

MONEY LAUNDERING - FACTOR OF DESTABILIZATION, CONTAMINATION AND GROWTH OF THE REPUBLIC OF MOLDOVA'S BANKING SECTOR SYSTEMIC RISK

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Abstract: *The success of criminal activity is dependent on the possibility to launder the money received by the illegal way through the banking system. The use of banking systems for money laundering leads to the undermining of individual banking institutions and, ultimately, of the entire banking system. At the same time, the increased integration of world banking systems and the removal of barriers to the free movement of capital have increased the ease with which illegal money can be laundered and complicate the money tracking process. At the same time money laundering is a major factor in the contamination of the entire economy: this phenomenon can erode the integrity of a country's banking institutions. Banks, as providers of a wide range of fund and credit transfer services, can be used in all phases of money laundering, placement, stratification and integration. Electronic funds transfer systems allow for rapid transfer of funds between accounts under different names and jurisdictions. In this way, we will analyze the influence of money laundering on the systemic risk and on the stability of the banking system in the Republic of Moldova.*

Keywords: *money laundering, banking system, systemic risk, destabilization.*

JEL Classification: *G21, E42, E5.*

1. Introduction

At the world level, the phrase "money laundering" characterizes the process by which the origin of the crime proceeds is concealed, while the people who commit the crimes concerned avoid legal consequences for their actions. Most often this phenomenon is related to illegal activities, namely financial crimes, corruption, smuggling, drug trafficking or extortion of money. Since at the global level there is no uniform interaction between countries on this account, money laundering is not only a large-scale, but also a dangerous phenomenon. According to data released by the World Bank (2017), only proceeds from corruption exceed \$ 1,000 billion a year (about 2.5% of world GDP) and these funds need to be laundered in a certain way.

To determine the actual extent of money laundering in the world due to the high latency of such crimes, and also because of the difficulty of obtaining reliable data, it is almost impossible. Meanwhile, according to experts of the International Monetary Fund, the total money laundered in the world is in the range of 2-5% of world GDP. This means that annually from 0.9 to 2.4 trillion dollars, received illegally, are introduced in various ways into the global economic turnover of money (Phare, 2002).

Like corruption, money laundering also affects all of us, and sometimes this phenomenon leads to quite serious social and political consequences. This leads to destabilization of the vulnerable countries economy, undermines the integrity of state institutions and destabilizes the financial system. In the end, all this affects the economic growth and economic development of states, and the tandem "corruption - money laundering" is both the cause and the consequence of poverty in many countries. Moreover, if proper measures are not taken, corruption and money laundering can turn into a vicious circle that can hardly be broken. On the one hand, money laundering provides organized criminal groups with the financial means necessary to carry out illegal activities and, thereby, leads to corruption, and on the other hand, corruption in itself "provides" resources, which then have to be "laundered".

In the case of the Republic of Moldova, money laundering has become a topical issue, since in 2014 -2015 the banking system was targeted by large-scale actions of this kind. In the Republic of Moldova, the economy is in a transition period, corruption has

reached a high level, and some aspects of the financial system are deprived of due supervision. Thus, the Republic of Moldova has become a target for some regional or even world groups engaged in money laundering. Everyone had the same starting point, namely, the moment when the banking sector almost completely passed under the control of opaque shareholders pursuing hidden interests. As a result, the loudest cases of money laundering through domestic banks occurred precisely at that time. In 2010-2014, transactions were made through the domestic banking system was about 20 billion USD from the Russian Federation. This has turned the Republic of Moldova into a machine for laundering money of illicit origin and their further transfer to the destination countries. At the same time, the episode The involvement of politically vulnerable persons, high-level corruption, fraudulent financial means, or the use of offshore structures are just the most important elements that allowed the creation and operation of sophisticated money-laundering mechanisms using the domestic banking system

2. What is money laundering?

At present, a single approach to the definition of the concept of money laundering has not been developed in world practice. For the first time, the official interpretation of the term "money laundering" was given in 1984 by the US Presidential Commission on Organized Crime in relation to proceeds from drug trafficking (U.S. Government, 1967). The commission used the following wording: "Money laundering" is a process by which the existence, illegal origin or use of income masqueraded so that they appear to be of legitimate origin is concealed."

According to the model law on money laundering and the financing of terrorism, resulting from the joint work of the United Nations Office on Drugs and Crime (UNODC) and the International Monetary Fund (IMF), money-laundering is defined as the process of concealing or disguising the identity or origin of illegally obtained income so that it seemed that they came from legitimate sources.

The EU offers the following definition: Money laundering is the de facto financial part of all the crime that generates profit. It is the process by which offenders attempt to hide the origin and real possession of income from their criminal activities (Phare, 2002).

In the Republic of Moldova, money laundering is an offense defined by Law no. 190 from 26.07.2007: Money laundering - actions, established in the Criminal Code at art. 243, aimed at attributing a legal aspect to the source and provenance of illicit income or concealing the origin or membership of such income.

One of the first among the international legal instruments that defined the task of combating money laundering was the UN Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances adopted in 1988 (United Nations, 1988).

The goal of most crimes is to obtain economic benefits. In general, the situation can be represented as follows (Figure 1).

The basis of the policy of any bank in accordance with the Wolfsberg principles should be the rule that the bank can establish relations only with those clients whose sources of income or financing can reasonably be confirmed of their legal origin. At the same time, the Wolfsberg norms allow that specific mechanisms for countering money laundering of proceeds from crime can be determined at the discretion of the bank.

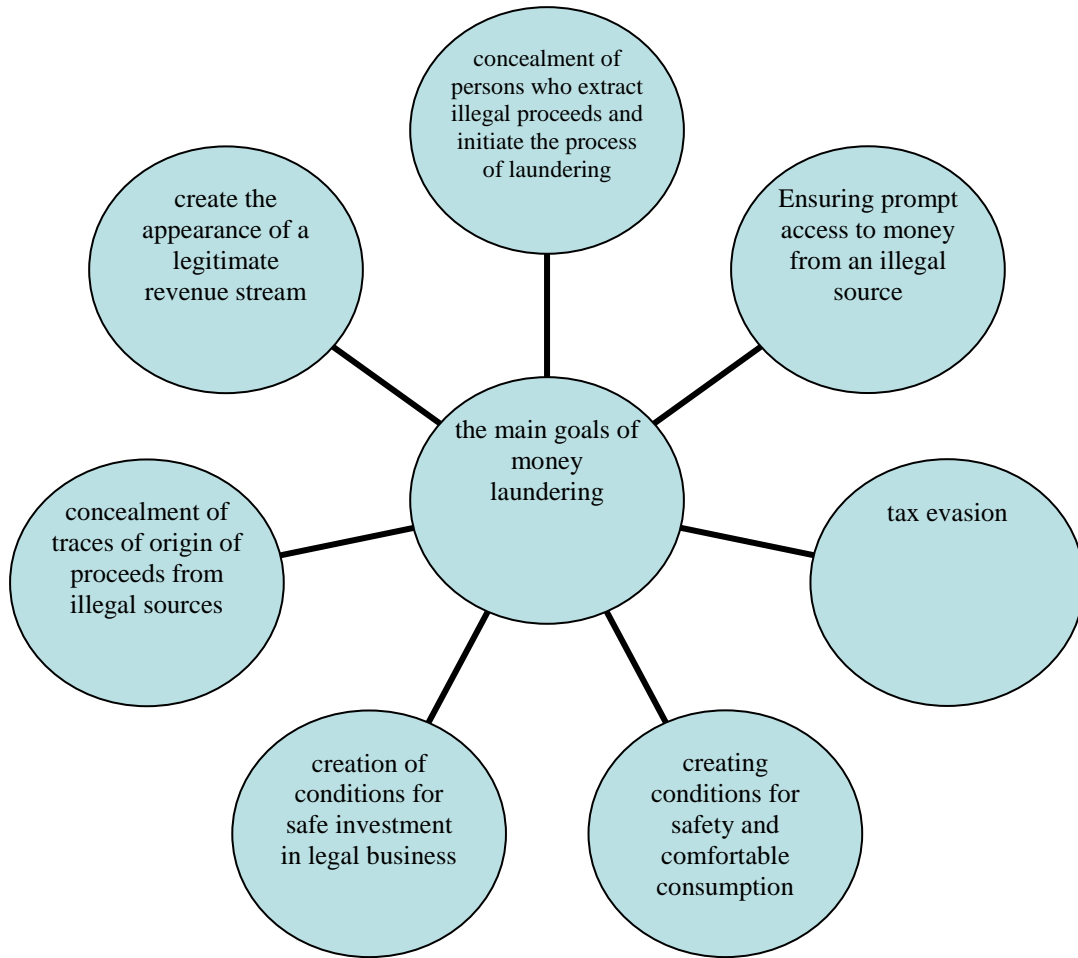


Figure 1. The main goals of money laundering

Source: Created by author

3. How money laundering works?

Although methods of money laundering may be different and the level of their sophistication may also be different, however, international practice shows that this process most often occurs in three stages. From the chronological point of view, we are talking about the transfer of funds directly related to the crime, "masking" the route to prevent the pursuit of money, and the provision of money to the beneficiary, the origin of which has already become legal. In international practice, these stages are also referred to as placement, stratification, and integration of financial resources.

Placement - at this stage, the funds are placed from the source of receipt and put into circulation through financial institutions, shops, exchange offices, casinos, etc. This stage is the most dangerous for criminals, since the bodies authorized to exercise supervision and financial organizations are responsible for verifying the origin of money and carefully collecting information about the client.

Stratification - during this stage, a number of transactions are carried out, the purpose of which is to "remove" funds from the source of their origin. Most often this method is used as an electronic transfer from a number of accounts in various banks located throughout the planet, mainly from those related to offshore jurisdictions. Thus, since the authorities of the respective jurisdictions often do not interact with investigative

bodies that specialize in combating criminal activities, the identification and disclosure of money laundering facts is increasingly complicated.

Integration - if first two stages were successfully, then on the third, the funds are included in the legal economic turnover. That is, the funds received illegally are invested in such a way that they seem to be profit from any legal business. Often, for this purpose, they resort to the acquisition of real estate or luxury goods, fictitious loans or represent the implementation of some export-import activities. In addition, as a result of this stage, property or funds that appear to be obtained as a result of legal activity, provide the beneficiary with disposal.

Currently, the legalization (laundering) of criminal proceeds, being an integral part of organized criminal activity, primarily of a transnational nature, represents an increased social danger and requires the implementation of a complex of general state, including special, measures aimed at counteracting this negative phenomenon. It is representatives of transnational organized crime, whose illegal actions are increasingly acquiring an external resemblance to the legitimate activities of transnational corporations, seek to infiltrate banking institutions for:

a. illegal access to redistribution of financial resources of shareholders and depositors of banks;

b. creation of a secure, well-disguised system of laundering "dirty" money, which is not accessible to the measures taken at the international and national levels for special social and legal control;

c. use of the statutory activity of banks in conducting various transactions both inside the country and abroad, covering illegal financial transactions, primarily related to conversion, cashing out cash and withdrawing capital, as a rule, in the most "safe" offshore jurisdictions;

d. investing already "laundered" resources in the financial and banking sector, which is one of the most liquid on the world market, thus acquiring legal, so-called incremental revenues;

e. gaining prestigious position in the society, additional so-called status dividends, which are effectively used to access new sources of super profits, establish strong corruption links for illegally covering up their illegal activities. As a result of hidden coalescence of transnational organized crime and banking institutions, illegal competition is developing, in fact, the "disintegration" of financial and banking institutions that can undermine public confidence in them and cause serious long-term negative consequences for the financial and credit system, before its deformation.



Figure 2. Money laundering in the spheres of economy

Source: Johnston, Chai and Schumacher, 2000.

This is especially important in the context of the present threat of the second wave of the world financial and economic crisis.

At the same time, it should be noted that effective development and implementation of schemes for laundering criminal proceeds is significantly hampered without active or passive involvement of the top management of the bank. This kind of problem is most fully reflected by the example of the infamous American The Bank of New York (BoNY). Since 1999, the world's leading mass media have been actively discussing the issue of how to develop and implement a "beautiful" scheme for laundering criminal proceeds, which the Wall Street Journal estimated used "up to 80% Russian importers", the senior vice-president of BONY and the vice president of the London branch of this bank were involved. It is noteworthy that the vice president of the London branch, L. Edwards, even delivered a report on the fight against money laundering to the clients of The Bank of New York from Scandinavia, Russia and Eastern Europe.

4. Money laundering as a factor that destabilizes the economy, leads to an impoverishment of the population and fuels corruption

Money laundering can take place in various forms. They depend on the type and level of the crime, as a result of which funds were received. The most common are the forms resulting from the receipt of bribes / bribes, extortion of money, conflicts of interest and theft of public or private funds. In the case of the Republic of Moldova, an eloquent example of money laundering is the theft of funds from the banking sector, which resulted in the collapse of three banks - Banca de Economii, Banca Socială and Unibank, and the subsequent need to use huge sums of public money to eliminate the consequences of what happened.

The main activity of banks is to mediate the circulation of money in the economy - from the owners of savings to investors. At the same time, banks do not use their own money in their activities, but money drawn from the population and from firms, which confirms the public nature of banking institutions and the fact that they are of public interest⁴. Prior to committing the notorious thefts, the lion's share of money in the three banks concerned was private (money raised from the population and from firms) and public funds that belonged to various state institutions (money for the payment of pensions and wages, funds for medical insurance,). As a result of corrupt acts and malicious acts of some managers, these funds were stolen by means of creditor activity and were provided to certain firms. To hide the traces of money and their beneficiaries, a large-scale money laundering process was launched. Thus, the funds were transferred to a number of foreign firms and transferred to offshore jurisdictions. At the same time, to continue the lending process, some funds still returned to the three notorious banks - to repay old loans - and then again issued through new loans. All this mechanism, which was confirmed by the investigation of "Kroll", was applied until those three banks had exhausted all the resources that did not belong to them. To prevent losses of depositors and other banks, the National Bank of Moldova (NBM), with the participation of the government, covered the shortage at the expense of public funds. Thus, money that could be used for repair and construction of roads, for the needs of schools and hospitals, for other state investments, that is, public property, went to cover the stolen funds.

It can be noted that embezzlement in the banking sector and the further process of money laundering have affected the economic environment and, consequently, the citizens of the country, at least several times. At the first stage, public funds were used to save depositors of the three notorious banks. Then, confidence in the national currency, financial system and economic prospects of the country was seriously undermined by the arbitrariness of a number of bank managers and the use of money by depositors for illegal purposes. Ultimately, the money stolen can return to the country again in the form of anticompetitive investments that could disrupt the investment climate, or in the form of

funds that will continue to support corruption and illegal activities. The theoretical presentation of the advantages of money laundering in comparison with the "clean" economic system is set forth in Table 1.

Table 1. Consequences of money laundering compared with the benefits of a "clean" economic system

Effect	The economy, which has suffered from money laundering	Economy not affected by money laundering
Economical	- anticompetitive practice - the deterioration of the investment climate - theft of public property	- loyal competition - attractive investment climate - sustainable economy
Social	- intensive corruption - migration	- workplaces - quality public services
Political	- bribery of deputies - seizure of state institutions	- effective management - responsible public administration

Source: Created by author

To protect its economic system, the state needs an appropriate institutional and legislative framework aimed at preventing money laundering and combating this phenomenon. Even when the first Criminal Code was adopted, it included specific norms on combating money laundering. Subsequently, the legislation in this area was gradually upgraded - from the Law on the Detection of Incomes Obtained as a Result of Grave Crimes, adopted in 1993, to the latest Law on the Prevention of Money Laundering and Combating it, developed in 2016. Although certain norms change, the main goal remains the same - prevention and combating money laundering to protect the legitimate rights and interests of individuals and legal entities, as well as the state. To achieve this goal, a number of reporting entities are identified that are most susceptible to this phenomenon and are required to apply measures to identify individuals and legal entities, as well as the actual beneficiary, to notify the specialized body about the existence of suspicions about money laundering. Among the reporting entities, the most important are the financial institutions - both banking and non-banking, exchange offices, real estate agents, state notaries etc.

It is necessary to consider the relationship between the vulnerabilities of financial institutions and households to the risk of money laundering.

The first direction is the transfer of vulnerability to the risk of money laundering from financial institutions to households:

1) direct involvement of money laundered from households legally raised from households, that is, households become indirect unwilling participants in the money laundering process. For example, the scheme outlined in the report of the EAG Working Group on typologies "Risks of using non-bank financial institutions in schemes for laundering proceeds from crime" is the scheme for unlawfully seizing the funds of depositors of the credit union under the "financial pyramid scheme";

2) the indirect involvement of money illegally raised from households in money laundering.

The second direction is the transfer of vulnerability to the risk of money laundering from households to financial institutions:

1) For example, fraudulent schemes are known on the securities market, such as: the laundering of money by an individual (household) by acquiring an open joint-stock shell company, money laundering by an individual (household) obtained as a result of tax evasion, with electronic transfer of securities or the acquisition of shares in another country, money laundering by an individual (household) obtained as a result of insider trading, using Internet-based trading accounts, and others;

2) In the sector of non-banking financial institutions, the following fraudulent schemes organized by individuals have been identified: the organization of a fictitious pawnshop by an individual (household) to cash out money, the collusion of an unscrupulous natural client with a pawnshop about distorting the appraised value of a thing for cashing out cash means and others;

3) In the banking sector, fraudulent schemes are known, such as: the organization of pseudo-entrepreneurial structures for the purpose of money laundering by means of withdrawing and crediting funds to bank accounts, organizing the cashing of criminally acquired funds abroad, illegal banking activities.

Thus, the directions and forms of the interrelationships of financial institutions and households to the risk of money laundering are determined on the basis of their qualitative characteristics. Thus, the transfer of vulnerability to the risk of money laundering from financial institutions to households can be due to the involvement of household funds in illegal financial transactions, as well as the spreading to households of the negative consequences of the realization of the risk of money laundering. In turn, the transfer of vulnerability to the risk of money laundering from households to financial institutions (commercial banks) can occur both by involving the financial institution in money laundering (both through collusion with the staff of the institution and without their participation), and by creating separate financial institutions, which imitate financial and economic activities, but are primarily engaged in the laundering of criminal proceeds.

The impact on the systemic risk in the financial market of the vulnerabilities of financial institutions and households to the risk of money laundering and their interrelations can be characterized by the following: financial institutions (commercial banks) accumulate vulnerabilities to the risk of money laundering, both inherent in them directly and transferred from households, and the formation of corresponding threats to these vulnerabilities is triggered by the mechanism for realizing the risk of money laundering.

5. Conclusions and recommendations

The results of recent years prove that the Republic of Moldova was a favorable territory for cross-border groups involved in money laundering. Due to the increased corruption at the highest level, the available legislative deficiencies and the interference of political forces in the work of the supervisory authorities, the domestic financial system has become vulnerable to the risk of theft and money laundering. Even after reforming the national framework in the field of banking supervision and preventing and combating money laundering, the temptation to use the domestic financial system as a platform for the legalization and transit of funds of dubious origin remains quite high. For example, in 2016, the SPBD received about 600,000 forms from the reporting entities, which indicated that, following the results of the assessment, the transactions were found to be questionable. As a result, 236 cases were sent to the prosecutors (the prosecutor's office and the NPPM), 19 to the Main State Tax Inspectorate, 22 to the financial market regulators (NBM and the NCFM), and 38 to some law enforcement agencies. The largest share falls on the banking sector, that is, 11 domestic banking institutions accounted for about 99.6% of the total received forms.

The fight against money laundering should include other measures related to the economic policy of the state. Thus, along with the exclusion of institutional and legal deficiencies that are typical for this sphere, such measures as de-orphotization of the economy, the introduction of international standards of transparency or a thorough check of investments of dubious origin should also be on the agenda of the powers that be. In addition, taking into account that the banking sector remains the most vulnerable component of the increasingly sophisticated money-laundering mechanisms, the NBM at the sector level should adopt a consistent policy aimed at preventing, identifying and managing the risks that accompany this phenomenon. This applies to non-bank financial institutions, which are increasingly represented in domestic financial turnover and are most susceptible to theft and criminal activity. In this sense, international practice suggests a number of measures, and the most important are the following:

a. The definition of a clear procedure for identifying risks and coordination in the internal plan - financial institutions should allocate sufficient resources to promote anti-corruption and anti-money laundering programs. The manager should clearly explain to the team that it is necessary to show complete rejection of such phenomena as corruption and money laundering; • Applying adequate preventive measures to recognize the client, including these ultimate beneficiaries - in the process of interacting with clients, financial institutions should have mechanisms to monitor suspicious transactions and identify potential "red flags". Along with this, customer profiles or any similar tools should be adapted to the specifics of the activities and clients;

b. Identification and special management of relations with politically vulnerable persons - due to the status and political influence of certain individuals, the risk of their involvement in money laundering is much higher. So, in the event that the client identification procedure identifies politically vulnerable persons, financial institutions should take additional reasonable steps to establish the source of funds, and apply actual monitoring of business undertakings over time;

c. Information storage and information exchange with responsible institutions from the relevant field - as reporting entities, financial institutions need to ensure that there are clear and rapid procedures for transferring information to responsible institutions that may relate to money laundering;

d. Simplification of cross-border cooperation - at the international level, states should ensure that there are agreements on the rapid exchange of information on the relations and relationships between financial institutions. In addition, banks must ensure that they properly assess activities that involve residents of jurisdictions that do not implement international standards for transparency and disclosure.

In conclusion, it should be noted that only joint efforts of authorized state bodies, the National Bank, other financial and credit institutions, various subjects of entrepreneurial activity and citizens of the Republic of Belarus will make it possible to develop a strong immunity from a financial credit system of our country to any attempt to launder criminal proceeds.

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