

GENERAL DIRECTIONS FOR MONEY LAUNDERING RISK ASSESMENT AND FINANCING OF TERRORISM

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ABSTRACT

General frameworks that are designed to combat money laundering and financing of terrorism, show great efficacy when directed to target resources towards having the greatest effect. The design of such frames that contain general principles for combating money laundering and terrorist financing, can only be achieved through thorough analysis and understanding of the process of money laundering and risk assessment of the financing of terrorism on national level.

The approach in understanding the issues is based on the recommendations of the FATF (Financial Action Task Force), containing guidelines for the proper identification, assessment and understanding of the risk of money laundering and financing of terrorism at the national level, at the level of a national jurisdiction, and it measures and activities, and the use of resources for mitigation of risk, on a risk-based approach.

KEYWORDS: Combat Money Laundering, Frameworks, Risk-Based Approach, Terrorism Financing

INTRODUCTION

Fight against money laundering and terrorist financing is the basis for any national security and achieving a stable and strong financial system. The process of combating money laundering and terrorist financing is a joint effort of various state structures, such as policy makers in the country, supervisors, legal system, public sector and private sector, especially financial institutions. To prevent money laundering that will serve as a means of financing terrorist activities requires a close cooperation of all these structures in order to develop appropriate frameworks and principles, laws and regulations that will help in the detection, prevention and eradication of that criminal activity. The foremost thing is to understand the process of money laundering and the threat of terrorist financing, and thus to understand the vulnerability and weaknesses of the process.

The purpose of the assessment of the risk of money laundering and terrorist financing is to help public and private sector in the fight against this type of crime and to show how big is the risk of money laundering and funding terrorism to national security and the financial sector as well as display the effectiveness of those measures in combating these methods. In other words, the goal is more effective targeting and prevention of these criminal activities.

GENERAL PRINCIPLES OF MONEY LAUNDERING AND FINANCING TERRORISM

Money laundering and terrorism financing are financial crimes that has economic effects. These criminal activities affect the stability of a country, its financial sector or the external stability more generally. Money laundering is a process by which the illicit source of assets obtained or generated by criminal activity is concealed to obscure the link between the funds and the original criminal activity. Terrorist financing includes raising and processing that illegally acquired property

to provide resources for terrorist organizations or individuals to pursue their activities. Although both processes differed essentially in many ways, in common is that they use the same flaws in financial systems, such as anonymity and lack of transparency in the execution of financial transactions.

According to FATF, criminal activities such as illegal arms sales, smuggling, drug trafficking and other organized criminal activities, generates a large amount of money. Despite these activities, there are embezzlement, computer crime, internal trafficking, bribery, which also generate a large sum of money, which creates the need to “legitimize” the illegally obtained funds through money laundering. When an activity generates a large amount of money, individuals or groups involved in the activity must find a way to use the funds without attracting attention. This is achieved by covering the sources and change or move resources from one place to another where there is unlikely to attract attention. According to the 2000 United Nations Convention Against Transnational Organized Crime, also known as the “Palermo Convention”, money laundering can be defined in several different definitions, which are basically similar to the definition under the FATF.

Everywhere that money is directed to laundering, by definition, that money comes from criminal activities such as drug trafficking, arms trafficking, fraud and so on, which should be stressed that the financing of terrorism can include assets from perfectly legitimized sources that are used just for financing terrorist activities. Here, attention turns more on how to hide the “purpose” for which the money are allocated, rather than their source. Financing of terrorism through money laundering can serve a variety of goals, such as operating expenses, buying food, rents, but also real terrorist acts. Terrorists, like criminal enterprises, rely on the confidentiality of financial transactions through financial institutions. This implies that terrorists and money launderers apply the same methods to hide ill-gotten gains to not notice the money transfers.

MONEY LAUNDERING STAGES

The process of money laundering is a complex process that involves application of various complex series of transactions that are difficult to separate from one another. But overall, the money laundering process can be divided into three stages.

Stage I – Placement

This stage includes physical separation of money and property (assets) acquired through criminal activity. This stage is the initial stage where illicit acquired property is brought into the financial system, where funds are circulated through various institutions and facilities such as banks, shops, casinos and other businesses that may be both domestic and foreign.

Stage II – Layering

Here, comes to the separation of illegally acquired assets from their source through layers of financial transactions. The goal of this stage is to conceal the true source of funds and to cover audits, the source and ownership of funds.

Stage III – Integration

In this stage illegally acquired funds and assets are recognized as legitimate by re-entry of funds in the economy and posing as funds from performing normal business activities or personal transactions.

CONSEQUENCES OF MONEY LAUNDERING

Money laundering process has a very large impact on the economy, security and social welfare. Although money laundering occurs in every economy most affected are economies of developing countries and in countries that have weak, brittle economy. The reason why money laundering occurs more frequently in these countries is that these countries have very fragile financial system, lack of banking regulations and a lack of effective legal frameworks, so they are subject to money laundering and financing terrorism. The latter can be considered as the biggest danger of the money laundering process.

Consequences of money laundering are numerous. If a country is perceived as a haven for money laundering, then it is attractive to those who commit crime and those aimed at increasing the lucrative aspect of criminal activities. As another result of money laundering businesses is that money launderers undermine legal businesses in the private sector, as a consequence there is a serious microeconomic effects seriously felt by the private sector. These businesses are known as “front” companies controlled by criminals engage in criminal activities that cause reduction in prices or availability of their products/services below market prices, by which receive competitive advantage over legitimate businesses, where the legal private sector suffers. As the biggest consequence of money laundering in relation to the national economy is that this process causes weakening of financial institutions. Money laundering can adversely affect the stability of certain banks, insurance companies, brokerage houses, institutions dealing with trade in securities and so on. Furthermore, money laundering has great influence on economic policy decisions makers, economic distortion and instability, loss of tax revenues, reputational risk of the country and social costs.

GUIDELINES FOR ASSESSING THE RISK OF MONEY LAUNDERING AND FINANCING TERRORISM

The techniques and methods used to launder money are similar to those applied to finance terrorism. An effective system for combating money laundering and terrorist financing must cover all possible risks. That system should prevent, detect and punish the illegal placement of funds in the legal system and prevent the provision of funds to terrorists and terrorist organizations to finance their activities with those illicitly acquired assets.

The guidelines and principles for assessing the risk of money laundering and financing of terrorism are based on the recommendations of the FATF. According to the recommendations of the FATF (recommendation 1), is required of all bonds of the Law on risk assessment to cover the risks relating to customers, risks associated with a specific country or geographical area, then, the risks associated with transactions, services and associated with the distribution channels. Risk assessment of money laundering and terrorist financing enables clear focus efforts and adopting appropriate measures to combat money laundering and financing terrorism. The legal basis in almost all countries is the Anti-Money Laundering and Financing of Terrorism Law, which entails analysis of the risk of money laundering and financing of terrorism in accordance with the guidelines imposed by the competent authority for the application of that law. In the analysis of risk of money laundering and financing terrorism is included evaluation of each group/type of customer, type of business relationship, as well as services provided by a person (payer) within its business. Each institution concerned should have its own system for risk management, and that system should provide continuous identification, assessment, monitoring, mitigation and management of the risk of money laundering and financing terrorism. The system for assessing the risk of money laundering and financing terrorism, in order to function properly, it is necessary to include the following guidelines

for risk analysis:

- Assessment of the risk of doing business;
- Internal policies and procedures related to controlling the risk of money laundering and financing of terrorism;
- Organizational structure responsible for conducting the analysis of risk control; and
- Confidence in the system and justification of control.

RISK ASSESSMENT FOR BUSINESS

The term “risk” includes many segments to be considered. If all segments are perceived, the level of risk can be reduced so as to reduce threats and vulnerability or their impact. To determine exposure to risk of money laundering and terrorist financing must be recognized every segment of the business which may appear a threat of money laundering and financing terrorism, or must assess vulnerability to this threat. These risks should be continuously identify at all management levels of the organization. Given that the assessed risks should adequately assess the exposure to risk of money laundering and terrorism financing, which will allow the subject to assess the likelihood of a negative impact that could have originated from that risk, and the potential effect that risk has on the realization of performance targets. Risk assessment of money laundering and financing of terrorism assumes that different products and services offered from these companies, or other transactions that enable them, are not as vulnerable to abuse by criminals.

The risk assessment is carried out to allow the application of the control measures that are proportionate to recognize the risk. It allows subjects to focus on those customers, products, services, transactions and channels of operation, which is the greatest potential risk. Given the nature of financing terrorism differs from the nature of money laundering, risk assessment must include an analysis of vulnerability to terrorist financing. Given that the money used to finance terrorist activities may be derived from legal sources, the nature of these sources differs. When the money to fund terrorism come from illegal sources or from criminal activities, the risk assessment relating to money laundering can be applied to assess the risk of funding terrorism.

IDENTIFICATION OF RISK

In the first step undertaken in the risk assessment of money laundering and financing of terrorism, it is necessary to recognize certain types of risk, such as risk from state, from customers, geographic location, transactions, products, services, distribution channels and so on, which are characteristic for specific subjects. Depending on the subject, it must be taken into account the other categories of risk in which money laundering and financing of terrorism can occur. Geographic risk or a state risk can occur due to the client's location, the destination of the transactions of the client, but also for its own business entity to whom it comes, its location and the location of the organizational units that are under his ownership. This type of risk, in combination with other risks categories, gives very useful informations about the potential exposure to money laundering and financing of terrorism.

Due to the risk assessment of money laundering and financing of terrorism, the entity should determine whether a customer has collaboration with some association with increased risk of money laundering and terrorism financing and based on custom criteria, subject can determine whether a customer is a big risk. There are several types of risk analyzes for potential clients and customers, but mostly is applied a general analysis for different categories of customers. Based on individual risk classification, different appropriate measures can be applied for client monitoring.

Complete analysis of the risk of money laundering and financing of terrorism must address any potential differences that exist in the transactions, products or services offered by a company to its customers, and the way in which the offer is submitted to the client. The entity should pay attention to the risks of money laundering and financing of terrorism that could stem from the application of new technologies. In order to perform risk analysis, the entity should describe all of its products and services provided and to assess whether client to its sells its products or services could abuse them for money laundering or for financing terrorism.

ANALYSIS (MATRIX) OF THE RISK

When assessing the risk of money laundering and terrorist financing, the entity that makes the analysis should establish all recognized risk categories into one of four risk categories: low, medium, high and unacceptable risk. The institution concerned must take into account all the factors that affect these criminal activities, such as geographic location, number and volume of transactions, relationship with the client and so on, and has to acknowledge the differences in the way which its established business relationship with that customer. Risk of money laundering and financing of terrorism, therefore, depends on all the combinations of factors and the diversity of possible combinations, which vary between institutions. The overall risk will get if the risk analysis take into account geographical risk correlated with other risk factors.

Matrix of risk is applied by institutions for risk assessment in identifying customers located in a zone of low risk, customers located in a zone of higher risk, but still acceptable, and for those customers who carry a very high or unacceptable risk of money laundering and financing of terrorism. When the subject classifies the risks should take into account the full range of risk categories (for example, offered services and products, size of institution, organizational structure and so on). It should taken in mind that the risk matrix is not unchangeable, but that it changes according to the change of subject. Risk assessment helps the operator to discern how the risk of money laundering and terrorism financing vary from customer to customer, product, geographic area, etc., and this allows the entity to direct its efforts in the area of high risk in which it operates.

Risk of money laundering and financing of terrorism is specific to each entity and requires an appropriate management approach, at the appropriate level and structure, based on the size of the organization. Purposes and principles of risk management of money laundering and terrorist financing should ensure establishment of appropriate policy and procedures for protection that includes creating rules to measures taken for the identification and monitoring of customers, promote high ethical standards and high professional standards.

To manage financial risk of money laundering and terrorist financing requires all subjects to engage and define business units with different competence, knowing their exact role, level of authority and responsibility. It takes developing procedures for managing the risk of money laundering and terrorist financing at different levels in certain organizational units, and procedures for managing the risk of money laundering and financing terrorism comply with the objectives and principles for assessing the risk of money laundering and financing of terrorism.

OUTCOME OF RISK ASSESSMENT

The actual results of a risk assessment can take different forms. For the public authorities that are ultimately the main users of the assessment, there is often an expectation that some form of a written report will be produced, although this is not strictly speaking a requirement of Recommendation 1. Regardless of the form and presentation of the money

laundering and terrorism financing risk assessment, it should ultimately allow public authorities to make a judgment on the levels of the risks and priorities for mitigating those risks. The policy response can then be made commensurate to the nature and level of the risks identified. It is therefore advisable that the risk assessment contain sufficient information about the source, nature, and extent of each risk to help indicate appropriate measures to mitigate the risk.

Once completed, authorities will have to consider how broadly the results of the risk assessment are to be disseminated amongst the various stakeholders. More specifically, Recommendation 1 requires countries to have mechanisms to provide appropriate information on the results of the risk assessments to all relevant competent authorities and self-regulatory bodies (SRBs), financial institutions and Designated Non-Financial Businesses and Professions.

A particular objective of a money laundering and terrorism financing risk assessment could be to provide information to the public in order to enhance the general understanding of government Anti-Money Laundering / Countering the Financing of Terrorism initiatives. A typical output of a national money laundering and terrorism financing risk assessment is generally a public document.

CONCLUSIONS

Identification, assessment and understanding of money laundering and terrorist financing is a major part of the implementation and development of national strategies to combat money laundering and terrorist financing, including adoption of laws, regulations, strengthening the various sectors concerned and other mitigation measures to the risk of money laundering and financing terrorism.

The results of assessing the risk of money laundering and terrorism financing without distinction for which it is needed, provides a useful information for financial institutions and non-financial businesses and professions to support performing own risk assessment.

When the risks of money laundering and financing terrorism are properly understood, national authorities may apply measures to combat money laundering and financing terrorism by applying the principle “risk-based approach”, which is central to the FATF standards, Recommendation 1.

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