FINANCIAL REGULATION & SUSTAINABILITY LEVEL-7

MONEY LAUNDERING

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1. Introduction:

In general, money laundering refers to the act of hiding the presence, illegal source, or use of proceeds obtained from criminal activities, followed by the disguising of the income's source to give the impression that it is real. The core of money laundering is deception. One of the earliest methods of evading official inspection is the use of international trade to transfer money covertly from one

nation to another. The majority of government law enforcement agencies likewise avoid using international trade as a means of money laundering (Zdanowicz, 2009).

2. Stages of money laundering:

Placement:

Placement refers to the primary phase in which illegally acquired funds, typically in the form of cash, are introduced into the financial system. The process may entail dividing substantial sums of money into smaller deposits to evade discovery or depositing them into banks, frequently across various locations or countries (Villányi, 2021).

Case study of Anglo Irish Bank :

David deposits illegal funds into bank accounts, keeping them below reporting thresholds. He establishes shell corporations in offshore nations to conceal the money's source. He moves the money from his bank accounts to these entities, complicating tracking. Some of the illicit funds are invested in securities, such as stocks, bonds, and mutual funds, using shell firms' brokerage accounts. David also invests in money market instruments to diversify his portfolio. Offshore accounts are set up to keep the money under the identities of individuals acting on behalf of others. This case study good example placement stage (Arthur Beesley 2018).

Layering:

During this phase, the funds are transferred through multiple transactions to create additional separation from their illicit origin. This may encompass the process of transferring monies across various accounts or financial institutions, engaging in the purchase and sale of assets, or executing intricate financial transactions across international boundaries (Villányi, 2021).

Case study Scottish crypto scheme :

Scott converts illegal funds into digital currency using lenient online platforms, obfuscating payment origins with accounts and fictitious names. Cryptocurrency mixing services, or tumblers, combine tainted cryptocurrency with legal transactions, making it difficult to trace origins. Scott moves the cryptocurrencies to offshore accounts, using a complex system of shell corporations and nominee directors. He also allocates cryptocurrencies into real estate holdings, creating legitimacy and merging illegal cash into the legal economy. The layering part of this case study is perfect example how layering is done (Euan Healy 2024).

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Integration:

The last phase entails reintegrating the illicitly obtained funds into the lawful economy. One way to accomplish this is by allocating the monies towards investments in enterprises or real estate, acquiring high-end products, or reintegrating the funds into the banking system as lawful revenue (Villányi, 2021).

Case study of jet airways :

The Indian airline company Jet airlines case shows the example of integration can be done in ML. Amir uses illegally obtained funds to invest in high-end real estate, business ventures, and foreign investments. He uses shell companies or nominees to acquire properties, disguises them, and diversifies his portfolio. He also invests in high-value purchases, financed through legal earnings and laundered money, merging illegal profits with lawful resources. Amir also contributes to charitable organizations to improve his reputation and legitimize the source of laundered funds. This strategy makes it difficult to trace the funds (Pti, 2024).

3. Techniques of ML :

Smurfing (Structuring) :

Smurfing is a money laundering method where illegal cash is divided into smaller increments and allocated to multiple bank accounts to bypass financial restrictions. Smurfs, acting on behalf of criminals, execute minor transactions to maintain transactions below reporting thresholds. After successful deposits, funds are transferred to alternative accounts or mixed with legal cash, creating the illusion of lawful revenues. Despite its simplicity, smurfing can be highly efficient, but financial institutions and law enforcement have developed methods to identify and counteract it. (*Examples of Money Laundering Techniques*, 2024).

Trade-Based Laundering :

Trade-based laundering (TBL) is a criminal method used to illegally transfer funds across international borders by manipulating commodity values, volume, or nature. This involves inflating or undervaluing goods, distorting descriptions, or fabricating customs declarations and invoices. The complexity of TBL and the size of global commerce make it challenging for authorities to identify and combat it. Criminals often use shell companies, intermediaries, and offshore financial centers to detach from their illicit activities (*Examples of Money Laundering Techniques*, 2024).

Round Tripping :

Round-tripping is a method used by money launderers to transfer payments across international borders to conceal their illegal sources. This involves expenditure of capital from a country and repatriation under the pretence of lawful investments or commercial dealings. For example, a UK-based firm "A" seeks to recover illicit profits, while an offshore entity "B" is established in a tax haven. The funds are then allocated to "A" through lending, shares, or other legitimate activities, reintegrating into the UK's economy. This

cyclical movement complicates authorities' task of tracking money laundering (*Examples of Money Laundering Techniques*, 2024).

Real Estate Laundering :

Real estate laundering is a common form of money laundering where individuals divert illegal profits into the property market to conceal their financial sources. The United Kingdom is a popular location for real estate laundering due to its robust property market and perceived investment climate. Criminals exploit loopholes in property transactions, using shell corporations, offshore accounts, or third-party intermediaries to conceal their identities and funds (*Examples of Money Laundering Techniques*, 2024).

Case study of Sophie :

Sophie uses illicitly obtained funds to buy high-end real estate properties, obtain mortgage loans from financial institutions, and lease properties to renters. This legitimizes the money within the banking system. Sophie also invests in stocks and securities, using her own name or nominee directors. She also invests in lawful business ventures, such as startups or franchises, to create extra income while integrating the illegal funds into the economy. This strategy helps Sophie integrate the illegal money into the legal economy (Panlogic, 2024)

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Shell Companies and Trusts :

Shell companies and trusts are often used in money laundering schemes to conceal illicit payments. These organizations, often in offshore jurisdictions, exploit vulnerabilities within the financial system and international legislation to sustain and perpetuate operations related to money laundering. Shell companies function as a front to conceal fund origin, facilitating the movement of funds across accounts and creating the perception of valid transactions.

Trusts, as legally binding agreements, provide anonymity and impede investigative procedures, especially when created in jurisdictions with stringent confidentiality laws or inadequate regulatory supervision (*Examples of Money Laundering Techniques*, 2024).

Case study of Para-bank :

The Latvian correspondent banking system facilitates the creation of several anonymous shell companies for clients from the former Soviet Union. These firms are established in various onshore and offshore jurisdictions. Shell firms serve as conduits for transferring cash of various legality (white, grey, and black) from Russia, Ukraine, and other former Soviet republics. These funds are moved through international correspondent banking relationships to offshore savings accounts and business suppliers. The establishment and management of the shell firms is carried out by para-bank "business introducer" entities that weaken the authenticity of customer documentation (Stack, 2015).
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How does financial regulation deal with ML?

The Financial Conduct Authority (FCA) is responsible for investigating and penalizing violations of the Money Laundering Regulations, which mandate customer due diligence and continuous monitoring of business interactions. This includes authorized firms, Annex I financial institutions, cryptoasset exchange providers, and custodian wallet providers. These entities engage in specific activities outlined in Annex I of the Banking Consolidation Directive and Capital Requirements Directive, including financing mechanisms, financial leasing arrangements, and secured custody services. Enrollment with the FCA is mandatory for Annex I financial institutions (*EG 19.14 the Money Laundering, Terrorist Financing*

and Transfer of Funds (Information on the Payer) Regulations 2017 - FCA Handbook, 2016)

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4. MLRO :

MLRO examines the impact of technology on the responsibilities of Money Laundering Report Officers (MLRO), focusing on the principles of ML and MLRO. The research aims to provide a comprehensive understanding of the MLRO's responsibilities and minimize the use of technology. The study uses a qualitative study with a semi-structured questionnaire to explore the evolving requirements of MLROs, emphasising the importance of adhering to these evolving requirements (Vella, 2022).

Strengths:

Greater Efficiency:

Machine learning algorithms have the capability to analyse extensive quantities of transaction data at a far faster rate than humans, enabling prompt detection of potentially suspicious conduct. This approach has the potential to detect money laundering techniques that may elude detection through conventional methodologies.

Enhanced Precision:

Machine learning can undergo training using past data that encompasses established money laundering trends. This enables the system to detect intricate patterns and anomalies that may pose challenges for human observers.

Scalability:

Machine learning systems can effectively manage the increasing amount of financial transactions, making them well-suited for huge organizations.

Weaknesses / Transparency :

Explainability Challenges:

The intricate characteristics of certain machine learning algorithms can pose difficulties in comprehending the rationale behind the identification of a specific transaction as suspicious. The absence of openness poses challenges for regulatory bodies and hinders the ability to contest instances of false positives.

Bias in Data:

In the event that the training data employed for the machine learning model exhibits bias, the model may acquire and perpetuate said prejudice. This has the potential to result in the unjust targeting of specific client segments or the oversight of potentially illicit activities employing less prevalent methods of money laundering.

Data Privacy Concerns:

The utilisation of extensive consumer data for the purpose of training machine learning models gives rise to concerns regarding data privacy. It is imperative to guarantee data anonymization and adhere to data protection standards.

5. POCA :

The Proceeds of Crime Act 2002, commonly referred to as POCA, is a legislative measure enacted in the United Kingdom with the primary objective of identifying and thwarting the acquisition of illicit funds through criminal activities. This action represents a component of a comprehensive endeavour aimed at suppressing criminal behaviour and efficiently dismantling networks associated with organised

crime. The Proceeds of Crime Act facilitates the seizure of assets acquired through criminal activity. However, the legislation also includes provisions for the seizure of funds and assets, even if they have been obtained through lawful methods, if it can be demonstrated that they are indirectly obtained from unlawful conduct (Walter, 2022).

Strengths:

Asset Recovery:

POCA offers robust resources for law enforcement to retrieve assets acquired via criminal activities. This serves as a deterrent for offenders and facilitates the recovery of monies that can be donated for societal benefit.

Civil Recovery:

The Proceeds of Crime Act (POCA) grants authorities the ability to reclaim assets through civil processes, irrespective of the absence of criminal accusations. This reduces the evidentiary requirement in comparison to criminal trials and facilitates the identification of unlawfully acquired profits.

International Co-operation:

POCA enables international collaboration in asset recovery cases, enabling the UK to collaborate with other nations in the retrieval of stolen assets situated overseas.

Weaknesses / Transparency :

Complexity:

The complexity of the statute poses a significant challenge for law enforcement and legal professionals in efficiently navigating it. Delays and inefficiencies may arise as a result of this.

Limited Scope:

POCA predominantly concentrates on cases within the country. Retrieving assets situated in intricate offshore frameworks or nations with feeble legal systems might provide challenges.

Insufficient Public Reporting:

There could be a dearth of publicly accessible information regarding the quantity and monetary worth of assets retrieved through POCA. Enhanced transparency has the potential to enhance public confidence and showcase the efficacy of the legislation.

6. SCOPA :

Scope The initial step is an assessment of the existing body of literature pertaining to the concept of 'private police', with the contention that its existing parameters are insufficient in encompassing the 'policing' function of the regulated sector. Furthermore, it delineates the legislative structure that has been established to address the issue of money laundering. Furthermore, this study provides a contextual analysis of the regulated sector, specifically focusing on the domestic inter agency policing connections inside the suspicious activity regime as implemented in Scotland. This analysis examines the judicial interpretation of the 'failure to report offence' as outlined in section 330 of the Proceeds of Crime Act (POCA) 2002, and its subsequent impact on the involvement of the regulated sector in the investigation and prosecution (SARs) system (Egan, 2010).

Strengths:

Risk-Based Approach:

The regulations employ a risk-based approach, wherein the criteria are customised based on the assessed risk of money laundering associated with a customer or transaction. This prevents the imposition of a significant load on circumstances with low danger.

Emphases Customer Due Diligence (CDD):

CDD plays a vital role in the identification and authentication of customers, hence thwarting the infiltration of criminals into the financial system.

Suspicious Activity Reporting (SARs):

Suspicious Activity Reporting (SARs) enables authorities to conduct more efficient investigations into potential money laundering activity.

Weaknesses / Transparency :

Burden on Businesses:

Compliance can impose a significant burden on firms, necessitating the allocation of resources and the provision of personnel training.

Covert Techniques:

The SCOPA Act grants law enforcement the authority to employ covert techniques, such as undercover operations and intercepting communications, during the course of investigating grave criminal activities. Collecting evidence is of utmost importance, yet, it gives rise to apprehensions over privacy and the possibility of misuse.

Closed Material Proceedings (CMPs):

Closed Material Proceedings (CMPs) are a legal provision under SCOPA that permits certain aspects of court proceedings to be conducted in a confidential manner, with the aim of safeguarding sensitive information or national security. Although there are controls in place, the widespread utilisation of CMPs can restrict public scrutiny and accountability.

7. Greenwashing :

The term "greenwashing" pertains to the act of portraying financial items, particularly investments, as possessing environmental, green, or ESG attributes, despite lacking such attributes. The situation at hand involves a potential misrepresentation that may result in the misselling of financial instruments, so posing a risk to investors seeking sustainable or environmentally friendly investment prospects. The potential for greenwashing tactics may arise due to the intricate nature of the new European legal environment and the potential exploitation of certain clauses, despite the stated goal within the framework to differentiate between them (Bodellini, 2023).

To effectively address greenwashing, it is crucial to enhance collaboration between ESMA and national competent authorities, promote regulatory harmonisation among member states, and establish more stringent and explicit guidelines for qualifying green and sustainable financial products (Bodellini, 2023).

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# 8. UK regulatory approach to greenwashing :

It is around the UK government's approach to implementing phase 1 of their strategy, which involves informing investors and consumers. The main focus is on tackling the issue of 'greenwashing'. Deceptive or unsupported assertions regarding the environmental performance made by businesses or investment funds regarding their products or activities. Resulting in the acquisition of incorrect goods, which erodes confidence in the market and the misallocation of funds designated for sustainable investments. As of 2021, 60% of investors focused on environmental, social, and governance (ESG) issues saw greenwashing as a significant threat. This has raised

concerns for the Financial Conduct Authority (FCA). The Roadmap primarily aims to assist customers in making more informed assessments regarding the sustainable attributes of products and companies (Amin et al., 2022).

9. Affects of Regulation :

AML, sanctions, MiFID and data privacy fines by country ($M)
Top 5 countries in 2021
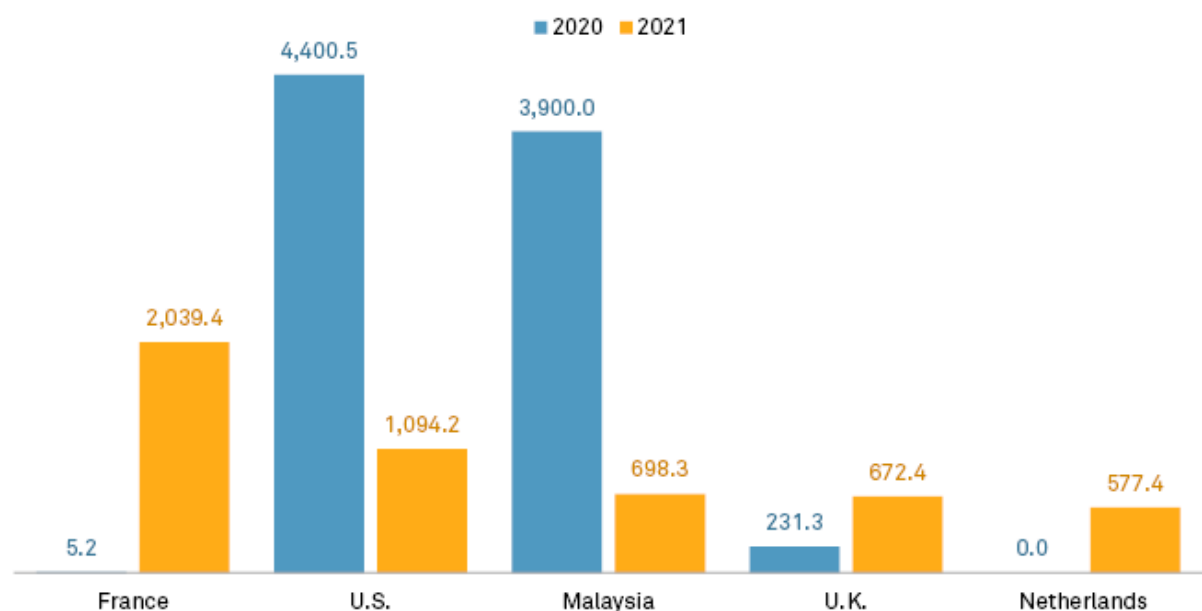
Data released Jan. 11, 2022.
Data covers enforcement actions against financial institutions and their employees for noncompliance with anti-money laundering, sanctions, the EU's Markets in Financial Instruments Directive (MiFID) and data privacy regulations.
Source: Fenergo

As we see the graph the fines collected by different countries to the ML frauds.

We can interpret that in France, UK and Netherlands ML was been increased rapidly so, that they have to introduce new regulatory policies and increase the punishment for ML so that it can be reduced. Looking into positive sides countries like USA and Malayisa the fines was been reduced which means the polices are good and in the future the aim should be NIL.

10. SDR :

A regulatory measure is being proposed for all FCA-authorised enterprises to strengthen the requirement that claims connected to sustainability must be honest, transparent, and free from any misleading information, in order to combat greenwashing. We are also seeking input and advice on providing more instructions.

Guidelines for naming and marketing investment goods to ensure the appropriate use of sustainability-related terminology. Four labels designed to assist consumers in navigating the investment product market and bolster consumer confidence. The objective is to enhance consumer-oriented information by offering consumers clearer and more readily available details that enable them to comprehend the fundamental sustainability characteristics of a product. This text provides comprehensive information specifically aimed at institutional investors and consumers who are looking for more details in pre-contractual, ongoing product-specific, and entity-specific disclosures. Distributors must meet the requirements to ensure that they provide consumers with product-level information, including the labels (*PS23/16: Sustainability Disclosure Requirements (SDR) and Investment Labels*, 2023)

Suspicions on the rise

Suspicious Activity Reports filed
(000s)
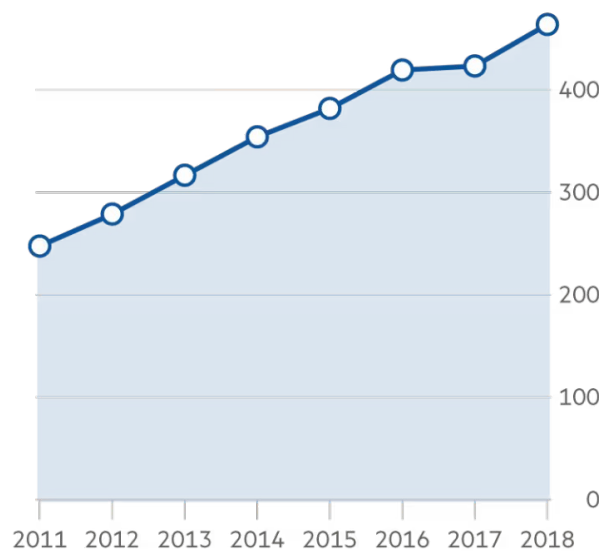
Defence against money laundering SARs
(000s)
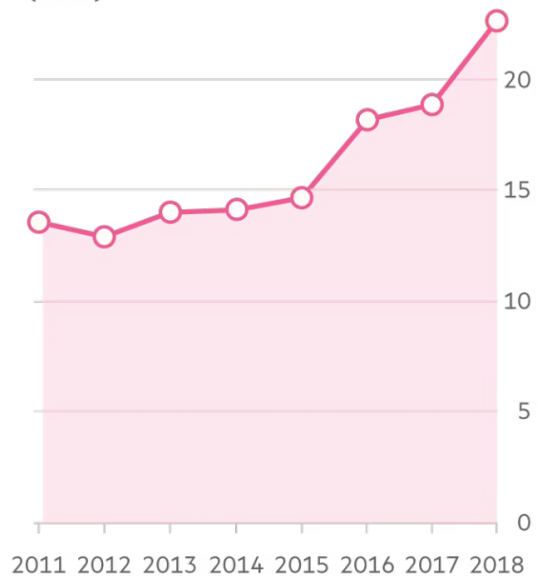
Methodological break: year ending Sep up to 2016, then year ending March
Source: National Crime Agency
© FT

11. Conclusion :

Money laundering is a complex financial crime that involves hiding illegally acquired funds from illegal activities. It is primarily based on deceit and involves various methods such as shell firms, trade-based laundering, and round-tripping. Financial regulation is crucial in combating money laundering, with authorities like the Financial Conduct Authority and legislative measures like the Proceeds of Crime Act. Machine learning algorithms can improve anti-money laundering efforts by analyzing transaction data and identifying

trends. However, challenges like explainability, potential bias, and privacy concerns need to be addressed. The financial sector also faces challenges in combating greenwashing, which involves misleading representations of financial products as environmentally beneficial or sustainable. To counter money laundering and maintain the credibility of the financial system, efficient cooperation among regulatory bodies, financial institutions, and other parties is essential.

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