter Lilley, is considered by the *Daily Mail* (UK newspaper) as a leading British expert in the AML/CFT field. Lilley has been involved in preventing, detecting and investigating global business crime and ML for over two decades.

His book presented a revealing account of how the proceeds of global organized crime are being laundered through the world's financial and business systems. It provided a comprehensive portrait of the scale and scope of global ML, and its infiltration of the world's legitimate business structures, and presented concrete

examples of how highly organized and sophisticated criminal organizations and terrorist groups seriously undermine many countries' economies.

2.2.3. *Russian Federation in the International Framework of Combating Legalization (Laundering) of Criminal Proceeds and Financing of Terrorism*

This book played a significant role in the development of the present study. The book's authors had considerable expertise and experience in the AML/CFT field. Viktor Zubkov served as Prime Minister of Russia from September 2007 to May 2008 and was a head of the Federal Financial Monitoring Service of the Russian Federation, while Sergey Osipov worked as a deputy head of the Financial Monitoring Service of the Russian Federation.

The book described essentials of the theory and practice of the ML concept, and provided a detailed account of how Russia implemented the FATF standards. It also conceptualized historical facts with regard to the formation of the ML phenomenon, and highlighted certain issues that persist in the field. The book was mostly used at the early stages of the research process for the present study, when conducting a preliminary review of relevant literature and aiming to accrue background knowledge on the field.

Former Minister of Finance of the Russian Federation Alexei Kudrin has commented that the book by Zubkov and Osipov represented the first research publication in Russia on financial monitoring, which was considered the main instrument for combating illegal use of the financial framework.

2.2.4. *Technology and Anti-Money Laundering: A Systems Theory and Risk-Based Approach*

Technology and Anti-Money Laundering, by Dionysios Demetis introduced an intellectual discussion of many substantive issues relating to control of ML. Demetis, from the London School of Economics, developed his ideas based on systems theory

and looked at ML control from technology-based perspectives, as complex and integral to the proper functioning of FI.

A number of other scholars have commented on this seminal work. Ian Angell from the London School of Economics noted that the book contained a solid theoretical foundation for AML research and practice. The book also criticizes how some AML professionals are uncritically using so-called technological solutions, and describes concrete ideas on how technologies could be used more effectively by using a case study on a financial institution.

Michael Mainelli, professor at Gresham College and co-founder of Z/YEN Group (a UK consultancy firm), suggested that the Demetis' book made a great contribution to the understanding of AML at both systems and practical levels. He also emphasized that the author tried to see how far technology could address some audacious goals and provide a set of practical solutions for more effective use of technology for AML purposes.

The revision of Demetis' book helped acceptance of informative ideas with regard to weaknesses and strengths of using high-tech solutions when combating ML and associated illegal undertakings. In this regard, the book provided invaluable insights and perspectives useful toward the development of ideas when presenting results and drawing conclusions in the present study.

2.2.5. *Money Laundering Law and Regulation: A Practical Guide*

This book was written by a number of practitioners about the ML phenomenon and corresponding laws working to combat it. It revealed direct influence of current AML/CFT policies on people who perform their duties in banks and financial services regulated by relevant laws for combating use of the legal financial system for illegal purposes.

The book also provided thorough explanation of laws and regulations relating to ML control, while the final chapter gave a detailed account of how the new AML/CFT laws are being implemented in practice. In this regard, the book provided significant information toward understanding how current AML/CFT strategies could influence implementation of the FATF standards.

The book's authors are experienced professionals in the AML/CFT field. For instance, Simon Farrell specializes in weighty and complex crimes, including ML. He co-authored *Butterworth's Guide to the Proceeds of Crime Act 2002*and *Blackstone's Guide to the Fraud Act 2006*. Robin Booth specializes in criminal fraud, collusion and ML, and chairs the Law Society's Money Laundering Task Force. The other two co-authors, Guy Bastable and Nicholas Yeo, specialize in aspects of white-collar crime and regulation, with particular expertise in ML and criminal asset recovery.

The book has garnered positive feedback from a number of scholars. Phillip Taylor MBE and Elizabeth Taylor from Richmond Green Chambers (a company that offers legal expertise direct to the English public) concluded that the paper represents a comprehensive and logically laid out work of reference written by experts. Andrew Campbell, a professor of international banking and finance law at the University of Leeds (UK), noted the book was an excellent guide for practitioners and all those involved in the fight against ML.

2.2.6. *Money laundering: An endless cycle? A comparative analysis of anti-money laundering policies in the United States of America, the United Kingdom, Australia and Canada*

This book provided a detailed examination of anti-ML policies and legislative frameworks in a number of jurisdictions, and considered how successful these jurisdictions have been in implementing international measures to combat ML. The

book offers a comparative analytical review of anti-ML policies adopted in the US, Canada, UK and Australia, and considers to what extent they have followed and implemented the identified global anti-ML policies.

Author Nicholas Ryder is a professor in Financial Crime at the University of the West of England and has published many other publications in this area. Those included, “The Financial War on Terror” (2015),“The Financial Crisis and White Collar Crime”(2014) and “Financial Crime in the 21stCentury”(2011). However, those papers did not specifically address this study; rather, they provided overall accounts of measures implemented against use of the legitimate financial framework for illegal purposes.

The above-mentioned sources were considered the most relevant with regard to conducting this study, but other pertinent sources were also included and cited. Among them, a number of interviews were conducted with people working in the field. As explained above, ML is considered one of the key issues by members of international society, as a technique to try and disguise assets and the way they were generated. Therefore, most of the information in this field is confidential and unknown in the public eye because of the sensitivity of the topic.

2.3. The birth of the money laundering

Before the early 1990s, a limited number of people had conceptions of what ML was. Perhaps they saw it as connected to the process of removing damaged or dirty bills from circulation to replace them with newly issued ones (Masciandaro, 2004). Over the past two decades, the term has gained much wider recognition and many people are now aware of the actual meaning and likely know it relates to socially reprehensible activities. However, understanding the definition of the concept has not proven sufficient for people to understand how they can directly or indirectly be exposed to it.

The formation of the ML phenomenon dates back to the 1920sUS, when it referred to methods of transforming illegal funds into those seemingly obtained through legal means. Large amounts of funds were passed through different cash-rich businesses, such as laundromats (coin laundries) and car washes (Zubkov & Osipov, 2008). US gangs sought to commingle illicit funds with legal income from their enterprises, thus making the process "clean" and avoiding additional taxation.

Zubkov and Osipov (ibid) asserted that the emergence of ML concept is often connected with the famous American gangster Al Capone because of his business activities in the 1920s. At those times, Capone had been commingling illegal funds generated from bootlegging (illegal alcohol trading) with his legal income from a network of laundromats, before introducing them to the legitimate financial environment. However, Robinson (2004) argued this was just a legend and suggested the term ML came into common use as it exactly reflects the process of mixing "dirty" funds with legally generated ones.

Robinson's theory about Capone seems vague, as a number of other sources (Lilley, 2006; Zubkov & Osipov, 2008) certified that Capone was indeed engaged in illegal activities that had elements of disguising the true source of funds. However, Robinson's thinking represents one of the initial stages in defining the ML concept.

Meyer Lansky is another pioneer concerning the ML phenomenon, and one whom a number of scholars (Lilley, 2006; Zubkov & Osipov, 2008; Robinson, 2004) regarded as a person who introduced a complicated scheme of disguising the true source of funds in the US. Lansky believed that if money was far from its origins it could not be traced back by tax organs. Accordingly, he would hide his assets in Swiss banks, which guaranteed anyone secrecy in their private banking operations.

However, funds untouchable for tax authorities also posed problem for their owners. Assets deposited in Swiss banks could not be easily repatriated, nor could they

be used in the country of origin (Zubkov & Osipov, 2008). This made Lansky seek new routes on how to return the legalized funds and let them enter the legitimate financial environment of the US as legally obtained funds. Eventually, Lansky found a way to do this by establishing gambling venues in Cuba. This profitable and high-demand business in the 1930s allowed him to return the funds.

Lansky laundered illegal funds generated in the US by transferring them to his enterprises in Cuba and at the same time transmitting his hidden assets from Swiss banks to Florida via Havana as profits of his legal undertakings in Cuba (Robinson, 2004). Many criminals maybe grateful to Lansky for this introduction of fundamental ML techniques, even though Lansky did not use the term "money laundering," he is considered the one who established the fundamental grounds for its development.

According to Safire (1993) the first use of the term dates to 1973 in the US during the Watergate scandal, when the administration of President Richard Nixon was accused of having a damaged reputation. Some $200,000 sent as a charitable donation to Mexico raised many concerns as to whether the money was used in financing illegal operations during Nixon's reelection campaign. After that, the term started to be frequently used in judicial proceedings and was set in print in the process of developing various laws and AML/CFT regulations worldwide.

Zubkov and Osipov (2008) pointed out that ML can be explained as a transformation of illegal proceeds into legally obtained funds. This means ML helps to conceal the true source of funds so they can be used freely. ML, therefore, specifically refers to the process of commingling illegal funds with legally generated income. The specific methodology used to launder money makes it difficult for competent authorities to trace the information regarding underlying illegal activity.

According to Lilley (2006), a look at the alchemist's theory can help to illustrate the ML concept. That theory describes how basic metals can be transmuted into gold.

This idea was used as a metaphor to describe the ML phenomenon. A typical ML scheme consists of a three-stage methodology of placement, layering and integration (see Figure 2). This methodology was offered by the FATF member countries in the 1990s to be used worldwide for analysis of cases and to understand how illegal proceeds could enter the legitimate financial environment.

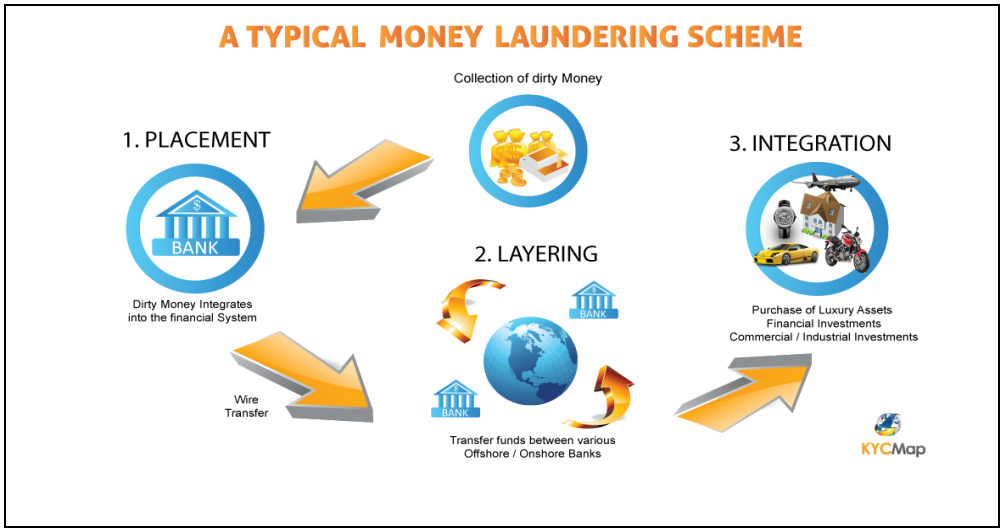

Figure 2. Typical Money Laundering Scheme. Adapted from KYCMap. Retrieved March 25, 2017, from http://kycmap.com/what-is-money-laundering.

The first stage of ML indicates the process of how illegal funds enter a legitimate financial system. This is essentially done by breaking up large amounts of cash into less-suspicious smaller portions to be deposited into a bank account or to purchase a wide range of monetary instruments, such as traveler's checks and money orders, which could then be deposited in accounts at another location. The placement phase is very important in the ML cycle, as it opens a route for illegally obtained funds to enter the legitimate financial framework, thereby enabling the ML process to continue. However, this phase is also the riskiest in the full ML chain, as at this step potential money launderers could be detected by customer due diligence (CDD) procedures applied by FIs.

After the first stage of ML is completed, the layering phase starts and allows criminals to conduct a series of fund movements to distance them from their origin. The

overarching purpose of the stage is to move money around by channeling funds to different locations within the same financial environment or via transfers to other countries. That is, to confound competent authorities' attempts to trace the funds. The layering makes the ML process extremely difficult to detect because of the techniques used to move money around among different financial locations.

In the aftermath of the first two phases, the integration stage begins when illegal funds are reintroduced to the legitimate financial environment, allowing criminals to use these "legally obtained funds" to purchase, for instance, real estate, luxury assets or business ventures. The integration phase of ML indicates that the country's AML/CFT regime is not in line with the international standards in the above-mentioned field.

The basics of the ML concept have been discussed to illustrate the methods used to ostensibly legalize illegally obtained funds. This answers the first question of what ML is, and leads the study of the second question: Where does the dirty money that will be laundered come from? The glossary of the FATF's 40 Recommendations (2012) presents a list of predicate offenses for ML that exemplifies how illegal proceeds could be generated. Among others, participation in an organized criminal group, terrorism and TF, human trafficking including sexual exploitation of children, and illicit trafficking of narcotics and psychotropic substances are regarded as sources of illicit funds.

This leads to a third question as to why ML is an urgent global problem. In a broader sense, ML is essentially the result of illegal activity that could not be carried out without committing a predicate offense. As reported by Booth et al. (2011), a predicate offense for ML is the underlying illegal activity that generates proceeds that, after being laundered, leads to the offense of ML. That is, this form of legalization of funds is a possible reason for threats to the integrity of a financial environment if international society pays less attention to understanding and implementing international standards aimed at combating misuse of the multinational financial framework (Shin, 2015).

ML could bring a number of negative consequences; for instance, increased illegal activities, decreased attractiveness to foreign investments, undermining of the legitimate private sector, deterioration of FIs, and political and financial instability (Chatain et al., 2009). In this regard, the need for prompt action, more important than ever, has served an impetus for governments to formulate regulations and set up a body that could establish a comprehensive and consistent framework to combat use of the international financial environment for illegal purposes.

2.4. International AML/CFT initiatives

Considering the number of efforts that have been implemented to fight illegal use of the international financial system, only those initiatives that have made a significant contribution to the field were considered and presented in this paper. A list of those initiatives targeting illegal use of the financial environment is presented in chronological order to demonstrate how the nature and context of ML has expanded.

Before presenting AML/CFT initiatives, it is useful to look into the history underlying their development. It must be emphasized that in the process of dismantling the Watergate scandal, the expression “follow the money” became publicly known, and its origins remain unclear.

Campbell (2012) contended it was often said “follow the money” was coined by “Deep Throat,” an anonymous informant on covert or illegal actionwithin the Federal Bureau of Investigation (FBI). *Washington Post* reporter Bob Woodward periodically met with this dark figure as the Watergate scandal unfolded. Deep Throat was self-revealed in 2005 as W. Mark Felt, formerly the second-highest-ranking official withinthe FBI (Campbell, 2012).

The “follow the money” policy was launched with the aim of countering illegal drug and other unscrupulous dealings by requesting that FIs establish and maintain a

"paper trail," especially on transactions that were conducted in cash. Henning (2015) considered the Watergate credo of "follow the money" as the reason for a plethora of laws requiring banks and other money-transmission businesses to keep traceable records on their customers and report suspicious transactions.

Both the "War on Drugs" and "follow the money" are among reasons for a number of fundamental laws, regulations and international initiatives aimed at protecting the legal financial framework from being misused. As the present study is concerned with international regulations against the misuse of the multinational financial framework, the role of the FATF, as a key body established to establish a comprehensive and consistent framework in the AML/CFT area, is described in detail. The United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances, adopted in 1988, was the first document criminalizing ML and was mainly focused on laundering of proceeds from illegal drug trading.

Table 1

Key initiatives targeting money laundering

Year	Name of the initiative	Major contribution
1988	UN Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (Vienna Convention)	Required all countries to criminalize ML.
1988	The Basel Committee on Banking Supervision Statement on Prevention of Criminal Use of the Banking System for the Purpose of Money laundering	The statement sought to inform the banking sector on the threats that ML could pose. In addition, a set of guiding principles were provided that banks would have to employ to protect their integrity.
1990	Council of Europe on: 'Laundering, search, seizure and confiscation of the proceeds of Crime'.	ML was extended to include other predicate offences. Countries could prosecute even if the offences took place elsewhere and the third party's involvement was taken into consideration. Thus, the convention tried to put balance between legislation and human rights.
1990	FATF's Forty Recommendations	The FATF became an ad-hoc body to draw international standards for combating ML. Lacking in legal power at the beginning, later on the FATF standards were recognized as international standards in the AML/CFT area when the UNSCR 1617 was adopted in 2005.
1991	European Economic Commission Council Directive 91/308/EEC	Concluded that other professions and undertakings along with FIs should be considered due to the possibility of being used for ML.
1995	The Egmont Group A united network of the Financial	The group was established as a center for exchange of intelligence and practice regarding ML and TF and

	Intelligence Units	provided a forum for FIUs to exchange information in the AML/CFT area. The exchange could be carried out via network called Egmont Secure Web (ESW), which permits members of the group to communicate with one another via secure e-mail.
1996	FATF's Revised Recommendations	The revisions reflected evolving ML techniques and broadened the scope of the FATF standards beyond drug-money laundering.
1997	United Nations Office on Drugs and Crime Global Programme Against Money Laundering	A technical assistance program in relation to criminal investigations, which in partnership with International Police Organization (Interpol) maintains an automated database of information regarding legislation and law enforcement in different countries called International Money Laundering Information Network (IMoLIN). IMoLIN. The network includes a database on legislation and regulations throughout the world, an electronic library, and a calendar of events in the AML/CFT field. The objective of the program is to strengthen the ability of member countries to implement AML/CFT measures and assist them in pursuing this goal.
2000	The UN Convention Against Transnational Organized Crime (Palermo Convention).	The convention expanded the scope of ML to include all serious offences besides drug related offences. The list of supervised institutions was extended to include non-banking FIs.
2001	European Community Directive 2001/97/EC	The directive demonstrated that European Union's legislation endorsed all underlying ML offenses besides drug-oriented illegal activities.
2003	FATF's Revised Recommendations	The need for typologies to investigate different ML scenarios was included in this set of the standards. Moreover, the revisions put forward a need for the recommendations to be regarded as 40+9 due to the enlargement in the scope of the FATF in 2001 to include 9 special recommendations on TF.
2005	European Commission Directive 2005/60/EC	The directive illustrated a shift to employ a risk-based approach to deal with ML and associated threats to the integrity of international financial framework.
2012	FATF's Revised Recommendations	The latest version of the recommendations, which alleviated a need for 9 special recommendations on TF and included them into a comprehensive set of the FATF's 40 Recommendations. Besides, dealing with ML and TF, the FATF's mandate was expanded to treat the proliferation of weapons of mass destruction.

Note: Data were adapted from *Technology and Anti-Money Laundering. A Systems Theory and a Risk-Based Approach*. London, United Kingdom: Edward Edgar Publishing Limited.

Though the Vienna Convention had been adopted, that alone did not appease the curiosity of highly industrialized countries such as the US, UK and France, which considered the measures indicated in the document were insufficient for preventing use of FI for laundering of drug proceeds (Pieth & Aiolfi, 2004). Therefore, in the aftermath of the G7 member countries' decision during the summit in Paris in 1989, the FATF

was established to develop policies in the AML/CFT area and become an agenda-setter in the field (Lilley, 2006).

2.5. History of the FATF

The FATF was established in response to mounting concerns over ML. Recognizing the threats to the banking system and FIs, the G7 heads of state convened atask force from the G7 member states, the European Commission and eightother countries. Inevitably, the body's membership was expanded to include almost all countries of the Organisation for Economic Co-operation and Development (OECD), Gulf Co-operation Council, Russian Federation, Argentina, Brazil, China, Hong Kong (China) and Singapore. The FATF presently consists of 35 member states and two regional organizations (European Commission and Gulf Co-operation Council) and is headquartered in Paris (FATF, 2012).

According to Pieth and Aiolfi (2004), the idea of introducing an ad-hoc group to deal with ML belonged to US President Ronald Reagan. Originally, the notion of establishing the FATF was planned for discussion on the sidelines of the G7 Summit held in Harrisburg, US in 1988. However, because of political maneuverings, France opposed the suggestion. A year later, France put forth a similar suggestion when the G7 summit was held in Paris. Therefore, for unclear reasons, the unlikely cooperation between the US and French administrations at that time resulted in creation of a unique structure: an ad-hoc body that was to remain permanent and establish itself as the agenda-setter for preventing ML (Pieth and Aiolfi, 2004).

The decision to establish the FATF was driven by the need to promote the program of the Vienna Convention, which required the UN member countries to fight against accrual of proceeds from drug-related offenses. The need to criminalize ML as a methodology that could help criminals transform illicit income into legally obtained

funds was also among factors that brought the FATF into existence. The FATF's foundation was greatly important for establishing a comprehensive set of measures to be implemented by all countries for combating ML and related offenses.

2.5.1. Objectives, functions and tasks of the FATF

According to the mandate of the FATF (2012), the body is to have a number of established functions and objectives. The objectives are meant to set international standards and promote effective implementation of legal, regulatory and operational measures for combating ML, TF and associated threats to the integrity of the international financial environment.

The FATF has a number of functions for fulfilling its objectives. Its functions and tasks body are represented by measures developed to conduct analysis of methods and trends used to coop the legal international financial system for illegal purposes. Additionally, the body develops international standards for AML/CFT purposes and conducts assessment and monitoring of its member jurisdictions through "peer reviews" that serve as mutual evaluations for determining the degree of technical compliance and effectiveness of the present AML/CFT regime.

The FATF also identifies non-cooperative jurisdictions with strategic deficiencies in their national AML/CFT systems, and coordinates measures to protect the international financial framework against threats those jurisdictions pose. Non-cooperative jurisdictions are usually placed in a specific blacklist maintained by the FATF that contains intelligence regarding countries with strategic deficiencies in AML/CFT. There is a gray list in addition to the blacklist, which incorporates jurisdictions with fewer deficiencies. Countries that meet all requirements of the FATF standards are not placed on those lists, but are still monitored, though less strictly.

Additionally, the FATF promotes implementation of the AML/CFT standards through a global network of FATF-style regional bodies (FSRBs) and international organizations. The FSRBs were modeled to serve as regional centers for AML/CFT purposes to ensure that member jurisdictions understand and implement the standards (see Appendix A for the list of FSRBs).

All the FATF standards, guidance and other policies were developed as a result of consultations among the member countries, associated members (FSRBs), the IMF, World Bank, observer organizations and the private sector. The IMF and World Bank play a crucial role in developing and promoting the FATF standards. In particular, they conduct countries' assessments regarding the degree of compliance with the FATF standards, and publish detailed reports on the results. Other previously mentioned institutions provide technical assistance for capacity building in AML/CFT, and issue various guidelines in that area.

2.5.2. Structure of the FATF

As illustrated in Figure 2, the FATF consists of the Plenary, the president, assisted by a vice-president, the Steering Group and the secretariat, which have certain functions and tasks. The FATF Plenary is the decision-making body and consists of member jurisdictions and organizations wherein all decisions are taken by consensus during plenary meetings. The FATF decision-making body determines the measures on how the body conducts its affairs. Additionally, the FATF Plenary adopts standards, guidance and reports developed by the body.

Among other tasks, the FATF Plenary may establish and mandate working groups and other subgroups when necessary to support its activities. All member states, associated members, the IMF, World Bank and observers can participate in working group and subgroup meetings. The FATF's mandate (2012) sets forth four working

groups in the body's structure: Working Group on Evaluations and Implementation (WGEI), Working Group on Money Laundering and Terrorist Financing (WGTM), Working Group on Typologies (WGTYP) and International Co-operation Review Group (ICRG). Each is assigned its own responsibilities aimed at ensuring a high level of AML/CFT-related compliance.

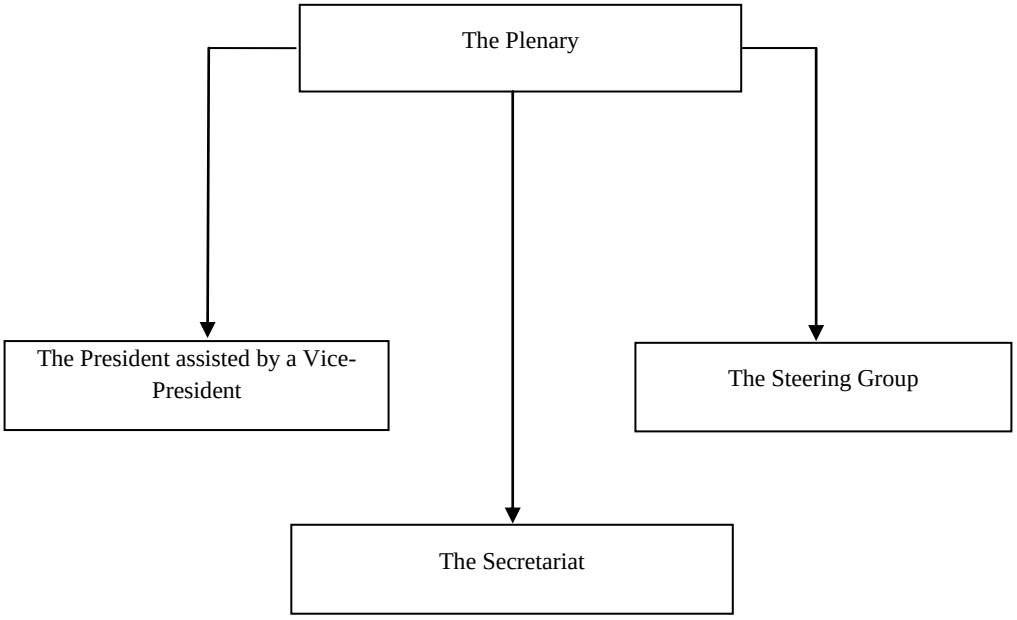

Figure 3. Structure of the Financial Action Task Force. Adapted from FATF (2012). Retrieved January 30, 2017, from http://www.fatf-gafi.org.

The Plenary selected the president from among the member jurisdictions to serve a1-year term. The president chairs meetings of the Plenary and the Steering Group, and oversees the FATF Secretariat. The FATF steering group is an advisory body under the president that helps the president carries out the Plenary's decisions. The secretariat consists of an executive secretary and the secretariat staff numbering 17 according to the FATF webpage (2017). The secretariat facilitates cooperation between member jurisdictions, associated members and observers, and assists the FATF in its activities.

2.5.3. FATF's 40 Recommendations

The FATF's 40 Recommendations are regarded as international standards in the AML/CFT area in accordance with UNSCR 1617 adopted in 2005. As illustrated in

Table 1, the original 40 Recommendations were developed in 1990. As Pieth and Aiolfi (2004) asserted, the FATF member jurisdictions decided the recommendations needed to be revised periodically to address the emerging trends and techniques of ML and correlated offenses. The Recommendations accordingly were revised in 1996, 2003 and 2012.

However, the FATF's mandate was broadened in 2001 to address the funding of terrorism after the 9/11 terrorist attacks in New York. Eight (later nine) special recommendations on TF were adopted. The focus on TF added "countering the financing of terrorism" to the AML abbreviation; thus becoming AML/CFT thereinafter.

The FATF's mandate was broadened again in 2008 to encompass financing of proliferation weapons of mass destruction, which resulted in changes to the FATF's 40 Recommendations with emphasis on targeted financial sanctions regarding the newly targeted issue. The revisions illustrate the context of the originally drawn recommendations and amendments that have been enacted.

As stated above, the FATF's 40 Recommendations were originally developed in 1990 to protect the international financial environment from being used for illegal purposes. The recommendations called on countries to recognize and ratify the Vienna Convention and required countries' FIs to apply enhanced CDD measures to large transactions. This could help prevent large amounts of funds obtained illegally from entering the legitimate financial sector. Moreover, the recommendations needed countries' FIs to maintain records regarding all transactions and keep the intelligence for at least 5 years, which permits reconstruction of individual transactions.

Apart from that, countries were mandatedto establish a cooperation mechanism between the competent authorities and FIs to protect their financial systems from being misused. Among other tasks, countries had to ensure FIs were legally obligated to

submit reports about suspicious transactions if they had reasonable grounds to suspect that funds were proceeds of illegal activity. Additionally, the 40 Recommendations 1990 called on countries to ensure that FIs could establish and maintain internal procedures to bring the initiatives in line with the FATF standards.

Ultimately, according to the FATF standards, countries should establish a legal basis for pursuing international cooperation and ensure that their competent authorities could constructively and promptly cooperate with their counterparts on a wide range of topics related to effective implementation and promotion of the standards. Countries' competent authorities were also tasked with upholding binding bilateral agreements to facilitate and strengthen their cooperation.

Nevertheless, as Pieth and Aiolfi (2004) claimed, the FATF's 40 Recommendations 1990 had shortcomings, as they were only applicable to banking institutions and focused on drug trafficking as a predicate offense. Conversely, the CDD standards remained very general when enhanced accuracy was needed to prevent the misuse of FIs. However, the FATF's 40 Recommendations in 1990 were the basis for all other amendments to the standards in the future, and constituted the original initiative toward implementation of FATF's instruments.

The updated FATF's 40 Recommendations were released in 1996 and extended the list of predicate offenses for ML beyond dealing with drug-money laundering. The Recommendations required countries to determine a list of serious offenses that could be designated as predicate offenses for ML. According to Pieth and Aiolfi (2004), France, as a founder jurisdiction of the FATF, suggested being proactive, and went as far as possible to include all crimes in the concept of predicate offenses for ML. Meanwhile, the differences in the countries' legal frameworks did not permit inclusion of all offenses in a category of predicate offenses for ML. In other words, an offense

that may constitute a serious crime in one country may not be considered the same for another country.

The set of recommendations released in 1996 brought many changes regarding the nature of the predicate offenses for ML and the concept of the phenomenon. What used to be linked only with the proceeds of drug-related offenses turned into a free-standing idea that could be attached to any serious offense (Pieth & Aiolfi, 2004).

In 2003, the FATF Recommendations were expanded again, incorporated all subsequent changes to the standards, and were then regarded as the 40+9 FATF Recommendations. They listed 20 areas to be considered as predicate offenses for ML and helped to strengthen the CDD measures suggested for FIs and enhanced due diligence for higher-risk customers and transactions. The recommendations also designated the list of DNFBPs to ensure the FATF standards were implemented with regard to them (see Appendix B). The revisions also regarded legal persons' and legal arrangements' transparency; countries were required to ensure there was adequate, accurate and timely information on the beneficial ownership and control of legal persons available for competent authorities to proceed with further analysis.

The latest amendments to the 40 Recommendations were introduced in 2012, incorporating all changes to international standards in the AML/CFT area. Considering the importance of countering financing of terrorism, the nine special recommendations were integrated into the updated array of FATF standards, which returned the recommendations to their original count of 40.

An IMF (2012) paper reported that a few components of the elaborated FATF standards were particularly important. It acknowledged that the 40 Recommendations demonstrated the importance of a risk-based approach (RBA) with regard to implementation of the standards and its applicability when countries' AML/CFT regimes were assessed for compliance with international practice.

Booth et al. (2011) argued that the RBA to AML/CFT meant that countries, competent authorities and institutions that handle and manage people's funds were expected to identify, assess and understand ML and TF risks to which they were exposed. Subsequently, countries should take commensurate measures to mitigate risks effectively. Pieth and Aiolfi (2004) contended that the RBA, to some extent, shifted part of the country's responsibility in AML/CFT onto FIs. Additionally, tax crimes were included in the list of designated predicate offenses for ML, which broadened the scope of the FATF standards.

According to the IMF (2012) paper, the FATF's 40 Recommendations of 2012, among other things, incorporated financing of proliferation of weapons of mass destruction and addressed targeted sanctions to prevent, suppress and disrupt them. Ultimately, the recommendations emphasized anti-collusion measures. The 40 Recommendations of 2012 are the latest version, though some modifications were made in 2013, 2015 and 2016. This set of recommendations contains the list of predicate offenses for ML (see Appendix H). It must be emphasized that this research considers only this latest version.

Pieth and Aiolfi (2004) emphasized that the FATF40 Recommendations would have remained as just another document if they were not recognized as international standards in the AML/CFT area. Though the FATF standards could not pass laws, they established standards that have global reach, and the body was recognized as a primary organ in AML/CFT. Considering the importance of the fight against ML, the UN adopted the Political Declaration and Action Plan against Money Laundering in 1998 (Demetis, 2010). The declaration stated that the FATF's 40 Recommendations were the standards by which measures against ML should be judged, and represented the initial steps for the FATF standards to be recognized worldwide.

The next initiative to emphasize the importance of the FATF standards was taken in 2005 when UNSCR 1617 was adopted. As Ryder (2012) pointed out, the resolution urged all member countries to implement comprehensive international standards embodied in the 40 Recommendations for AML/CFT purposes. All initiatives discussed in this paper confirm the international community demonstrated a high degree of commitment toward understanding and implementing the FATF standards. Nearly 200 jurisdictions have now endorsed the Recommendations (FATF, 2017).

2.6. Summary of the chapter

This chapter presented an overview of the literature which has been reviewed in this study. An introduction section provided a brief description of broad issues related to ML phenomena and indicated that ML is still considered as a challenging problem area, which could affect international society. Besides, the section illustrated that irrespective of continuous efforts against ML and associated offences, encouraging results have not been really witnessed. The results of those initiatives are supported by the AML/CFT statistics, which demonstrates that the actual performance of national systems designed to protect the legitimate financial environment form being misused is not in line with the FATF's goals.

Subsequently, a number of publications with regard to the research topic were conceptualized and a brief account of the relevant sources in AML/CFT field was provided. Moreover, some of those international initiatives, which contributed to the fight against illegitimate use of legal financial system, were listed as well.

The last section emphasized the role of the FATF in the establishment of international standards for AML/CFT purposes. Additionally, the section enlightened, that the FATF was founded to be an ad-hoc body and set a comprehensive international framework for combating ML and associated offences. Besides, the section

incorporated a sequence of time within which the FATF's 40 Recommendations were developed and upgraded with explanations underlying reasons for their development and expansion.

CHAPTER 3

AML/CFT REGIMES IN THE US AND THE UK

3.1. Introduction

The FATF standards provide a complex of measures that should be taken by each country in order to establish and maintain their AML/CFT systems. This chapter gives a detailed account of how the US and UK have been in implementing the FATF standards. Moreover, this chapter describes how these countries established, developed and upgraded their national AML/CFT regimes.

3.2. US in a global fight against money laundering

The US is the third largest country in the world both by area (9.8 million km^2) and population (323 million as of 2016) *CIA World Factbook*. The country comprises 50 states, the District of Columbia, and 16 territories of which five are inhabited: American Samoa, Guam, Northern Marianas, Puerto Rico, and the US Virgin Islands. The continental US is bordered by Canada to the north and Mexico to the south. The US population is generally well-educated and over 81% lives in urban areas (FATF, 2016). The US gross domestic product (GDP) was estimated to be $17.91 trillion as of June 2015 (World Bank, 2015).

The United Nations Office on Drugs and Crime (UNODC) estimated proceeds from all forms of financial crime in the US, excluding tax evasion, were $300 billion in 2010 (about 2% of the country's economy) (UNODC, 2011). The country is considered one of the major political and financial centers in the world because of the scale of its economy and political conjuncture.

According to the last MER on the AML/CFT regime in the US, which was published in 2016, the global dominance of the US dollar establishes a platform for

trillions of dollars to be transacted through the country's banks on a daily basis. This condition, as J. Connor argued, creates significant risks for the US financial sector to become a target for potential ML activities and illicit flows of cash through cross-border channels (personal communication, May 15, 2017).

At the same time, the US is also at risk of being abused by terrorist groups that could employ the openness, unique scope and global reach of the US financial framework for their illegal operations (FATF, 2016). In this regard, the US is seen as an attractive destination for domestic and foreign illegal proceeds at the integration stage of ML.

Legal persons in the US are also vulnerable because of serious gaps in the regulatory framework, in particular the absence of a requirement to make information about beneficial ownership available to law enforcement agencies (LEAs) (FATF, 2016). These risks are magnified by the fact DNFBPs are not subject to comprehensive AML/CFT requirements (ibid).

Nonetheless, as St. Goodspit contended, the reason for the above factors could be the scale of the US economy (personal communication, May 20, 2017). Although, as in many countries, most companies in the US are established for legitimate purposes, there are always examples of such entities being used in complex ML and TF schemes (FATF, 2016).

3.2.1. US AML/CFT regulations

The US substantially contributed to the development of AML/CFT-related policies in the past. The regulations, against the use of the legitimate financial sector for illegal purposes, were developed in the US pre-dating those developed by the EU and FATF. AML-related policies in the US can be traced back to the 1960s when the

Department of Treasury raised concerns about linkage between illegal activities and offshore bank accounts (Doyle, 2002).

It is frequently said that US AML policies inherently connected with the fight it began in the 1970s against illegal drug trading (Ryder, 2012). The history of the ML phenomenon may help illustrate that the concept itself was made public as a drug-related problem. It must also be emphasized that the first documented evidence that criminalized ML was the Vienna Convention, which required countries to adopt measures that would enable their competent authorities to identify, trace, and freeze or seize proceeds from illegal drug-dealings (Demetis, 2010).

The US was the first country to criminalize ML, in 1986 (Ryder, 2012). Anti-drug-related policies in the US resulted in introduction of several laws and regulations to deal with illegal proceeds generated through drug dealing. The Bank Secrecy Act (BSA) was the first document that established fundamental grounds for all other regulations in the AML/CFT field that would be adopted in the US. It was enacted in 1970 and, according to Eugene Rossides, former assistant secretary of the US Department of Treasury, was introduced with the aim of building a system for combating organized and white-collar crime (ibid). The act also aimed at deterring and preventing the use of secret foreign bank accounts for tax fraud and the use of those accounts to disguise the true sources of funds (Pieth & Aiolfi, 2004).

The BSA was followed by a number of other laws developed and enacted with the same intent: the Money Laundering Control Act of 1986, which recognized ML as a federal criminal offense; Annunzio-Wylie Anti-Money Laundering Act of 1992, which introduced suspicious-activity reporting (SAR) requirements; Money Laundering Suppression Act of 1994, which extended the scope of reporting obligations; and Money Laundering and Financial Crimes Act of 1998, which triggered and required publication and delivery of the National Anti-Money Laundering Strategy (NAMLS).

The NAMLS was released with the aim of better coordinating cooperation between LEAs and financial regulators for combating ML. Additionally, as Ryder (2012) argued, the NAMLS was intended for strengthening domestic enforcement mechanisms to block the flow of illicit funds into the country.

The series of regulations mentioned above does not confine the US stance toward fighting ML. After the 9/11 events, another fundamental law, the Uniting and Strengthening America by Providing Appropriate Tools to Restrict, Intercept and Obstruct Terrorism Act (US Patriot Act) was adopted in 2001. This act amended the provisions of the BSA of 1970 and Money Laundering Control Act of 1986. It has also been applied to any FI from any jurisdiction that conducts business either in the US or with an institution based in the US (Hopton, 2009).

Lilley (2006) argued that the Patriot Act was enacted because individuals and groups of people who committed terrorist acts in the US were receiving funds from partners abroad. Therefore, by adopting the act, the US tightened its regulations for all FIs performing business either in the country or with its affiliates in the US.

3.2.2. Implementation of international standards in AML/CFT field

US has recognized and implemented majority of international regulations in AML/CFT area. The country ratified the Vienna Convention and signed the Palermo Convention. The US is also a co-founder of the FATF and has been a subject of several mutual evaluations. The last mutual evaluation was undertaken in 2016 with the aim to identify the level of compliance with the FATF standards in the country. Lately, the results of this evaluation were published in the form of MER in 2016.

The US is represented in the FATF by the Department of State and Office of Terrorist Financing and Financial Crime. The Department of Treasury via its Financial Crime Enforcement Network (FinCEN) co-founded the Egmont Group of FIUs. The

FinCEN (the US FIU) maintains the ESW, which permits the members of the Egmont Group to exchange intelligence and communicate with one another through secure email. This network has been widely used by the FinCEN to share relevant intelligence, receive and grant requests from foreign FIUs.

Table 2 demonstrates the number of requests sent by FinCEN through ESW to foreign FIUs, whereas table 3 illustrates the amount of requests sent by foreign FIUs to the FinCEN. This table also gives an account of incoming and outgoing disclosures received by the FinCEN. The term disclosures in this particular case means the FIUs' spontaneous actions with the purpose of assisting other intelligence units with information related to ML, TF and associated predicate offences.

Table 2

Egmont FIU Information Sharing Statistics-seeking/receiving information

Description	2011	2012	2013	2014	2015
Outgoing requests sent by FinCEN	284	366	773	416	409

Note: Data are adapted from the MER of the US AML/CFT regime published in 2016 (Source: http://www.fatf-gafi.org/media/fatf/documents/reports/mer4/MER-United-States-2016.pdf).

Table 3

Egmont FIU Information Sharing Statistics

Description	2011	2012	2013	2014	2015
Incoming requests received by FinCEN	728	772	765	845	1 021
Incoming spontaneous disclosures received by FinCEN	291	327	316	526	914
Outgoing spontaneous disclosures sent by FinCEN	58	57	45	17	779

Note: Data are adapted from the MER of the US AML/CFT regime published in 2016 (Source: http://www.fatf-gafi.org/media/fatf/documents/reports/mer4/MER-United-States-2016.pdf).

The US is also a member of the Basel Committee on Banking Supervision. A majority of the FIs that perform their business in the US are members of the Wolfsberg Group, an association of 13 global banks aimed at developing guidelines for management of financial crime risks. Ryder (2012) contended that the US also provides technical and mutual legal assistance to help other jurisdictions enhance their AML/CFT regimes. Tables 4 and 5 show how the US established and maintains

cooperation with its counterparts with regard to issues related to ML, TF and associated predicate offenses.

Table 4

Reach of the U.S. liaison network to facilitate international cooperation

Federal Agency	**Number of countries covered**
Drug Enforcement Agency (DEA)	86 offices in 67 countries
Department of Homeland Security/ICE/HSI	62 offices in 46 countries
Federal Bureau of Investigation (FBI)	60 offices covering over 200 countries
Internal Revenue Service-Criminal Investigations (IRC-CI)	Liaisons posted in 10 countries

Note: Data are adapted from the MER of the US AML/CFT regime published in 2016 (Source: http://www.fatf-gafi.org/media/fatf/documents/reports/mer4/MER-United-States-2016.pdf).

Table 5

Incoming Mutual Legal Assistance (MLA) and Extradition Requests (2009-2014)

Incoming MLA Requests			
Total MLA requests received in criminal matters			5200±
Total MLA requests received in matters involving money laundering, terrorist financing (providing material support or resources for terrorism), and asset forfeiture			1541
Response to incoming MLA requests	**ML**	**TF**	**Asset Forfeiture**
Granted	568	53	501
Denied (grounds include lack of evidence, assistance not legally available, and other process reasons)	64	3	72
ML and asset forfeiture cases: Other reasons for not executing request (includes unable to locate evidence, withdrawn, and other non-process reasons)	150	N/A	102
TF cases: Other reasons for not executing request (includes no response from requestor, unable to locate evidence, and withdrawn)	N/A	14	N/A
Inexecutable under the law of the US	4	0	10
Total number of MLA requests related to ML, TF & asset forfeiture	**786**	**70**	**685**
Incoming Extradition Request			
Total extradition requests received in criminal matters			3800
Total extradition requests received in matters involving money laundering, terrorist financing (providing material support or resources for terrorism), and asset forfeiture			21
Response to incoming extradition requests		**ML**	**TF**
Granted		10	0
Denied		3	0
Other (Includes cases withdrawn, fugitive not located, fugitive located in another country or fugitive arrested in requesting country)		6	0
Inexecutable under the law of the US		2	0
Total number of extradition requests related to ML & TF		**21**	**0**

Note: The data are adapted from the MER of the US AML/CFT regime published in 2016 (Source: http://www.fatf-gafi.org/media/fatf/documents/reports/mer4/MER-United-States-2016.pdf).

3.2.3. Competent authorities in the US

The US is among countries that have a series of primary, secondary and tertiary authorities that administer the country's AML/CFT regime. The primary authorities in the US are the Department of Treasury, Justice Department and Department of State.

Each of these agencies is supported by a number of secondary authorities such as the FBI, National Drug Intelligence Center, Office of Terrorism and Financial Intelligence, and FinCEN. The above-mentioned institutions are in turn supported by tertiary authorities such as various FIs and DNFBPs.

The role of primary authorities in this chain is overseeing implementation of the FATF standards. Meanwhile, secondary and tertiary agencies are tasked with ensuring that enacted laws and regulations are being implemented in line with the goals of the FATF and their respective governments. Based on this single research effort, it is difficult to list the tasks performed by each of the above-mentioned institutions; accordingly, selected ones are considered in this section-the FBI and FinCEN.

The FBI was established in 1908 and is responsible for investigating financial crimes, including ML, TF and fraud (FBI, 2017). However, it is not authorized to directly enter into businesses performed by FIs. For this reason, it solicits assistance from the FinCEN, which provides filtered intelligence to the institution for the purpose of further investigation and prosecution.

The FinCEN was established in 1990 with a mission of enhancing US financial security by protecting the country's legitimate financial sector from being misused. The FinCEN also promotes transparency in international financial systems, while its objective is to collect, analyze and disseminate financial intelligence upon request of law enforcement agencies or foreign partners. This dissemination of intelligence maybe also performed spontaneously when the FinCEN has reasonable grounds to suspect funds are the proceeds of criminal activity or related to TF.

Bercu (1994) stated that the idea of creating the FinCEN was initially discussed in 1981, yet it was not established until 1990. At that time the primary function of this unit was dealing with proceeds from drug trafficking, though the FinCEN had the potential to tackle a broader range of illegal activities. For instance, as Ryder (2012)

noted, US authorities used the FinCEN databases during the Gulf War. The intelligence therein allowed the Department of Treasury to freeze accounts with funds valued at or above $3 million and that were suspected of having links with Iraqi President Saddam Hussein. Table 6 contains a list of institutions that actively use FinCEN databases when investigating various crimes, including financial ones.

The FinCEN administers the BSA, which requires FIs and DNFBPs to file STRs, if any. In the wake of the 9/11 events and introduction of the Patriot Act in 2001, the FinCEN's functions have been broadened beyond BSA. It merged into the Department of Treasury's Office of Terrorism and Financial Intelligence; a move that adjusted the operational capacities of the FinCEN, which were extended to include dealing with TF.

The FinCEN has a highly developed platform for receiving suspicious activity reports (SARs; in the US, the term "STRs" was replaced by "SARs") from its FIs. The FIs in the US file their SARs to the FIU using the BSA E-Filing System. This system is hosted on a secure website, providing FIs with secure access after they apply and receive a user ID and password from the FinCEN.

The number of SARs filed by FIs in the US continues to increase. However, the number of prosecutions is less than might be expected. Table 7 indicates the average number of SARs received by the FinCEN annually in 2012-2014 and the total amount of SARs reported from 2010 to 2014. Table 8 incorporates the number of SAR filings by FIs from FY 2010 to FY 2015.

The number of ML investigations is shown in Table 9, which show many cases were investigated by various LEAs in different periods. However, this does not mean that investigated cases led to the further prosecution and/or conviction. Table 10 integrates the number of charges for committing ML from 2010 to 2014. It also indicates the number of convictions and the rate of convictions for corresponding years.

Table 6

Top Five (5) FinCEN query Users in Fiscal Year (FY) 2015

Agency name	**Number of FinCEN Query Searches**
Federal Law Enforcement and other Competent Authorities	
Drug Enforcement Administration	256 011
Internal Revenue Service Criminal Investigation	223 111
Immigration and Customs Enforcement	191 324
Office of Personnel Management	189 301
Federal Bureau of Investigation	63 267
New York County District Attorney's Office	34 255
Florida Department of Law Enforcement	8 945
Illinois State Police	6 909
California Department of Justice	5 865
Texas Department of Public Safety	5 578

Note: Data are adapted from the MER of the US AML/CFT regime published in 2016 (Source: http://www.fatf-gafi.org/media/fatf/documents/reports/mer4/MER-United-States-2016.pdf).

Table 7

Reports received by FinCEN annually

Average number of reports received per year (2012-2014)					
SARs (Suspicious Activity Reports)					1 725 322
CTRs (Currency Transaction Reports)					15 283 950
CMIRs (Reports of International Transportation of Currency or Monetary Instruments)					209 918
FBARs (Foreign Bank and Financial Account Reports)					927.151
8 300 Reports (Reporting Cash Payments of over USD 10 000)					259521
Average number of Bank Secrecy Act reports received annually					**18 405 862**
Total number of Suspicious Activity Reports (SARs) reported (2010-2014)					
2010	1 326 372	**2011**	1 517 520	2014	1 973 813
2013	1 640 391	**2012**	1 587 763		

Note: Data are adapted from the MER of the US AML/CFT regime published in 2016 (Source: http://www.fatf-gafi.org/media/fatf/documents/reports/mer4/MER-United-States-2016.pdf).

Table 8

Number of SAR filings by financial institution (2010-2015)*

By	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**
Depository institutions	697 367	798 688	896 610	981 429	886 923	439 889
Money Services Businesses (MSBs)	596 494	685 009	640 419	616 761	771 025	441 383
Casinos and Card Clubs	13 987	17 627	23 401	31 919	46 575	24 900
Securities and Futures	18 758	19 903	22 437	18 808	22 448	10 492
Life Insurance Companies	N/A	N/A	726	3066	2897	569

Note: Data are adapted from the MER of the US AML/CFT regime published in 2016 (Source: http://www.fatf-gafi.org/media/fatf/documents/reports/mer4/MER-United-States-2016.pdf).

The FinCEN, according to Ryder (2012), plays a crucial role in the US AML/CFT framework for two reasons. First, it brings ML legislation into different FIs,

which should adopt reporting mechanisms, maintain records and file SARs, if any, to create a paper trail of evidence to be used by LEAs.

Table 9

ML investigations initiated by IRS-CI, ICE-HSI and the FBI (2011-2014)

Agency	FY 2011	FY 2012	FY 2013	FY 2014
Internal Revenue Service-Criminal Investigations (IRS-CI)				
ML investigations initiated	1 726	1 663	1 596	1 312
ML prosecution recommendations	1 383	1 411	1 377	1071
ML indictments/information laid	1 228	1 325	1 191	934
ML sentences	678	803	829	785
Immigration and Customs Enforcement Homeland Security Investigations (ICE-HSI)				
Financial Investigations Initiated (including for ML/TF)	6620	6526	6606	6594
Federal Bureau of Investigation (FBI)				
ML investigations	309	282	269	220

Note: Data are adapted from the MER of the US AML/CFT regime published in 2016 (Source: http://www.fatf-gafi.org/media/fatf/documents/reports/mer4/MER-United-States-2016.pdf).

Table 10

Number of ML charges, convictions and conviction rate (2010-2014)

Action	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014
18 USC 1956: Money laundering (proceeds laundering)					
Charged	1879	2147	2163	2172	1895
Convicted	934	983	958	1072	1129
Conviction rate	51%	55%	53%	59%	57%
Total for 2010-2014					
Charged	3081	3757	3754	3466	3369
Convicted	1703	1802	1884	1935	1967

Note: The data are adapted from the MER of the US AML/CFT regime published in 2016 (Source: http://www.fatf-gafi.org/media/fatf/documents/reports/mer4/MER-United-States-2016.pdf).

Second, the unit seeks to provide intelligence and analytical support to LEAs, thereby helping them perform their functions. The FATF has seen the FinCEN as the FIU that meets the standards' requirements. The FinCEN has assisted a number of other countries in creating their FIUs, and has supported the FATF in performing its tasks.

3.2.4. Financial sector and DNFBPs

This section provides general information and the amount of registered FIs and DNFBPs in the US at the time of publishing the last MER.

1. **Banking sector**: Around 1,300 depository institutions differing by size and locations are registered in the US. About half of these are banks (the six largest US banks hold more than 40% of total domestic deposits), while the others were credit unions (mutually owned and holding less than 10% of domestic deposits).

2. **Lending**: US banks offer a wide range of lending products at the commercial and retail levels. For instance, insurance companies provide commercial loans, while residential mortgage loan originators (RMLOs) offer mortgage lending in the retail mass market. A number of other lenders such as pawn shops and other **unregulated** commercial lenders also perform their business in the US, but the scale of their business operations could not be estimated.

3. **Securities dealers, mutual funds and investment advisers**: These are very high in number in the US, in the thousands. For instance, there were about 4,100 broker dealers,8,100 mutual funds with total assets of more than $15 trillion, nearly 12,100 investment advisers (IAs) were registered by the US Securities and Exchange Commission as managing $67 trillion in assets,17,000 state-registered IAs, and 325,000 state-registered investment adviser representatives.

4. **Money services businesses (MSBs)**: There are around 41,788 MSBs registered with FinCEN, of which 25,000 reported having agents. Individuals in the US send about $37 billion/year to residences abroad through MSBs, while the average remittance value of a transaction from the US to Latin America and Mexico was estimated to be between $290 and $400, respectively.

5. **Life insurance companies**: About 895 life insurance companies employing or otherwise using 1,007,600 agents, brokers or service employees provide their services in the US. These companies provide life insurance services and frequently also provide related investment savings services, including annuities.

6. **Lawyers**: There are approximately one million lawyers in the US, of whom 400,000 are the members of American Bar Association (ABA), a voluntary bar association of lawyers and law students. Lawyers are licensed by the state bar associations and bound by a professional code of ethics. Some maintain personal bank accounts for client use (mostly escrow accounts in which clients' funds are stored for future transactions).

7. **Accountants**: About 1.17 million accountants and auditors (including approximately 660,000 Certified Public Accountants [CPAs]), in the sectors of accounting, tax preparation and payroll services generating $137 billion annually conduct business in the US. Similar to lawyers, accountants are licensed professionals; however, they do not maintain private bank accounts for their clients' funds.

8. **Real estate agents**: There are about 394,400 real estate agents in the US. These are also members of various cooperative real estate associations, which can impose conditions (including financial ones) on the purchase and sale of attractive, high-value real estate, and which act as gatekeepers.

9. **Dealers in precious metals and stones**: Approximately 200,000

10. **Trustees**: The exact amount of trustees could not be identified as these kinds of arrangements are not registered or subject to supervisory oversight. Any natural person may act as trustee. The only identifiable groups of professional trustees in the US are trust companies, which are FIs with fiduciary powers to act as trustee. However, the BSA does not provide any explicit obligations for trustees.

According to the last MER, DNFBPs (other than casinos) are not required to report SARs. However, they are obligated to report their SARs via designated Form

8300, which requires FIs to file SARs on transactions with currency or other monetary instruments of $10,000 or more.

Table 11

Number of depository institutions

No. of Regulated entities for BSA examinations						2015 Assets under supervision (USD trillion)
Federal Banking Agency (FBA)	**2011**	**2012**	**2013**	**2014**	**2015**	
Board of Governors of the Federal Reserve System (BGFRS)	1 047	1 063	1 064	1 065	1 058	5.8
Federal Deposit Insurance Corporation (FDIC)	4 598	4 460	4 312	4 138	3 995	2.7
Office of the Comptroller of the Currency (OCC)	2 086	1 955	1 810	1 663	1 537	11.1
National Credit Union Administration (NCUA)	7 179	6 888	6 620	6 620	6 350	1.2

Note: Data are adapted from the MER of the US AML/CFT regime published in 2016 (Source: http://www.fatf-gafi.org/media/fatf/documents/reports/mer4/MER-United-States-2016.pdf).

3.2.5. Concluding remarks

As can be seen, the US stays at the forefront of the global fight against ML, TF and other threats to the integrity of its domestic and international financial framework. In this regard, Ryder (2012) contended this should not be surprising because of the scale of funds that pass through the US banking system.

St. Goodspit acknowledged that the US pursues high-value appropriation for the committing of ML offenses, and penalizes FIs that demonstrate non-compliance with the FATF standards (personal communication, May 20, 2017). For instance, in 2014 alone, confiscations and penalties totaled almost $4.4 billion (FATF, 2016).

J. Connor reported that LEAs in the US make good use of their extensive investigation capabilities and intelligence to uncover and address criminal cases, including financial crimes (personal communication, May 15, 2017).As shown above, the US actively pursues international cooperation. It also provides good-quality, constructive MLA to other countries.

While the US appears to have a robust AML/CFT regime, its regulatory framework still has a number of serious gaps. The last MER demonstrated the regulatory framework in the US is less well-developed and has some significant inadequacies. One was considered to be connected with minimum coverage of certain types of DNFBPs. These are investment advisers, lawyers, accountants, real estate agents, trusts and company service providers.

Another shortcoming of the US AML/CFT system, as identified in the last MER, is the lack of timely access to intelligence with regard to beneficial ownership from FIs and DNFBPs. There was also no uniformity found at the state-level AML/CFT efforts, and it was unclear whether the same AML/CFT procedures are applied in every state. Lastly, a lack of comprehensive AML/CFT supervisory procedures for DNFBPs was found. All these gaps indicate the US remains vulnerable to potential threats from ML and associated offenses. In this regard, the FATF implored the US to continue improving its AML/CFT system.

3.3. UK in the international AML/CFT framework

The United Kingdom of Great Britain and Northern Ireland, commonly the United Kingdom (UK), is a political union made up of four constituent countries: England, Scotland and Wales on the island of Great Britain, and Northern Ireland. Official estimates in 2004 indicated a population of 59,834,300. The UK’s overall population density is one of the highest in the world, with about a quarter living in England's prosperous southeast, and is predominantly urban and suburban, with about 7.2 million in the capital, London (FATF, 2007).

The country was one of the 28 EU member states, but since its referendum in June 2016 it is no longer a member. The UK ranks as one of the world’s top three financial centers, alongside the US and Japan. Additionally, based on market exchange

rates, it is the fifth-largest economy in the world. The UK is also Europe's second largest economy, after Germany, and the sixth-largest overall by purchasing power parity (PPP) exchange rates (ibid).

The financial sector is the largest contributor to the UK's balance of payments, and a major contributor to its GDP and employment. Within the UK, the importance of London is core to the country's international position. The city is one of the three leading global financial centers, together with New York and Tokyo. London receives revenue from possessing the largest share of many international financial markets (IFSL, 2009).

The UK's financial sector includes banking, insurance, fund management, securities dealing, derivatives and fund management; the UK has one of the largest commercial banking industries. Authorized banks in the UK totaled 324 as of the end of March 2008, including 250 foreign banks, which were de-facto located in the UK.

Assets and liabilities of the UK's banking sector comprised 7,917 billion GBP as of the end of 2008. Foreign banks, mostly from Europe, hold over one-half of UK banking sector assets (IFSL, 2009). These assets are the second largest in the world and the country is the largest center for cross-border banking, with 18% of international bank lending in 2008 (IFSL, 2009).

According Pieth and Aiolfi (2004) London stays ahead of New York, Paris and Frankfurt for number of foreign banks. Additionally, London is one of the most important centers for private and investment banking. Around one-half of European investment banking activity is conducted in London. Twelve major retail banks in the UK dominate this sector (IFSL, 2009).

Pieth and Aiolfi (2004) asserted that in London the movement of capital is relatively free and easy. Ryder (2012) argued that the extent of ML in the UK is hard to calculate and estimates vary. For instance, the Financial Services Authority (FSA) (per

Ryder, 2012) reported that the amount of laundered money in the UK ranges from 23 billion to 57 billion GBP. Meanwhile, Her Majesty's (HM) Treasury suggested a more conservative 10 billion GBP.

The UK has a comprehensive legal structure for combating ML and TF (Ryder, 2012; FATF, 2007). However, as Pieth and Aiolfi (2004) wrote, the UK's AML/CFT system has been criticized for lacking effective enforcement of its legislation. As the National Risk Assessment (NRA) of the UK's AML/CFT system demonstrates the issues with ML and other relevant offenses in the UK are related to the size and complexity of the its financial sector (HM Treasury-Home Office, 2015, p.4). This could mean the UK is more exposed to criminality compared with that in financial sectors in many other countries.

3.3.1. UK's AML/CFT regulations

Pieth and Aiolfi (2004) reported the development of the AML/CFT regime in the UK is a relatively recent phenomenon. At the early stages of its establishment, the legal framework for dealing with laundering of drug-related proceeds was only noted by the Misuse of Drugs Act enacted in 1971. However, as Pieth and Aiolfi (ibid) noted, it was not until the 1980s before public and political concern made a considerable shift toward the issue of ML in the UK.

In 1986, the UK Parliament enacted the Drug Trafficking Offences Act to deal with the laundering of drug-related proceeds (Pieth & Aiolfi, 2004). While the initial focus of AML-related regulations was geared toward dealing with proceeds from drug-trading, the adoption of the Prevention of Terrorism Act in 1989 extended the scope of ML-related offenses to include terrorism. This act was further repealed and replaced by the Terrorism Act in 2000 (FATF, 2007).

The UK's AML/CFT regulations were subsequently amended via a number of other laws, such as the Criminal Justice Act of 1988, which extended the country's AML provisions to include all indictable offenses; Criminal Justice Act of 1988, which criminalized drug-related ML; and Money Laundering Regulations of 1993 and 2001, which required FIs to implement CDD procedures, record keeping, internal control mechanisms, and also extended the application of AML measures to a number DNFBPs (Pieth & Aiolfi, 2004).

The current legislation that criminalizes ML in the UK is the Proceeds of Crime Act (POCA), enacted in 2002. This act considers the single set of ML offenses, such as concealing criminal property or arrangements with respect to criminal property, to be applied throughout the UK to all criminal proceeds (FATF, 2007). Moreover, POCA provides the framework for asset recovery in the UK, as well as a number of investigative powers to enable LEAs to investigate ML (HM Treasury-Home Office, 2015).

3.3.2. Implementation of international regulations in AML/CFT field

The UK, as one of the founders of the FATF, continues to play a leading role in developing and promoting global standards in the AML/CFT area (HM Treasury-Home Office, 2015, p.13). The UK has implemented a number of requirements coming from different legislative instruments that have been recognized internationally (Ryder, 2012). For instance, the country signed the Vienna and Palermo Conventions. In doing so, the UK introduced a number of changes to its legislation and brought it in line with the requirements stipulated in the above-mentioned international statutes.

Among other achievements of the UK's AML/CFT system is an act performed by the Bank of England that supported initiatives stemming from the Basel Principles on Banking Supervision. These initiatives were developed to protect legitimate financial

sector from being misused (Pieth & Aiolfi, 2004). Ryder (2012) reported that the UK, unlike the US, had to implement several AML directives coming from the EU.HM Treasury leads the UK delegation to the FATF meetings and represents the UK at FSRBs (HM Treasury-Home Office, 2015, p.13).

The UK has clearly recognized and implemented international best practices and industry guidelines in AML/CFT. The membership of the UK FIU in the Egmont Group of FIUs, and the fact the UK was one of the founders of this group, could serve as an example of the country's involvement in AML/CFT-related international affairs. The UK's stance on cooperation with its foreign counterparts is visible from the number of requests made by foreign FIUs to the UK FIU from 2002 to 2006 (Table 12).

Additional evidence of the UK's positive stance toward combating ML and associated offenses is the membership of its FIs in the Wolfsberg Group. Finally of note is the UK's presidency in the FATF in 2007, which also demonstrates a high level of political will and commitment in implementing and promoting the FATF standards.

Table 12

Requests received from foreign FIUs

Year	2002	2003	2004	2005	2006
Requests received	353	529	465	366	525
Average response time (days)	54	63	110	148	22

Note: Data are adapted from the MER of the UK AML/CFT regime published in 2007 (Source: http://www.fatf-gafi.org/media/fatf/documents/reports/mer/MER%20UK%20FULL.pdf).

3.3.3. Competent authorities in the UK

In the UK, as in the US, the AML/CFT regime is administered by many primary, secondary and tertiary authorities. The UK's primary authorities are HM Treasury, the Home Office, and Foreign and Commonwealth Office (Ryder, 2012). HM Treasury accounts for a leading primary authority, and is responsible for overseeing implementation of the international AML/CFT standards in the country. The Home Office, ranked as the second primary agency, is responsible for managing the LEAs in

the UK in relation to tackling ML, TF and correlated predicate offenses. The Foreign and Commonwealth Office role in the chain of primary bodies is monitoring implementation of international treaties and conventions concerning AML/CFT.

The primary authorities listed above are supported by a number of secondary bodies in performing their functions. These secondary authorities are represented by the Financial Services Authority (FSA), Serious Organized Crime Agency (SOCA), National Crime Agency (NCA), HM Revenue and Customs, and Crown Prosecution Office (CPO), among others (Ryder, 2012; HM Treasury-Home Office, 2015, p.26). As can be seen, the abundance of the UK's secondary authorities is nearly the same as for the US; among them, SOCA and NCA are discussed in this section.

SOCA was formerly the UK FIU and administered the assets-recovering provisions under POCA. The functions of the UK FIU were first carried out by the Economic Crime Unit (ECU) within the National Criminal Intelligence Service (NCIS) in 1992. SOCA was established following the requirements of the Serious Organized Crime and Police Act enacted in 2005. SOCA, until ceasing its functions, had been fulfilling a number of tasks, such as tackling serious organized crime and collecting crime-related intelligence (Ryder, 2012).

The creation of the NCA was announced by the Home Secretary (a senior official within HM Government) in June 2010. Its objective was to deal with issues such as organized crime, fraud, cybercrime and border protection (Ryder, 2012). After these changes in the UK's legal framework, the role of the UK FIU was transferred to the NCA. The UK FIU now operates within the Economic Crime Command in the NCA (HM Treasury-Home Office, 2015, p.25).

The UK FIU belongs to the law enforcement type of the correspondent units and is tasked with receiving, analyzing and distributing financial intelligence collected from FIs. FIs in the UK submit their SARs to the FIU (in the UK, as in the US, the term

"STRs" is replaced by "SARs") when they have reasonable grounds to suspect funds are the proceeds of crime related to TF (FATF, 2007).The UK FIU, besides analyzing SARs, makes them available to LEAs for further investigation, except for SARs that belong to sensitive categories (ibid).

The UK FIU receives the largest amount of SARs of any country in the EU. From 2013 to 2014 it received around 354,000; an 11% increase over 2012 to 2013 (HM Treasury-Home Office, 2015, p.25). However, according to HM Treasury-Home Office (2015, p. 40-41), these figures are low compared with the overall size of the sector and nature of the activities it undertakes. Moreover, in SARs received from the accountancy sector, in 21% of submitted reports the reason for suspicion was not clearly explained. Meanwhile, in 50% of reports the FIs did not clarify what kinds of services were provided for their customers when suspicion arose.

The amount of SARs analyzed by the UK FIU is small compared with the amount of SARs received. The UK FIU usually seeks to analyze and disseminate SARs that have the greatest impact on reducing risk to the UK financial framework (HM Treasury-Home Office, 2015, p.35). Almost all SARs received are made available to LEAs and other end users of analysis, such as FIs and DNFBPs (FATF, 2007).

FIs in the UK have several options when filing their SARs with the UK FIU. For instance, they file either through the "MoneyWeb" site that provides a secure extranet system for electronic reporting and submission of SARs for businesses reporting 250+ a year, or through encrypted email, a secure email system for electronic reporting and submission of SARs for major reporters such as banks and money transfer services (e.g., Western Union).

Reporting entities may also file SARs online through a National Crime Agency website (http://www.ukciu.gov.uk). FIs can also use compact discs to enter their reporting files, and then submit them to the UK FIU in a predetermined manner. The

last option FIs may use to submit their SARs to the UK FIU is providing hard copies via post or fax using the FIU's preferred form, letters, or the FIs' own version of SARs (FATF, 2007).

The UK FIU maintains statistics of SARs received, including a breakdown of the type of FI, DNFBP, or other business or individual filing a SAR (HM Treasury-Home Office, 2015, p. 93). Table 13 illustrates part of the total amount of SARs reported to the UK FIU by sector and year from 2002 to 2006. From the last MER, published in 2007, on the UK's AML/CFT regime, the below-mentioned statistics demonstrate reporting from different regulated sectors. The numbers are also found to increase over time; thus indicating a level of awareness of the AML/CFT regulations and the ability to recognize and report suspicious activity. Table 14 provides the number of defendants proceeded against for ML-related offenses.

Table 13

Total number of SARs reported by sector and year

Sector	2002	2003	2004	2005	2006	Total	% Total
Accountant	155	692	7 521	14 567	9 896	32 831	4.58
Anonymous	15	43	266	303	145	772	0.11
Banks	37 871	67 094	96 799	127 918	142 140	471 822	65.85
Barristers		172	82	67	33	354	0.05
Bureaux de change	8 220	6 370	5 467	3346	3 045	3 045	3.69
Cheque Casher	98	581	360	474	2 134	3 647	0.51
Estate Agents	7	5	104	209	129	454	0.06
Finance Companies	674	820	678	1 452	1 869	5 493	0.77
Foreign entities		1		1	23	25	0.00
High Value Dealers	277	275	143	107	42	844	0.12
Independent Financial Advisors	117	221	267	320	227	1 152	0.16
Money Transmission Service	1 232	6 754	4 431	9 140	6 732	28 289	3.95

Note: Data are adapted from the MER of the UK AML/CFT regime published in 2007 (Source: http://www.fatf-gafi.org/media/fatf/documents/reports/mer/MER%20UK%20FULL.pdf).

Tertiary authorities in the UK are represented by the British Bankers' Association, Joint Money Laundering Steering Group (JMLSG), and Finance and Leasing Association, among others. Given the limitations of this particular section, only the JMLSG is briefly discussed herein. The JMLSG comprises 17 of the primary

leading trade associations in the UK. Its objective is to disseminate good practice among the UK's FIs to counter ML through issuance of various guidelines. It has been producing its anti-money laundering guidance since 1990. The JMLSG periodically reviews its guidelines, and introduces amendments if required.

Table 14

Defendants proceeded against for money laundering related offences

Year	**2003**		**2004**		**2005**	
Legislation	Proceeded Against	Found guilty	Proceeded against	Found guilty	Proceeded against	Found guilty
POCA	89	15	413	129	1302	566
Criminal Justice Act 1988	131	58	96	50	5	5
Drug Trafficking Act 94	80	50	43	28	20	24

Note: Data are adapted from the MER of the UK AML/CFT regime published in 2007 (Source: http://www.fatf-gafi.org/media/fatf/documents/reports/mer/MER%20UK%20FULL.pdf).

3.3.4. Concluding remarks

As can be seen, the UK and US have adopted aggressive stances toward combating ML and associated offenses. As Ryder (2012) stated, the UK has implemented all international AML/CFT standards at the scale exceeding international benchmarks. The UK has been a member of the FATF since its creation and has been the subject of several mutual evaluations. It has recognized, and taken a positive approach toward, implementing and promoting the FATF standards. As a result of the last mutual evaluation, the UK is regarded as a country with a satisfactory level of compliance with the FATF standards.

Despite all the above achievements of the UK's AML/CFT regime, the country still lacks a comprehensive approach with regard to effective enforcement of its AML/CFT regulations. This deficiency is similar to that found by FATF experts in the US. Though the UK has shown a relatively high level of compliance with the FATF standards, it still has certain strategic deficiencies in terms of legal enforcement when implementing AML/CFT legislation.

Additionally, in the UK, cash remains one of the primary means when committing ML and other financial crimes. According to HM Treasury-Home Office (2015, p.4) cash-based ML, particularly cash collection networks, international controllers, and money service businesses, pose high ML risks to the country's legitimate financial environment.

Although the UK government has continuously invested in efforts to tackle cash-based ML and the illicit drug trade, this is still recognized as one of the most risky areas. It should be also emphasized that the overall threats to the UK from serious organized crime and contingent ML were regarded as high according to the last MER. Moreover, the UK government estimated the economic and social costs of serious organized crime, including expenses toward combating it, exceed 20 billion GBP/year (FATF, 2007). These numbers demonstrate that regardless of the UK having a comparatively sound AML/CFT regime, it is still vulnerable to potential threats from illegal undertakings affecting its society.

The last MER demonstrated a number of specific deficiencies found by the FATF experts. These were insufficient CDD procedures in the FIs, no requirement set in the regulatory framework for identification of beneficial ownership, no explicit obligation to obtain information on the purpose and nature of the business relationship in the UK in all cases, and no specific obligations for FIs and DNFBPs to pay special attention to all complex, unusually large transactions, or unusual patterns of transactions that have no apparent economic or lawful purpose. In this regard, the FATF also implored the UK to continue improving its AML/CFT system.

At the time of writing this section, it was found out that the UK's government impulse the establishment of Joint Money Laundering Intelligence Taskforce (JMLIT) in May, 2016. This JMLIT brought together LEAs of the UK and representatives of financial sector to combat ML and associated offences. Initiative was originally driven

by the UK's banks and LEAs with a full support of HM Government and Home Secretary. This team has identified goals, which are meant to ensure the cleanliness of the UK's financial markets since criminals target them to launder proceeds of crime. Moreover, the team aimed at enhancing the UK's international reputation for tackling economic crimes effectively.

This JMLIT stance for providing an environment for financial sector and government to exchange and analyse intelligence to detect, prevent and disrupt ML and wider economic crime threats against the UK. JMLIT includes twelve major banks that operate in the UK. These are Barclays, HSBC, BNP Paribas, Royal Bank of Scotland, JPMorganChase among others. The effective cooperation of this team, according to the webpage of NCA (2017), has already led to the following results between May, 2016 and March, 2017:

1. 63 arrests of individuals suspected of money laundering;
2. The instigation of more than 1000 bank led investigations into customers suspected of money laundering;
3. The identification of more than 2000 accounts previously unknown to law enforcement;
4. The heightened monitoring by banks of more than 400 accounts;
5. The closure of more than 450 bank accounts suspected of being used for the purposes of laundering criminal funds;
6. The restraint of £7m of suspected criminal funds; and
7. The granting of in excess of 40 Proceeds of Crime Act orders

In addition, JMLIT has developed 19 alerts and one strategic assessment on ML typologies currently being used by criminals to launder their criminal proceeds through the UK's FIs. The UK is the first country that created this kind of taskforce, which demonstrates that the FIU and other competent authorities in combination with FIs

could work as a team and achieve effective results. This JMLIT is the first taskforce that began the era of joint actions against the use of legal financial environment for illegal purposes. With this in mind, it could be argued that if every country takes the same stance towards fighting ML and associated offences, it could help to minimize the negative impact of these undesirable phenomena.

3.4. Summary of the chapter

This chapter presented an overview of AML/CFT regimes of the US and UK, with an emphasis on how these countries established, developed and upgraded their national systems. It became apparent these countries have strong understanding of the risks ML, TF and other predicate offenses pose, and have been rigorously implementing the FATF standards and other international AML/CFT regulations. Nevertheless, the US and UK still have a number of strategic deficiencies in fulfilling their obligations in terms of enforcing implementation of their AML/CFT regulations by FIs and DNFBPs.

CHAPTER 4

ANALYTICAL FRAMEWORK

4.1. Introduction

After reviewing a considerable amount of materials on the research topic, it became apparent that a particular theory was needed to address the research questions. Accordingly, a selection of relevant systems of thought demanded meticulous attention and a number of continuous efforts. With this in mind, three particularly relevant theories-the Walker Gravity Model, theory of crying wolf and systems theory-were studied in an attempt to explore possible solutions to the issue at hand.

These theories were considered independently from one another and are presented in this section as follows: an introduction of each theory, discussion on the theories' perspectives, and theories' shortcomings in addressing the research problem. This chapter begins with interpretation of a number of theories that were reviewed in the early stages of the research process. Next is a description of the main theory. The last section summarizes the chapter.

4.2. Analytical framework

4.2.1. Walker Gravity Model

The history of international efforts in the AML/CFT area demonstrates that policies against illegal use of the international financial system were mainly "case-oriented." However, in the latter few decades of the 20th century, a methodology was put into practice and took the ML problem toward "problem-oriented policing," which involved looking beyond individual cases to discover patterns and causal factors (Walker & Unger, 2009).

The economics of ML, aimed at exploring the scale and impact of illicit funds, is a relatively new field (Masciandaro et al., 2007) and, according to Walker and Unger (2009), is politically supported by the FATF. As stated, per IMF estimations, around $2 trillion is laundered annually, constituting 2% to 5% of the global GDP (Lilley, 2006). However, the method of this estimation is not traceable, even by academics conducting intensive studies within the IMF, and seems more a wet finger approach than serious measuring (Thoumi, 2003; Truman and Reuter, 2004).

The Walker Gravity Model was the first serious attempt at quantifying ML on a global scale (Walker & Unger, 2009). In 1995, a prototype of the model was developed and subsequently suggested $2.85 trillion was laundered globally. This exceeded figures suggested by IMF Managing Director Michel Camdessus in 1998.

Walker's prototype gravity formula assumes the following variables to estimate the global scale of ML:

$$F_{ij}/M_i = \text{Attractiveness}/\text{Distance}_{ij}^2 \text{ where}$$

$$F_{ij}/M_i = (\text{GNP/capita})_j * (3BS_j+GA_j+SWIFT_j - 3CF_j - CR_j +15)/\text{Distance}_{ij}^2$$

In this formula F_{ij}/M_i is the share of proceeds of crime that country I sends to country J, GNP/capita is GNP per capita, BS is banking secrecy, GA is government attitude, SWIFT is the SWIFT member, CF is conflict, and CR is collusion. The "distance" factor in the model is the number of kilometers between countries.

The basis of this formula was used to quantify the scale of ML. The model uses publicly available crime statistics to estimate the amount of money generated through crime in every country, and considers socio-economic indicators in estimating the proportions of funds that will be laundered and the countries where funds will be effectively legalized. An assessment can be made of the likely extent of global ML by aggregating these estimates.

The Walker Gravity Model was remarkable in terms of techniques used to quantify the scale of ML in a global context. Considering the necessity of informative statistics in the AML/CFT field, the model represented a coherent approach to drawing conclusions on the degree of compliance with the FATF standards in different countries. However, the model was not regarded as one that could be used when conducting the present study. This decision was bolstered by the fact this model is mostly statistics-oriented, and as such could not be utilized to address the present research problem, which deals with issues concerning relationships between the FIU and FIs.

4.2.2. Theory of Crying Wolf

Money laundering is receiving greater attention as a phenomenon that could lead to the wide range of consequences discussed in this paper thus far. The FBI, among other institutions measuring the global scale of ML, estimated that $1.5 trillion is laundered annually (Takáts, 2007). Additionally, discovering terrorist groups' involvement with ML after the 9/11 attacks became a national security concern.

As a response to those challenges, law enforcement agencies began paying meticulous attention to predicate offenses for ML. Most importantly, they required banks to report and identify suspicious activities; institutions failing to do so would face fines. Banks responded with an explosive number of reports that in many cases contain licit activities. In *The Wall Street Journal*, for instance, a case of falsely reported former presidential candidate and US Senate Majority Leader Robert Dole was discussed; a case that indicated improperly filed STRs could victimize innocent parties (Takáts, 2007).

However, when reporting cases are excessive, the FIU may not consider them as real cases of ML, and subsequently pay them less regard. In other words, two sensitive actions take place while reporting: first, there is production of false reports that may

involve innocent parties, and second, the lack of attention paid to these reports potentially risks ignoring of actual ML cases. The exponential increase in the number of reports can be called the "crying wolf" phenomenon. This phenomenon was used as a theory in an IMF working paper written by Takáts in 2007, titled, "A Theory of 'Crying Wolf': The Economics of Money Laundering Enforcement."

The meaning here comes from one of Aesop's Fables, *The Boy Who Cried Wolf*. This tale describes a young shepherd who repeatedly tricks nearby villagers by saying that wolves are attacking his herds of sheep. When one actually does appear and the boy again calls for help, the villagers believe it is another false alarm and the wolf eats the sheep. This metaphor ideally represents a situation of excessive reporting, as the FIU in such a case pays insufficient attention when receiving huge amounts of meaningless reports from FIs. Takáts used this metaphor to demonstrate how excessive reporting could dilute the information value of these reports.

Takáts (ibid) developed a model that explicitly investigated the agency problem between government and bank, wherein the government needs information from the bank to investigate a transaction that may or may not be ML. The economy of the model consists of a single money transfer. The transaction is either ML or a legitimate transfer. The probability that the transaction is ML is $\alpha \in (0, 1/2)$. ML causes harm ($h>0$) to society. The government and bank are modeled explicitly and form a principal-agent relationship, wherein the bank maximizes private profit and the government maximizes social welfare.

Meanwhile, the cost of maintenance and reporting decreases the bank's private profit. Of course, the bank does not prefer this, while it constitutes a reason for filing large numbers of potentially meaningless reports via a simple technological solution, thereby reporting everything, be it innocent or guilty. Profits are naturally decreased by the fine, and for this reason banks assign a transaction fee including the cost of

compliance to the customer, and the bank's cost of undertaking the transaction is normalized to zero.

According to Takáts (ibid), the agency problem arises because the bank does not internalize the social gains stemming from prosecution of ML. That is, banks are less sensitive to the social gains that could result from the prosecution of cases regarding ML and other correlated offenses that, in turn, affect the primary objective of the bank; i.e. making money. Therefore, the government implements fines to encourage socially desirable policies and make the bank successfully monitor and report.

Takáts (ibid) used a Bayesian theorem to determine ML probability using equations β_0 and β_1, which illustrate the likelihood of ML considering whether the signal is low or high.

$$\beta_0 = \Pr(ML|\sigma = 0) = \frac{\alpha(1-\delta)}{\alpha+\delta-2\alpha\delta}$$

$$\beta_1 = \Pr(ML|\sigma = 1) = \frac{\alpha\delta}{1-\alpha-\delta+2\alpha\delta} > \beta_0$$

where β_0 is the low signal of ML, $\beta_1$is the high signal of ML, *Pr* is the probability ML occurs, σ is the signal of transaction, δ is the precision of the signal, and α is a plane angle. To test the model, Takáts provided two predictions that can be investigated empirically. These predictions were based on information regarding the number of SARs filed with the FinCEN and the number of prosecutions subsequently rendered on those reports.

FinCEN testimonies also support the model's predictions by describing "defensive filing" as strikingly similar to the effects of crying wolf, indicating that the number of SARs filed with the FIU skyrocketed and banks filed reports regardless of the level of suspicion. This resulted in law enforcement efforts being compromised by this large number of filings (ibid).

Takáts' (2007) model illustrated how excessive reporting can dilute the information value of reports. Excessive reporting in the model was investigated by undertaking formal analysis of ML, wherein banks monitor transactions and report suspicious activity to the respective government agencies, which use these reports to conduct further investigation. If banks fail to report ML when it occurs, the government imposes fines. The model was used to suggest implementable corrective policy measures, for a decrease in the amount of fines and introduction of reporting fees, which could help manage misunderstandings between authorized government bodies and FIs.

The metaphor of crying wolf, as adapted by Takáts (2007), helped in understanding underlying aspects of FIs' behavior, which could show false tolerance with the AML/CFT regulations in their filing enormous amounts of ultimately meaningless reports with the FIU. A concept considered self-conscious among FIs in terms of STR submission, where fines are imposed by the FIU, could also eventually lead to increased numbers of such meaningless reports.

Nevertheless, the theoretical background from Takáts (ibid) was not considered sufficient for addressing the research problem, as this study still required a theoretical framework to more broadly explain the relationships between the FIU and FIs. Takáts' perspective with respect to decreasing fines and introducing reporting fees seems ambiguous because even if a government (FIU) takes such action, it is less likely FIs will be happy with this, as they could earn much more money from their high-net-worth individuals compared with that from reporting fees.

All things considered, Takáts and his use of implications those of agency theory helped find connections with regard to the possible application of this theory for the present study.

4.2.3. Systems Theory

Demetis (2010) argued that AML is a demanding research domain and interdisciplinary at its core. As a research area, it draws researchers from a wide range of fields. Those doing research in this particular area could examine the interference and consequences of law for AML purposes across various nations. Researchers from social sciences or economics backgrounds maybe interested in the effects of AML on socio-political and economic fields, while those who represent sciences such as physicians and mathematics may engage in modeling activities perceived in the area.

Systems theory, according to Demetis (2010), should be thought of as a collection of highly abstract concepts applicable to a series of problem fields. For this reason, Demetis (ibid) employed the theory in *Technology and Anti-Money Laundering: A Systems Theory and Risk-Based Approach*. This book provided a theoretical approach to describing the domain of AML as a system itself, while at the same time examining the consequences by which technology comes into play within the system.

Demetis (2010) used systems theory to examine a variety of information systems and their connections with AML compliance by entities in charge of combating use of the international financial system for illegal purposes. Demetis (ibid) described application of systems theory to AML through empirical findings on the multitude of interactions that are technologically supported and construct a much more complex picture of dealing with AML, thereby influencing how ML is perceived.

The empirical findings to make use of systems theory were carried out based on a case study on Drosia Bank (altered name). Application of systems theory to the AML system demonstrated that a variety of technological solutions applied for AML purposes may affect AML within a bank. In other words, even high-tech solutions may not help build a robust AML system. Organized inaccurately, technology may affect the performance of the AML regime.

Viewing the AML system through systems theory may influence the way ML analysis teams perform their duties. The effects of these interactions could impact the functioning of the FIU, which is burdened with receiving an increasing number of STRs (Demetis, 2010). Eventually, the information that was supposed to be useful could become problematic when the AML system becomes harder to manage. Systems theory as applied by Demetis (2010) in his seminal work did not fit the needs of the present study, which was aimed at disclosing tacit ideas behind interaction between the FIU and FIs. However, the theory helped in understanding the role of technology when complying with the FATF standards.

4.3. Agency theory

As explained, a considerable number of attempts were made for finding the most suitable theoretical framework for the present study. Reviewing such theories as the Walker Gravity Model, theory of crying wolf and systems theory resulted in accepting them as non-compliant systems of thoughts in addressing the study goals, for a variety of reasons as explained above. Therefore, another attempt was made with the aim of discovering a theory that could help to examine the research problem from other theoretical perspectives.

After additional research, it became apparent the most suitable theory for helping to address the needs of the present study was agency theory. Numerous papers were reviewed before making arriving at this decision. The most relevant sources for understanding agency theory were mainly represented by such articles as “Agency Theory: Background and Epistemology” (Bendickson et al., 2016) and “Agency Theory: An Assessment and Review” (Eisenhardt, 1989). By reviewing these materials’ background knowledge was obtained on the history of agency theory, especially how the theory was formulated and which school of thought influenced its emergence.

Agency theory describes relationships between a principal (a natural or legal person who has controlling authority) and an agent (one who is authorized to act for, or in the place of, another). The literature on agency theory focuses on prerequisites and consequences that may result when trying to mutually align the interests of the principal and agent.

Famed economist Adam Smith noted the problem between the principal and agent a long time ago in his seminal book, *The Wealth of Nations*, published in 1776. As Bendickson et al. (2016) emphasized, the book demonstrated how the emergence and increasing hegemony of capitalism mechanisms established a hazardous chasm between owners and managers. Smith (1776) also concluded that other people's money could not be watched with the same level of anxiousness as if they were the directors' own assets. That is, according to Smith (ibid), negligence and excess always prevail in management of a company.

4.3.1. History of the agency theory

A look into the history of how agency theory was formulated may help in understanding the factors that influenced its emergence. As Bendickson et al. (2016) acknowledged, one of the most significant contributions to the development of agency theory was made by German sociologist Max Weber. In 1947, Weber published a paper on bureaucracy that represented an important attempt to contend with the agency problem.

Weber's paper described an ideal type of bureaucracy in which individuals were rational, while people clearly understood and respected rules and preferences. For Weber, the basis of bureaucracy was that one party (natural or legal person) could make a legal claim to be engaged in certain activities, and enter into relationships by their own choice. However, their membership in the organization was based on the rules that

had been set. In Weber's ideal type of this bureaucracy, the agency problem was no longer a pressing issue, owing to the fact that either principal or agent had well-defined tasks and responsibilities.

For Weber, a leader's capacity to enforce expectations came from law. Yet at the same time, the agent could leverage their skills to perform work that the principal was unwilling or unable to do. Nevertheless, contractual obligations and enforcement mechanisms limited the ability of the agent to exercise their willing. Unfortunately, as Bendickson et al. (2016) concluded, Weber's type of bureaucracy could not be employed these days in its original form, and bureaucracy was criticized by many scholars.

According to Bendickson et al. (2016), Robert Merton was among scientists who criticized bureaucracy at an early stage. Merton (1940) argued that bureaucracy was problematic because it separated individuals from their personality. Another criticism came from Herbert Simon, a Nobel Laureate in economics. Simon's (1965) paper on administrative behavior contributed to the field of management by providing an intellectual rationale as to why management mattered. An ideal type of bureaucracy assumed that in a modern economy all prices were known and individuals were rational and educated, while Simon (ibid) believed that individuals were boundedly rational; i.e., their rationality was limited by factors such as information asymmetry, cognitive ability and time.

Simon (1965) claimed that previous scholars had failed to note or fully explores the difficulties that bounded rationality could pose for organizations. Seen from this perspective, as Bendickson et al. (2016) contended, managerial orders may not be understood because of individuals' bounded rationality. Hence, the agency problem could emerge not from the underhandedness of the agent (or principal), but as a natural result of poor communication.

A number of other scholars, including Chester Barnard and Mary Parker Follett, have also contributed to the development of agency theory (Bendickson et al., 2016). Both were concerned with the development of cooperative systems and how these systems could survive a world in which conflict and power seemed to be prioritized over cooperation. Unlike Weber, Barnard and Follett recognized that humanity was too capricious to accept knowledge and authority as a guide (Whyte, 1969).

Barnard (per Bendickson et al., 2016) believed the only way for authorities to be treated well depended on the consent of the governed agents that could be reached if people were well-motivated. Barnard also acknowledged that organizational pride, purpose and culture could guide workers' behavior. Additionally, Barnard's recognition of people's capability for self-determination, and the notion that individuals could have interests besides the cooperative, were central to understanding the principal–agent problem (Keon, 1986).

Follett, guided by ideas of German idealism, especially the works of Johann Gottlieb Fichte, believed people's rights and true selves emerged from their social relationships (Bendickson et al., 2016). Therefore, the principal issue, from Follett's perspective, was how to maintain cooperative systems wherein rights and values emerged from social interaction.

Recognizing how cooperative systems could break down, and that people gain identity through social systems, Follett understood how the principal-agent conflict could occur (Bendickson et al., 2016). More specifically, Follett (1998) recognized that managers and owners were needed one another, as without capital, managers would not be able to run competitive companies, while without managers, owners would not be able to separate themselves from running the company and, would therefore be forced to learn management skills necessary to run the company. Hence, finding a way to integrate the needs of both parties tricks principal and agent relationships.

Follett (1924) believed conflict resolution systems should be developed based on compromise, and contended there were three general mechanisms that could help to solve the agency problem. Among them, only one truly stood the test of time. The first mechanism was domination of one side over another. However, domination was a poor option for two reasons: (1) it was almost impossible for owners to completely dictate terms to managers and (2) considering managers did not own the company, they could not easily dominate owners (Bendickson et al., 2016).

Follett's second mechanism was compromise; i.e., meeting in the middle with concessions. However, as neither side gets what it wants, this could cause negative feelings and emergence of other divisive issues (Wright, 2000). The third mechanism was integration; i.e., combining what both sides want into a unique solution, which was regarded as the key to reducing and/or resolving the agency problem (Bendickson et al., 2016). In the agency context, as Bendickson et al. (ibid) argued, principals generally want agents to take greater risk, and agents are often risk-averse because their wealth is tied into the corporation.

Considering the range of ideas presented by different schools of thought, the emergence of a coherent agency theory did not occur until the 1970s to 1980s, in what was developed by Jensen and Meckling (1976) and Fama and Jensen (1983). Agency theory emerged in the 1970s because of a decline in the US economy, as in the 1930s (Bendickson et al., 2016). For this reason, some of the most interesting feedback regarding agency theory originated from the Chicago School of Economics, a citadel of free-market capitalism under the intellectual leadership of Milton Friedman, George Stigler and other leading experts from the 1950s to 1980s (Yergin & Stanislaw, 2002).

The core thesis of Jensen and Meckling (1976) was that the market provides incentives to limit agency; in particular, it provides incentives to both parties to limit agency costs. This is done not to let the agents improve their skills, as they might want

to obtain a better position in the market. This could occur because of the efficiency of markets in which information is well-known and easily disseminated (Bendickson et al., 2016). Therefore, companies, especially the decision makers, have incentive to reduce agency costs. If they fail to do so, negative consequences emerge. Thus, if there is an issue with a firm, investors may be aware of that and could punish the firm accordingly. That is, both principal and agent could suffer from the loss of market capitalization. Firms could lower the risk of being left without capitalization through contracts with the agents, which could help to monitor them properly.

Additionally, if companies conduct analysis on the aspects of the possible agency problem, irrespective of assessment costs, they could be more successful (Bendickson et al., 2016). Mahoney (2004), a critic of the Chicago School, called this approach optimistic, as firms can readily identify all aspects of an agency problem. As Bendickson et al. (ibid) acknowledged, the Chicago approach made several important findings in the development of agency theory as a belief in the efficiency of markets, which could impel the governance mechanisms toward reducing or eliminating the agency problem.

4.3.2. Two perspectives inside the agency theory

As explained, a considerable number of ideas influenced the emergence of agency theory. It took time for the theory to become comprehensive, and it was and still is used by many scholars in varied fields such as accounting, economics, finance, marketing, political science, organizational behavior and sociology (Eisenhardt, 1989).

According to Eisenhardt (1989), agency theory from the very beginning has developed along two lines: positivist agency theory and principal–agent research. They share a common unit of analysis: the contract between principal and agent. However, they differ in their style of approaching the agency problem. Positivist agency theory

deals with situations that lead to difference of interests between the principal and agent. Subsequently, that stream describes the governance mechanisms that limit the agent's self-serving behavior.

Eisenhardt (1989) acknowledged that, from a theoretical perspective, positivist agency theory has mostly been concerned with describing governance mechanisms that could help solve the agency problem. Eisenhardt also believed positivist agency theory considered two scenarios as possible solutions to the agency problem. The first was outcome-based contracts that could be used to limit agent opportunism. This type of contract may help to mutually align agents' preferences with those of the principal, as the rewards for both depend on the same level of competence. The difference of self-interests between principal and agent could thereby be reduced.

The second scenario considers information systems could also limit opportunities of the agent. In other words, information systems inform the principal about what the agent is actually doing, which could constrain the agent because he or she will not be able to deceive the principal. As can be seen, these scenarios were designed to condition the agent, excluding any possibility of the agent behaving against the principal's needs.

However, Eisenhardt (1989) pointed out positivist agency theory had been criticized by organizational theorists (Hirsch, Michaels & Friedman, 1987; Perrow, 1986) as minimalist and by microeconomists (Jensen, 1983) as tautological and lacking rigor. Nevertheless, a considerable number of studies have been conducted on positivist agency theory, and these brought popularity to this stream of agency theory.

The second stream of agency theory, as stated above, is principal-agent research. Unlike positivist agency theory, principal-agent research concerns a general theory of the principal-agent relationships that could be applied to employer-employee, lawyer-client, buyer-supplier and other agency relationships (Harris & Raviv, 1978). As

Eisenhardt (1989) stated, principal-agent research focuses on determining the optimal contract between the principal and agent. In the principal-agent stream, a goal conflict is assumed between principal and agent, which results in the agent being more risk-averse than the principal.

Likewise, the positivist stream of principal-agent research describes the relationships among principal and agent in terms of two cases. The first refers to a situation where in the principal knows what the agent is actually doing; a case of complete information. The principal in this circumstance buys the agent's behavior; thus, a behavior-based contract is more efficient for the principal. This type of contract is outcome-based, which may needlessly make the agent more risk-averse than the principal.

The second case, according to Eisenhardt (1989), assumes the principal does not have complete information about the agent behavior. That is, the principal does not know exactly what the agent has done. Considering the self-interested behavior of the agent, he or she may or may not behave as agreed upon in the contract. The agency problem comes into existence as principal and agent have different goals, and it is difficult for the principal to determine what the agent is actually doing.

As Eisenhardt (1989) contended, there are two aspects of the agency problem cited in the formal literature. The first is *moral hazard*, which refers to the lack of competence of the agent; i.e., to neglect his or her responsibilities. The second is *adverse selection*, which refers to misinterpretation of the agent's abilities. Put another way, the agent may claim to have certain skills when entering into employment. For example, adverse selection could occur when a research scientist claims to have experience in a scientific field and the employer cannot sufficiently judge whether this is accurate.

Adverse selection occurs as the principal cannot completely ensure employees' skills either at the time of hiring or when the agent entered into employment (ibid). Eisenhardt (ibid) concluded that in the case of unobservable behavior, which could occur because of *moral hazard* and *adverse selection*, the principal has two options. The first one invests in high-tech solutions, which could help to reveal the agent's behavior to the principal.

Another option is to bind the agent via a contract, which could force him or her to follow documented obligations. Thus, such an outcome-based contract could motivate behavior through it coalignment of the agent's needs with those of the principal, but at the cost of transferring risk to the agent. Notwithstanding, Eisenhardt (1989) acknowledged that even outcome-based contracts could pose risks for the principal because the outcome constitutes only a part of the behavior's function.

A wide range of policies in, for instance, government, economic climate, competition, and changes in technology are among factors that could influence a volatile outcome. Subsequently, uncertainties that arise could introduce difficulties for the principal in forecasting the agent's behavior. In other words, when outcome uncertainty is low, the costs of shifting risk to the agent are low and the outcome-based contract is efficient.

4.3.3. Contribution and criticism of the agency theory

The above situation could generate difficulties in the management of relationships between principal and agent because of the entities' different goals. However, agency theory made significant contributions to the field of organizational thought. According to Eisenhardt (1989), it reminded us that much of organizational life is based on self-interest. Moreover, it emphasized the importance of a common problem structure.

Another of agency theory's contributions to organizational thought regards treatment of information. In agency theory, information is regarded as a commodity, which has a cost and can be purchased (Eisenhardt, 1989). The importance of information in agency theory indicates significance of information handling systems, which could help control opportunism of the agent.

An additional contribution lies in the theory's risk implications (Eisenhardt, 1989). As illustrated, agency theory assumes uncertainties of outcome; i.e., the future may bring prosperity, bankruptcy or other results, and is only partly controlled by the members of the organization. Eisenhardt (ibid) argued outcome uncertainty coupled with differing goals between principal and agent could impact deals between these entities.

The contributions of agency theory could be seen from a number of studies and researchers that used this theoretical framework. As mentioned, the theory has been used by scholars from many different backgrounds (Eisenhardt, 1989). However, Perrow (1986) and others have criticized the theory for being exclusively narrow and having few testable implications. Together with the criticism, the above-mentioned scholars suggested research should be undertaken in new areas, as this could expand the theory to a richer and more complex context.

4.3.4. Agency theory's applicability to the research topic

As agency theory's perspectives have been discussed, its applicability to the research topic is described herein. Agency theory was selected from among other theories because it evidently could help in understanding relationships between the FIU and FIs. With the aim of matching agency theory's implications in this particular research, the FIU has been regarded as the *principal* and reporting entities as *agents*.

The FIU has been assigned a role of the *principal* as it governs the movements of funds through FIs by drafting and promoting laws to regulate this process. A bunch of regulations and procedures are designed to promote transparency and ability to monitor transactions, thus pursuing measures to control ML and associated offences. The FIU, as the *principal*, employs the services provided by FIs in order to perform its AML/CFT function at state and international levels. In this regard, the FIU substantiates its ability to control the *agent* through certain regulations in order to protect the legitimate financial framework.

The above mentioned scenario is corresponding to the implications of the agency theory which describes relationships between *principal* (a natural or legal person who has controlling authority) and *agent* (one who is authorized to act for or in the place of another). Moreover, as Provan and Milward (1983) argued, "in agency-theory terms", principal's role is to monitor the activities of their agents, who provide services to their clients. FIs were considered as *agents* as they are the gatekeepers towards illegal funds to enter a legitimate financial environment. In this sense, FIs are used by the FIU as an instrument against the use of legal financial sector for illicit purposes, that is, to curb ML and correlated criminal acts.

The relationships between these two institutions have been analyzed through the lens of the agency theory by looking at each entity's behaviour on how they treat the FATF standards. This analysis helped to understand that each institution has its own perceptions towards understanding and implementation of the FATF standards, which in most cases is not in line with the AML/CFT regulations. In other words, there is a difference of interests between the FIU and FIs in terms of fulfilling their obligations and following common goals those required by the FATF. The agency problem in this specific case emerges not from the underhandedness of the agent, but rather as a natural result of poor communication between these entities.

Agency theory helped in examining tacit ideas behind the interaction between the FIU and FIs, as these play a crucial role in detecting and preventing illicit funds at an early stage, and emphasize a need for common actions if these institutions are to contribute to the development of their national AML/CFT regimes, which eventually reflects their efforts in the international arena.

4.4. Summary of the chapter

The chapter began with a description of the theories reviewed in the process of conducting this study to clarify the processes related to interaction between the FIU and FIs. A number of theories, such as the Walker Gravity Model, theory of crying wolf and systems theory, were discussed, detailed, and the rationale behind their use in the present study was explained.

A detailed account of agency theory and interpreted historical aspects with regard to the foundation of the theory were then presented. Ideas of different scholars and schools of thoughts that influenced the formulation of agency theory were also provided. For instance, it became apparent Weber, Simon, Merton, Barnard and Follett were among the scholars whose thought substantially contributed to agency theory's coming into existence. The Chicago school, represented by Jensen and Meckling, also contributed to the development of coherent ideas with regard to agency theory. A brief account regarding the applicability of agency theory in addressing the needs of this study was also given.

CHAPTER 5

FINDINGS AND DISCUSSION

5.1. Introduction

Booth et al. (2011) asserted ML represents a legal concept that anti-ML legislation has fought for about 25 years, and these days most countries have a legal framework that criminalizes it. However, as the literature demonstrates, there are still a number of problems to be solved. Among other persisting issues, there is insufficient cooperation between the FIU and FIs when understanding and implementing the FATF standards.

Based on the present study alone, it is difficult to be certain about the factors that may have caused inconsistencies in the relationships between the FIU and FIs. However, this study represents an additional effort to explore possible reasons that may assist these two institutions in performing their duties in a way that differs from the goals of the FATF standards.

This chapter gives a consolidated account of the ideas developed and presented herein after an in-depth analysis of collected information with respect to the goals of this study. The ideas evolved from an extensive review of the literature, research questions and research methodologies discussed in this paper.

The research topic is briefly introduced, followed by interpretation of the factors that may have caused the research problem. Personal viewpoints are then integrated with regard to the degree of compliance with the FATF standards in the US and UK. Ideas are then discussed with respect to a set of recommendations that could help in promoting awareness and sensibility in the AML/CFT network. A summary concludes the chapter.

5.2. Sensing the other: The cause célèbre of the research problem

As reported by Lilley (2006), the enduring perception of ML is connected with a person who suspiciously presents the bank teller with a briefcase overflowing with cash. A look into the history of the ML phenomenon demonstrated the concept itself took its essentials from the eagerness of criminals to hide their money by commingling illicit funds with legally generated income. Ph. Pardo reasoned money is usually laundered by extremely intelligent people, such as politicians or those who work for them (personal communication, May 9, 2017). These kinds of people accordingly do not want to be revealed, yet they eventually could be caught by law enforcement for their illegal acts.

The idea presented above could be opposed by Demetis (2010), who wrote that in many cases LEAs intentionally ignore illegal operations performed by a certain group of people or any other individual so they can receive revenue and become self-sufficient. This makes things even worse, as the lawmakers themselves are likely to violate the laws drawn to fight illegal use of the financial environment.

Operating under an assumption that intelligent people launder money, it can be more readily understood why only a certain number of criminals, such as Capone and Lansky, explored and employed innovative methods of making their dirty funds clean. These ML techniques included disguising the true source of funds in a number of steps, which were more recently introduced to the public as a three-step ML methodology.

As noted in previous chapters, it can be seen that both the above criminals were conducting their illegal business mostly in the US or through it. The US has also served the role of a platform in which many AML/CFT initiatives have been initiated. Taking these facts into account, it could be speculated the ML phenomenon had its roots in the US in either case, theoretical or practical, even though the country has from the very beginning demonstrated its willingness to protect the international financial framework from being misused.

There are a number of inconsistencies in policies the US has suggested and lately confronted. For instance, Nixon's "War on Drugs" in 1971 and the Watergate scandal in the 1970s demonstrated that even if the country proposed certain initiatives to counter a problem, they could not be considered helpful when the proposing country itself fails to properly follow the suggested set of rules. This kind of situation may have led other countries and FIs located in those countries to believe that if one country puts forth initiatives and then violates them itself, the same approach may be taken in treating certain obligations "recommended" by laws in a specific field, as with AML/CFT.

Ph. Pardo argued such a country as the US had AML regulations much earlier than they became public (personal communication, May 9, 2017). This idea may be connected with how the Watergate credo of "follow the money" has served as a basis for development of many laws that required FIs to establish and maintain a "paper trail" with regard to any transactions they conduct, especially those in cash (Henning, 2015).

Meanwhile, J. Connor (a pseudonym given to an interviewee) argued laws usually come from big countries such as the US, and they are in fact developed based on their own experience and expertise (personal communication, May 15, 2017). However, this does not simply mean all countries should follow the same rules, because of their geographical, cultural, language or any other relevant differences applicable to a particular situation.

Looking back on the formation of the ML phenomenon and the initiatives that have been put into practice, it could be argued that regardless of the many AML/CFT regulations, the ML issue has yet to be fully solved. Moreover, because of evolving financial instruments, including FinTech and digital currencies such as Bitcoin, dealing with illegitimate use of the financial sector seems more problematic than ever (Sharipov, 2014). This means new laws and regulations could gradually be developed

and made public, which is not always the correct way of operating. In other words, members of the public may not enthusiastically receive such laws, especially FIs, as they stay at the forefront of preventing illegitimate funds from entering legal financial environments.

Considering the above circumstances, it could be argued the first factor that might have caused friction in interaction between the FIU and FIs lies in ***disagreement*** coming from FIs in different countries. This can be explained by the fact FIs were not pleased by new regulations that could prevent them from operating freely. Lilley (2006) also argued that if an organization rigorously tried to apply the FATF standards it could be time-consuming and pose difficulties for performing any business. A similar perspective was presented by Pieth and Aiolfi (2004), who contended comprehensive implementation of the FATF standards by FIs could affect all customers, rather than detecting the small percentage of dishonest or questionable ones.

The idea of ***disagreement*** could be connected with a practical case that involved FIs in Austria. There, those institutions used to open bank accounts and issue savings book called *Sparbuch*. Lilley (2006) pointed out these books could be opened under a code name enabling their user to deposit and withdraw cash anonymously. There were an estimated 26 million passbooks in existence, with a total balance exceeding $50 billion in the country with a population of seven million (Lilley, 2006).

These numbers could help clarify why the number of *Sparbuch* holders exceeded Austria's population, and this fact brought great concern for international society, as laundering the proceeds of crime through the use of such passbooks was extremely easy. Ultimately, Austrian *Sparbuch* gained infamy, and in February 2000 the FATF had to threaten Austria with suspension of its membership in the body if the country did not eliminate these anonymous passbooks (Lilley, 2006). This pushed

Austria to eliminate issuance of such books forever, as eventually the Austrian government banned their use.

These facts could be reasons for speculation that many FIs in Austria probably lost their clients or "high-net-worth individuals" who were feeding them with a silver spoon. Therefore, it could be hypothesized that FIs were displeased with the FATF standards, as those requirements, as J. Connor argued, interfered with the original purpose of their business; i.e., making money (personal communication, May 15, 2017).

Another factor behind difficulties in cooperation between the FIU and FIs stems from the first one and implies a ***lack of respect*** given to the FATF standards by FIs and countries in different regions of the world. This line of thinking can be supported by Pieth and Aiolfi's (2004) argument. They reported the FATF standards would have remained just another document if the body had not established a strict monitoring regime based on peer pressure. This means the FATF standards at the initial stages were not properly recognized and, therefore, in such countries as Austria, FIs did not pay enough attention to the AML regulations imposed by their governments.

However, when those FIs continued paying improper attention to the treatment of the FATF standards, they eventually faced massive fines from their respective governments. In this regard, a practical example of a bank among those jealous FIs can help in understanding how the entity behaved and what kinds of measures were taken to eliminate its jealousy. Considering the limits of this particular section, only a brief account of a bank and measures taken against it are presented.

The Riggs Bank for years billed itself as one of the most important banks in the US. However, in the 2000sit found itself facing massive fines from the US government for serious AML/CFT deficiencies (O'Brien, 2004). As Chatain et al. (2009) reported, the bank was fined more than $40 million for opening multiple private banking accounts for former Chilean dictator Augusto Pinochet and other politically exposed persons

(PEPs). The bank accepted millions of dollars in deposits under various corporate and individual account names with less, or no, attention to suspicious activities connected with movement of the funds in these accounts. This type of attitude led customers to cease their business relationships with the Riggs Bank. The reputational damage prevented the bank from attracting new business partners and its management was distracted from the bank's normal business activities.

Although it was not closed by regulators, the bank lost earnings and could no longer succeed in profitable banking. It consequently ceased operations in 2005. What happened with the Riggs Bank could imply the bank had not addressed the FATF standards with sufficient respect and continued to selfishly violate them, incurring massive fines from the US government for its disagreeable attitude.

The third factor that leads to cumbersome relationships between the FIU and FIs is connected with the FIs' ***lack of understanding*** of the FATF standards. This conclusion is based on the apparent fact many FIs do not sufficiently understand the standards. This argumentation could be supported by evidence from Demetis (2010) on the case of Drosia Bank. In the process of conducting his study, Demetis held a number of interviews with personnel of the bank, which yielded many comments on the quality of STRs and their frequency. Among the divisions interviewed, a unit known as the Money Laundering Reporting Officer (MLRO) commented on the volume of STRs collected from various branches of the bank as follows:

> "Such an increase is indeed alarming, but nevertheless expected. The ongoing training of personnel is one of the reasons behind this trend and we are likely to expect even more STRs in the years to come. We have already requested additional resources to handle such an increase and we are likely to employ even more people to handle it".

This supports the argument there is a ***lack of understanding*** of the FATF standards. A supporting argument could be found through interviews conducted for the present study regarding interpreting some of the FATF standards. Interviewees were asked to explain recommendation 20, "Reporting of suspicious transactions." Surprisingly, and confusingly, four different explanations were given. Deciphering the true meaning of the recommendation took a great deal of time. However, there is a lingering perception that even people who work in the field have different understandings of the FATF standards. Therefore, it could be speculated the personnel of FIs in many countries, mainly developing ones, could be also confused in their understandings of the FATF standards because of their lack of knowledge and/or experience.

Under those circumstances, it could be argued FIs may lack proper understanding of the FATF standards for many other reasons, such as language deficiencies, cultural differences and varying styles of thinking. This thought could be supported by J. Connor, who contended that laws developed by developed countries were less likely to be easily understood and applied in less-developed countries, at least not without causing some friction (personal communication, May 15, 2017). Moreover, FIs may prefer not to understand regulations properly and instead continue filing meaningless reports to the FIU by adopting an attitude of ignorance or, even worse, by blaming the FIU for uninformative explanations of the FATF standards.

The final potential reason for friction in the relationships between the FIU and FIs refers to the ***cost of compliance*** with the FATF standards. This cost implies having a special unit in the bank that must monitor and detect suspicious movement of funds, and file STRs with the FIU if any suspicion arises. The unit should also be interconnected with other divisions in order to carry out its functions properly.

Additionally, FIs should establish and maintain specialized technological solutions for detecting potential cases of misuse of their system; these typically are very expensive. At the same time, FIs should have training programs for their employees on dealing with customers, and organize courses to revise their level of knowledge in the AML/CFT field. These are just parts of those expenses FIs should bear in order to comply with the FATF standards.

These days, many FIs face huge costs in establishing and maintaining their compliance units. For instance, the MLRO division in Drosia Bank argued the maintenance of the AML/CFT compliance unit came at a huge cost, which created friction within the bank when asking for more resources from institutional higher-ups (Demetis, 2010).

Meanwhile, a number of banks in the US have also complained that the AML/CFT measures became very intrusive after introduction of the BSA in 1970. Additionally, according to Ryder (2012), these measures undermine the unique relationship between banks and their clients and are very expensive and burdensome to comply with. However, these complaints were not well received by lawmakers who continued imposing increasing tasks on FIs (Ryder, 2012).

The above facts and views could be connected with the thoughts of St. Goodspit (a pseudonym given to an interviewee), who argued that banks in some countries, being burdened with additional tasks and compliance costs, could impose extra fees on their customers when handling transactions (personal communication, May 20, 2017).

The same idea was presented by Takáts (2007), who argued that when banks' profit falls due to fines for non-compliance with AML/CFT regulations, the banks pass transaction fees on their clients. The fees include the cost of compliance, and cover part or all of the cost to the bank for undertaking the transaction. It could therefore be argued

banks are covering their compliance costs at the expense of their customers, who are not even aware of what they are paying for.

To check the viability of this idea, a local bank in Japan was visited and representatives were asked whether they could provide all the details of such fees they charge for their services. This attempt yielded only very vague answers, which indicates those asked were unable to provide substantive information because of their internal policies. Meanwhile, the bank should have taken into consideration the request made by their potential customer, as the customer may have needed such details for personal calculations.

The situation described above could mean the requirements imposed on FIs by a huge number of emerging laws have created extra costs for ordinary people rather than for the banks that aimed to make money. Nevertheless, it is very hard to blame the banks for this sort of behavior, as they are usually established for providing financial services for people. However, under pressure from a great amount of regulations, FIs must shift part of their expenses onto their customers to stay true to their original purpose.

As can be seen, emphasis here was mainly placed on the role FIs play in causing difficulties in interactions with the FIU. Nevertheless, it is hard to underestimate the role the FIU plays, and continues to play, as a buffer zone between FIs and other competent authorities. It must be also emphasized that all the factors listed previously are fully connected with the FIU and other members of the AML/CFT network. For instance, the reason for ***disagreement*** with the FATF standards may have surfaced as a result of insufficient introduction of the standards by the participants in the AML/CFT network at an early stage. In fact, FIs already possessed their own perceptions toward securing against dirty funds entering the legitimate financial environment.

A look into a case connected with Swiss banks could help in understanding the above point. In 1970s, Swiss National Bank President Fritz Leutwiller and the Swiss Bankers Association (SBA), to save the reputation of the Swiss banking system after the so-called Chiasso scandal, developed the first version of the Swiss Bankers Code of Conduct (CDB), in 1977 (Pieth & Aiolfi, 2004). This was a purely private document that represented a sort of "gentlemen's agreement" among 400 banks in Switzerland as a self-regulatory instrument for protecting their institutions from being misused. Moreover, a number of sanctioning measures, such as fines of 10 million Swiss francs, could be levied if a bank breached the agreement.

This particular case demonstrates banks were already prepared and aware of the need to protect their financial systems from being misused. With this in mind it could be hypothesized that they did not welcome a set of new regulations suggested to FIs for protecting their system. Additionally, in those days, the FATF lacked power, which probably did not allow it to economically deliver its goals to the public so as to be easily understood and perceived by the entities that were handling the people's funds.

The ***lack of respect*** afforded the FATF standards could be connected with that the body itself had not received much recognition in the early stages of its development. This owed to the absence of supportive initiatives that have more recently been introduced by the UN, in 1988 (Political Declaration and Action Plan against Money Laundering in 1998) and in 2005 (UNSCR 1617).

Although, lacking recognition in its initial stages, the FATF achieved much wider popularity later, as nearly 200 countries endorsed its 40 Recommendations as a comprehensive framework to counter illegitimate use of the legal financial framework. As the FATF has evolved, the FIU's role has also increased; among other tasks it needed to educate FIs on how to protect their businesses from being misused.

The ***lack of understanding***, among other factors, implies FIs were and still are not sufficiently educated to spot only those transactions that are illegal, per se, as a very cloudy perception of suspicious transactions endures. This fact leads to the question of whether the AML/CFT network members are involved in educating FIs. Based on the findings from previous chapters, it is apparent the FATF consists of certain units that coordinate activities within the body. However, taking into account the central body has roughly 20 employees who operate out of the headquarters; the body is less likely to reach countries not located nearby. For this purpose, a number of so-called FSRBs were established in different regions of the world to promote the FATF standards in those jurisdictions.

It is hard to underestimate the role of those FSRBs in promoting the standards. Nevertheless, as the literature proves, results of that promotion have yet to be seen. It seems the level of bureaucracy in those institutions exceeds the level of willingness to help less-developed countries in making their AML/CFT regimes more sustainable rather than remaining weak. K. Stroligo argued that, according to the FATF standards, FIs should not submit STRs on a case-by-case basis (personal communication, May 25, 2017). This means FIs rather than submitting hundreds of thousands of ultimately meaningless reports should focus only on those that seem truly suspicious. In this regard, K. Stroligo suggested that training of personnel is highly important.

In fact, when FIs submit a great amount of would-be STRs, they do not comply with the AML/CFT standards. With this in mind, the question emerges as to how it is possible to spot thousands of ML cases per month, as is done in a number of banks mentioned before, and be sure all contain criminal elements. As a rule, many banks use so-called suspicious-transaction-detecting software. However, as Demetis (2010) argued, even the use of highly sophisticated detection systems cannot guarantee illegal activity was committed through a bank. In this regard, the ***lack of understanding*** should

be regarded as one of the major factors behind unproductive dialogue between the FIU and FIs.

The final potential factor for friction in relationships between the FIU and FIs follows the reasoning of the ***cost of compliance*** with the FATF standards. This is probably the most important source of difficulties in cooperation between the two entities. Of note, the ***cost of compliance*** also applies to the FIU, which in parallel with FIs should have a special system for processing and analyzing STRs. If the number of reports continues to increase, this may affect the processing limits of the system and lead to a backlog. This argument can be supported by Demetis' (2010) case study of the Drosia Bank. The results demonstrated the FIU of the country where the study was conducted informally asked financial institutions to lessen the amount of reports because of the limits of the FIU's report-processing system.

While the amount of STRs sent from FIs to the FIU could overload the unit's system, it could be argued that excessive obligations imposed by governments on FIs may also prevent even the FIU from performing its functions. Additionally, this fact implies the FIU should also bear extra costs for maintaining and improving the capacity of its intelligence-processing machines to receive, process and analyze STRs coming from FIs. However, even if the FIU of a developed country can afford additional expenditures for maintaining its analytical systems, less-developed countries are not necessarily able to follow suit.

S. Tsukada argued that the ***cost of compliance*** burdens FIs by preventing them from demonstrating effective results, as their main objective is making money (personal communication, May 29, 2017). S. Tsukada also contended that from the very beginning, the cost of compliance brought many challenges for FIs. This may be because the FIs were not specifically trained to spot suspicious transactions for the simple reason of not being sufficiently educated to perform the action.

S. Tsukada also argued there are a plenty of FIs that do not violate AML/CFT laws; however, they are also burdened with a task of fully complying with the FATF standards (personal communication, May 29, 2017). This could mean customers of such institutions, being aware of tough regulations affecting a certain bank, are less likely to use its services considering the terms of privacy. For this reason, the presence of so-called offshore jurisdictions provides an ideal platform for criminals to hide and hedge their funds. It could also be speculated banks with tightened AML/CFT regulations are basically used by ordinary people. Making use of FIs' services, ordinary people are more likely to face extra fees for protecting FIs from illegal undertakings, though they commit no crimes.

Considering the preceding information, it may become apparent there could be a central factor that applies for all those mentioned above: the ***lack of sensibility*** in treatment of the FATF standards by the FIU and FIs. Given that both, by perceiving their own interests, were not enough sensible when understanding and implementing the standards in the past, this eventually led to less productive dialogue between them. It must be also noted that the two are highly important in establishing and maintaining any countries' AML/CFT regimes. Lack of productive cooperation between them could lead many countries to be regarded as non-cooperative jurisdictions by the FATF.

While the issue of sensibility is important, the role of the FATF standards should not be underestimated. Countries and their FIs still do not properly deliver and understand the standards. A number of reasons may be cited, such as inability of the FATF, as a body, to deliver its standards to the public in an affordable manner that is easily understood and accepted; in other words, to make sure regulations are designed to be followed in a way that is acceptable for everybody. Even though K. Stroligo argued the FATF's recommendations represent minimum AML/CFT standards, asking people

to do what they lack capacity to do makes the standards very difficult to implement (personal communication, May 25, 2017).

Another reason can be found in language; cultural and legislative barriers that make it difficult for many countries to establish and maintain their AML/CFT regimes. For instance, in less-developed countries, most any chance to generate money is welcomed. With this in mind, the government could decide to open up its banking system to everybody. In terms of language barriers, the standards are written in a very technical and confusing manner that makes them extremely hard to understand. In countries in which English is not a first language, the writing style of the standards could pose further obstacles to their being understood. Understanding the FATF standards requires a certain level of professional academic skill and legal education.

Consideration of those barriers raises a question of how employees of an ordinary bank in a country with a lower standard of living can properly understand and apply requirements set in the FATF standards. Employees in such areas are probably less likely to follow government regulations properly, owing to a lack of knowledge, and therefore less sensibility in treatment of the standards. This in turn may eventually lead to ineffective cooperation between the FIU and FIs.

5.3. Discussion of AML/CFT regimes in the US and UK

5.3.1. US in a global fight against money laundering

The US is among countries with a robust and well-developed AML/CFT framework. A detailed examination of the US AML/CFT regime demonstrated that the country took aggressive approach toward combating illegal use of its financial framework in the mid-19th century. These days, the FATF recognizes the US as a country with a satisfactory level of compliance with the AML/CFT standards. Understanding of the FATF standards in the US is supported by a considerable number

of internal and external initiatives. The US released the National Money Laundering Risk Assessment (NMLRA) in 2015, and has issued various guidelines for the private sector in recent years.

The US FIs, in parallel with the government, have a good understanding of the risks ML and TF may pose, and take commensurate measures to minimize them. These FIs are aware of their obligations in pursuing AML/CFT regulations, and possess highly sophisticated systems for detecting and preventing potential activities related to ML and TF. They also have well-established cooperation mechanisms with the FinCEN, which to a certain degree could be seen in the number of SARs sent to the unit annually. It should also be noted that LEAs in the US are active queries of intelligence collected by the FinCEN.

Another particularity of the US AML/CFT system is great involvement of all competent authorities in the common fight against ML, TF and other predicate offenses. The US's competent authorities maintain relevant statistics for use when tracking information related to a particular offense. This makes the system even more effective, as the data collected and stored for many years can eventually be used for uncovering covert cases, even if they were not investigated in a timely manner.

Considering the above, it could be argued the US AML/CFT system should not have any strategic deficiencies or serious gaps in implementing the FATF standards. However, the last MER, published in 2016, demonstrated that the US regulatory framework in fact has a number of significant gaps. This section incorporates logical analysis of all those gaps and provides viewpoints with respect to each. The last MER showed following results:

1. Regulatory framework does not fully cover some of the DNFBPs, such as investment advisers, lawyers, accountants, real estate agents, trust and company service providers;

2. A lack of timely access to intelligence with regard to beneficial ownership;
3. No uniformity in the state-level AML/CFT efforts and a lack of clarity whether the same AML/CFT procedures are applied in every state;
4. A lack of comprehensive AML/CFT supervisory procedures for DNFBPs.

The first and last of these shortcomings appear to have similarities in terms of issues they address, as incompleteness of the regulatory framework could ultimately have resulted in its ineffectual realization. With this in mind, these two gaps are discussed together. In the US, according to the last MER, the financial sector bears most of the burden with respect to BSA requirements. However, as the MER shows, these entities do not fulfill their obligations under the act. For instance, DNFBPs are entities that provide professional services for so-called high-net-worth individuals. Because of the nature of the services they provide, they are less interested in disclosing any information about their customers.

Lilley (2006) argued that these professional advisers have detailed knowledge about their clients; nevertheless, these types of entities usually generate a very low amount of SARs for competent authorities. The number of registered DNFBPs in the US and the amount of SARs they reported suggests this sector appears poorly regulated. In this regard, comments the FATF experts made with respect to covering DNFBPs by the US regulatory framework seem relevant.

The problem of regulating DNFBPs was also raised in many publications by experienced professionals in the AML/CFT field. For instance, Lilley (2006) argued that in a murky world of dirty dealings, the original nature of basic ML schemes would quickly fail as soon as international and national regulators introduced AML measures. Lilley asserted the introduction of AML regulations shifted the spread of illegal fund laundering to non-financial businesses, such as disreputable professional advisers, who became active because of the expansion of illegal undertakings (Lilley, 2006). In other

words, criminals became rich, and therefore could afford services provided by entities specializing in assisting their clients with arranging a business without tainting their reputation will illegality.

The DNFBPs left unregulated in the US could pose many threats to the integrity of the country's legitimate financial framework. It can also be argued that these institutions are not pleased, and would not be pleased if the US introduced additional regulations to constrain their businesses. Meanwhile, if this happened, these entities would definitely ***disagree*** with the approach taken by the US government. It must also be emphasized that the existence of DNFBPs creates high volumes of revenue for the government in the form of taxes, as well as for the institutions themselves.

Considering the above mentioned idea, if the US toughens its regulations, these DNFBPs could eventually cease their activities in the country and pursue more attractive business environments. In this regard, tightening and enforcing regulations for DNFBPs in the US requires the government to introduce significant initiatives. However, in the era of capitalism, this idea seems ambiguous.

Many publications have discussed the role of the US government when controlling its FIs and DNFBPs. Ryder (2012) argued that the existence of tough AML/CFT regulations in the US could create a platform for "patrons" to come into play. This category of individuals would definitely have their own perspectives, which could partially include generating revenue from the agencies under their supervision.

The idea presented above can be supported by Ph. Pardo's argument who believed that if such large countries as the US were really intent on cutting a criminal group off at the head, they could easily do it (personal communication, May 9, 2017). Nevertheless, there are some tacit ideas that either the country or FIs possess, and that prevent them from performing their functions properly. Likewise, there is a possibility

that in some countries, governments established a balance with the underground economy so both could benefit.

The second gap in the US AML/CFT regime refers to the lack of timely access to information about beneficial ownership. The lack of access to relevant intelligence by LEAs in the US could pose challenges for investigation processes. This could happen because in the era of FinTech and other technological solutions, tracking suspicious movements of funds is a difficult task. If FIs and other professional advisers assist potential criminals in hiding their income sources, the task of LEAs could even be doubled.

The last MER demonstrated the financial sector in the US was surrounded by many invisible regulatory mechanisms that prevent it from conducting productive dialogue with the government. This means there are some forces in the US that prevent full access to the relevant intelligence in a timely manner, although the country presented a number of successfully investigated cases to the FATF experts.

The final gap can be connected with the previously discussed shortcoming by arguing that every US state has different FIs and DNFBPs in terms of size, nature and frequency of their business operations. With this in mind, it could be contended that certainty of all elements of the basic AML/CFT system of the US being applied to every state is less likely, owing to the reasons explained above.

5.3.2. UK in the international AML/CFT framework

The UK, along with the US, has taken a progressive and effective stance toward combating ML, TF and other predicate offenses. It should be emphasized that the UK's attention toward ML pre-dates that of some other European nations. The UK's commitment to bringing its legislation in line with the FATF standards can be seen from its willingness and readiness to implement internationally recognized AML/CFT

standards. This can be also witnessed from a number of those initiatives and policies the UK government has pursued throughout the years. The FATF considered the UK's AML/CFT system as having a satisfactory level of compliance with the body's standards.

The UK's stance on implementing the FATF standards is not limited to its international efforts. The country also pursues development of various reports and periodically conducts risk assessment of external and internal vulnerabilities to its AML/CFT regime. For instance, HM Treasury and Home Office released the first National Risk Assessment Report on the UK's AML/CFT framework in 2015. The report was one of the recommendations given to the country in the process of the last mutual evaluation, which was undertaken in 2007.

FIs in the UK work in parallel with the government and have a good and evolved understanding of risks related to ML and TF. They also have sound technological solutions for detecting suspicious activity. In addition, the UK government has established a well-organized platform for FIs to submit their SARs. This evidence, in combination with the number of reports submitted to the UK FIU by its FIs, suggests the level of cooperation between the UK's government and FIs appears to be high.

The UK FIU has tight connections with its LEAs, which are the active users of intelligence collected by the unit. As in the US, the UK's competent authorities also maintain statistics and keep records of relevant information to be used when tracing data related to a particular offense. Taking into account the level of compliance with the FATF standards, it could be argued the UK's AML/CFT system has no fundamental gaps. However, the last MER, published in 2007, suggested the system still has a number of deficiencies to be addressed.

The amount of gaps identified in the system is significant; therefore, only a select few, which forma general picture of all the shortcomings, are discussed in this section. These are as follows:

1. Insufficient CDD procedures in the FIs;
2. No requirement set in the regulatory framework for identification of beneficial ownership;
3. No explicit obligation to obtain information on the purpose and nature of the business relationship in the UK in all cases;
4. No specific obligations for FIs and DNFBPs to pay special attention to all complex, unusually large transactions, or unusual patterns of transactions, that have no apparent or visible economic or lawful purpose.

These deficiencies are somewhat similar to those identified in the US, except for the fact that in the UK, activities with cash generated through drug trafficking are still substantial. Cash remains the mainstay of the most serious organized criminal activities in the country, which indicates potential for high cash turnover businesses there; i.e., drug dealing, fraud and serious organized crime. As Pieth and Aiolfi (2004) contended, the UK has a reputation as an ML center because of the scale of its economy and the ease of doing business there.

All the above-mentioned deficiencies are essentially interconnected because in the UK the law enforcement mechanisms, appearing very accurate and well-organized on paper, are in reality still weak. This was recognized by the FATF experts as in the last MER. The absence of effective CDD procedures in FIs in the UK could signify there is no, or a low degree of, understanding of the FATF standards. The standards require countries' FIs to receive the maximum amount of information about their clients, including the nature of their business, the purpose of the transaction, and the

final receiver of the funds. In ignoring this basic requirement, the UK puts itself in a dangerous and seemingly disreputable position.

Given the above points, it could be argued that the UK's AML/CFT regime maybe easily used by any individual or legal person who potentially wants to commit a financial crime, including ML. Additionally, the absence of, or weak, CDD procedures in banks could be a reason for speculating that FIs either have insufficient understanding of the FATF standards or they have understanding but do not wish to comply.

If there is a ***lack of understanding***, this means the UK is not involved or less involved in educating its FIs about the FATF standards. However, this ***lack of understanding*** seems doubtful here, as the UK's government introduced, and continues to initiate, many guidelines to its FIs through JMLSG. With this in mind, it can be assumed FIs in the UK intentionally demonstrate a false tolerance and false ***respect*** to the regulations coming from the government.

The second deficiency is related to the first, as no requirement in the regulatory framework for identification of the beneficial owner demonstrates the absence of effective CDD procedures in FIs. This gap is, to some extent, similar to that found in the US where LEAs are lacking timely access to information about beneficial ownership. However, if in the US it was only lack of timely access, for the UK there would be no access, as the information collected from customers cannot fully meet the needs of LEAs. In light of this, it can be argued the regulatory framework with no requirement to obtain precise information about beneficial ownership could lead the UK to eventually be regarded as a country with strategic AML/CFT deficiencies.

The third and fourth deficiencies are also connected. Non-existence of an explicit obligation for FIs and DNFBPs to be precise with regard to the information they receive from their clients creates an image the UK's FIs are less interested in

implementing the FATF standards. The absence of specific obligations to pay special attention to all complex and unusually large transactions is a reason for speculating there is, as the FATF experts identified, weak enforcement of established AML/CFT procedures.

5.3.3. Concluding remarks

The discussion of the AML/CFT regimes in the US and UK raises many concerns. Specifically, it became apparent the degree of compliance with the FATF standards in these two countries is relatively high. However, as MERs demonstrated, the AML/CFT systems in the US and UK, while incredibly robust, still have some fundamental gaps. A possible explanation for this could be the fact these countries lack effective enforcement of adopted AML/CFT regulations for a number of reasons.

First, the scope economic and political conjuncture prevents these countries from effectively realizing their AML/CFT policies. This could partially include giving bribes to these countries' authorities so they will turn a blind eye to illegal operations by illicit operators. The same opinion was shared by J. Connor, who argued the levels of collusion in the US and UK are very high (personal communication, May 15, 2017). This is because multinational corporations in these countries are extremely lucrative and therefore can pay large amounts of money to their patrons, thereby securing their business.

The reasoning presented above could be indirectly connected with the FIs' ***disagreement*** with the FATF standards in the US and UK, which signifies they are displeased with the AML/CFT regulations. The lucrative FIs in these countries may consider the expenses paid to the government in the form of fines make up only a piece of their revenue, and therefore do not pose any concern for them.

The second reason that probably prevents the US and UK from enforcing implementation of AML/CFT regulations could be the fact FIs, by possessing high volumes of funds, may feel they can do whatever they please because their patrons will help them in the case of an emergency. That may be why FIs do not show sufficient ***respect*** toward treatment of the FATF standards.

The third possible reason for friction in the relationships between the FIU and FIs in the US and UK is probably connected with the ***cost of compliance***. As mentioned, FIs need to invest a considerable amount of funds for establishing effective internal AML/CFT systems. However, some FIs, mainly those in less-developed countries, cannot inject a significant amount of funds into such systems. Even for large corporations, complying with the FATF standards can prove extremely costly.

The central problem with understanding and implementing the FATF standards in the US and UK is connected with the ***lack of sensibility*** in the treatment of the standards by the FIU and FIs. Nevertheless, as mentioned before, this ***lack of sensibility*** comes from the FATF standards, owing to those reasons discussed in this paper.

S. Tsukada argued that in the early stages the FATF standards had a lack of emphasis of whether entities that would follow the standards had enough capacity to implement them correctly (personal communication, May 29, 2017). S. Tsukada also contended the FIs do not have enough capacity to conduct precise analysis of information when filing STRs with the FIU, as they are not trained to do so and the concept of suspicion still appears vague.

The most convenient way to comply with the FATF standards, according to S. Tsukada, is when LEAs ask FIs through the FIU to provide intelligence on case by case basis (personal communication, May 29, 2017). This means that LEAs should first identify criminals and then solicit assistance from the FIU and FIs in receiving information with regard to the movements of their funds.

Considering the above circumstances and facts, it could be argued that accurately and precisely implementing the FATF standards requires joint efforts from the AML/CFT network members, especially the FIU and FIs. This cooperation is extremely important considering that the ***lack of sensibility*** in treatment of the FATF standards could eventually lead to all the negative consequences discussed in this paper. This ***lack of sensibility*** could also lead to increased criminal acts that may prevent peace and agreeability in international society.

5.4. Raising awareness and sensibility in the AML/CFT network

In recent century, the fight against ML has reached a crisis point. A similar perspective was shared by Doyle (2002), who contended that after the 9/11 events the war with illegal use of the legitimate financial environment reached its pinnacle. Doyle also argued the role FIs play in protecting the legal financial framework became more important than ever (ibid).

The connection between TF and ML resulted in strengthening of AML/CFT measures, and FIs being regarded as gatekeepers in the fight against these phenomena. In this regard, it could be argued that illegal actions of some banks in the US that were willingly or unwillingly involved in the planning of the 9/11 events led to tougher AML/CFT regulations.

Doyle (2002) argued that at that time the public attention paid to the issue of ML was greater than ever, while these days the ML problem is even more serious than before. This is because of the development and promotion of modern financial technologies, such as FinTech, Bitcoin and other relevant instruments that allow people to transact within seconds. These developments further complicated the process of tracing potentially illegal movements of funds, necessitating meticulous attention by governments if they are to keep pace with these innovations.

The role of the FATF standards as guiding principles for protecting the international financial framework from being misused is highly relevant. The FATF has established a common platform by which all countries can negotiate and share their opinions on how AML/CFT measures can be strengthened. However, as mentioned, the FATF standards to some extent could be a cause célèbre for friction in interaction between the FIU and FIs.

Doyle (2002) also noted the FATF and its standards, rather than protecting the international legal financial system, disturbed societal order and violated international law. Doyle raised this viewpoint because the FATF in February 2000 introduced the first report on non-cooperative jurisdictions. This report identified jurisdictions that had strategic AML/CFT deficiencies. Additionally, the FATF, by issuing this document, threatened non-cooperative jurisdictions with economic sanctions if they refused to bring their legislations in line with the FATF standards.

Doyle (2002) viewed the problem with economic embargos from a policy perspective, claiming economic restrictions historically had not brought any positive results. At the same time, Doyle, by criticizing that the FATF standards violated international law, meant they interfered with the unique right of sovereignty given to each country (ibid).

The right of sovereignty is granted to countries by Article 2 of the UN Charter, which says every country is endowed with the sovereign right to rule its own executive, legislative and judicial affairs. In this regard, Doyle (2002) believed the FATF blacklist notified targeted states they should follow the standards or otherwise they may face sanctions. For Doyle, this was a violation of countries' unique sovereign rights.

Doyle (2002) also argued the FATF was established by leading countries of the world based on their own experiences and ideas. In raising this viewpoint, Doyle (ibid) suggested the FATF nations should first take care of their own problems before probing

into those of other countries. This meant regulations made public by developed countries were less likely to be fully understood and enacted by other nations owing to those reasons discussed in this paper.

Doyle's ideas remain contemporary because they precisely reflect the reasons for the problems between the FIU and FIs. By interfering in nations' sovereign rights, the FATF and its standards caused instability in the way countries established and maintained their relationships with FIs. This circumstance eventually led to friction between competent authorities, especially the FIU and FIs. FIs were not happy with laws that affected their unique relationships with their clients, and violated the privacy of conducted transactions.

The main aim in the present research was to disclose tacit ideas behind interaction between the FIU and FIs, as they play a key role in detecting and preventing illicit funds at an early stage. This particular section sheds light on issues related to tacit ideas that prevent the FIU and FIs from establishing productive dialogue.

The problems between the FIU and FIs occur because of the reasons uncovered in this study. These reasons reflect only a visible part in the interaction between the entities; however, there are a number of invisible and murky elements in their relationships. One of those, and the most important, is difference of interests in the way they pursue their goals. The FIU, as a "representative office" of the FATF, requires FIs to obey rules and bring their activities in line with the FATF standards. Meanwhile, FIs threatened with possible fines from the FIU demonstrate false tolerance with the AML/CFT regulations.

As mentioned, filing of STRs is an indicator of the level of compliance with the regulations. Accordingly, as shown herein, FIs file copious reports with the FIU, which at times exceed the FIU's capacity to process information. This so-called defensive

reporting has a number of facets. The first is that FIs usually file only reports that contain no criminal element; e.g., daily transactions with their law-abiding customers.

The next facet is that FIs do not want their wealthy clients to cease doing business with them. With this in mind, FIs fail to file any information about their transactions with the FIU. The entities hide movements of funds related to that category of clients in a special classified database, which is not to be opened even if FIU examiners visit a bank during their daily routine.

The third facet is that FIs, as practice and theory show, are less interested in following any law that creates constraints, either financial or enforcement, for ease of doing business with their customers. Therefore, FIs burdened with unaffordable amounts of duties and expenses transfer a part or the whole of their responsibilities onto their less-lucrative clients. By doing this, these entities introduce more paperwork and additional costs for such clients. In this regard, AML/CFT initiatives promoted by the FIU lead to the burdens of extra fees and added bureaucracy for ordinary customers when dealing with relevant documents. Hence, laws adopted to facilitate people's prosperity eventually could lead to extra expenses down the road for ordinary people.

The difference of interests creates information asymmetry, as referred to in agency theory. FIs burdened with a huge range of AML/CFT laws demonstrate their positive approach in pursuing them; however, they indirectly burden the FIU with a need to conduct precise analysis of filed STRs themselves. This occurs because FIs have no intent of wasting their time complying with the FATF standards, rather doing their primary business of making money.

Another hidden element in the relationships between the FIU and FIs is the presence of collusion, which creates additional constraints when the two entities are nearing productive dialogue. Review of some prosecution cases related to financial

crimes made it evident that, in some countries, the FIU and FIs both show false tolerance with the FATF standards.

The above mentioned idea could be explained by purporting that both entities are greatly fatigued by AML/CFT regulations, and therefore, rather than fighting, they prefer to deal with one another. The results of this cooperation are then reported to the government as productive ones. This circumstance implies not only FIs, rather the FIU being overloaded with false reports does not pay attention to those reports anymore and circumvents proper treatment of the FATF standards.

The next tacit element in cooperation between the FIU and FIs implies the entities are generally aware of the FATF standards, but still ignore the original nature of AML/CFT regulations, as complying with them is cumbersome. The standards were developed to guide countries in establishing a sophisticated AML/CFT platform that could help them protect their financial systems from being misused.

However, as Doyle (2002) mentioned, in the 1990s at the outset of the worldwide attempt to apprehend money launderers, the FATF estimated around $85 billion was laundered from the proceeds of drug trafficking in the US and Europe. More recently, these numbers came to account for $300 billion in 1993 and in the 2000s increased to $600 billion.

Doyle (2002) mentioned the accuracy of the above numbers was questioned by a number of scholars. Nevertheless, the proportions of laundered funds brought great public concern, as they showed decades of intense lobbying by the FATF had led to such questionable results. In this regard, the effectiveness of the FATF standards to date, it could be argued, has remained unclear. The most recent IMF estimations had the amount of money laundered annually exceeding $2 trillion. This number serves as evidence the problems between the FIU and FIs persist, as these entities play a crucial role in detecting illicit funds at an early stage.

Doyle (2002) argued outside observers viewing the impressive set of AML/CFT regulations might be confused. They may envision that a nearly worldwide force against ML and associated offenses had been marshaled and effective results could be expected. However, as practice shows, regardless of how much has been done to ensure harmonization among AML/CFT regulations, the positive impact has yet to be seen (Doyle, 2002).

K. Stroligo, Ph. Pardo, J. Connor and St. Goodspit argued the only way to ensure convergence among AML/CFT regulations and practice was establishment of productive dialogue between the government (FIU) and FIs (personal communication, May 25, 2017; May 9, 2017; May 15, 2017; May 20, 2017). These entities should cooperate irrespective of how the difficult and cumbersome nature of complying with the FATF standards, because non-compliance could lead to negative outcomes and cause an undesirable image for certain countries and FIs.

The above raised argumentation coming from interviewees could mean, that the ***lack of sensibility*** in treatment of the FATF standards will not generate any positive outcomes, because the standards are continually strengthening in response to evolving threats to the integrity of the international financial framework. The same opinion was shared by K. Stroligo and J. Connor, who argued that, regardless of pros and cons in the treatment and effectiveness of the FATF standards, they must not be ignored (personal communication, May 25, 2017; May 15, 2017).

Doyle (2002) argued that FIs that have ties with illegal undertakings are likely to undermine public confidence in the safety and security of the financial sector. In addition, In addition, Doyle contended that the large amounts of laundered funds are usually withdrawn from scarce financial resources of developing and financially troubled nations (Doyle, 2002). In this regard, it could be argued that measures against

ML and associated offenses are not only related with crime, but also with preserving the integrity of FIs and the financial environment as a whole.

Taking the above emphasized idea into account, the FIU and FIs working as a team could help in building an effective AML/CFT regime. The role of these entities in the entire AML/CFT network is highly significant. The results of such cooperation between the participants of the AML/CFT network, especially the FIU and FIs, could be seen from the case of the UK, where JMLIT was established. In particular, the UK's LEAs and FIs, in combination with its government, started aggressive fight against any financial crime, which prevent the country's financial market to become self-sufficient.

5.5. Summary of the chapter

This chapter began with a brief introduction of the research topic, followed by discussion of relevant potential reasons behind the research problem coming into existence. It became apparent four reasons could cause the research problem: ***disagreement*** with the FATF standards, ***lack of respect*** to the FATF and its standards, ***lack of understanding*** of the FATF standards, and ***cost of compliance*** with the FATF standards. Also evident is the main reason, causing all the above-mentioned issues, stems from ineffective and unaffordable representation of the FATF standards to the public at an early stage.

This chapter also gives a detailed account of how the US and UK have progresses in implementing the FATF standards. Emphasis was placed on describing how these countries established, developed and upgraded their national AML/CFT regimes. It became apparent they have developed very robust systems; however, a number of fundamental gaps were identified by the members of the FATF expert team that undertook examination of these countries' AML/CFT systems in 2016 (US) and 2007 (UK).

Finally, a conceptual picture was provided of how the FIU and FIs could strengthen their cooperation and contribute to the fight against ML and associated offenses. The section presented original ideas with regard to the issues related to the reasons preventing the FIU and FIs from conducting productive dialogue. A number of tacit ideas revealed after applying the implications of agency theory were also discussed. Discussion established a perception the FIU and FIs need to cooperate with one another to achieve desirable results.

Final remarks were made with respect to the JMLIT, a taskforce established in the UK to tackle problems associated with ML and other illegal activities. In particular, it was stressed that the UK's LEAs and FIs, in combination with its government, began an aggressive fight against any financial crime that prevents the country's financial market from becoming self-sufficient.

CHAPTER 6

CONCLUSION

6.1. Concluding remarks

Money laundering is a term that greatly concerned international society at the outset of the 20thcentury, as it helped illegal undertakings, mainly represented by drug dealers, in hiding the original sources of their income. However, being connected with disguising of the original source of funds, the phenomenon should date back to the century when banking and other financial services emerged.

These days, the corrosiveness of economic crime continues to erode public order in many less-developed countries. Meanwhile, in large financial centers, criminals actively use ML techniques to hide the sources of their income, and eventually are able to enjoy the fruits of their dirty dealings. There are many examples evidencing that large amounts of money were, and still are, being relocated to big financial markets from low-income countries (e.g., Nigeria), thus deteriorating and exhausting financial resources of the latter.

The present research aimed to analyze interaction between the FIU and FIs when detecting and preventing promotion of ML activity. Three major tasks were pursued in conducting the study: a historical account of the issue, a detailed examination of documents from the FATF, and analytical framework-agency theory. With the aim of matching the above-mentioned tasks, a number of research questions, three in particular, were developed.

At the initial stage of the research, an attempt was made to synthesize historical accounts and archival information so as to provide a picture of major historical influences on the formation of the ML phenomenon, uncover why the concept became a global concern, find what kinds of initiatives were taken to counter the problem, and

dismantle possible reasons behind the lack of sensibility in treatment of the FATF standards. A number of established research methods, such as analysis of historical records and interviews, were subsequently employed to match the goals of the first research question.

The second phase of the research aimed at understanding how the FATF standards are being implemented in different jurisdictions. To this end, relevant documents and interviews were analyzed to explore how the US and UK have progressed in implementing the standards.

The purpose of the final phase of the research was development of a set of recommendations that could help in promoting awareness and sensibility in treatment of the FATF standards by the FIU and FIs. For this goal, the findings generated as a result of historical and document analyses were examined through the lens of agency theory. This was for disclosing tacit ideas behind interaction between the FIU and FIs.

The study found ML is the outcome of criminal activity and, as long as illegal undertakings continue to violate laws, it cannot be totally eradicated. Many laws were enacted and many decisions were made in the past by large nations, such as the US and UK, on how to protect the legitimate global financial sector from being misused.

Over time, some guiding principles and laws intended to help dealing with ML and any other crime that generates this unlawful activity were developed by members of international society. These efforts culminated in establishment of the FATF, which became an ad-hoc body tasked with developing and promoting AML standards. Subsequently, a set of the FATF's 40 Recommendations was developed, incorporating almost all the provisions of earlier-enacted laws. In addition, the FATF standards were revised and became even stricter after the 9/11 events that underscored the connection between ML and TF.

The FATF standards were developed to be implemented by all nations; however, because of the diversity of legislative frameworks, it took time before each member of international society brought its laws in line with these recommendations. Meanwhile, as this study demonstrated, the FATF's recommendations have yet to be implemented, for various reasons.

The fact is the practical implementation of all these recommendations required countries' competent authorities and FIs to detect and prevent illicit funds from entering the legal financial system. The bridge between LEAs and FIs in this detecting mechanism was provided to the FIU by the FATF standards. The FIU's main target was set for it to be a center for receiving, analyzing and disseminating intelligence collected from FIs in the form STRs to other competent authorities (LEAs).

FIs were not happy or ***disagree*** with their new function of filing STRs and in this sense they meant not to demonstrate enough ***respect*** to the implementation of the FATF standards. Besides, the standards were not easily understandable or there was ***the lack of understanding*** of the FATF standards by FIs. With this in mind, in order to avoid this ***lack of understanding***, FIs had to spend additional amount of funds to keep educating their personal about the FATF standards. Moreover, they were not pleased by the amount of money needed to be injected in the establishment a stand-alone unit within an institution to comply with the FATF standards. In other words, the second factor that caused inconsistencies in the relationships among the FIU and FIs was ***the cost of compliance***.

The function of filing STRs multiplied by establishing and maintaining a standalone compliance unit, interfered with the unique relationships between FIs and their customers. The terms of privacy were highly important either for the bank's clients and/or for the institution itself. However, FIs that rejected implementing AML/CFT

regulations could eventually be fined if their systems were found to be used by criminals to move assets.

This disagreement with the FATF standards resulted in friction between the FIU and FIs, and with the purpose of showing false tolerance with the AML/CFT regulations, instead of filing only suspicious transactions, most all activities began to be reported. This led to the agency problem which emerged not from the underhandedness of the agent (or principal), but as a natural result of poor communication.

Review of materials related to the US and UK made it apparent these countries, as well as their FIs, have a good and evolved understanding of potential threats posed by ML, TF and associated offenses. It was also found these countries created robust AML/CFT regimes with capacity for detecting and preventing illicit funds at any stage of their movement.

However, the US and UK are lacking in enforcing their AML/CFT legislations. This means these countries are strong on paper, though not in action. The high percentage of money laundered annually taking place in or through these countries could serve to support this idea. This is when these countries' suspicious activity detecting systems have been recognized as the most effective in the world. The problem of excessive reporting also persists in these countries.

This study found the problem is related not only with the phenomenon of crying wolf, but also refers to the level of commitment of how the FIU and FIs understand and implement the FATF standards. In this regard, it identified a lack of sensibility in how the parties treat these standards. It also found this lack of sensibility does not simply come from the FIU and FIs, but rather from how the standards were presented and developed.

The above-mentioned ideas led to development of a set of suggested recommendations that could help promote awareness and sensibility in the AML/CFT

network, particularly with reference to the FIU and FIs. These institutions play a key role in detecting and preventing illicit funds at an early stage.

6.2. Suggested recommendations

The application of agency theory demonstrated there were some tacit elements in the relationships between the FIU and FIs when implementing the FATF standards. To a certain degree, these elements refer to the difference of interests in how these two institutions pursue their obligations for implementation of the FATF standards. The present study also found the role of collusion in the interaction between the FIU and FIs is relevant. The third tacit component refers to the fact the FIU and FIs are aware of the FATF standards, but still ignore the original nature of AML/CFT regulations, as complying with them is a cumbersome process. All these findings lead to a set of recommendations, as follows:

1. **Joint Task Force**. Creation of a task force is highly important if countries wish to establish effective AML/CFT systems. The task force should bring together government, competent authorities and FIs to work as a team to protect the legal financial framework from being used for illegal purposes. The task force should have its own objectives and should be independent in pursuing its actions. Its members should be chosen from among individuals with a high degree of professionalism, experience and expertise in the AML/CFT field. Moreover, these personnel should be periodically trained and educated to keep pace with recent developments in technology and techniques for disguising funds. The UK was the first country to have already established a task force with nearly the same functions. The combination of joint efforts in the UK has already yielded significant results and changes in the country's AML/CFT system. In this regard, the UK's JMLIT is the first

multidisciplinary team of experts that serves to protect the integrity of the UK financial sector.

2. **Editing** of the FATF standards' interpretative notes with more precise and easily understandable explanations. Reasons for this recommendation have been revealed throughout this paper.
3. **Closer involvement** of the FATF in countries' AML/CFT systems in terms of providing extensive training and methodologies to be applied when they detect suspicious activity for both the FIU and FIs. The role of technical assistance should also be relevant and far-ranging in this involvement, as less-developed countries do not have capacity to afford high-tech solutions when dealing with disclosing complex issues related to ML, TF and other predicate offenses.
4. Being **careful** when designating countries as non-cooperative jurisdictions, as this designation could lead to flows of criminal activity from sanctioned countries to their neighbors. The economic impact should also be taken into account when the designation concerns less-developed countries. This designation implies calling on more responsible members of society to ban any financial relationships with designated countries. This could cause additional challenges for these less-advanced economies when trying to conduct business with other countries. Ineffective and careless designation could lead to unpredictable consequences, such as economic and political chaos in the singled-out countries.
5. **Ongoing training** of FIU and FI personnel independently by countries. While the FATF's role is also important in providing relevant conditions for training AML/CFT professionals, countries' own roles in this field should not be underestimated. National states are advised to know the economic, political and cultural conjuncture within their borders; therefore, this

knowledge could help them in training and educating their people appropriately and affordably. Countries in cooperation with the FATF and its FSRBs should seek to establish training centers within their jurisdictions and cooperate with one another. This could help in sharing knowledge and the practice of disclosing cases related to ML, TF and other predicate offenses.

These recommendations could help the AML/CFT network members in understanding some of their shortcomings when addressing such a complex issue as dealing with ML, TF and other predicate offenses. These types of financial crimes can potentially erode the integrity of the international financial environment and should be considered with greater care and precision by members of international society because of the consequences they could generate.

6.3. Suggestions for further research

Taking into account the full corrosiveness of ML and associated offenses, it can be argued that this field has yet to be thoroughly explored. Therefore, additional studies are greatly important, as fund-disguising techniques will continue evolving because of the development of modern financial technologies. Bitcoin, for instance, provides a platform for transacting peer-to-peer, excluding traditional FIs and without government supervision and control. While there are a few studies on the role of new payment methods, additional ones, in particular concerning risks of applying Bitcoin technology for ML, could help in exploring how these new methods are being applied for criminal purposes.

6.4. Limitations of the study

The only limitation of this study was its lack of access to detailed information because of the secrecy of the field. Therefore, this research was conducted based solely on publicly available sources.

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APPENDIX A

List of FATF-Style Regional Bodies

1. Asia/Pacific Group on Money Laundering (APG) *(See also: APG website:* https://www.apgml.org/*);*
2. Caribbean Financial Action Task Force (CFATF) *(See also: CFATF website:* www.cfatf-gafic.org/*);*
3. Council of Europe Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (MONEYVAL) *(See also: Moneyval website:* www.coe.int/t/dghl/monitoring/moneyval/*);*
4. Eurasian Group (EAG) *(See also: EAG website:* www.eurasiangroup.org/*);*
5. Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG) *(See also: ESAAMLG website:* www.esaamlg.org/*);*
6. Financial Action Task Force of Latin America (GAFILAT) (formerly known as Financial Action Task Force on Money Laundering in South America (GAFISUD)) *(See also: GAFILAT website:* www.gafilat.org/*);*
7. Inter Governmental Action Group against Money Laundering in West Africa (GIABA) *(See also: GIABA website:* www.giaba.org/*);*
8. Middle East and North Africa Financial Action Task Force (MENAFATF) *(See also: MENAFATF website:* www.menafatf.org/*);*
9. Task Force on Money Laundering in Central Africa (GABAC) *(See also: GABAC website:* www.spgabac.org/*).*

APPENDIX B

List of Designated Non-Financial Businesses and Professions (DNFBPs)

1. Casinos (internet and ship-based);
2. Real estate agents;
3. Dealers in precious metals;
4. Dealers in precious stones;
5. Lawyers, notaries, other independent legal professionals and accountants-this refers to sole practitioners, partners or employed professionals within professional firms. It is not meant to refer to 'internal' professionals that are employees of other types of businesses, nor to professionals working for government agencies, who may already be subject to AML/CFT measures;
6. Trust and Company Service Providers refers to all persons or businesses that are not covered elsewhere under these Recommendations, and which as a business, provide any of the following services to third parties:
    a) acting as a formation agent of legal persons;
    b) acting as (or arranging for another person to act as) a director orν secretary of a company, a partner of a partnership, or a similar position in relation to other legal persons;
    c) providing a registered office; business address or accommodation, correspondence or administrative address for a company, a partnership or any other legal person or arrangement;
    d) acting as (or arranging for another person to act as) a trustee of an express trust or performing the equivalent function for another form of legal arrangement;
    e) acting as (or arranging for another person to act as) a nomineeν shareholder for another person.

APPENDIX C

List of Red Flags

1. **Red Flag Scenario 1:** A customer fails to provide phone or fax numbers or the numbers provided are maintained by third-party office services;
2. **Red Flag Scenario 2:** A prospective customer presents a diplomatic passport from an obscure country - particularly one in Africa, where such passports are easily obtained for modest amounts of money. The passport may be genuine…but the holder may be a criminal;
3. **Red Flag Scenario 3:** A customer presents a photocopy of his or her passport when opening a new account. Tip: Train employees to refuse to accept photocopies of passports or other identification documents which are presented to open new accounts. Today's photocopying technology makes it all too easy to apply a new photo to an original document so that it appears genuine when copied;
4. **Red Flag Scenario 4:** Relying on third-party due diligence. If a client is referred to you by a third-party organisation, be sure that the due diligence documentation provided by the other organisation relates directly to the prospective client that you are looking to do business with. Solely relying on another organisations' due diligence will prove to be plain foolish if you rely on it to proceed with a deal which ultimately unravels;
5. **Red Flag Scenario 5:** Being asked to do business with shell companies. A prospective new client may present you with the legal documents of a seemingly legitimate company, along with identification for nominee directors. If you suspect-or know for sure-that these individuals are "fronts" for the actual account beneficiary, walk away;
6. **Red Flag Scenario 6:** Be suspicious of prospective clients that maintain a financial performance which is noticeably inconsistent with that of other businesses of comparable size in the same industry;
7. **Red Flag Scenario 7:** A group of foreign nationals visits your organisation to open multiple accounts. It may mean that they are doing the same at other financial institutions in your city-thereby setting up the banking framework for a laundering operation. You should also beware of instances where multiple accounts are being set up using variations of the same name;

8. **Red Flag Scenario 8:** Frequent inconsistencies in an account's activities. If a business that claims to operate only on a regional or national level has a large number of international cash transfers, you may need to investigate. Similar incongruities should be scrutinized as well;
9. **Red Flag Scenario 9:** New account applications from customers from suspect jurisdictions. Countries such as Vanuatu, Antigua, Nauru and the Philippines are major centres for money laundering activity, due to lax banking regulations, the presence of organised crime, drug trafficking, etc. Prospective customers from these jurisdictions should be scrutinized with extra care. Tip: For a full list of suspect jurisdictions, visit the website of the FATF at www.oecd.org/fatf. The FATF is a 29-country organisation based in Paris that monitors and promotes policies to control money laundering;
1. **Red Flag Scenario 10:** Numerous cash transactions for amounts just under the legal threshold for reporting. For example, in the US, any bank transactions of USD 10 000 or more must be reported by the financial institution. Other countries have similar reporting requirements. Making transactions for amounts just under the threshold limit is one of the most widely known laundering tactics, but it continues to be extensively used by money launderers worldwide. In addition, large numbers of cash transfers to and/or from offshore banks or companies should be subject to scrutiny, as should frequent or unusually large cash receipts or payments which have been made by a customer whose business is normally conducted primarily with cheques or other non-cash instruments.

APPENDIX D

Request for informational interview sent to each of the potential interviewee

〒874-0839
Beppu City, Oita Prefecture, Japan
Minami Tateishi ikku 5-5
Yamaguchi Corp. bldg. 2 ap. 306
mirzsh15@apu.ac.jp
May 10, 2017

Dear respondent,

I am a student at Asia Pacific University Ritsumeikan and belong to Graduate School of Asia Pacific Studies, Master's Program, and Development Economics division. I am particularly interested in learning more about the theory and practice of money laundering and those measures that could be taken to tackle down this problem. These days I am carrying out research entitled "Raising awareness and sensibility in the AML/CFT network". In a recent conversation with (a colleagues' name) she/he suggested me to contact you about your practice in the field of the research that is being conducted by me. She/he mentioned that you possess extensive experience and outstanding knowledge in the field.

I am not approaching you with any other purpose other than research; I would simply appreciate any general advice or information you could offer me that could be helpful in exploring the needs of my study. I would be very grateful for the opportunity to meet/talk with/to you for 10 to 15 minutes either in person or by phone, email or via social network such as Skype, Facebook, Viber or WhatsApp in the near future. Thank you for your time. I will be looking forward to receive an email from you at your convenience.

Sincerely,

Sharipov Mirzosharif

Sharipov Mirzosharif

APPENDIX E

Letter with the details of the interview

〒874-0839
Beppu City, Oita Prefecture, Japan
Minami Tateishi ikku 5-5
Yamaguchi Corp. bldg. 2 ap. 306
mirzsh15@apu.ac.jp
May 15, 2017

Dear respondent,

I would like to confirm a phone interview with you. Below are the details for our scheduled interview. I have also attached a list of tentative questions in this email that could be asked during the interview. I can contact you at any convenient time that suits your schedule, in this regard, please kindly indicate time and date.

During the interview I will be using IC recorder to record our conversation. It is intended to take 15 minutes of your valuable time for the interview. I will be looking forward to discuss relevant topics with you regarding my study and take this opportunity obtain additional knowledge about topic under investigation. If you have any questions, please don't hesitate to contact me. I can be reached at +818090640077 or via email reflected above.

Sincerely,

Sharipov Mirzosharif

Sharipov Mirzosharif

APPENDIX F

Permission Request Letter

To: FATF Secretariat, 2 rue André Pascal

75775 Paris Cedex 16, France

From: 〒874-0839

Beppu City, Oita Prefecture, Japan

Minami Tateishi ikku 5-5

Yamaguchi Corp. bldg. 2 ap. 306

mirzsh15@apu.ac.jp

May 17, 2017

Dear FATF Secretariat,

I am a student at Asia Pacific University Ritsumeikan and belong to Graduate School of Asia Pacific Studies, Master's Program, and Development Economics division. I am particularly interested in learning more about the theory and practice of money laundering and those measures that could be taken to tackle down this problem. These days I am carrying out research entitled "Raising awareness and sensibility in the AML/CFT network".

I am writing to request your permission to use following materials from your website for the purposes of my research:

1. Anti-money laundering and countering the financing of terrorism measures. United States. Mutual Evaluation Report. December, 2016;
2. Third Mutual Evaluation Report. Anti-Money Laundering and Combating the Financing of Terrorism. The United Kingdom of Great Britain and Northern Ireland. 29 June 2007.

I am requesting non-exclusive rights to use information from the above mentioned materials in a part of my research paper. Your assistance in granting me with access to the use of these materials will be highly appreciated. I will be looking forward to receive an email from you at your convenience.

Sincerely,

Sharipov Mirzosharif

APPENDIX G

Letter from the FATF

Good Morning,

Thank you for your email and your interest in our work.

Further to your request for permission to reproduce material from *the Mutual Evaluation Report of the United States of America 2016* and the *Mutual Evaluation Report of the United Kingdom 2007* to be published in your Master thesis entitled "*Raising awareness and sensibility in the AML/CFT network*", we are pleased to confirm that permission is granted to use the material described above subject to the conditions stated below:

- All rights granted herein are non-exclusive, world rights in one edition, print, electronic, online and accessible versions.
- Permission to reuse the material in all reprints, revisions, ancillary aids, promotional material and derivative works, provided that they are related to the same edition.
- This permission does not allow translation of the quoted material. Such permission should be subject to a separate request.
- Due acknowledgement should be given to the FATF.

Yours sincerely,

Alexandra Wijmenga-Daniel
Communications Management Advisor
FINANCIAL ACTION TASK FORCE
2 rue André Pascal-75775 Paris Cedex 16
Tel: +33 1 45 24 95 23-Mob: +33 6 21 39 41 54-Fax: + 33 1 44 30 61 37
alexandra.wijmenga-daniel@fatf-gafi.org | www.fatf-gafi.org

APPENDIX H

List of predicate offences

1. Participation in an organized criminal group and racketeering;
2. Terrorism, including terrorist financing;
3. Trafficking in human beings and migrant smuggling;
4. Sexual exploitation, including sexual exploitation of children;
5. Illicit trafficking in narcotic drugs and psychotropic substances;
6. Illicit arms trafficking;
7. Illicit trafficking in stolen and other goods;
8. Corruption and bribery;
9. Fraud;
10. Counterfeiting currency;
11. Counterfeiting and piracy of products;
12. Environmental crime;
13. Murder, grievous bodily injury;
14. Kidnapping, illegal restraint and hostage-taking;
15. Robbery or theft;
16. Smuggling;
17. Tax crimes (related to direct taxes and indirect taxes);
18. Extortion;
19. Forgery;
20. Piracy; and insider trading and market manipulation.

When deciding on the range of offences to be covered as predicate offences under each of the categories listed above, each country may decide, in accordance with its domestic law, how it will define those offences and the nature of any particular elements of those offences that make them serious offences.