

MONEY LAUNDERING AND LEGALIZATION OF PROCEEDS OF CRIMINAL ACTIVITY

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DOI: <https://doi.org/10.31410/EMAN.2018.342>

Abstract: *The problem of money laundering as a process in which the money generated from the proceeds of crime is legalized is nowadays extremely current issue. The aim of money laundering is to achieve a situation where money would be "cleaned up" and should not attract the attention of law enforcement or tax authorities and should not raise doubts that they have been acquired in a legal way. Money laundering is a very dangerous crime for society, primarily because the money that is being legalized represents the proceeds of another very serious crime. The essence of this report is, in particular, the definition of the concept of "legalizing income from crime, or more precisely money laundering", definition of phases of money laundering, money laundering methods, means of legalizing income from crime by defining characteristic features and amending Act no. 297/2008 of the National Council of the Slovak Republic on Protection against the Legalization of Income from Crime and on the Protection against Terrorist Financing. This paper is the output of the project "Modernisation and consolidation of R&D infrastructure in the area of financial security information technologies" (Code of the project: 2623012000) and the project GAAA 11_2/2016 „A comparison of the business environment in selected countries in terms of individual market segments“.*

Key words: *legalization of income from criminal activity, criminal law, a crime, money laundering, organized crime, legislation, banking operations.*

1. INTRODUCTION

Almost all criminal activities yield profits, often in the form of cash, that the criminals then seek to launder through various channels. Money laundering is an offence in its own right — but it is also closely related to other forms of serious and organized crime as well as the financing of terrorism. In addition to organized criminal groups, professional money launderers perform money laundering services on behalf of others as their core business.

The scale of money laundering is difficult to assess, but it is considered to be significant. The United Nations Office on Drugs and Crime (UNODC) estimates that between 2 and 5% of global GDP is laundered each year. That's between EUR 715 billion and 1.87 trillion each year.

Most organized crime shares a common denominator — the financial motive. Organized crime groups boost their assets and then inject them into the legal economy through different money laundering schemes. Tracing these assets means tracing the networks.

Money laundering is the act of concealing the transformation of profits from illegal activities and corruption into ostensibly "legitimate" assets.[1] The dilemma of illicit activities is

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accounting for the origin of the proceeds of such activities without raising the suspicion of law enforcement agencies. Accordingly, considerable time and effort is put into devising strategies which enable the safe use of those proceeds without raising unwanted suspicion. Implementing such strategies is generally called money laundering. After money has been suitably laundered or “cleaned”, it can be used in the mainstream economy for accumulation of wealth, such as acquisitions of properties, or otherwise spent. Law enforcement agencies of many jurisdictions have set up sophisticated systems in an effort to detect suspicious transactions or activities, and many have set up international cooperative arrangements to assist each other in these endeavours.

In a number of legal and regulatory systems, the term money laundering has become conflated with other forms of financial and business crime, and is sometimes used more generally to include misuse of the financial system (involving things such as securities, digital currencies, credit cards, and traditional currency), including terrorism financing and evasion of international sanctions.[2] Most anti-money laundering laws openly conflate money laundering (which is concerned with source of funds) with terrorism financing (which is concerned with destination of funds) when regulating the financial system.[3]

Some countries treat obfuscation of sources of money as also constituting money laundering, whether it is intentional or by merely using financial systems or services that do not identify or track sources or destinations. Other countries define money laundering in such a way as to include money from activity that would have been a crime in that country, even if the activity was legal where the actual conduct occurred.[4]

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2. DEFINITON OF INCOME FROM CRIME OR OF DIRTY MONEY

Money laundering is the generic term used to describe the process by which criminals disguise the original ownership and control of the proceeds of criminal conduct by making such proceeds appear to have derived from a legitimate source.

The processes by which criminally derived property may be laundered are extensive. Though criminal money may be successfully laundered without the assistance of the financial sector, the reality is that hundreds of billions of dollars of criminally derived money is laundered through financial institutions, annually. The nature of the services and products offered by the financial services industry (namely managing, controlling and possessing money and property belonging to others) means that it is vulnerable to abuse by money launderers.

The conversation or transfer of property, the concealment or disguising of the nature of the proceeds, the acquisition, possession or use of property, knowing that these are derived from

criminal activity and participate or assist the movement of funds to make the proceeds appear legitimate is money laundering.

Money obtained from certain crimes, such as extortion, insider trading, drug trafficking, and illegal gambling is "dirty" and needs to be "cleaned" to appear to have been derived from legal activities, so that banks and other financial institutions will deal with it without suspicion. Money can be laundered by many methods which vary in complexity and sophistication.

Money laundering involves three steps: The first involves introducing cash into the financial system by some means ("placement"); the second involves carrying out complex financial transactions to camouflage the illegal source of the cash ("layering"); and finally, acquiring wealth generated from the transactions of the illicit funds ("integration"). Some of these steps may be omitted, depending upon the circumstances. For example, non-cash proceeds that are already in the financial system would not need to be placed.[5]

According to the United States Treasury Department:

Money laundering is the process of making illegally-gained proceeds (i.e., "dirty money") appear legal (i.e., "clean"). Typically, it involves three steps: placement, layering, and integration. First, the illegitimate funds are furtively introduced into the legitimate financial system. Then, the money is moved around to create confusion, sometimes by wiring or transferring through numerous accounts. Finally, it is integrated into the financial system through additional transactions until the "dirty money" appears "clean." [6]

3. HOW IS THE OFFENCE OF MONEY LAUNDERING COMMITTED?

Money laundering offences have similar characteristics globally. There are two key elements to a money laundering offence:

- The necessary act of laundering itself i.e. the provision of financial services; and
- A requisite degree of knowledge or suspicion (either subjective or objective) relating to the source of the funds or the conduct of a client.

The act of laundering is committed in circumstances where a person is engaged in an arrangement (i.e. by providing a service or product) and that arrangement involves the proceeds of crime. These arrangements include a wide variety of business relationships e.g. banking, fiduciary and investment management.

The requisite degree of knowledge or suspicion will depend upon the specific offence but will usually be present where the person providing the arrangement, service or product knows, suspects or has reasonable grounds to suspect that the property involved in the arrangement represents the proceeds of crime. In some cases the offence may also be committed where a person knows or suspects that the person with whom he or she is dealing is engaged in or has benefited from criminal conduct.

4. PHASES OF THE PROCESS OF MONEY LAUNDERING

The money laundering process can be divided into 3 basic phases: (periods, stages):

1. Phase of depositing = introduction = dipping, (phase of placement), during which the cash emanating from the criminal activity is placed in the financial system. This is mainly about investing in financial institutions, but also in the personal need of members of organized crime, the criminal organization itself and its functioning. The financial

means placed in this way are mostly masked as legal income from business activity. Businesses and companies that work with small cash (especially restaurants, currency exchange offices, clothing stores, etc.) are used the most frequently as a "pinny". In this stage the people who are laundering money are the most vulnerable because the money is not yet separated from its illegal source. In later stages, the tracing and proving of illegal origin of money is very difficult. "It's like throwing a stone into a pond. You can see that it hits the water when it splashes. When it starts to fall, the circles run over the surface and you can still watch the point where it dived. But as it falls deeper, the water calms down. Until the stone hits the bottom, any traces of it are long gone, and you could hardly ever find it." [7]

2. Phase of masking = layering phase "rests in eradicating the traces of illegal profits. The proceeds of crime, which have already been separated from their illicit source in the first phase, pass gradually through cashless and cash transactions, enter bank accounts to leave them immediately after for the purpose of various purchases of bills and notes, gold, jewelry, real estate, works of art or antiques. Transactions are carried out either through legal entities (natural or legal persons), or new companies are created for this purpose. "[8] All this is done with the sole aim of covering their true origin and thus eliminating traces of illegal profits. Illegal profits move between many companies and institutions within a single country and internationally. The most important task of this phase is to interrupt the possibility of searching for operations, especially by their lack of clarity and abundance. "This is a key stage where it is necessary to turn dirty money into a clean one, while at the same time thoroughly damping traces and disrupting the flow of money." [9] Currently, camouflage is also facilitated by online transactions that provide sufficient anonymity, speed, distance and small auditability. This phase is also characterized by the transfers and placement of income derived from criminal activity into so called tax havens.
3. Integration phase, final phase, when by former two phases cleaned money returns and integrates into the legal economy, through legal transactions, various kinds of investments, and further money handling, which no longer carry traces of criminality and create already completely legal profit, often also taxable. "Ensures the apparent legitimacy of wealth derived from criminal activity."

The money laundering process in such a three-staged scheme is rare in practice. Phases are usually not expressly separated, often merging or overlapping. In practice, the first and third stages often merge, especially in the legalization of criminal proceeds using small-cash companies.

Such cleaned money is often invested by organized groups so that the laundering process can be repeated, as to create easier conditions for committing further crimes. For example, a profitable combination of investing is investment in chemical companies, transport and real estate. Thus, in this particular case, such investments will facilitate future drug production (through easy access to the necessary chemicals), smuggling (by using purchased vehicles or using transport companies), and consequently further money laundering (through fictitious rental of purchased real estate).

5. MONEY-LAUNDERING TACTICS

There are many ways to launder money, ranging from simple to complex. One of the most common ways to launder money is through a legitimate cash-based business owned by a criminal organization. For instance, if the organization owns a restaurant, it might inflate the

daily cash receipts to funnel its illegal cash through the restaurant and into the bank. Then they can distribute the funds to the owners out of the restaurant's bank account. These types of businesses are often referred to as "fronts."

Another common form of money laundering is called smurfing, where a person breaks up large chunks of cash into multiple small deposits, often spread out over many different accounts, to avoid detection. Money laundering can also be done through the use of currency exchanges, wire transfers, and "mules" or cash smugglers, who smuggle large amounts of cash across borders to deposit them in offshore accounts where money-laundering enforcement is less strict. Other money-laundering methods involve investing in commodities such as gems and gold that can be easily moved to other jurisdictions, discretely investing in and selling valuable assets such as real estate, gambling, counterfeiting and creating shell companies.

While traditional money-laundering methods are still used, the internet has put a new spin on an old crime. The use of the internet allows money launderers to easily avoid detection. The rise of online banking institutions, anonymous online payment services, peer-to-peer transfers using mobile phones and the use of virtual currencies such as Bitcoin have made detecting the illegal transfer of money even more difficult. Moreover, the use of proxy servers and anonymizing software makes the third component of money laundering, integration, almost impossible to detect, as money can be transferred or withdrawn leaving little or no trace of an IP address.

In many ways, the new frontier of money laundering and criminal activity lays in cryptocurrencies. While not totally anonymous, these forms of currencies are increasingly being used in currency blackmailing schemes, drug trade and other criminal activities due to their anonymity compared to other forms of currency.

Money can also be laundered through online auctions and sales, gambling websites and even virtual gaming sites, where ill-gotten money is converted into gaming currency, then transferred back into real, usable and untraceable "clean" money.

Anti-money-laundering laws (AML) have been slow to catch up to these types of cybercrimes, since most AML laws attempt to uncover dirty money as it passes through traditional banking institutions. As money launderers attempt to remain undetected by changing their approach, keeping one step ahead of law enforcement, international organizations and governments are working together to find new ways to detect them.

6. PREVENTION OF LEGALIZATION OF PROCEEDS OF CRIMINAL ACTIVITY AND FINANCING OF TERRORISM [10]

Integrated supervision over all participants of the financial market, which is carried out by the National Bank of Slovakia, is currently risk-based and thus, one of its main goals is to promote the elimination of specific risks in supervised entities. It is therefore quite substantiated that it is aimed at the prevention of legalization of criminal proceeds and of terrorist financing (or at enforcing the countermeasures against money laundering and terrorist financing).

The basic legal framework consists first of all of the Act No 297/2008 Coll. on the Prevention of Legalization of Proceeds of Criminal Activity and Terrorist Financing and on Amendments and supplements to Certain Acts as amended by the acts No. 445/2008 and No. 186/2009, which determines for the National Bank of Slovakia in the conduct of supervision over the financial

market its powers and obligations in this area - particularly in provisions of Section 29 and 31. Based on mentioned provisions the National Bank of Slovakia actively co-operates by enforcement of the preventive law with the Slovak FIU, which is located under the umbrella of the Ministry of Interior.

This specific intendment of supervisory activities is supported by one of the crucial goals of the National Bank of Slovakia in the process of carrying out its financial market supervisory tasks - to foster the stability of the financial system as a whole, as well as to promote safe and sound functioning of financial market in order to maintain its credibility. Considering the EU membership of the Slovak Republic, it is of utmost importance to pay adequate attention to protection against legalization of criminal proceeds and terrorist financing because dirty money flows can harm not only the stability and reputation of the Slovak financial sector but also the common European market can be endangered by that.

Terrorism and its support puts human beings lives at stake and by that undermines the basis of European Community. Criminals are trying to misuse financial sector institutions for money-laundering purposes. Financing of terrorism can be carried out also via financial institutions, but that is not the only way, and for the purposes of terrorism financing legal money may be used as well.

7. CONCLUSION

Money laundering is the process of disguising the proceeds of crime and integrating it into the legitimate financial system. Before proceeds of crime are laundered, it is problematic for criminals to use the illicit money because they cannot explain where it came from and it is easier to trace it back to the crime. After being laundered, it becomes difficult to distinguish money from legitimate financial resources, and the funds can be used by criminals without detection.

Amending Act No. 297/2008 Coll., the regulation of European Parliament and Council (of the EU) 2015/849 of 20 May 2015 on the prevention of the use of the financial system for the purpose of money laundering or terrorist financing is transposed into law system of the Slovak Republic. This regulation amends decree of European Parliament and Council (of the EU) no. 648/2012 and repeals directive of European Parliament and Council 2005/60/ES and Commission Directive 2006/70/ES, which required to introduce a duty of identifying the end-user of advantages and to administer in documentary form, continuously update the identification data about the person and store these data.

In the system of protection against legalization and terrorist financing, the revised act will take into account the principle of assessing these risks not only at the level of the obligated persons but also at the level of the European Union (Articles 6 and 8 of the IV. AML Directive). Obligated persons should consider their own risk factors, including those related to their clients, countries or geographic areas, products, services, commerce or distribution channels, when assessing the risks of legalization and terrorist financing, and must reflect the nature and size of the obligated person, and take into account the national assessment of risks. Transposition also ensures compliance with the requirement of Article 7 IV. AML Directive, which sets the obligation to develop a national assessment of the risks of legalization and terrorist financing, in which the Slovak Republic should identify, assess and understand the risks of legalization and terrorist financing, and subsequently take appropriate measures to reduce these risks. The Act regulates the role of the coordinator responsible for coordinating and updating the national risk assessment, as well as the co-ordination of other institutions in these activities.

ACKNOWLEDGMENT

This paper is the output of the project “Modernisation and consolidation of R&D infrastructure in the area of financial security information technologies“ (Code of the project: 2623012000) and the project GAAA 11_2/2016 „A comparison of the business environment in selected countries in terms of individual market segments“.

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