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**FUNCTIONING OF FINANCIAL MONITORING SYSTEM IN
UKRAINIAN BANKS**

Abstract: The article considers the essence of the concept of "legalization (laundering) of income obtained by criminal means". The characteristic activities of the international group for combating money laundering - FATF. Peculiarities of conducting financial monitoring by banks of Ukraine, the state and problems. The dynamics of information on the financial operations of banking and non-banking institutions. Provides suggestions and recommendations that will contribute to the improvement of the system of financial monitoring and maintaining a stable functioning of the banking system.

Keywords: bank, banking system, financial monitoring, FATF, the legalization (laundering) of incomes obtained in a criminal way.

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Introduction. The legalization (laundering) of proceeds from crime has received considerable attention both at national and international level, because the legalization of proceeds from crime creates certain risks which affect the whole of the State and the banking system as the main financial intermediary, is a big threat to the economy of the country.

The aim of a significant number of criminal acts is to make profit an individual or a group of people who carry out this criminal act. Money laundering - a process that allows you to hide the illicit origin of the money. This process has a dangerous character, because it allows criminals to use their profits without jeopardizing the source of such income.

In this regard study on the functioning of the financial monitoring system in banks in Ukraine has of particular importance.

Literature review and the problem statement. Money laundering has ultimately become a successful tool for criminals because the financial system does not prevent the possibility of money laundering. Research questions of the financial monitoring devotes considerable attention to domestic and foreign scientists, such as Baranovsky A. [Baranovsky A. 2003], Dmitrov S. [Dmutrov S. & Yegov A. & Kovalenko V. 2007], Kyrishko A. [Kyrishko O. 2011], Kadnichanska V. [Kadnichanska V. M. 2012], Quirk P. [Quirk P. 1997] and many other outstanding scientists.

The purpose of the article. The purpose of the study is to summarize the theoretical aspects of the organization of the system of financial monitoring and implementation practices as well as search for ways to improve the financial monitoring system in banks of Ukraine.

Research results. The conditions of formation of national economy and the development of integration with the international financial system in Ukraine, more than ever, an urgent need to prevent and counter the laundering of proceeds of crime. Effective and efficient financial monitoring system enhances

the stability of the financial system as the scope of the implementation of the financial policy of the state.

Conducting financial monitoring to combat money laundering is an important function of the state, since the legalization reduces economic growth, worsen the investment climate by diverting (withdrawal) of the turnover of funds, failure to pay taxes, embezzlement of budgetary funds etc. In modern conditions in connection with the release of additional budget funds for the modernization of the economy, the minimization of employers spending (including by hiding income from taxation), the development of fraudulent schemes embezzlement problem of effective implementation of financial monitoring is particularly important.

Criminal activities such as drug trafficking, prostitution, the financing of terrorism, proliferation of weapons of mass destruction gives substantial profits, the origins of which criminals have to hide from the state, for example, by changing the shape or move funds to where less likely to attract the attention.

As a consequence, an increase in "dirty" money, which get into circulation can undermine national economies, cause great damage to credit institutions (as the active financial intermediaries, credit institutions are often used in the process of legalization of illegally obtained money) and cause inflation.

Today, Ukraine is in the face of the deteriorating financial and economic situation, increase volumes of "laundered" money, expand the scale of the shadow economy. Thus, according to the State Service for Financial Monitoring in Ukraine in 2013 was about 45 billion hryvnia laundered [Richnuy zvit 2013].

All this gives grounds to consider the need to combat the legalization (laundering) of proceeds from crime or financing of terrorism, both in Ukraine and throughout the world.

First, we consider the essence of the concept of "legalization (laundering) of proceeds of crime".

The concept of "laundering" money has an interesting history. The term "money laundering" appeared in the early twenties of the XX century in the US, when gangs have invested the proceeds from his gangster activities. The main objective of criminal organizations was getting super-profits, which should be legalized (laundered). Otherwise it disappears meaning of their work. The famous gangster Al Capone was difficult to spend ill-gotten money under scrutiny of US intelligence, he created a huge network of laundries with very low prices. It was difficult to trace the actual number of customers, so revenues could write for any of these establishments [Rodolfo Uribe 2003]. Hence the term "money laundering". Until now the United States decided not to wash clothes at home, but in the laundries as their number remains considerable and prices are low.

The main intergovernmental body, which seeks to develop and implement international measures and standards to combat money laundering is the FATF, which was set up in 1989 according to the decision of the "Big Seven".

First priority of the FATF has been fighting the laundering of proceeds derived from drug trafficking. Today, the FATF has three main areas:

- Extension of the adopted recommendations to all continents and regions of the globe;
- Checking how to run in the Member States and how to implement in other countries measures to combat money laundering based on the 40 recommendations of the FATF, which is a guide to action;
- Monitoring of global methods and schemes of laundering of criminally acquired capital and the development of countermeasures.

The key document is the FATF recommendations set out in the form of annual reports of the organization. According to the findings of the third round of mutual evaluations of their members in 2012, the FATF revised and updated the recommendations in close cooperation with the regional groups of FATF and observer organizations [The FATF Recommendations 2012], including the International Monetary Fund, the World Bank and the United Nations. Viewing removes new threats and threats that arise clarifies and enhances many existing commitments, while maintaining the necessary stability and rigor Recommendations.

FATF standards have also been revised in order to tighten requirements for situations that constitute a high risk, in particular, financing of terrorism and the proliferation of weapons of mass destruction, which is a serious security issue country and world security.

With the independence of Ukraine the level of shadow economic relations was rather high, which gave impetus to the development of criminal activities in the state. Experts estimate that 55% of the Ukrainian GDP is produced in the shade, with no money in the budget are directed to social needs: support for teachers, doctors, pensioners, the army and so on.

On the legislative levers used in Ukraine to combat money laundering, then it can be attributed to the Penal Code, which criminalizes activities related to the laundering of proceeds of crime.

The main basic law is the Law of Ukraine "On prevention and counteraction to legalization (laundering) of proceeds from crime or financing of terrorism", which establishes the legal basis for the organization and functioning of the system of financial monitoring in Ukraine.

This law is aimed at protecting the rights and legitimate interests of citizens, society and the state by defining the legal mechanism counteraction to legalization (laundering) of proceeds from crime or financing of terrorism and ensure the formation of the national analytical information that enables law enforcement agencies of Ukraine and foreign countries, to check and investigate crimes related to money laundering and other illegal financial transactions.

However, in November 2014 the President of Ukraine signed the Law "On prevention and counteraction to legalization (laundering) of proceeds from crime, terrorist financing and the financing of proliferation of weapons of mass destruction", which entered into force on February 6, 2015 [Zakon Ukraini 2014].

The law defines the legal mechanism counteraction to legalization (laundering) of proceeds from crime, financing of terrorism, proliferation of weapons of mass destruction.

The document provides for the formation of the national stocktaking database to provide law enforcement agencies of Ukraine and foreign countries the ability to identify, verify and investigate crimes related to money laundering and other illegal financial transactions. The law was adopted pursuant to the agreements with the International Monetary Fund and taking into account suggestions from the national law expert group on the development of financial measures to combat money laundering and terrorist financing (FATF).

The Act describes the system of financial monitoring, which is present in Ukraine as well as a list of financial transactions subject to obligatory and internal financial monitoring.

Thus, in contrast to the old law, the new law offers a comprehensive improve the national legislation in the sphere of financial monitoring in the following areas:

- introduction of a national assessment of the risks of financial monitoring system and improve risk-based approach;
- allocation of measures to combat the financing of proliferation of weapons of mass destruction;
- changes in the approach to the definition of predicate offenses (including tax offenses predicate);
- improving the legislative aspects that affect the quality of the investigation of crimes of the legalization (laundering) of proceeds from crime;
- amendments to the Criminal Procedural Code of Ukraine (concerning jurisdiction to legalize crimes);
- implementation of financial monitoring of national public officials and officials of international organizations;
- establishment of a threshold for international money transfers;
- the removal of the threshold amounts for financial monitoring realtors and notaries;
- exclusion of persons carrying out cash transactions;
- improve procedures stop financial transactions.

Thus, the new Law defines the grounds on which the deal could fall under financial monitoring, namely:

- financial transactions with cash;
- settlement of financial transactions in cash;
- the transfer of funds abroad on foreign trade contracts (except for operations to transfer funds to contracts that provide for import of goods to Ukraine).

Ukrainian legislation has fixed a number of basic principles defined "the FATF Forty Recommendations." Because of delays in the adoption of these principles, Ukraine in September 2001 was included in the "black list" of FATF. And only at the next session of the FATF, that held 25-28 February 2004 in Paris, Ukraine was excluded from the list of countries that do not contribute to the fight against the laundering of proceeds of crime.

A key element of combating laundering of proceeds from crime or financing of terrorism is a State Service for Financial Monitoring of Ukraine as a central executive body that implements the state policy in the sphere of prevention and counteraction to legalization (laundering) of proceeds from crime or financing of terrorism.

According to the Law of Ukraine "On prevention and counteraction to legalization (laundering) of proceeds from crime or financing of terrorism", financial intermediaries, including banking institutions, are served in the State Service for Financial Monitoring of Ukraine (SSFMU) about financial transactions which in accordance with the law subject to compulsory financial monitoring duties or for which there is a suspicion of involvement in money laundering or terrorist financing [Zakon Ukraini 2014].

An important aspect of the development of any country is the stability and the efficiency of its financial and credit activity and the economy as a whole. Therefore, to maintain it, as well as countering the legalization (laundering) of proceeds from crime or financing of terrorism, created by the current system of financial monitoring.

The system of financial monitoring plays an important role in public life, in fact helps to reduce crime in the area of economic activity, reinforces the social balance and contributes to financial recovery of the country as a whole.

In Ukraine for the regulation of relations in the sphere of combating legalization (laundering) of proceeds from crime or financing of terrorism, in accordance with the Law of Ukraine "On prevention and counteraction to legalization (laundering) of proceeds from crime or financing of terrorism" operates a two-tier system of financial monitoring which includes: the state financial monitoring and the primary financial monitoring.

An important component of the system of financial monitoring of Ukraine is the National Bank of Ukraine. It is the subject of state financial monitoring, which performs state regulation and supervision in the sphere of prevention and counteraction to legalization (laundering) of proceeds from crime or terrorist financing for banks, payment organizations and members of payment systems, which are banking institutions.

To prevent it from using the banking system for the legalization of criminal incomes and financing of terrorism, National Bank of Ukraine has established a special department, whose functions include the issue of the appropriate checks of banks 1 and 2 groups.

Department of Financial Monitoring of the National Bank of Ukraine was established in 2002 with the adoption of the Law of Ukraine "On prevention and counteraction to legalization (laundering) of proceeds of crime".

The main task of the Department of Financial Monitoring is to oversee compliance by banks, payment organizations and members of payment systems, which are banking institutions, branches of foreign banks, the requirements of Ukrainian legislation in the sphere of prevention and counteraction to legalization (laundering) of proceeds from crime or financing of terrorism (Figure 1).

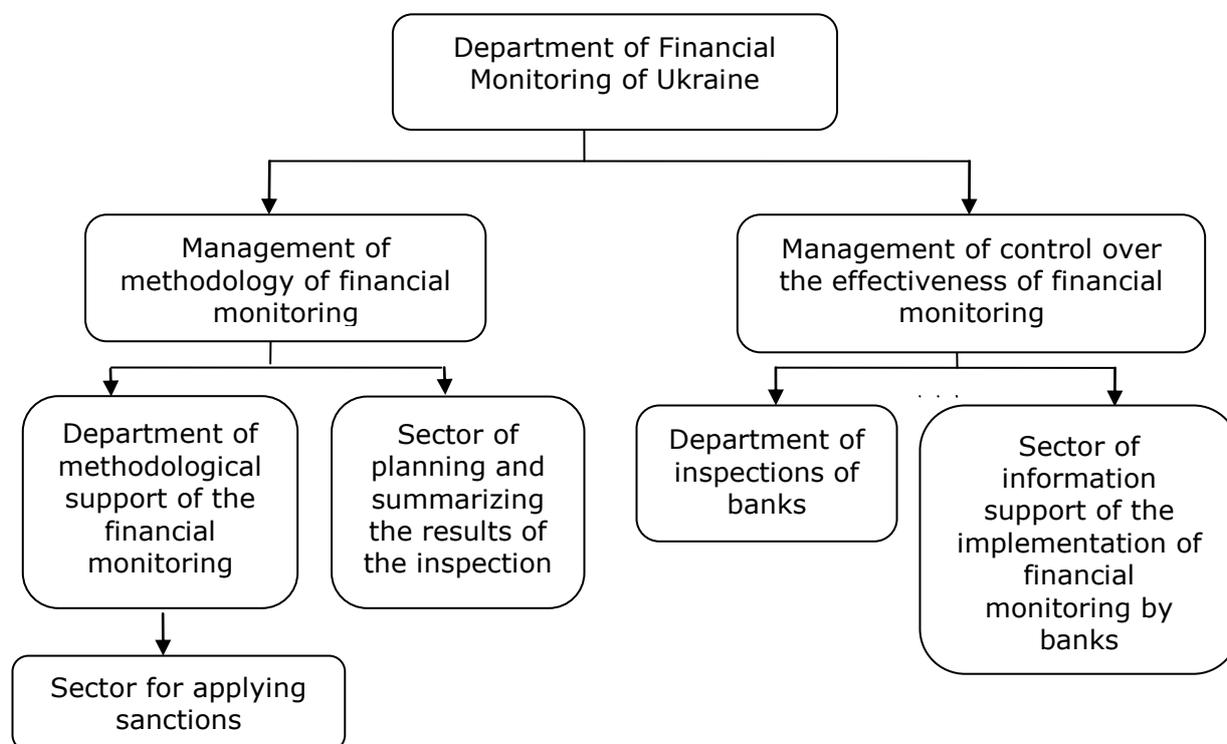


Figure 1 - The structure of the Department of Financial Monitoring of Ukraine

Source: built on the basis of our own research

Department of Financial Monitoring of the National Bank of Ukraine is composed of the Management of methodology of financial monitoring and of the Management of control over the effectiveness of financial monitoring.

Management of methodical and regulatory organizational support financial monitoring established to ensure a clear legal and regulatory framework, because established norms and laws of the state simply is not able to counteract the legalization (laundering) laundering.

Department of methodological support of the financial monitoring develops and improves methodological framework for the regulation of relations in the sphere of counteraction to legalization (laundering) of proceeds from crime.

Sector of planning and summarizing the results of the inspection forms documents after an inspection of banks (certificate of inspection or the inspection report - the single document form on the results of comprehensive inspections of the bank).

Sector for applying sanctions on violations of legislation in the field of prevention of legalization (laundering) of illegally obtained money, namely the imposition of fines, penalties, revocation of licenses and other.

The main task of Management of control over the effectiveness of financial monitoring is the implementation of banking regulation and supervision for its efficiency in the field of prevention of legalization (laundering) of proceeds from crime and terrorist financing.

Department of inspections of banks engaged in carrying out inspections of banks with the help of a plan of inspections to monitor banks' compliance with the law in the field of prevention of legalization (laundering) of proceeds from crime.

Sector of information support of the implementation of financial monitoring by banks involved in familiarization and training of staff of the bank for the proper performance of their duties for the financial monitoring, providing ongoing advice to employees of banks and provides other information provision for financial monitoring.

To ensure proper oversight of compliance by banks with the requirements of legislation regulating relations in the sphere of prevention and counteraction to legalization (laundering) of proceeds from crime or terrorist financing, on an annual basis, taking into account the risk assessment in this area during 2014, experts of the National Bank of Ukraine conducted 193 site inspections of banking institutions (188 scheduled and unscheduled 5) to comply with the requirements of the relevant legislation and compiled 44 acts off-site supervision. As a result of violations were applied appropriate sanctions / penalties.

The audit results provided an opportunity for banks to timely pay attention to the weaknesses in the risk management system legalization of criminal incomes or financing of terrorism in order to avoid and prevent future deficiencies.

Today the banking system is the most high-risk area. This is because, firstly, it is kind of an arena of struggle for the redistribution of property; secondly, "laundered" money is usually placed in bank accounts that are often open to nominees.

Banks and non-banks have sent a messages that includes the financial transactions relating to:

- activities "convert-centers" and companies with fictitious involved in the legalization (laundering) of proceeds from crime;

- appropriation of funds of economic entities and individuals, including by tampering of computer software;
- «junk" securities and debt obligations;
- acquisition of assets by illicit funds;
- theft / appropriation of budgetary funds and other government assets;
- fraud in insurance activities;
- illegal withdrawal of funds abroad;
- activities of pyramid schemes;
- financing of terrorism [Polozhenya 2003].

Increasing the number of posts, on the one hand, indicating the active work of the intrabank system of financial monitoring, on the other - an increase in financial transactions with signs of legalization (laundering) of proceeds of crime, poses a threat to the country's economic and financial situation worsen.

In 2013 according to statistics of SSFMU from banking institutions was obtained 96.37% of the total number of messages on the financial transactions (Figure 2).

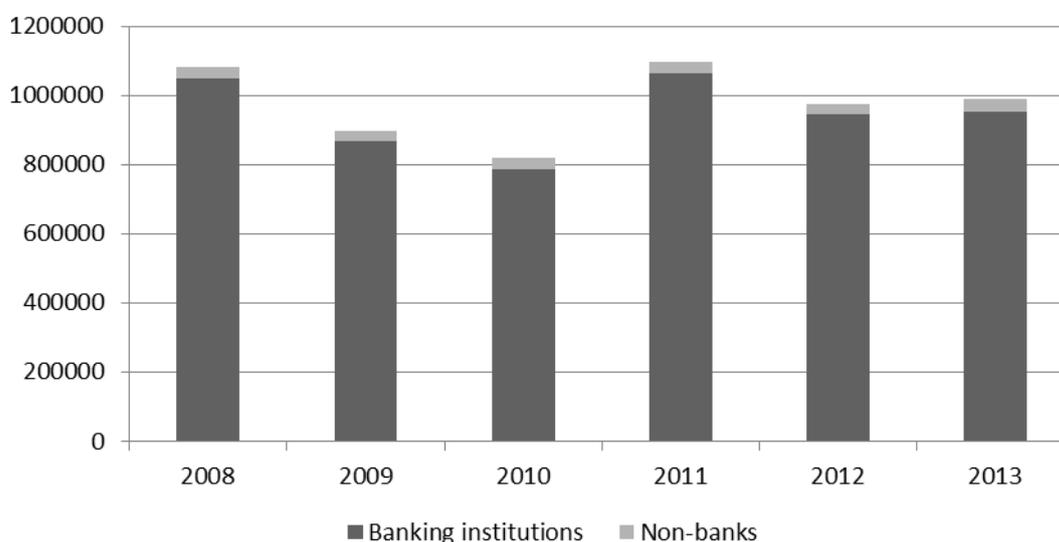


Figure 2 – The dynamics of information on financial transactions by bank and nonbank institutions during 2008-2013.

Source: built on the basis of [Richnuy zvit Dergavnoi slygbu finansovogo monitorungy Ukrainu 2013]

As you can see, the most active in the reporting system in the context of reporting entities are precisely the banks that send bulk of reporting transactions subject to financial monitoring.

Many Ukrainian scientists argue that the current system of financial monitoring in Ukraine is underdeveloped, because the Institute of struggle against legalization of illegally obtained money in Ukraine is still young: there is no general national practice to identify and investigate such crimes and commitment to justice for these acts; no effective stable system of training specialists with technology of investigation of crimes related to the legalization (laundering) of illegal proceeds, including the skills of search and identification of the money placed in offshore areas; not enough open and accessible statistics on money laundering offenses, without which it is very difficult to develop adequate responses (existing official statistics reflect only the tip of the iceberg or what

can not be hidden). All this gives grounds for improving the organization of financial monitoring system and increasing its efficiency.

In our opinion, the banking institutions should pay considerable attention to the formation of an effective system of internal financial monitoring.

According to the Regulation on the implementation of financial monitoring by banks №189 bank can establish intra-system prevention of legalization of criminal incomes or financing of terrorism, in which the individual powers of keeping a register of financial transactions, a decision on the report of the specially authorized body on financial transactions in the region concerned will carry out certain bank separated units of the bank (appointed senior officials of separate divisions of the bank).

The rules of banking institutions "know your customer" and customer identification as a method to minimize the risk of the financial institutions for the "laundering" of funds are central to the organization of activities of financial monitoring in the bank as the subject of initial financial monitoring.

Financial institutions need to have the details of each of its customers, namely, their place of residence, professional activity, sources of funds, the purpose of account opening etc. This will help them quickly identify possible signs of laundering of proceeds of crime.

The main principles of the development policy of "know your client» (KYC - «know your customer») is a standard of the Basel Committee on Banking Supervision [Basel III 2010]. They contain recommendations on the identification of customers, giving up the practice of conducting anonymous accounts and encourage banks to cooperate with law enforcement. The standards also referred to the need to carefully monitor the accounts of high-risk and banks are trying to attract customers with a high net worth. Declaration on the Prevention of criminal use of the banking system for money laundering adopted by the Basel Committee in December 1988, the first set of international standards for combating money laundering of the financial system.

An important component of effective work to prevent the legalization (laundering) of proceeds from crime is a constant monitoring of accounts and transactions. The bank has to put in order to understand the nature of the activities of his client and the nature of produce receipts on his bills. Based on this bank should not simplify the procedure of identification when transferring accounts to another banking institution, which has a policy of "know your customer" does not understand the reason for such an operation, since there is a possibility that the previous bank refused in customer service due to the inability to verify the data used to identify the client.

An equally important aspect of the effective operation of interbank system of preventing legalization of criminal incomes and financing of terrorism is to have ongoing training programs for their employees. Training schedule and content of training programs for the various sectors must be adapted by the bank in accordance with their needs. Training requirements should be different for new employees; for employees serving clients ("front office"); officials responsible for the observance of rules and regulations, or employees who serve more customers. Staff "front office", which works directly with the public should be trained to verify the identity of new customers, detect due diligence in the handling of customer accounts on an ongoing basis and to identify suspicious activity schemes. Regular training must be constantly repeated to remind employees of their obligations and to inform about new developments. It is important that all relevant employees are aware of the constant need for policy

and its implementation of KYC. Service culture in the banks, which promotes such understanding, is a major key to its successful implementation.

The system of financial monitoring of Ukraine is a structure that needs to respond flexibly to the challenges and threats that arise in real time. In connection with the difficult situation in the eastern regions of Ukraine, which is a consequence of the taking of hostages, civilian and military targets, worsening the socio-political situation and human casualties, urgent is the issue of depriving individuals associated with terrorist and separatist activities, sources of financing. In July 2014 SSFMU signed a number of recommendations for the reporting entities about the risks associated with the financing of separatist and terrorist activities on the territory of Ukraine. The guidelines provide that reporting entities should identify financial transactions in respect of which there are reasonable grounds to suspect that they are connected, touch or intended to finance terrorism, and to inform the SCFMU and certain law enforcement bodies, in particular the Security Service of Ukraine and strengthen the risk management system: to carry out the organizational and legal arrangements for customers whose activity indicates an increased risk of their operations

Conclusions. The process of forming a system of financial monitoring in the banking business as a system of prevention and counteraction to legalization of money obtained by criminal means is still at the development stage and requires research and development of practical recommendations, taking into account peculiarities of the national market and international experience.

Customer Identification Program, the policy of "know your customer", risk management system legalization of criminal incomes or financing of terrorism, training programs employees of the bank should be aimed at improving the efficiency of anti-money laundering, timely and effective response system to the new challenges in relation to the risks associated with Financing of separatist and terrorist activities on the territory of Ukraine.

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