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## PREVENTING THE RISK OF MONEY LAUNDERING IN COMMERCIAL BANKS

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### ABSTRACT

Money laundering is a crime that takes various forms of appearance. Therefore its prevention is essential to ensure a normal course of all the economic and business processes. Concrete actions against money laundering are named in the regulatory base but practice indicates various cases where money laundering is a fact. This report is focused on how to identify the mechanisms by which malicious person's crime activity cash is operated by the banks in the country, and how to counteract this crime.

**Key words:** banks; money laundering; prevention; law; mechanisms

### INTRODUCTION

In recent years, money laundering has become a global problem. The international nature of trade, payment systems, the advent of new technologies enable successful (in some cases) concealment and transfer of large flows of dirty money through their mixing with the proceeds of legitimate business. (1)

The actuality of this report stems from the fact that within the borders of the country we are more and more talking about cases that remain uncovered in their mechanisms of money laundering under different schemes, different members of society involved too. Widespread public opinion has it that these do not exhaust the list of cases in which such crime is committed. That motivates the writing of this article. As described below, one of the phases in the process of money laundering is related to its splitting and converting through the financial system. It is in this direction that the efforts of the author are focused - to reveal the ways in which financial institutions can reduce the risk of becoming part of this kind of criminal activity and to implement adequate preventive action.

The subject of the article are the financial institutions and, in particular, the commercial banks operating in the country.

The subject is centered in the prevention of the risk of money laundering through the banking system.

The main objectives placed are:

- To clarify the nature of money laundering;
- To analyze the respective legislation;
- To identify the institutions responsible for countering the risk of money laundering in financial institutions;
- To identify weaknesses and channels through which splitting of dirty money can be done misusing the financial institutions operating in the country;
- To reveal preventive actions that can reduce the risk of money laundering in banks.

### 1. Nature of money laundering

Money laundering is the process of concealing, through various forms of action, of the criminal origin of a property, thereby creating the possibility of integrating it into the legal economy. (2)

Money laundering constitutes a risk for the whole society, erodes good governance, and hence the foundations of democratic order. It has a negative impact on the economy as a whole, reduces the efficiency of the financial system, prevents the use of EU funds. Contributes to the destruction of the competitive environment and incentives for economic growth. Creates conditions for corruption of businesses, financial institutions and public administration, and also feeds

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organized crime and terrorism.(2p.9)

According to the Law on Measures against Money Laundering, it is the preparation, implementation and acceptance of the results of actions through which money or other property, as well as the produce of them, having come into possession of a person by or in connection with a crime, are brought into the legal business turnover.

According to the UN Convention on Transnational Organized Crime of 2000, money laundering is the conversion or transfer of property, knowing that such property is the proceeds of crime with the aim of concealing or disguising the illicit origin or assisting a person who is involved in committing a predicate offense in order to avoid the legal consequences of his actions.

Concealing or disguising the true nature, source, location, disposition, movement or ownership of / or rights to property, knowing that such property is the proceeds of crime. (3)

## 2. Legislation

- Law on Measures against Money Laundering;
- Implementing Regulations of the Law on Measures against Money Laundering;
- Insurance Act;
- Law on Securities, Stock Exchanges and Investment Companies;
- Public offering of securities;
- Law on Deposit Insurance in Banks;
- Act on measures against financing of terrorism;
- Ordinance № 27 of 12.09.1999 of the BNB for registration in the National Bank of transactions between residents and nonresidents;
- Ordinance № 28 of 12.09.1999 of the BNB for cross-border transfers and payments (Prom. SG. 111 of 1999).
- Ordinance № 29 of 12.09.1999 of the Ministry of Finance and the BNB on the terms and conditions for submitting the reports and declarations for the obligations of residents to nonresident
- Ordinance on the import and export of currency values adopted by Decree № 4 1994 of the PMC.
- UN Convention against Illicit Traffic of Drugs and Psychotropic Substances (the Vienna Convention) of 1988.;
- UN Convention on Transnational Organised Crime (Palermo Convention) in 2000.;
- Convention of the Council of Europe on laundering, search, pollution and confiscation of property proceeding of

crime since 1990. (Strasburg Convention) and 2005. (Warsaw Convention);

- EC Directive on prevention of the use of the financial system for the purpose of money laundering 1991, 2001. And 2005.

Regulations relating to the prevention of money laundering and financing of terrorism in our country is well developed and almost fully complies with international standards. Standing issue is its full practical application as well as presenting it to the knowledge of all stake holders and its strict compliance.

## 3. Institutions counteracting money laundering

The responsible authorities in whose portfolio stands the detection of mechanisms for money laundering are the State Agency "National Security" through the "Financial Intelligence" department. It works closely with the FATF (Financial Action Task Force) - an organization that sets the standards in combating money laundering and terrorist financing, and MONEYVAL (Committee of Experts on the Evaluation of measures against money laundering at the Council of Europe) - organization responsible for Europe on the prevention of money laundering.

FATF (Financial Action Task Force) - A working group for financial action established in 1989. Its recommendations form global legal and institutional frameworks against money laundering and terrorist financing. According to FATF credit and financial institutions should implement the following measures:

- Building and maintaining a system for managing the risk of money laundering and financing of terrorism;
- Identification and study of clients, including beneficial owners of legal persons;
- Categorisation of customers depending on the risk assessment of money laundering and financing of terrorism;
- In-depth study of customer and business relationships with higher risk;
- Simple measures to customers and business relations with lower risk;
- Monitoring and critical analysis of the operations and transactions of customers, especially those with a high risk;

Particular attention to the threats of money laundering arising from new electronic technologies (operations carried out without a physical presence).

International banking standards against money laundering have been developed on the basis of

the FATF. They involve the construction of the following standards:

- Basic Principles for Effective Banking Supervision;
- "Know your customer";
- General guidelines on account opening and customer identification;
- Global guidelines for combating money laundering for private banks.

Committee of Experts on the Evaluation of the Measures against Money Laundering at the Council of Europe – MONEYVAL, was established in 1997 by the Committee of Ministers at the Council of Europe to conduct self and mutual evaluation of measures to combat money laundering in countries that are not members of the FATF. Its objectives are aimed at improving measures against money laundering in accordance with FATF. (4) MONEYVAL has a status of a sub-committee of the European Committee on Crime Problems of the Council of Europe.

At the State Agency "National Security" there is a separate specialized administrative directorate of "Financial Intelligence" that receives, stores, examines, analyzes and reveals finance intelligence information under the terms and provisions of the Law on Measures against Money Laundering and The Act of Measures Against Financing of Terrorism. Functions assigned are preventing, detecting and combating money laundering and terrorist financing, also in relation to the movement of capital, corruption, bribery in international business transactions and confiscation. Fulfilling of their functional duties the Directorate liaise closely with the Bulgarian security and public agencies as well as with foreign partners. (5)

BNB Bank Supervision monitors the preventive measures against money laundering, terrorist financing and fraud. BNB supervises the adequate policies and procedures in banks and financial institutions, including strict rules on knowing the clients, to prevent the banks and financial institutions from being used, biased or unbiased way, for criminal activities.

Every two years maximum "Banking Supervision" at the BNB completes inspection of the bank's activities, including credit and operational risk, activities to protect classified information and protective measures against money laundering. In detecting suspicion of attempted money laundering they alert the Agency "Financial Intelligence" at the State Agency of National Security, who perform specialized study. Joint inspections between

the bodies of banking supervision and financial intelligence are commonplace. A complete inspection lasts a month. A thorough check on activities of the bank is carried out based on random sampling. (6)

#### **4. The relationship of the banking and financial institutions to the risk of money laundering**

One tool for money laundering is connected with their circulation through the banking system. That's why the level of risk in financial institutions in this respect is significant. The risk of money laundering and financing of terrorism lies in the risk client to use the financial system for money laundering or financing of terrorist activities and / or persons, who in turn would threaten the economic stability of banks and confidence in the financial sector as a whole. Banks are expected within the operation of control systems to observe the wide range of possible risks of money laundering, terrorist financing, fraud, and misuse of inner information. (1 p.12) Malicious persons are too inventive and follow various forms and mechanisms to "looping through" dirty money. From here arises the need to strengthen the methods and means of countering. The law have developed measures against the use of the financial system for money laundering, which banking and credit institutions, insurance and investment companies are subjected to. In this respect, it is necessary for the bank employees working with customers to be aware of the following activities:

1. identifying customers and verifying their identification;
2. identification of the owner of the client - legal entity, and taking appropriate actions to verify the identification in a way that gives sufficient reason to the person to be held to identify the actual owner;
3. gathering information from customers about the purpose and nature of the relationship that is established or to be established with him;
4. monitoring the established business or professional relationship and verification of the transactions carried out within the framework of these relations, how they correspond to the information available on the client, its business and risk profile, including clarification of the origin of funds in cases specified by law;
5. The disclosure of information about suspicious transactions, transactions and customers.

Each bank develops and adopts a system for control and prevention of money laundering in working with clients. Part of the system includes implementing adequate procedures for

establishing business relationships with customers.

In the daily activities of the bank an opportunity arises to gather sufficient information on the identity of customers and the nature of their business, which in turn enables the bank to better manage the risks associated with established relationships. The data analysis and assessment of the requirement of additional data are carried out following the procedures for an approach based on risk. Procedures take account of the different criteria, namely customer type, geographic location, products and services. Each of the criteria is essential in determining the risk profile of the client.

Thus, during the contractual relationship between the bank and its customer, the corresponding risk profile is created. The risk profile is most often divided into three main groups: low risk clients, medium risk clients and high risk clients. Each bank has a department that is in charge of monitor the situation (deviations thereof) of each of the different customer groups. According to the bank's policy a period must be defined in which the respective monitoring has to be carried out. In the most general case high-risk customers are monitored monthly, for medium risk - quarterly and the low risk group - annually. Depending on the size of the bank, the number of customers and its the corporate policies that period may vary.

#### **4.1. Mechanisms revealed for money laundering in financial institutions**

It is possible to use several different forms through which attempts have been detected split the "dirty money" via commercial banks, and namely: money laundering through cash transactions; through the use of current accounts; through securities transactions; by overseas (offshore) banks; through secured or unsecured loans.

##### **4.1.1 Money laundering via cash transactions:**

- detection of unusually large deposits of natural or legal person whose activity is normally performed by a current account;
- unusual increase in the number of deposits of a natural or legal person, especially if they are subsequently transferred for a short time outside the account and / or appointment that is not normally associated with the client;
- detection of individual customers who open a large number of deposits in small amounts, where the total value is significant;
- depositing and withdrawing unusually

large amounts on accounts of companies whose business is usually done through forms of cashless payment;

- frequently exchanging large amounts of money or coins with small denominations against denominations with greater value;
- frequent operations that are not related to the main activities of that customer on purchase of foreign currency in an unusually high volume;
- larger or unusual transfers of securities and their payment in cash.

##### **4.1.2. Money laundering through the use of current accounts:**

- reluctance to give complete information when opening an account or submission of documents whose authenticity raises doubts in the bank officer;
- payments made with cash on the same day or the previous by companies, the funds on the current account which usually enter through a bank;
- unusually large withdrawals of cash from account that has been unused (inactive) so far or from the account on which it was received unexpectedly large transfer from the country or abroad;
- especially large advance orders for overseas customers under contracts of sale of goods or services where there is a clause of "hidden" benefits for the vendor in the event of a subsequent default by the buyer;
- cash deposits on the same bill by a large number of individuals and / or entities without proper grounds;
- orders of transactions by customers to other financial institutions almost immediately after the deposit has been made when the operation is incompatible with the core business of the client;
- orders of transfers abroad by banks out of the SWIFT system, in which the bank is not accompanying the order with all the documents revealing the motivation of the transaction.

##### **4.1.3. Money laundering through securities transactions:**

- via purchase of large securities packages from natural or legal persons where the input does not match their financial situation;
- the purchase of large blocks of securities, where the funds are transferred from other banks;
- purchase and sale of large packages of securities in circumstances that seem unusual.

##### **4.1.4. Money laundering through overseas (offshore) banks:**

- the use of letters of credit and other methods of trade settlement in which foreign

trade documents cast doubt on the authenticity or when such business is incompatible with the core business of the client;

- accumulation of large amounts in the accounts of the company not meeting its turnover, and subsequent transfer to the account (accounts) abroad.

#### 4.1.5. Money laundering through secured and unsecured loans:

- sudden repayment of loans that has not been paid off for a long time;

- request for loans secured by a pledge of movables when their origin is unknown or uncommon to the financial condition of the customer;

- request for lending justified by perfect accounts of the borrower, reflecting major investments and income from activities carried out in offshore locations and countries - havens of bank secrecy;

- collateral on loans from third parties unknown to the bank for no apparent or plausible reason, and when these countries do not have a close relationship with the client;

- using credits for purposes different from the purpose of landing it;

- request for loans secured by guarantees from offshore banks.

#### 4.2. Preventing the risk of money laundering

In the daily workflow if a bank employee working with customers found suspected abuse related to money laundering he needs to respect the due process. The process of risk management related to the risk so identified must pass through the following steps:

- Review of the risk profile of the customer;
- Reporting to log suspicious transactions;
- Report to the specialized service in the commercial bank;
- Informing the Financial Intelligence - DANS;
- Investigation carried out by the specialized bodies.

In each of the banking institutions operating in the country employees are trained to recognize suspicious customers.

Suspicious clients are the following persons:

- representatives or proxies on open accounts for natural or legal persons presenting identity documents and licenses whose authenticity raises doubts;
- clients that have the public reputation of being criminals;
- Individuals who have signed on documents in connection with the

operation or transaction inconsistent with that of their identity document;

- Clients accompanied by others for no apparent reason and looking restless, which could give rise to reasonable doubt as to an exercise of a threat to them;

- Customers whose behavior or conversations with bank officials aimed at diverting the attention of the latter or to disorganize their work.

- Customers showing reluctance or refusal to identify themselves at the transaction or provide documents whose authenticity raises doubt in the bank officer;

- Customers indicating dissatisfaction or concern in completing the declaration of origin of the funds;

- Customers that link confusing details or there are inconsistencies in the presentation of the transaction;

- Clients who attempt a rapprochement with bank employees, offering money, gifts or unusual services for not completing the required documentation.

In 2013 Representatives of the Committee of MONEYVAL inspected Bulgaria's progress in the prevention and combating of money laundering and terrorist financing.

Regarding the financial sector of the inspection the conclusion is given that the state's representatives demonstrate a high level of understanding of the obligations regarding the identification and verification of the identity of the actual owner of their clients entities. Recommendations are given (for non-bank financial institutions) regarding the scope of information stored, as well as ignorance on the part of some financial institutions of countermeasures that should be taken in respect of persons. The primary assessment of the surveillance that was carried out (by the Financial Intelligence Agency – SANS, BNB and FSC, NRA) in respect of financial institutions, is largely consistent with the technical requirements and the presence of significant efficiency. It is been referred to the increased number of on the spot checks and documents surveillance, as well as on the sanctions enforced.(7)

Despite the positive assessment of the report of MONEYVAL, banking practice indicates that attempts to split the dirty money through commercial banks are far from lesser. Criminal raids of this sort are associated with high dose of ingenuity, as well as diversity concerning the owners of the money supply. Often they find a way to tempt and motivate by different means the bank employees.

**CONCLUSION**

Banking institutions are key to the economic activity of each subject in the state. Monetary stability of the country is based on its performance. That is why banks should work in the direction to minimize risk situations, making a negative impact on their risk profile. Money laundering is a criminal activity and its preventing has an important role mainly in financial institutions not allowing cleavage of dirty money. Banking institutions have good preventive measures in this regard, but the risk is still high.

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