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MONEY LAUNDERING

Master's Thesis

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Anotace

Diplomová práce se zabývá hodnocením efektivity boji proti praní špinavých peněz. V teoretické části práce jsou definovány pojmy praní špinavých peněz a jeho druhy, FATF (Finanční akční výbor) a AML (proti praní špinavých peněz). Praktická část je věnována analýze velkých skandálů poslední doby a hodnocení efektivity používaných AML mechanismů. Na základě tohoto byly zdůrazněny slabiny aktuálních AML mechanismů a nástroje jejich zlepšení.

Annotation

The thesis deals with evaluation of anti-money laundering effectiveness. In theoretical part money laundering, FATF (Financial Task Force) and AML(anti-money laundering) are defined. Practical part concentrates on the biggest scandals of the latest years and assessment of AML effectiveness. Based on this evaluation, weak places in AML mechanisms were identified. Additionally, tools of AML improvement were determined.

Klíčová slova:

Praní špinavých peněz, daňový únik, FATF, anti-money laundering, FATF rady, AML efektivita.

Keywords:

Money laundering, tax evasion, FATF, anti-money laundering, FATF Recommendations, AML effectiveness

Declaration Of Authorship

I hereby declare that this Master's Thesis "Money laundering" is my own work and it does not contain other people's work without this being stated in the references, and the bibliography contains all the literature that I have used in writing this thesis.

In Prague on April 28, 2017

Ganna Kryvosheieva

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Introduction

Shadow economy, also called unofficial economy, should not be considered as disease, but as a component of world economy. Its very existence is tightly connected with money laundering, which is the topic of my thesis. Money laundering includes a plenty of diverse illegal activities, which have common goal – to make dirty money look clean. Moreover, it erodes the very basement of national stability: financial sector becomes unreliable while government is taken as not trustworthy.

To reach internal and national stability scientists and politicians implement anti-money laundering systems, which aim to effectively fight corruption.

Goal of my thesis is to analyze key ideas of anti-money laundering, identify weak places and emphasize tools of its improvement.

In my opinion this topic is very relevant nowadays. At the present time ‘the best’ conditions for illicit cash flows are created. Because of high complexity of modern economies, difference in legislations, enormous number of everyday transactions and lack of information exchange between financial and non-financial institutions amounts of laundered proceeds steadily grows. In accordance with the United Nations Office on Drugs and Crime, size of money laundering transactions is estimated as 2-5% of global GDP, while authorities confiscate only 1% of them. Of course, financial sphere is at higher risk but hundreds of other branches are also threatened. They are even more vulnerable because they don’t have such developed mechanisms of anti-money laundering preventing as financial sector.

First hypothesis of my thesis is to prove that efficiency of anti-money laundering mechanisms is not satisfactory at the present time. Second hypothesis is to prove that human factor is of the highest significance in combating money laundering. It would be proven by using the following methods: analysis of existing standards, assessment of their effectiveness, sector analysis, comparison of determined goals with reached outcome, statics evaluations etc.

This thesis will consist of three chapters and is divided into theoretical and practical parts. First chapter will highlight theoretical aspects of money laundering and

anti-money laundering mechanisms. Detailed information about tax evasion, real estate crimes, corruption, terrorism financing and others types of money laundering will be provided. Moreover, first chapter will also contain characteristics of anti-money laundering (AML) and will describe Financial Action Task Force, as key player in fighting money laundering.

Second chapter will be concentrated on appraisal of effectiveness of anti-money laundering systems. Sufficient part of it will be dedicated to the description of the notorious frauds that took place in the last decade, it will prepare basis for further analysis of money laundering. Cases of HSBC, Petrobras, 'Global Laundromat' and carbon emissions were selected as illustrative examples to show different ways and methods that were used. It also will provide us with information about scale of this 'disease' in each particular case. Later on, analysis of anti-money laundering effectiveness will be complemented by naming its failures.

In the third chapter I will emphasize weak places of AML mechanisms including possible threats. Analysis of weaknesses will be partly done using HSBC case. Simultaneously, I will share possible ideas how to improve the tools, which are used by international community.

In my thesis I also highlighted features of social inclusion that is a highly relevant social topic. Moreover, using example of a real whistleblower, who disclosed HSBC data, I will emphasize main reasons, threats and opportunities for this activity.

In my research I have used more than 60 sources to find the most up-to-date information. For theoretical information were used articles of the following scholars: Schneider F., Raczkowski K., Black C., Levi M., Surendran S., Mauro P., Batra R., Sidani M., Mroz B., Fantaye D., Angela Samantha M., He P and others.

Among key sources of practical information were influential magazines as The Guardian, The Economist, The Telegraph, Forbes, The Financial Times, Kommersant. Essential part of information was received from the website of Financial Action Task Force that has thousands publications dedicated to money laundering. Among the most valuable sources of information were websites of International Consortium of Investigative Journalists and Organized Crime and Corruption Reporting Project where detailed information about the biggest money laundering scandals was found. Pricewaterhouse Cooper's Global Economic Crime Survey 2016 has also provided practical and theoretical overview of current anti-money laundering mechanisms.

Money laundering is a very extensive topic. It is also very tightly connected to

global terrorism financing and in many studies those activities are studied in bundle, in other words, money laundering is a source for terrorism financing. Today each sphere of business is under risk. Moreover, if we study anti-money laundering, it is even more complex. Criminal minds invent more and more sophisticated methods of money laundering, implementing them in a growing number of branches. Peculiarity of money laundering field is that launderers use imperfection of legislation and loopholes in them. It is impossible to scrutinize them all, moreover, these gaps in legislation are rather dynamic: once criminal scheme is disclosed and corrections in the legislation or monitoring systems of companies are done, criminals discover new spheres, new methods, new loopholes. Therefore, it is important to understand how money laundering activities can be identified, determine crucial weaknesses and strengths of anti-money laundering mechanisms.

Accordingly, I decided to concentrate on the overview of the highly mentioned aspects and, in the meantime, have described several examples that attracted public attention in the last years.

1. Theoretical part

Money laundering belongs to the most relevant topics discussed in media and academic circles. Thousands of articles and books have already revealed main motives, identified problems and tools used for money laundering but, nevertheless, at the present time more and more sophisticated and sometimes even simple schemes appear. Fighting money laundering is high on international agenda. This sphere is dynamic and it is very important for authorities and scholars to have up-to-date information in order to predict possible scenarios. Because of this, theoretical background is significant for understanding of what money and anti-money laundering actually are.

1.1. Money laundering as an integral part of shadow economy

The complexity of modern economies, free movement of people, capitals, items, scientific progress and enormous quantity of everyday transactions created the most favourable conditions for illicit cash flows. The shadow economy is hard to be quantified, but every year big amounts are transferred mainly from developing economies.

Why is it important to estimate the size of shadow economy? First, because it essentially influences assessment of macroeconomic indicators like GDP. Wrong reckons give wrong overview of real economic situation in branches and in countries as a whole. It is also important to identify how taxes are avoided to improve state budget revenues.

Shadow economy is considered unofficial economy. It should be perceived as integral element of economy. From the perspective of shadow economy, it should be considered as the fourth sector of economy, which is of fundamental significance and which is decisive for the opportunity to create value by minimizing the information gap in decisions that can be the legal, which is official economy, semi-legal (grey economy operations) and the entirely unlawful (Schneider,2015,p34-51). According to European

scholars, average size of so-called “grey zone” in economy makes around 20 -22% of GDP (Raczkowski, 2013, pp. 353-354.) Budget losses are tremendous mainly due to tax evasion.

There are several reasons that should make authorities concern about rapid growth of unofficial economy (Schneider, 2000, p.77-114):

- individuals feel themselves overburdened; it may result in even more obvious weakening of the economy;
- official indicators like unemployment, GDP, average income become inaccurate;
- if citizens realize that unofficial economy can offer better salaries they will choose to leave their official positions. But, according to surveys of Schneider, Mroz and others, 2/3 of money gained through unofficial activities are spent in the official economy, what positively effects the official economy.

According to Mroz (2012), shadow economy is a number of “unregistered activities aimed at yielding tangible benefits, in either natural or in monetary form, generating given consequences of value creating and/or distribution character. These activities are deliberately concealed from the public authorities for such reasons as avoidance of income or tax payments, avoidance of legal market standards or some certain obligations.

In accordance with Smith (1994) shadow economy is “market-based production of goods and services, whether legal or illegal, that escapes detection in the official estimates of GDP”.

Is it possible to measure the shadow economy? The size of the unofficial economy depends on specific features of countries. For example, in Hong Kong where public sector is relatively small, punishment is rigorous and tax morale is high, unofficial economy is rather small – less than 15%. By comparison, African countries like Nigeria or Egypt have shadow economy at the level of 60-70%. Rather big shadow economies have countries of former Soviet Union, for example, in Georgia, Belarus and Ukraine underground sector is estimated to reach 40%.

According to OECD statement, “Money laundering is any process by which illegal funds (money and goods) are made to appear legitimate.” (OECD, 2014)

Why is important to fight money laundering as substantial part of unofficial economy? Three main reasons can be emphasized:

- it assists crime by enabling them to self-finance and grow;
- its influence on financial system is corrosive;

- extent of laundering, which is difficultly measured.

1.2. Methods and Stages of Money Laundering

Despite the fact that money laundering has been investigated for several decades already, researchers have not still agreed on unified methodology. Basically, three methods of assessment can be emphasized:

- A) Direct procedures at a micro level that determine the size of the shadow economy at one particular point in time. As example the survey method can be named.
- B) Indirect procedures that use macroeconomic indicators in order to proxy the development of the shadow economy over time.
- C) Statistical models that use statistical tools to assess the shadow economy as and unobserved variable.(Schneider, 2015, p.34-51)

First method can be characterized by structured interviews that are usually held face-to-face in order to be sure that respondents will not avoid answering some questions or reply dishonestly. Usually questionnaire consists of three parts with the first part trying to find out what is respondent's perception of the issue. The second part is dedicated to respondent's activities in the shadow economy. The third part includes usual social questions.

There are questions about so-called 'black activities'. Did the person participate in such activity during the last year? Did he/she ever benefit from not paying of VAT or another tax? Among those activities are also payment in cash and reciprocal favours to friends or acquaintances?

The assessment of the shadow economy of highly developed countries as, e.g. Austria and Germany, is based on a combination of the second and the third methods. This approach assumes that the unofficial economy is a latent variable that can be reckoned with help of analysis of currency demand, official GDP, official working hours and tax burden. In the reality this method has a big disadvantage - it assess just relatively the size of the shadow economy (OECD,2014).

Talking about money laundering, three stages should be undertaken in order to make illegal funds appear legitimate.

The first step is placement – cash enters the financial system. Funds can be placed through different financial institutions, shops, casinos locally and abroad. The

process of placement can be accomplished through many different activities:

- a. Blending funds – the easiest way to hide illegal funds is to mingle them with legal ones.
- b. Asset purchase is considered a classical money laundering method. The aim is to make appreciable amount of illicit funds equally valuable but not so appreciable.
- c. Currency smuggling – physical removal of currency abroad.
- d. Currency exchanges – liberalization of foreign exchange markets gives space currency movements.
- e. Gambling – buying of gambling chips and making bets.
- f. Loan repayment – repayment of loans with illegal revenues.
- g. Bank complicity – when anyone of bank's owners is suspected of cooperation with criminals.

Next step is layering (also called structuring). It is the most complex stage that includes a number of activities, which aim to complicate process of trailing of illegal revenues for law enforcement agencies. Launderers keep funds moving, transferring them from country to country, dividing them into separate investments etc. There are two most popular methods:

- Converting of cash into monetary instruments.
- Tangible assets are, at first, bought using cash and after sold.

The third step is integration. This stage includes movement of previously laundered funds into economy. Money find their way back to their owner – criminal from legitimate source and appear to be perfectly legal. Those proceeds are now completely integrated to the financial system and can be used for any operation. The main purpose of this stage is to return money to its owner without attracting undesirable attention. Main methods are:

- Property dealing – a lot of criminals purchase luxury properties using shell companies. After those properties are sold, income of the seller is considered absolutely legitimate.
- False loans and front companies – launderers lend money themselves
- False export/import invoices – overvaluation of documents in order to justify future incomes
- Foreign bank complicity – use of international bank services facilitates to hide some financial operations from law enforcement agencies. It is not so easy to force

foreign bank institutions to cooperate; the law protects them (OECD/AfDB, 2012).

1.3. Characteristics of types of money laundering

Money laundering includes a plenty of diverse illegal activities, which have common goal – to make dirty money look clean. It erodes the very basement of national stability: financial sector becomes unreliable while government is taken as not trustworthy.

1.3.1. Tax evasion

Tax evasion is trouble for developing countries as well as for developed. It has adverse effects on the economy. It is also connected with undermining administrative efficiency (Sidani, 2014, p. 183-196). Tax evasion in developed economies has been long studied but it is still unclear how it functions in developing countries. Numerous surveys were conducted in countries like Uganda, Lebanon, Argentina, Chile, Albania or Ukraine. They showed that tax evasion is negatively connected to economic freedom, moral norms and effectivity of laws. Jackson and Miliron determined several indicators of tax evasion. Among them are economic factors, income levels, demographics, tax rates, behavioural influence a probability of detection. (Jackson, 1986, p.126).

Tax morale is a person's belief that he has a moral obligation to pay taxes. Studies of tax morale help to understand why some people pay taxes even when they know that the possibility that they can be detected is very low. For example, selfishness is one of the main reasons why people avoid paying taxes. Others might evade taxes because they think that tax system itself does not work properly and money from tax payers are distributed the wrong way.(Meder, 2012, p. 171-175).

A huge number of financial obligations determined by different laws, “push” people to hide different sources of their real income. Two main types of fiscal evasion can be named: legal tax avoidance or so called “under the protection of the law”, which includes only partial circumvention of the taxable amount and bogus evasion, that

violates the law and evader should be punished for it. Tax evasion is considered bogus and fraudulent when evader provides the authorities with wrong information about his income including false data about statement of his accounts, incorrect invoices, making out fictional payments and incorrect declarations, providing authorities with unreal accountancy registers, creating double evidence registers, where one of them is real and another is fake etc.(Boulescu, 1997,p.234)

Tax evasion procedures can be considered legal when a part of income or belongings of the person are evaded from taxation because of existence of specific financial and legislation rules or when earnings are established according to some standards that define taxable rate that is lower than the real one existing in economy.

Among the main factors that contribute to escalation of tax evasion are:

- Exorbitant taxation;
- Deficient legislation;
- Insufficient enforcement of the legislation, increased number of incidents

of smuggling, speculations etc (Saguna,2000,p.759)

Because of exorbitant taxation people try to hide earnings that appear to be the most difficult to be identified by authorities.

What is the trigger for economic agents that makes them participate in illegal activities? The most important motive is tax evasion. According to Feld and Frey (2007, p.103), “tax compliance is inseparably connected with tax morale and tax deterrence.”

Rather controversial question is how strong is the influence of top executives on the tax evading activities in the company. When employees of the company begin to feel pressure from higher management that company's taxes should be decreased, how should they react? Tax avoidance is determined as any kind of activity, that aims to reduce company's taxes compared to previous periods. In order to find out if there is any correlation between recruitment of concrete managers and decrease in taxes in companies where they start to work, many researches were conducted. According to approach of Bertrand and Schoar, individual executives pay significant role in determining of tax level of particular companies. (Black,2016, p.25)

Cheating of the government is very often considered as a respected skill, while honest paying is perceived by many as being naive.

1.3.2. Real estate schemes

Real estate has always been very attractive sphere to invest and was considered to be more or less stable placement of funds for all categories of population. Within past 30 years buying/selling of immovable properties became a vehicle of money laundering, which allowed many launderers to conceal their illegal incomes. The question is how to get to illegal amount legitimate appearance? One of the common schemes is the following: a launderer buys a property, pays the whole amount or the biggest part of it in cash, which allows him not to pay taxes. Later on, he sells this property to a buyer who is requested to buy only via bank account, demand draft or cheque, that means that the source of income is verified (Surendran,2012).

Switzerland was the most attractive place for those who want to hide their capitals for decades. Lately, situation has changed dramatically. It was done mainly due to implementation of new transparency policy. For example, a plenty of American businessmen had accounts in Geneva, Zurich or Bern. After the biggest bank of Switzerland UBS has admitted that it has helped more than fifty thousands Americans to evade taxes, the USA became even more persistent to force Switzerland bankers to disclose its clients. Finally, agreement has been reached and Switzerland agreed to deal with OECD in order to fight tax evasion, frauds and money laundering. This move has essentially affected rich people who wanted to hide their capitals. But, this sphere is so enormously profitable for its participants that new haven didn't linger to appear.

Real estate has always been one of the crucial destinations of illegal capitals movement but, at present time, became especially popular. Ultra-luxury properties are the number one target of companies and individuals who are willing to launder their illegal millions. Their main assistant is the National Association of Realtors who got an exemption from Anti-money laundering regulation compliance. This aspect allowed to raise real estate prices tremendously. Besides, it is completely legal due to the USA legislation to receive money intended for purchase of a house or a condo from anonymous offshore bank account. This fact easily explains why investments in real estate are one of the most favourable.

Nevertheless, buyers can't simply put several millions in his private account somewhere in Tanzania and pay for a luxury condo in New York. Firstly, they need to funnel somehow their illegal money into bank account. Basically money can officially

appear somewhere in a country of the third world and with a help of several shell companies end up in any of respectful international banks. Remarkable is the fact that traditional offshore havens like Caymans are the most stringent about corresponding to international AML rules. It was revealed by investigation of Mr. Shima Baradaran, a law professor at the University of Utah, USA. His research showed that it was easier to establish an untraceable shell company in the USA comparing to e.g. African countries. With his colleagues he sent more than 7000 emails to different companies that provide incorporation services pretending to be representatives of the Islamic charity. The researchers tried to introduce themselves as shady as possible. Moreover, many participants of this research were not even asked to show their Identification documents (Nelen,2008, p.751).

By the same token, in year 2010 Senator Carl Levin announced results of investigation which showed the role of the USA real estate in foreign corruption. Speaking of the brightest cases, son of the dictator of Equatorial Guinea bought himself a mansion in Malibu for astronomical \$30 million.

But the main question remains: why do the USA allow New York to be the centre of the world's real estate money laundering? The experts think that answer is rather obvious: New York needs these illegal funds to keep going and to hold real estate price on the highest possible level.

One of the most common ways to use real estate for money laundering is to use partly legitimate income and funds in cash of illegal origin (AUSTRAC,2015).

From the point of view of international trade, the biggest part of money laundering cases includes wire transactions. Nowadays billions of dollars are transferred within the countries and internationally and it is impossible to control them all. Real estate market is constantly growing especially in emerging countries. Due to the considerable number of real estate transactions, it is easy to disguise money laundering transactions among completely legal deals. The main difficulty on the emerging markets is absence of average market price; prices vary from region to region and from sector to sector. Moreover, a plenty of cases when laundered money from real estate operations had been used for terrorism financing were detected.

Fluctuations in prices of real estate are considered as an important factor that influences not only potential buyers or tenants but also building industry as a whole. Why are prices so striking different in different regions or countries is not an easy question.

At present, real estate market is attractive for both law-abiding citizens and law-breakers. For honest people it is an investment with a consistently growing net value, for money launders it is a tool, which helps illicit funds to obscure their origins. Moreover, many governments offer incentives like tax reduction or citizenship to potential buyers.

Money launders are usually using one of the following techniques: use of loans and credit finance, mortgages and monetary tools, corporate vehicles etc.

One of the main sources where citizens receive money for property purchase is a loan. Accordingly, this monetary instrument couldn't be neglected by money launders. Criminals to lend themselves money use loan-back schemes (OECD,2014).

1.3.3. Embezzlement and corruption

Corruption is very tight connected to tax evasion. Nowadays this term still doesn't have exact definition in the most part of international agreements. According to the NGO Transparency International corruption is the abuse of entrusted power for private gain. Corruption can be faced on the day-to-day administration level and the public service, which is known as "petty corruption" and on level of higher officials – "grand corruption". Some of corruption schemes have participants from several levels.

The power of non-state actors and multinational firms grows steadily. The abuse of obligations originating from private law is also considered as corruption. Bribery, breach of trust, illicit enrichment – all these activities are identified as corruption. With reference to EU statistics, every year around 13% of public budget is lost because of corruption and embezzlement.

Corruption is very often perceived in literature as violation of human rights. But isn't it "victimless crime"? It isn't. Corruption and embezzlement used for private gain usually result lead to decrease of spending on public services. It results in worsening of medical care, deteriorating of roads and public buildings, badly equipped schools and by and large poorer education. It is especially visible in developing countries with high corruption level. Corruption weakens the very basement of trust between government and public sector. Authorities cannot rely on help of public what can result in growing unrest and violence in the country. Tanzania is an instructive example of corruption

helping to accelerate stagnation and to concentrate power in hands of small group of people. There was no control over tax revenues, government contracts were received by new leaders, who drained money from the state budget. Lack of transparency and weak state institutions raise embezzlement and corruption.

Corruption cannot be measured. Data based on individual perceptions and very often not accurate assessments cannot be taken as sufficient. Definition of corruption is connected with ethical and philosophical questions. For example. Ravi Barta (2007) claims that poverty is the reason for corruption.

According to Mauro, corruption harms foreign investments and is negatively correlated with economic growth and development (Mauro, 1995, p.681).

Perhaps one of the very few examples where country can keep high growth rate together with high level of corruption is China.

On the whole, corruption is considered the leverage to slow down development of the market, increases cost of doing business. It can be also identified of one of the key reasons for failure of developing economies (Fantaye,2004, p.170).

Embezzlement is the fraudulent appropriation of property by a person to whom it was entrusted. Usually it is applicable to employees who embezzled public funds for personal gain. Basically, law-abiding people are accused of embezzlement while they have been employed in companies. It happens at all levels of business starting from clerks occupying the lowest positions up to higher management. For example, the president of Congo Mobutu had embezzled more than four billions dollars during his 32-year reign. It was done through borrowing of funds and receiving earnings of state-owned mineral companies. At the present time, country where GDP per capita is only a little bit higher than 100\$ own foreign creditors 12 billion dollars. As a result, poverty in the country is increasing (Boyce, 2002).

1.3.4.Terrorism financing

Nature of terrorism itself has changed dramatically in last fifteen years. Scientists lay stress on its global reach and how easy it adapts to different conditions. New era of terrorism is connected with networks like the Al-Qaeda and ISIS. There are three main peculiarities that are typical for contemporary terrorism. The first is that

terrorist attacks obtained more global character with its centres in Middle East, Africa and Asia. Second, the number of attacks has dramatically increased since the 11th of September. Intervals between terroristic attacks become smaller and smaller. Third, main terroristic organizations have significantly changed their structures and adapted them to the current situation.

Contemporary terroristic organizations have strong financial support and developed logistics network (Gardner, 2007, p.325).

Terrorism financing can be described as money laundering that has another final aim: instead of getting money for personal use, funds are used for encouraging, planning, assisting or engagement in acts of terrorism. Models of terrorism financing differ from average money laundering by the fact that funds for terrorism might come from legitimate sources. For example, huge amounts can be rising through legitimate activities and donations. Terrorist groups also don't have only financial interests, money for them are only a tool for achieving other goals like publicity, spreading fear and intimidation.

Terrorism is in most cases financed by:

- trafficking of humans, diamonds and counterfeit goods;
- extortion and intimidation;
- purchase/ sales of assets with high value, i.e. luxury properties;
- donations;
- tax evasion;
- use of shell companies;
- unlicensed money transmitters/remittance agents;
- concealment inside business structures etc (Angela Samantha,2012, p. 316-335).

While talking about terrorism financing typologies we can determine three steps that are the same as in classical money laundering: placement, layering and integration.

According to scholars who analysed different cases of terrorism financing, the biggest volumes of funds were received through unlicensed money transmitters/remittance agents and purchase of cheques (Angela Samantha,2012,p.85) .

It is very difficult for authorities to follow money used for terrorism financing because very often they are raised from legitimate activities. Compared to money laundering, it is important not only to decrease terrorism financing but also to completely eliminate it. Terrorists have noneconomic motives and they threaten not just economics but the very existence of peace on our planet. Ultimately, amounts of money

used for terrorism financing are significantly smaller in comparison with huge cash amount of traditionally laundered funds. This makes it difficult to detect such operations.

The point of combating terrorism financing is not just to disrupt several deals or transactions, but also to destroy their infrastructure and channels through which they get money.

1.3.5. Other types of money laundering

There are a lot of criminal activities except those that were listed above. The methods of contemporary money laundering are variable and criminals steadily improve them.

Cash smuggling. The first case of cash smuggling was reported in 1991 in the USA airport. A female Ghana immigrant declared only 9000\$ while had around 300 000\$, including packages that she had in her stomach. Cash smuggling is a process of physical removal of cash when it stealthily crosses the border. After that money are used in another country for legal purchase of real estate, establishment of new companies or investment. Despite development of new hi-tech facilities, traditional smuggling is still working. The reason why cash smuggling is still popular is the fact that those money can't be traced to any illegal activities or crimes. Smugglers usually need to change banknotes with smaller denomination to ones with larger. It helps to decrease physical volume of money (He, 2010, p.15-32).

Money laundering through financial institutions. Banking institutions are very often used by criminals for their illegal activities. Mainly it is due to vast variety of services and financial instrument provided by banks. Existence of banking secrecy is also very convenient for money launders that is why banking sector is vulnerable to for the criminals. Moreover, some banks can also participate in frauds: some of them purposefully, some out of negligence. For example, companies may constantly transfer money between their own accounts, big sums can be transferred in or out of the border. By and large, banks should pay particular attention to suspicious companies. For example, if company refuses to give phone number of office, names of directors and

owners, its annual statements differ substantially from the statements of other companies from the similar branch, often ask for cash transfers including offshore institutions etc.

Auction houses and lottery. While banks are steadily strengthening their AML measures, criminals are looking for other ways to launder money. Those spheres are yet not ready to combat money laundering and governments are not asking them to do so. Rare metals, jewellery, antique still provoke interest of money launderers. In order to combat money laundering, governments should impose to non-financial organisation the same responsibilities as to financial institutions.

Money laundering through shell companies or front companies. Shell companies have neither enough initial capital, nor organizational structure. Also such companies don't usually have premises for operation. This company is fictitious without operational activities. By comparison, front company has real business. The aim of this company is not to make profit but to launder the earnings of crime. (He, 2010, p.15-21)

Money laundering through underground banks. A special term has been used by FATF for underground banks – alternative remittance systems. It can be characterised as network of transfers out of the governance of the governmental financial supervision. They became popular in Asia – China, India, Pakistan. According to Chinese laws, formalities can significantly prolong the process of getting even small amount of foreign currency. In this case entrepreneurs prefer to cooperate with underground banks, it will be faster and cheaper.

Money laundering through offshore corporation or offshore financial centers. Islands like Bermuda, Bahamas, Virgin Islands are considered tax havens of the 21st century. Less strict legal regulations together with very low income taxes made those islands attractive for thousands of entrepreneurs. Offshore corporations are companies, that have their legal addresses in these areas, but businesses are operated from another places on the planet. First, criminals can use advantage of different taxation and legal systems, different language. For example, in case if launderer faces law suit there will be a number of hurdles, which can slow down the process. Second, requirements for company's foundation are rather low. Third, high level of privacy. It is not necessary even to disclose names of the stakeholders, earning etc. By and large, tax havens are well-known for their attractive conditions for money laundering and tax evasion. (He, 2010, p.15-21)

1.4. Anti-money laundering (AML) standards

In order to reach internal and national stability scientists and politicians implement anti-money laundering systems, which aim to effectively fight corruption. On average, level of corruption is much higher in less developed or transition economies.

After numerous successful terroristic attacks and increase of drugs activities countries are more focused on AML regulation. It is not a disease of contemporary economy only; policymakers were trying to fight illegal activities for centuries.

Money laundering should be perceived not as cause but as a symptom of this “disease” – it is only the outcome of other criminal activities. In order to combat money laundering level of criminality should be decreased. Some AML regulation methods can be ineffective because they just target the wrong area. Vast amounts of money are laundered with help of mediators because financial institutions try to stay clean.

Anti-money laundering legislation appears to be rather costly and sometimes even harmful. Scholars Masciandaro and Portolano assert using example of Italy that AML may negatively influence bank efficiency (Masciandaro, 2003, p.311). AML regulation induced crimes like racketeering, smuggling a kidnapping but proved itself incapable of fighting drug-trafficking. Honest people had to hide their assets from corrupted government a influential criminals what consequently lead to growth of criminal activities.

From alternative point of view, law matters. According to La Porta(2007), basic legislation proves itself as insufficient to fight money laundering because the incentives are not enough. There are two views on what aspects matter. Advocates of the first view claim that preventive measures are important. With a help of standardized disclosures costs for detection of money launderers will be lower. Second approach is connected with better confiscation rules and tighter international cooperation.

According to M. Levi, there are three basic approaches to money laundering regulation:

- general approach first adopted in the USA. It includes routine currency transaction reporting, both domestic and international. Casinos, banks and even car dealers are obliged to report about currency transactions beyond certain amount (usually 10 000\$).

- General approach adopted mainly in Europe and the Far East, i.e. Japan, Hong Kong. It requires mediators to report about suspicious activities but not routine cash deposit reports. The aim of this approach is to gather the most useful information instead of getting reports about all transactions.

- Third approach is considered more comprehensive as the second. It also includes reporting suspicious or unusual transactions but after being reported, information about these transactions is examined carefully in order to define if this particular transaction should be perceived as suspicious or not. After this information is transferred to criminal investigation authorities if necessary (Schneider, 2000, p.77-114).

Unfortunately, reporting practices proved themselves as not very effective. Moreover, they faced a strong opposition from bankers.

Combating money laundering is one of the main issues on agenda of international community. Present AML activities trace their roots back to the 1980s. In 1986, the United States of America started war against money laundering as part of their campaign against drugs. Later, members of G7 supported the idea of to combat money laundering worldwide. In 1989 Financial Action Task Force was established and in 1990 the first list of rules was released. After the tragedy that took place on the 9th of September, new rules connected to terrorism were added. These standards were created to improve detection in states that were willing to implement the standards.

Scholars like W. Jasinski claim that implementation of FATF Recommendations is not enough. Despite the fact that many countries have implemented these standards, there still are many launders, who are willing to move their illicit funds abroad. Adopting of risk-based approach (RBA) by authorities and financial institutions will ensure that measures used to prevent money laundering correspond to identified risks. Risk-based approach is characterized by understand risks that countries and their authorities are facing. RBA aims to make it more difficult for criminals to use financial institutions for purpose of money laundering.

RBA approach can also be applied to fight terrorist financing. Terrorists need to steadily receive funds not only for organization of attacks but also for propaganda and recruitment. That is why they are constantly seeking for new ways how to evade AML standards. It is much more complicated to detect funds that were spent for terrorist financing because it is almost impossible to find out that such operations as purchase of vehicles or chemicals were used for terroristic purposes.

1.5. Characteristics of Financial Action Task Force (FATF)

FATF (Financial Action Task Force) is an inter-governmental body established in 1989 by the Ministers of its Member jurisdictions (FATF,2017).Its goal is to set standards and promote them in order to fight money laundering, terrorist financing and other threats. Before 2001 FATF Recommendations consist of 40 recommendations, which can be divided into four big categories and 13 sub-categories. In 2001 nine specific Recommendations were added after terrorist attacks in the USA. List below shows how recommendations are classified using categories and sub-categories.

Table-1: FATF Recommendations.

Category	Sub-category	Recommendation
1 Legal systems	I. Scope of the criminal offence of money laundering	1-2
	II. Provisional measures and confiscation	3
2 Measures to be taken by financial institutions and non-financial businesses and professions to prevent money laundering and terrorist financing	III. Financial secrecy	4
	IV. Customer due diligence and record keeping	5-12
	V. Reporting of suspicious transactions and compliance	13-16
	VI. Other measures to deter money laundering and terrorist financing	17-20
	VII. Measures to be taken with respect to countries that do not or insufficiently comply with the FATF Recommendations	21-22
	VIII. Regulation and supervision	23-25
3 Institutional and other measures necessary in systems for combating money laundering and terrorist financing	IX. Competent authorities, their powers and resources	26-32
	X. Transparency of legal persons and arrangements	33-34
4 International co-operation	XI. Conventions	35
	XII. Mutual legal assistance and extradition	36-39
	XIII. Other forms of co-operation	40

Available from: The FATF Recommendations, 2012.

All countries members of OECD are also obliged to implement FATF standards. This means 35 countries.

The main task of FATF is determination of recommendations for combating money laundering a terrorists financing. First, risk should be identified and assessed, after that measures should be taken.

FATF recommendations are universally recognised as standards for anti-money laundering a countering the financing of terrorism.

FATF also makes Guidance and other advices, which could help countries to better implement recommendations.

A. AML/CFT POLICIES AND COORDINATION (FATFT. The FATF Recommendations, 2012)

1. **Estimation of risks and applying of a risk-based approach (RBA).** First, assessment and identification of the risks. Measures should be commensurate with the identified risks.

2. **National cooperation and coordination.** Relevant authorities should have effective mechanisms at their disposal. States should cooperate and coordinate with each other while fighting money laundering and terrorist financing

B. MONEY LAUNDERING AND CONFISCATION

3. **Money laundering offence.** Countries should be guided by the Vienna Convention and the Palermo Convention.

4. **Confiscation and provisional measures.** Countries must authorize relevant authorities to confiscate or freeze laundered property, earnings from money laundering, property that has been used for terroristic activities or estate of the same value.

C. TERRORIST FINANCING AND FINANCING OF PROLIFERATION (FATFT. The FATF Recommendations, 2012)

5. **Terrorist financing offence.** All actions connected to terrorists financing should be criminalized according to the Terrorist Financial Convention.

6. **Targeted financial sanctions related to terrorism and terrorists financing.** In order to prevent and suppress terrorists financing funds and assets of the suspects should be immediately frozen.

7. **Targeted financial sanctions related to proliferation.** In order to disrupt and suppress proliferation of weapons, funds and assets of the suspects should be immediately frozen.

8. **Non-profit organizations.** If non-profit organization is identified as vulnerable to terrorists financing abuse, country where it is situated, should reconsider the adequacy of laws in relation to non-profit organizations.

D. PREVENTIVE MEASURES (FATFT. The FATF Recommendations,

2012)

9. **Financial institution secrecy law.** Secrecy laws of financial institutions should not hinder implementation of FATF Recommendations.

10. **Customer due diligence.** It should be restrained for companies to have anonymous accounts or accounts apparently using fake names. Financial institutions should be demanded to undertake customer due diligence in number of cases.

11. **Record-keeping.** Financial institutions should keep information about all domestic and foreign transactions for at least five years. Such records should be granted to competent authorities upon request.

12. **Politically exposed persons.** Financial institutions should take specific measures additionally to standardize due diligence measures if they contact with politically exposed persons.

13. **Correspondent banking.** Cooperation with shell banks is prohibited. While dealing with cross-border corresponding banks financial institutions are obliged to take additional measures.

14. **Money or value transfer services.** States should take measures to ensure that natural or legal persons that accommodate funds are registered or licensed.

15. **New technologies.** Money laundering and terrorists financing risks connected to implementation of new products or technologies should be assessed.

16. **Wire transfers.** It should be ensured by states, that financial institutions should have all necessary information for wire transfers.

17. **Reliance on third parties.** Specific criteria should be met if financial institution wants to get permission for cooperation from the country.

18. **Internal controls and foreign branches and subsidiaries.** Financial institutions should ensure that their foreign branches and subsidiaries apply AML recommendations in compliance with rudiments of the home country.

19. **Higher-risk countries.** Enhanced due diligence measures should be undertaken while having business with natural and legal persons from the higher-risk countries.

20. **Reporting of suspicious transactions.** If it is suspected that funds are

proceeds of illegal activities, it is mandatory to immediately inform the financial intelligence unit (FIU).

21. **Tipping-off and confidentiality.** Law protects financial institutions as well as their directors and employees if they report their suspicions about illegal activities in their company to the FIU.

22. **Designated non-financial business and professions: customer due diligence.** Applicable for real estate agents, lawyers, casinos, dealers in precious metals etc.

23. **Designated non-financial business and professions: other measures.** Any suspicious activities should be reported.

E. TRANSPARENCY AND BENEFICIAL OWNERSHIP OF LEGAL PERSONS AND ARRANGEMENTS (FATFT. The FATF Recommendations, 2012)

24. **Transparency and beneficial ownership of legal persons.** Misuse of legal persons for money laundering and terrorists financing purposes should be prevented.

25. **Transparency and beneficial ownership of legal arrangements.** Misuse of legal arrangements for money laundering and terrorists financing purposes should be prevented.

F. POWERS AND RESPONSIBILITIES OF COMPETENT AUTHORITIES, AND OTHER INSTITUTIONAL MEASURES (FATFT. The FATF Recommendations, 2012)

26. **Regulation and supervision of financial institutions.** States should ensure that financial institutions effectively implement FATF Recommendations.

27. **Powers of supervisors.** Supervisors should adequately supervise and monitor correspondence of financial institutions to fighting money laundering and terrorists financing.

28. **Regulation and supervision of designated non-financial businesses and professions.** Designated non-financial businesses and professions should be supervised and regulated according to measure of this recommendation.

29. **Financial intelligence units.** Countries for purpose of analysis of suspicious reports and another information essential for AML should establish financial

intelligence units.

30. **Responsibilities of law enforcement and investigative authorities.** Law enforcement authorities should have enough responsibilities needed for identifying and tracing of suspicious activities, together with responsibilities to freeze properties that are suspected of being earnings of crime.

31. **Powers of law enforcement and investigative authorities.** Competent authorities should be provided with all necessary information while conducting investigations of money laundering and terrorists financing.

32. **Cash couriers.** Competent authorities should have legal authority to stop or restrain money in case of being suspected in relations with money laundering and terrorists financing.

33. **Statistics.** Overall information should be maintained.

34. **Guidance and feedback.**

35. **Sanctions.** Number of criminal, administrative and civil sanctions has to be available that can be used against legal and natural persons that fail to correspond to FATF Recommendations.

G. INTERNATIONAL COOPERATION (FATFT. The FATF Recommendations, 2012)

36. **International instruments.** Countries should fully ratify and implement international conventions.

37. **Mutual legal assistance.** Reciprocal legal assistance should be provided by countries. Adequate legal basis is necessary.

38. **Mutual legal assistance: freezing and confiscation.** States should ensure that they could act rapidly in response to requests of foreign countries to identify and after that confiscate or freeze the property or assets.

39. **Extradition.** Extradition requests should be executed by countries promptly and constructively without any delay.

40. **Other forms of international cooperation.** Competent authorities should swiftly and competently provide wide range of cooperation.

The FATF Recommendations were created as minimum standards, which every

country would be able to implement. In Appendix 1 and 2 we clearly see levels of OECD members' compliance with current FATF recommendations. According to Appendix 1, such important sub-categories as Due diligence, transparency of legal persons, regulation and supervision are just partially compliant. From Appendix 2 we can see that recommendations 12 – politically exposed persons and 16- wire transfers are the worst implemented. Moreover, FATF recognizes different legislation in every country and the same measures cannot be taken.

2. Practical part

The second chapter gives an overview of real financial crimes that took place in the latest 10-15 years. In my opinion, exact numbers are more useful for analysis comparing to vague theoretical suggestions. Digits speak for themselves showing if legislation and authorities' efforts are effective.

2.1. Overview of biggest AML scandals

Money laundering is one of the most widely- spread financial crimes. It traces its roots back to 2000 BC when Chinese traders were used to hide their proceeds to evade money from the authorities. In last 4000 years not much has changed, people still have the same motives, incentives and intentions.

Corruption belongs to the widest spheres of money laundering and new cases appear in media every day. Speaking of corruption measurements, Corruption Perceptions Index estimates corruption in public sector of countries. A scale of 0 to 100 is used to assess and compare corruption level in 176 countries ranked in the list of Transparency International. Consequently, we can compare results of different years and trace an obvious correlation.

Brazil has been suffering from impunity, power usurpation and corruption for a long time (FATF,2005). Major activities that serve as source of illegal proceeds are connected with financial system abuse followed by capital flight and corruption. Brazil is also well-known as transit country for drugs produced in Colombia, Bolivia and Peru destined for Europe. Moreover, the northeast part of the state is infamous for marijuana production. Weapons trafficking, embezzlement of state funds, frauds, smuggling of goods like fake CDs, computer software and others are also contributing to the increase of illicit gains.

Brazil is producing 65% of production of colored gemstones. Of course, dealers in precious metals and gems should have been controlled thoroughly according to AML/ CFT rules.

In order to comply with FATF Recommendations Brazil should have undertaken many changes in its legal system:

- new narrow audit requirement was implemented for companies in insurance branch;
- authorities tried to increase awareness of citizens about money laundering;
- expansion of centralized electronic information systems;
- ratification of United Nations Convention for the Suppressing of the Financing of Terrorism (the Terrorist Financing Convention);
- enhancement of preventive measures in financial sector etc

According to United Nations up to 60 billions USD are embezzled in Brazil every year. 97 out of 100 corruption cases resulted in nothing.

Notorious Operation Carwash task force has started as an ordinary investigation and ended up as the biggest detection ever conducted in Brazil. This affair became a major focus of public attention since April 2014. One of the key figures was Brazil's president Dilma Rouseff, who has been accused of manipulating the federal budget to conceal growing deficit. Huge protests took place at the same time when opposition tried to remove her from office. What is more, Dilma Rouseff has been a Chairman of Petrobras between 2003 and 2010 before her presidency started in 2011. In other words, the opposition claims that her election campaigns in 2010 and 2014 were financed using the proceeds of corruption schemes (Leahy, 2016).

Threat of impeachment has evoked many discussions around effectiveness of Dilma Rouseff's presidency. 2015 was so-called 'annus horribilis' for Brazil, while the inflation rate hit a 12% rate and GDP decline was forecasted to reach 3,5% in comparison to 1% decline in 2015 (Oliveira, 2016).

When Dilma Rouseff came to office in 2011 economy was steadily growing at more than 4%, when she was leaving this indicators became negative. Finally, she was impeached after 61 of 81 senators approved her removal and was replaced by Michel Temer, a representative of centre-right party, for the remaining period of two years and four months (Watts, 2016).

Petrobras, [Petróleo Brasileiro](#), is one of the biggest companies in Latin America. Its major stakeholder is Brazilian government, company is also listed in Sao Paulo and New York stock exchanges. Moreover, a lot of average Brazilians have Petrobras stocks in their portfolios. In the 80s company was partly privatized but during the presidency of Luiz Inácio Lula da Silva (2002-2010), who was a representative of the leftist

Worker's party (PT), government control was renewed. In 2007 Petrobras found so-called "pre-salted oilfields" – one of the most precious deepwater offshore oil discoveries for a long time.

How did actually Petrobras implicated in the scandal?

Brazilian police began to hunt black market money dealers at the Posto da Torre, which is a petrol station in Brasília where monies were exchanged illegally. Tracking down these dealers helped police to finally trail Paulo Roberto Costa who was former director of Petrobras. Later on, investigators found out that the Worker's Party has appointed its favourable candidates on the highest executive positions. After that, up to 3% of total contract values were transferred to the members of the PT and their partner companies. Petrobras received huge investments assessed in billions of dollars for its projects. The highest ranks have also co-operated with contractors of Petrobras. Some corruptionists have placed their funds in Swiss banks, others have invested in art collections (Leahy, 2016).

Among key contractors of Petrobras are Odebrecht group and AOS. By the same token, companies linked to Petrobras have also faced acquisitions. For example, according to The United States department of justice, notorious Odebrecht group was inflicted to pay at least 3,5 mln dollars penalty for violating American foreign bribery laws. Odebrecht and its affiliate Braskem SA – petrochemical company were plead guilty in paying bribes to officials in many countries. They have transferred huge amounts to their Swiss accounts and have used American financial system to launder money through numerous shell companies.

Assistant Director in Charge Sweeney claimed that when foreign officials receive bribes it sufficiently menaces national security and puts free market system in danger (The United States Department of Justice, 2017).

Sphere of Mr. Odebrecht's interests is very wide and includes branches from military0industrial complex to agriculture with a huge construction business being a centre of it all. The company was a pioneer in private-government partnership in Latin America. In the past years company was focused on the building and reconstruction of stadiums for the football World Cup FIFA 2014 and summer Olympic Games in 2016, building of transport and energetic infrastructure and also vast industrial projects in mining and petrochemical branches. The orders portfolio in the end of 2014 was worth almost 34 bn. dollars (Bizin, 2017).

The investigation has established that Mr. Odebracht and his employees have

corrupted management of state owned Petrobras in billions dollars and they have been laundering money systematically. A special piquancy to the situation is added by the existence of special division in Odebrecht group, dealing with distribution of unearned income.

To many outside observers it looks like a wide corrupted network has been operating and has included almost all high-level policymakers. But it looks like illegal activities of Odebrecht were not limited only by Brazil. Approaches that have been widely used in homeland have found its place also abroad. The company has corrupted the governments of different countries, among them last three presidents of Peru, evidence of shady payments have been traced in Panama, Columbia and Ecuador. Marcelu Odebrecht has been sentenced to 19 years and is already imprisoned.

Amount of Odebrecht Group's penalties varies from source to source and is estimated to be from 2,5 to 4,5 bn. dollars. For example, Bloomberg assessments are close to 2,5 bn. dollars. Amount of penalties doesn't look killing for the company with current orders portfolio of 21 bn. and 1,5 bn. as financial assets on a balance. But the quality of portfolio has dramatically decreased: projects in Angola, Ecuador and Venezuela are connected with higher risks because of the complicated situation in those countries. Odebrecht Group has faced huge reputation loses on the Latin-American market. Number of projects is frozen and many customers forbid Odebrecht Group to sell its shares in concessions until the investigation is over. It seriously influences credit quality of the construction company. In last two years credit rating of the firm has been decreased from BBB to CC (that makes 12 positions), Eurobonds are traded at the price of 50-60% from par value (Bizin, 2017).

As for Petrobras, According to Folha de S. Paulo, it is currently involved in 47 lawsuits in Brazil that are in connection with investigation. Only one case was lost by Petrobras but the company has filed an appeal. In 22 cases the company received favorable decisions, 24 are still ongoing. There were also Petrobras stakeholders among plaintiffs. They alleged that they have been hurt by the corruption scandal. Plaintiffs have also demanded compensation for moral damage and loss of profit (Mattoso, 2017).

In 2017 another fraud has been disclosed that revealed amount of 2,7 bn. dollars to be laundered in Sao Paulo, Brazil via operations with luxury properties (Transparency International, 2017).

To be precise, 1280 high-priced properties were bought through 236 firms registered in jurisdictions like the British Virgin Islands and some American states.

This data explains why real estate crimes are so popular among individuals, who want to conceal their proceeds: no necessity to divide proceeds into numerous transactions in order to hide them, vast sums can simply be laundered via one transaction.

Last year Russia has occupied 131st position in Corruption Perceptions Index created by Transparency international. It is rather negotiable if this index shows real situation in the country because it is based on public opinion.

Transparency International Index reflects notions of entrepreneurs and politicians from different countries about level of corruption in particular country (Transparency International).

Russian Federation lost 12 positions in the rating but in fact it has remained on the same spot. According to director of Transparency International – Russia Anton Pominov, it can be justified by adding of new members to the list. He has also mentioned that lower positions in the rating have occupied only those countries where is war or genocide at the present time (Zharikova,2017).

Representatives of Transparency International also emphasize that corruption perceptions index and the level of very corruption are different things. “ No one knows how to calculate the level of corruption. Level of homicides is easy to calculate: if person is killed we see the result, he is dead. Corruption is very vague: two parts have agreed on some terms, one part has received bribe- legal authorities didn’t know anything. That is why morale in society is evaluated”, said Mr. Pominov.

Final index consists of correlated variables. Sources used for calculation of this index didn’t include opinion polls, instead appraisals of experts and entrepreneurs from 13 independent organizations have formed the basis of the index.

Leak of Panama Papers belongs to the most important outside factors that influenced positions in rating. On the contrary, notorious criminal cases of officials didn’t influence the position on the index at all.

According to the Russian public opinion research center, more than 50% of Russian citizens didn’t percept the arrest of minister of economic development Alexei Ulyukayev as fight against corruption but as a “representative example or a form of persecution”. According to the Vice president of international movement Transparency International Elena Panfilova “arrests of high-level officials don’t look like the real fight against corruption, thus, only highlighting current problems”.

Transparency International has created recommendations that would help Russia

to improve anti-corruption climate. Adoption of laws considering lobbying activities and protection of the complainants are among those recommendations. Law enforcement authorities should also react on the journalistic and public investigations (Zharikova,2017).

“The problem is that with currently existing level of native corruption price of ‘oiling the wheels’, which is part of overhead, is higher than economy from its application. In perspective it can paralyze market economy as a whole.”- said Andrei Belkovsky, political scientist, deputy editor-in-chief “ Management in Russia and abroad” (Koval’, 2017).

In recent years absolutely new ‘standards’ of corruption were formed. Bribes have dramatically increased from usual 2-5% to 50-60%.

One of the biggest scandals of the last years in Russia was disclosure of so-called “Moldavan scheme” of money laundering. Earlier media has reported about alleged scheme of money laundering through Moldova and Latvia in 2011-2014. Moreover, Moldavian authorities complained about unwilling of Russians to assist in the investigation.

It has been revealed in 2017 that the British banks were also participants of the money laundering scheme, which is now called “Global Laundromat”. As The Guardian reports, they have seen documents proving that at least 20 bn dollars were shift from Russia within the period between 2010-2014. Investigators believe that the real amount might be around 80 bn. dollars. They are also trying to detect who are the people behind “Global Laundromat”. According to evaluations, up to 500 people can be involved: politicians, oligarchs, wealthy officials (Harding,2017).

With reference to banking records received by Organized Crime and Corruption Reporting Project (OCCRP) and Novaya Gazeta, through UK banks and foreign offices with their subsidiaries in UK around 740 mn dollars were laundered. The most part of this amount has been laundered through HSBC Bank and its branches – 545,3m dollars. Other well-known banks involved in this scandals are RBS, Coutts (bank used by the Queen), Standard Chartered, UBS, Citibank, Barclays, ING. See Appendix.

In the USA two banks have detected to participate in this scheme – Citibank with 37m dollars and Bank of America with 14m dollars (Harding,2017).

The very first references of Moldovan Scheme and “the Global Laundromat” have been made by Novaya Gazeta more than five years ago. For all these years Novaya Gazeta together with journalists from other countries tried to answer two main

questions:

- who has got those 22 bn. dollars (according to Reuters)
- how was the money spent (Williams, 2017)

Furthermore, the main country-beneficiary was Denmark (954,5m), who has occupied the first place in the Corruption Perceptions Index by Transparency International as the least corrupted country in the world according to scientists' and entrepreneurs' opinions. The second biggest beneficiary was Hong Kong with 929,5m dollars. China and Cyprus occupied the third and the fourth places accordingly.

Below you can see the table with key Russian banks, through which money leaked.

Table-2: List of banks participating in 'Global Laundromat'

<i>Bank name</i>	<i>Amount</i>
Russkij zemelnyj bank	\$9 775 279 037
Baltika Bank	\$3 514 358 488
Evropejskij Ekspress	\$1 187 229 550
Bank Zapadny	\$929 705 446
MAST-BANK	\$848 013 379

Available from: Loginova, 2015.

Investigators presume that money didn't have united source but represent mix of funds received from the biggest state contracts, smuggling of electronics, clothes and military products, embezzlement and even from financing of political projects in Europe.

How did actually Moldovan scheme work?

In recent years it became much more complicated to transfer illegal proceeds abroad. Earlier criminals have used fictitious export/import agreements but when customs control became more thorough they had to find other ways. And the new method has been created. It also appeared that there is no better cover than court. In order to launder illegal proceeds two offshore companies are founded. For example, first company draws a bill of exchange for some huge amount (let us say 500 m dollars) to another offshore company with specific payment date. On that date borrower

says that he doesn't have money to pay. At this time new players come on the stage – guarantors who are represented by Russian companies and a citizen of Moldova. What was the role of Moldova citizen who has never seen such amount of money in his life? He was needed only to secure Moldavian jurisdiction. In 2011 company from UK Valemont Properties Ltd has bought a bill of exchange from another UK company Goldbridge Trading Ltd. Principal was 400m dollars. Several Russian companies were mentioned as guarantors, including company Legat and Moldavian citizen Maxim Mishechihin.

What is notional when we speak about Legat is that his founder was 62 years old pensioner from Moscow Michail Gorohov. Actually, he was founder of 36 companies. His job was to register companies and to sign all necessary documentation to open bank accounts. Each company could have up to ten accounts that have usually worked for several months and after that were replaced by new ones. Debt is certified by all parties - Goldbridge Trading Ltd, Russian guarantors and Moldavian citizen but no one has money to pay the debt. Consequently, Valemont Properties Ltd goes to the Moldovan court in Ryskhan city where Mr Mishechihin is registered. In the end of April 2012 judge Valeriy Gyshe has passed judgement that 400 m dollars had to be paid to Valemont Properties Ltd. This amount was paid by Russian guarantor Legat. Later on, money were transferred to Latvia in particular to Danske Bank that has very strong branch there. As a result, from Latvian banks laundered funds were transferred to UK, Germany, Switzerland and other countries (Zharikova, 2017).

But why did Russian criminals decide to use Moldavian courts instead of Russian? The answer is simple: sums of money that were asked by Moldavian judges were essentially lower than sums requested by their Russian colleagues.

No one was surprised that in developing countries where level of corruption is several times higher than in industrial lands. But it was a big shock for the general public to find out that respectable British banks could have participated in such crime. To turn to that scandal, The Guardian has contacted all the banks involved to ask how could this happen. Royal Bank of Scotland (RBS) replied that perform in compliance with their regulations in order to fight against money laundering and financial crimes. They also added that they have control over identifying, evaluating, monitoring and alleviating the risks. It is also worth mentioning that RBS is 71% owned by UK government. Another bank Coutts is also owned by RBS and, according to The Guardian, has received 32,8 m dollars via its branch in Zurich. Moreover, Coutts has

been fined by Switzerland's financial regulator because of violating anti-money laundering rules in several cases (Harding, 2017).

According to L Burke Files many transactions that were revealed needed advanced due diligence. Many transaction were not random but a repeated pattern. Another member of this criminal scheme was British shell company Seabon Limited. In 2013 this company showed income of just one pound. In February 2016 company was liquidated. Later on, it was disclosed that the company were involved in transactions of 9 bn. dollars. Another example was company named Ronida Invest LLP which transferred 6,4 bn. dollars. Another key player that should be mentioned is Trasta, Latvian bank, that was highly involved in process of money laundering and was closed in 2016 (Harding, 2017).

With reference to Organized Crime and Corruption Reporting Project (OCCRP), the official owners of many shell companies were citizens of Ukraine. "Bosses" of companies appeared to live in small town Myronivka near the capital of Ukraine, Kyiv. The UK company Valemont Properties demanded payment of 180 m dollars from another British company Seabon Ltd. It is obvious that defendant didn't have this amount of money and the debt was covered by guarantor Laita M LTD owned by Mr. Oleg Bilonog, who lives in Myronivka. He was employed as a worker in the construction company. Another "boss" was Oleksiy Romaniuk – official owner of Seabon Ltd, who appeared to live next door to Mr. Bilonog. This director was known to work in coffee shop in the capital of the country. The third person from Myronivka was Mykola Kislov, owner of US company Albany Inc. Exactly this man approved payment of 580 m dollars as debt to company Mirabax Investments (Loginova, 2015).

According to Alexander Sugonyako, the president of the Association of Ukrainian Banks, The Global Laundromat is an offence on a large scale that couldn't be possible without assistance of higher officials (Loginova, 2015).

There is hardly an anti-money laundering scheme where Swiss banks were not involved and it is rather obvious. Switzerland is one of the key financial centers in the world handling around 6,7bn dollars. It is 4,1% of the total world assets under the guidance. In accordance with risk assessment made by FATF in June 2015, Switzerland is very attractive for money launderers. Nevertheless, Switzerland tries to strengthen AML measures. Fraud, breach of trust, participation in criminal organizations and corruption are among main threats in terms of violation of the law. Additionally, banks,

money and credit services were identified as less protected. Banks understand the risks that they are facing and trying to comply with AML measures. Switzerland's compliance level, considering 40 recommendations, was Large Compliant (FATF, 2016).

It is very important to understand the risks in order to build a strategy how to overcome them. Switzerland understands risks it faces and use both qualitative and quantitative approach to evaluate them.

Nevertheless, one of the biggest Swiss banks HSBC was involved in a big scandal while being convicted in fraud, particularly, tax evasion. Among other imputed activities were participation in illegal trade and money laundering. The bank was charged by Belgium - center of the world diamond trade. Investigation began from Mr. Erez Daleyot, Belgian-Israeli diamond magnate, with some shady connections who appeared to have in 2005 38,5 m dollars on his account in HSBC bank connected to shell company registered in the British Virgin Islands. Later on, when he reported 886 m dollars in profit for 2014, he had shortly received a tax ruling from Israel, in conformity with which he should pay just 5% in taxes on 85 m dollars. Moreover, Mr Erez Daleyot was convicted by Lazare Kaplan International company who claimed that he participated in conspiracy in order to launder 135 m dollars mainly through HSBC accounts. It was also revealed that Mr Daleyot was not the only client from the diamond industry: in compliance with HSBC files, there were around 2000 professionals from this industry (Chittum, 2015).

Diamond business has always been very profitable. According to Ian Smillie, a cofounder of the Kimberley Process, diamonds are a great opportunity to launder money, to conceal proceeds, to evade taxes, and many others. United Nations put a lot of efforts to put an end to trading of blood diamonds that are mainly used to finance wars.

Diamonds are probably the best active used by smugglers. It is even better than cash: they don't loose value because of inflation, don't burn in the fire, don't decay. They are easy to be concealed and to be sold.

Bit it would be still impossible to succeed in this kind of business without support of Swiss banks. Pursuant to files from ICIJ and Le Monde, bankers at HSBC were eager to cooperate with diamantaires. This assistance has also included tax evasion. Many data were received from the secret HSBC files smuggled by their employee who turned to whistleblower and gave this information to French authorities.

Next, bank was accused of “ encouraging fiscal frauds and supporting privileged clients by giving them access to offshore accounts mainly in the British Virgin Islands and Panama.” HSBC doesn’t have lack of dubious contacts except Mr Daleyot. Arkadi Gaydamak, a Russian-Israeli businessman accused of his participation in arms-trafficking scandal, Emmanuel Shallop who was involved into diamond tax crimes, Fisi Daskal, a German-Belgian diamond dealer – all those people were loyal clients of HSBC (Chittum, 2015).

2.2. Analysis of AML standards effectiveness

Money laundering has an obvious tendency to increase over time. According to Levi, the main reasons are weekend confiscation and arresting actions (Levi, 20002, p. 181).

Many scientists were engaged in evaluation of effectiveness of FATF Recommendations. For example, according to Jensen and Cheong many developing countries were successful in implementation of recommendations and showed positive results in fighting against money laundering. But when each recommendation was considered separately it became visible that many states had just partial correspondence to FATF Recommendations. For instance, 90% of countries have partial correspondence to customer record keeping requirement, 80% to suspicious transaction reporting claims etc. (Jensen, 2011, p. 110-120).

According to David Lewis, FATF executive secretary, FATF has three main tasks to do:

- to detect and identify ways criminals launder money and terrorist organizations hide and after that access their illegal proceeds.
 - To set global standards that complicate process of money laundering
 - To evaluate how effectively countries combat against money laundering
- (FATF. Remarks at Conference, 2016).

FATF endowed economies with legal and operational tools which were successfully used for purpose of elimination of terrorists' financing and decrease of money laundering in different areas.

As mentioned above, one of the most important goals that are targeted by FATF is to detect and identify new methods that were created by criminals to conceal proceeds of their illegal activities. The most dangerous among them are terrorists and terrorist groups who are successfully raising and moving their funds. These criminals develop new methods how to stay undetected using gaps. FATF's key priority is to keep their recommendations update and ensure their relevance.

By and large, starting from 2008 risks of terrorism financing, which were identified in FATF's 2008 Terrorist Financing Report, didn't change significantly and still remain relevant.

In 2015 FATF passed another report on Money Laundering through the physical transportation of cash. This document attracted attention to the oldest but still the most preferred way of money laundering- physical cash transportation.

FATF- MENAFATF report served as a source of information about techniques and methods used by smugglers and other criminals to cross the border.

Annual meetings of researchers and experts provide a great opportunity to summarize preliminary data and clarify what was still not clear (FATF Annual Report 2015-2016).

Last complete review of recommendations has been conducted in 2012 but FATF tries to keep all standards up-to-date. For this reason some recommendations were rectified in 2016 to fully reflect recent tendencies. As examples we can take a look at recommendations five and eight.

Recommendation 5 includes enhancing of the standards that require countries to criminalize the financing of travel for foreign terrorist fighters. Of course, it has a lot to do with the situation in Syria and Iraq.

Amendments to Recommendation 8 aim to protect non-profit organizations (NPO) from misuse from the side of terrorist organizations. States should adopt suggested measures to protect their NPO.

But the main question still remains: are FATF Recommendations implemented effectively? Or are they staying only on the paper? Dozens conferences, hundreds meetings and thousands of documents and reviews... What results did they really cause? Finding an answer to this question correlates tight with the goal of my paper.

With reference to scholars Jun and Lishan, many developing countries select adoption without enforcement or way of selective implementation. Both these strategies are not effective enough (Jun, 2010, p. 215-225).

To turn to scandal with Swiss bank HSBC, leak of their data showed that they were ignoring numerous warnings connected to their suspicious activities with clients involved in diamond trade. After it was disclosed that HSBC has offered lucrative conditions to diamond dealers and many schemes were revealed it faced huge penalties. But it became obvious that banks like HSBC with the wide system of offshore companies are a part of unique infrastructure that aims, on the one hand, to loot poor countries and, on the other hand, to evade taxes in rich countries. According to Scott Horton, a lecturer at Columbia Law School, considerable corruption in the natural resources business doesn't include suitcases of cash. On the contrary, huge payments are done in the world's most prosperous financial centres: Geneva, London, Paris, New York, Amsterdam etc. Money are rarely moved between banks of Sierra Leone or Liberia (Chittum,2015).

Investigations have also revealed that HSBC Private Bank continues to offer its services to the persons named unfavorable by the United Nations. Those individuals were acknowledged to be connected to arms trafficking, money laundering or blood diamonds. HSBC has also served to notorious regimes of former leaders of Egypt and Tunisia as well as to the current Syrian president Bashar al-Assad. Moreover, a lot of politicians from Kenya, Georgia, Russia, Ukraine, Lebanon, Democratic Republic of Congo, Zimbabwe currently have accounts in the Swiss bank (Chittum,2015).

HSBC reported that they admitted their mistakes and they have undertaken significant steps to implement new stricter standards and to exclude clients that are not in compliance with these standards, especially those clients that raise concerns because of tax compliance.

At the same time HSBC persuaded clients that their personal details would not be disclosed to any authorities even if the accounts will appear to be not declared to tax authorities in clients country of residence. According to the International Consortium of Investigative Journalists, bank employees have also informed clients how they can avoid paying taxes. These advices have also included opening bank accounts in the name of offshore firm in order to avoid the European Savings Directive, a Europe-wide rule with a purpose to fight against tax evasion via exchange of bank information (BBC News, 2015).

Influence of FATF as institution that oversees fulfillment and compliance of AML recommendations can hardly be underestimated. Making out reports is one of the priorities of FATF who later gives those report to appropriate governments to show if there financial institutions operate in compliance with AML recommendations.

Another example where AML effectiveness can be estimated is carbon emissions market. If a state has an excess units of carbon emissions, it means it has made emissions under established quote, accordingly, it can sell these units to countries that have overproduced above the level that was allowed. Those units are officially called “assigned amount units” (AAUs). Consequently, a new trading market was founded where AAUs can be legally sold to countries and third parties in accordance with Article 17 of the Kyoto Protocol (Kyoto Protocol).

The Kyoto protocol was ratified in 1997 and was the first document that made mandatory to meet emission reduction targets. This year is considered to be the start of international carbon emissions trading. In accordance to the Protocol there are three mechanisms that can help to meet emissions obligations:

- Emissions trading, so-called ‘carbon market’.
- The Clean Development Mechanism (“CDM”), generated by article 12, in compliance with it countries that aim to reach an emission-reduction target could implement an emission-reduction project in particular developing countries. Due to this mechanism, certified emission reduction (“CER”) credits were created, they can also be traded in the carbon market.
- Joint Implementation (“JI”), generated by article 6 of the Kyoto Protocol, due to it country with an emissions limitation obligation can fulfill its obligations by establishing an emission-reduction or removal project in certain member countries. Due to it, the following units were created: emission reduction units (“ERU”) and removal unit (“RMU”).

They all are measured in tons of carbon dioxide (UNFCCC, 2012).

Nowadays this market is relatively small in comparison with other commodities markets but is steadily growing. Key players on the market are the USA, Canada, Brazil, India, China etc. Units are sold privately or on the international market. Moreover, on the secondary market there are carbon emissions futures, forwards, spots and options contracts. With its dynamic development carbon emissions market can’t function without assistance of banks, international intermediaries which include both

bourses and individuals.

In accordance with Europol representative, there is “no strong regulations or checking principles as there is in banking to prevent such activities as money laundering”. Moreover Interpol reports, that carbon trade offences are a type of environmental crimes that grow rapidly, with its extent remaining unclear (Mason, 2009).

Vat frauds appear to be among the most common. This fraud takes place when a criminal buys carbon emissions VAT-free in Europe and sells it on the domestic market with VAT to the customer and after escapes with these proceeds. VAT never reaches the budget. According to The Guardian, almost 5 bn. euro were lost because of carbon frauds before 2009, including 1,6 bn. in France. French authorities have described it as “the heist of a century”. Three men have purchased emission allowances from abroad (outside EU). Brokers from Europe have later resold the allowances, received price incl. VAT and never gave VAT to authorities. Later on, in order to launder those funds and reinvest criminals used bank in China. This scheme didn’t function long and was caught in June 2009. According to Katheline Schubert, an environmental economics professor at the Sorbonne university in Paris, such schemes are no more possible in the EU but this sphere is still vulnerable (Mazoue, 2016).

FATF has created a number of indicators, which help to detect money laundering. They include:

- Poor knowledge on the subject
- Rapid growth of turnover in a short period of time
- Unrealistic interest rates for loans
- Direction to pay to offshore accounts or to the third parties
- Huge cash withdrawals
- Essential information on invoices is missing (e.g. VAT number) etc

Another way to launder money through carbon emissions is development of ‘green project’ where solar or wind farms will be used. These, so-called, ‘green fronts’ can obtain emissions-reduction or emissions-savings credits from authorities. Later on, criminals can sell those credits to particular firms directly or trade on the emissions market. This approach gives opportunities for money launderers to place, layer and integrate the funds. Using this scheme money can easily be reinvested and will stay undetected because illicit funds can be combined with legal proceeds. If such operations go undetected in the beginning they can bring larger and larger profits to their criminal

owners.

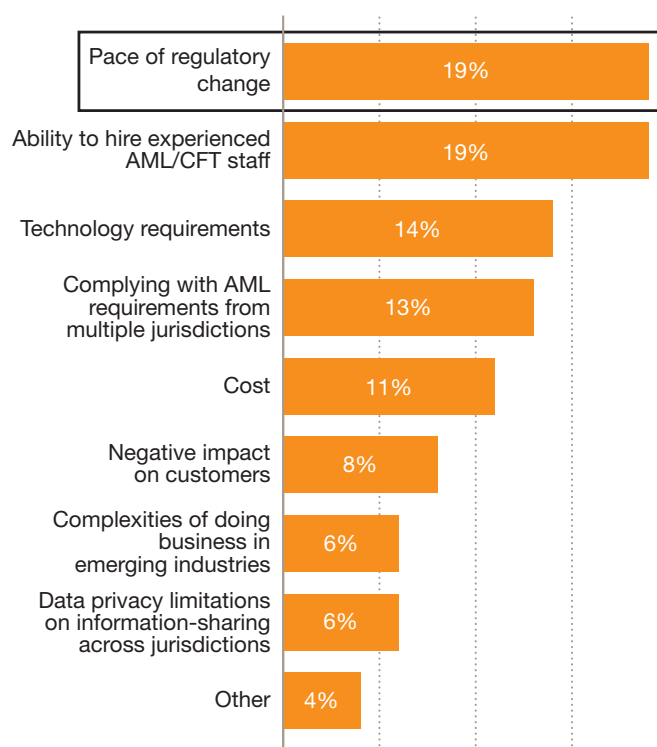
Lack of proper customer due diligence is clearly seen in example mentioned above. This brings us to the fact that AML can not be effective unless the basic standards are not fully implemented and it has no sense to put further efforts to develop AML standards on the higher levels.

Another example of undetected activity in the carbon emissions market was sale of carbon offsets several times. In 2010 in Hungary their Ministry of Environment and Water sold 800 000 CERs. The problem occurred when it was revealed that offsets were already used by Hungarians themselves. Logically, used credits were useless on European carbon exchanges. Later on, credits were sold to Japan and, in a while, have found their way back to European exchange in Paris (The Economist, 2010).

Applicable AML regulations where transactions with unidentified parties would be forbidden could have prevented fraud, which resulted in 2,6 m dollars profit for criminals. Proper due diligence would also help in preventing the fraud (Clifford, 2013).

In accordance with the United Nations Office on Drugs and Crime (UNODC), size of money laundering transactions is assessed as 2-5% of global GDP with public authorities confiscating only 1% of these funds. Besides financial institutions many other spheres of business can be harmed: digital/mobile payment services, life insurers and retailers and others. These market players are not ready to protect themselves from sophisticated tools used by money launderers. With reference to data received from WealthInsight, global expenses on AML compliance are forecasted to reach 8 bn by 2017 with annual growth of 9%. If it would be so easy to take a bunch of rules and use them to guard against criminals everyone would have done it. But there are many considerable challenges that companies face while implementing AML/ CFT requirements.

Graph-1. Challenges to AML compliance



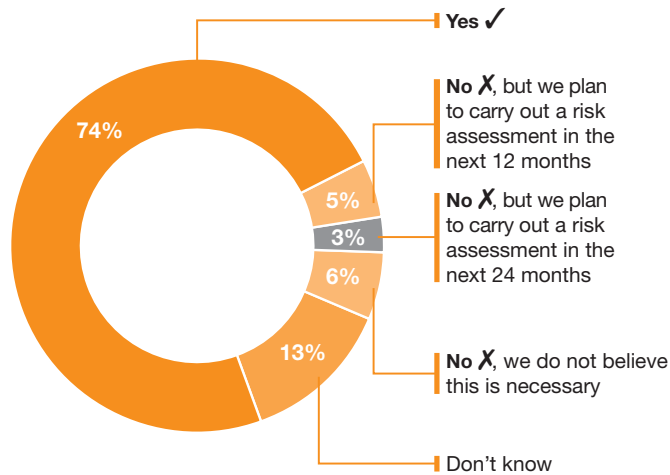
Available from: Pricewaterhouse Coopers AML analysis, 2016.

Key challenges illustrated in the graph-1, show us that human factor remains of significant importance: low speed of changes in AML mechanisms is also dependent on people and how rapidly they can react. Lack of experienced personnel is always a dilatory factor. Costs and different requirements from multiple organizations can not be neglected by companies and they should be discussed at higher level.

Another significant challenges are represented by unclear legislation. The most essential problems occur in questions concerning due diligence and transactions monitoring.

On top of that, survey conducted by Pricewaterhouse Cooper showed that almost quarter of their respondents among non-financial institutions didn't provide any AML/CFT risk assessments or were not aware if they do. Graph below represents replies received from the respondent participating in survey (Global Economic Crime Survey 2016).

Graph-2.Awareness of respondents about AML/CFT risk assessments



Available from: Pricewaterhouse Coopers. Global Economic Crime Survey, 2016.

These results are rather worrying and emphasize that awareness of AML/CFT risk assessments should be risen.

To conclude, in the last 10-15 years there is a significant progress in combating money laundering, many new countries have implemented AML mechanisms, AML institutions work in tight cooperation and number of disclosed frauds steadily grows. On the other hand, despite of huge investments in development of systems and methods of risks assessment, numerous frauds are made right under officials very noses.

Criminals show consistent growth pace of their illicit activities and AML authorities are in most cases one step behind. Furthermore, current AML mechanisms face many challenges that should be overcome .

3. Weaknesses and strengths of AML

It became clear from the previous chapter that AML mechanisms are not effective enough. In order to improve them, it is very important to identify loopholes and gaps that provide negative effect. Moreover, with the growing rate of financial crimes AML mechanisms should also be improved and correspond to the most relevant threats.

3.1. Analyses of AML's weak places

Assessment of AML effectiveness in the previous chapter showed us that current AML regulators have numerous weak places. The latest experience of AML scandals have shown that even perks can be misused. When I say 'perks' I mean achievement of information from whistleblowers. Investigators don't need to spend thousands of hours to collect information piece by piece, the most valuable and up-to-date data will be given by an insider.

Whistleblowing is reporting about wrongdoings at work or disclosing any suspected activities for public's sake. Law should guide those individuals. For example, in the UK exists special framework called the Public Interest Disclosure Act (PIDA,1998). It was also considered as a tool to promote whistleblowing especially when wrongdoings are a matter of public importance. That includes money laundering, credit rating agencies, shadow banks, financial institutions and others.

In the USA there is an analogue to PIDA called the Sarbanes-Oxley Act. Richard Moberly wrote an article that examined how did actually this law work during the past ten years. According to him, because of the fact that whistleblowers faced requital, their eagerness to participate in disclosures and share information decreases. They were also not involved enough in the process of uncovering of the Great Crises 2007-2008. People don't believe that protection promised by the authorities will really work (Moderly, 2012).

With a reference to HSBC case mentioned in the previous chapter, banks try not to reveal information about their clients whatever it costs. Nowadays bank states that it was "accountable for past control failures." But representatives of it have told that now it is "fundamentally changed" (BBC News, 2015).

In my opinion, whistleblowing should be perceived as necessary part of anti-money laundering. HSBC would not probably face any prosecution if data didn't leak.

Due to information given by Hervé Falciani it became clear that one of the biggest private banks in the world didn't comply with even fundamental AML recommendations. Standards of due diligence were also very low.

Falciani downloaded huge amounts of data where was information considering many offshore account with names of account holders. Moreover, there were also conversations between bank representatives and clients. It created a big threat for well-off people.

Nowadays it is questioned what were the true intentions of Hervé Falciani. In 2006 he was transferred from Monaco branch of HSBC to Geneva. As systems specialist, he wanted to “make better checks of the bank's activities” the same way as he did it in Monaco. But, Mr. Falciani met repulse while some part of bankers wanted to continue working ‘unmonitored’. With a reference to Mr. Falciani's interview for *Der Spiegel*, “Banks such as HSBC have created a system for making themselves rich at the expense of society, by assisting in tax evasion and money laundering”. He has also mentioned that there was a special department in HSBC that was dealing with concealing of clients identities and transactions. Mr. Falciani says that he tried to pay attention to existing data problems but was ignored (Hamilton, 2015).

From the point of view of HSBC, Mr. Falciani is a criminal who tried to sell data to Lebanon but was unsuccessful. The bank alleges that Mr. Falciani has stolen the data and wanted to profit from it. But, according to the Swiss law on money laundering, “The criminalization of money laundering of Article 305bis of the Penal Code (CP), that came into force in 1990, provides that anyone who commits an act intended to obstruct the identification of the origin, discovery or confiscation of property that he knew or should have presumed were derived from a crime, shall be liable to imprisonment or a fine”(FATF, 2005).

Currently HSBC faces investigations in the US, Argentina, France and Belgium but not in the UK, where is bank's headquarters. Despite bank's allegations that since 2008 significant changes in AML compliance have been made, according to BBC Panorama, who has spoken to another whistleblower from HSBC Private Bank, in 2013 HSBC still had some problems with tax evasion. The journalists of the ICIJ also reported that HSBC was also suspected of being involved in cooperation with Katex Mines Guinee, organization connected to arms trafficking in the West Africa. What shows insufficient implementation of anti-money laundering recommendations is the fact that all dubious connections of HSBC were disclosed not because of AML

compliance and reporting systems but because of data leaks. Journalists have also asked Rona Fairhead, the head of auditing at HSBC, why did the audit committee have nothing to do showing concern about poor AML compliance? The fact remains doubtless: internal or external audit at HSBC didn't show any sufficient incompliance with AML (Ball, 2015).

HSBC reported that in 2012 they improved their tax transparency policy. That included developing of KYC (Know Your Customer) risk assessments to combine opinions and reports from outside auditors. The matter concerns standard AML requirements as tracing and reporting transactions over 10 000 dollars. But the criminals have also improved their techniques of money laundering- e.g., dividing transactions into smaller sums, using alternative financial systems etc.

Whistleblowing has proved itself as a source of useful information that helped to reveal financial crimes, what resulted in infliction of penalties or prosecution (Call, 2014).

HSBC case has also proven how broad can be influence of one bank or just one whistleblower. Many people are afraid to alert violation of law at work because they are not sure in current mechanism of security. Will authorities protect them? Who will protect them if their powerful employer decides to accuse them of data theft? There are many people with high morale but who don't feel themselves secured and are afraid to report financial crimes they witnessed.

Another weak place that was revealed by HSBC case was the misleading categorization of professions and scarcity of beneficial ownership details. Many powerful women were classified as 'housewives'. Among them was Mary Wells Lawrence, advertising industry ground-breaker, who appeared to be beneficiary of four accounts. One of the accounts contained around 140 m dollars. Another 'housewife' was Arlette Ricci, granddaughter of well-known Nina Ricci, the heiress of an enormous fortune. This woman appeared to be a beneficial owner of an offshore company registered in Panama- Parita Compania Financiera S.A, with maximum amount on its account 22 m dollars.

Later on, she has been charged in France for having an undeclared account. By and large, around 7300 women were classified as 'housewives' and around 4000 people as 'without profession' or 'students'(Fitzgibbon, 2015).

Moreover, suspected arms dealers were classified as 'businessmen'. HSBC continued to cooperate with notorious company Katex Mines Guinee even after it was

named by the United Nations as ‘possible provider of weapons’ to Liberian rebels. According to the International Consortium of Investigative Journalists and Le Monde, the account was opened in HSBC in 2001; maximum amount was around 6 m dollars in 2006 shortly before it was closed. Katex Mines Guinee wasn’t the only link between HSBC and the West Africa; troubled bank appeared to be connected with numerous companies involved in bloody wars in Africa.

Considering situation with HSBC a very important question arises: to what extent was higher management aware of what was really going on in the bank? Or did they intentionally not inform audit committee because they knew that sources of money entering their system were illegitimate? According to The Guardian, HSBC wasn’t just passive participant of tax evasion schemes of its clients, but vice-versa, proactively attracted new clients by offering them opportunities to avoid tax arisen from a treaty signed between Switzerland and the European Union. Here comes the biggest threat to AML efficiency- loopholes in legislation (Leigh,2015).

The treaty allows EU citizens to continue concealing their millions in anonymous accounts in Swiss banks. At the same time Swiss banks become obliged to levy certain tax themselves from their clients. Later on, this so-called ‘withholding tax’ that was primarily 15%, would be collected from all clients and the total amount would be transferred to the proper EU government. But HSBC created a way how to avoid payment of tax: European savings directive (ESD) applied only on proceeds of individuals not companies. Ultimately, the bank offered its clients to transfer their money to company accounts.

Technically it would be money of a shell company registered somewhere in the British Virgin Islands or Cayman Islands. Moreover, company can be registered as hold by trust or foundation in Liechtenstein where all information about trust deeds is kept secret. In such case the real owner of proceeds can be named as ‘beneficiary’ of the trust not the owner (Leigh, 2015).

Another loophole in Swiss legislation is possibility to have a numbered bank account. Real name of the owner of account is known only to a small group of employees. If a person wants to withdraw cash or make a transaction he just needs to say his code word to employee. Painter, Mr. Shaw, Captain Kirk were code words of real HSBC clients. According to Swiss Banking Act from 1934 it is still forbidden to disclose identity of clients. Moreover, even the retired bankers and bankers whose licenses were revoked will be punished by tree years in jail for disclosure.

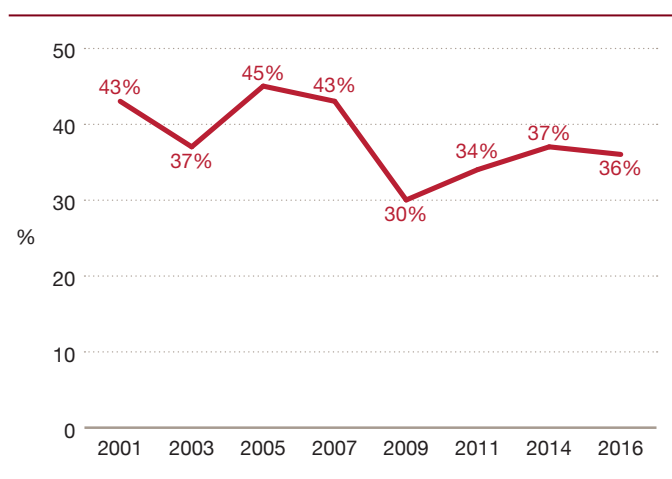
With reference to statements above, that brings us to another weak place in anti-money laundering - people. If people are interested to hide particular information they will do whatever it costs to evade compliance with AML standards and get their profits.

Speaking of corporate social responsibility, it is often neglected or underestimated by big corporations despite public attention that has dramatically increased in the past years. If we take example of HSBC, its sustainability report is more concentrated on environmental impact not social (HSBC. Our approach, 2017).

While talking about new threats to prosperous functioning of financial and non-financial institutions, cybercrimes occupy the second position. In accordance with Global Economic Crime Survey 2016, 32% of companies were somehow affected. Most part of the companies are absolutely not prepared for this type of attack and don't fully understand the risks.

Another issue that complicates reaching of compliance with AML standards is lack of qualified personnel. Moreover, around 30% from 6000 respondents Global Economic Crime Survey 2016 conducted by Pricewaterhouse Coopers have reported to endure financial crimes within last 2 years.

Graph 3. Reported rate of economic crimes.



Available from: Pricewaterhouse Coopers AML analysis, 2016.

At first sight, the graph shows us positive tendency that number of crimes decreases. But can it also mean that simply higher percentage of crimes was not detected? Furthermore, according to findings of Pricewaterhouse Coopers 1 in 10

economic crimes were discovered by incident. Moreover, level of reported crimes in many countries has grown significantly. For example, in 2016 in Africa there was growth in Kenya (from 17% to 61%) , Zambia(from 26% to 61%) and South Africa (remained 69%) comparing to 2014 (Pricewaterhouse Coopers AML analysis, 2016).

While financial sector uses the most sophisticated tools to protect itself from fraudsters, at the same time, other branches remain more vulnerable. In accordance with Pricewaterhouse Cooper's analysis, in 2016 the most significant growth in reported economic crimes was in the following branches:

- 9% in aerospace and defense (moreover, bribery and corruption cases have shown growth of 16%)
- 8% in transportation and logistics
- 6% in energy, utilities and mining
- 9% in manufacturing (incl. only asset misappropriation)

Lack of transparency is also an essential challenge to the world economy, especially when clients have relations with partners from countries with not developed AML system.

Speaking of the financial point of view, it is rather expensive to comply with AML standards. Only limited information is announced to public and costs on AML are very often not included in public financial statements. According to Pricewaterhouse Coopers LLP companies are usually including AML costs into general costs.

Cost is always an issue. Increasing number of notification and reports provokes significant growth of staff. Monitoring of several systems at once also requests higher costs. Also maintaining of Know Your Customer improvement and implementation of Talent programs together with attracting skilled employees are rather expensive (Accenture Consulting, 2015).

According to FATF every country with low AML compliance is a threat to the whole system. Thereby, criminals can introduce their illicit proceeds through weaknesses detected in AML systems of non-cooperative jurisdictions. That is why FATF follows thoroughly progress of each country.

To sum up, AML/GFT framework is not ideal and is influenced by many factors that complicate fulfillment of its recommendations. What is important, FATF helps countries to identify key weaknesses and together with these countries they create an action plan, according to which, loopholes and main weaknesses are identified. Progress

of AML strengthening is visible but the way to success is still too long. On the practical examples I emphasized typical problems and weaknesses that different branches and institutions face. This knowledge can be applicable to other spheres as well because many of these threats can be faced almost in every type of business.

3.1. Tools of AML improvement

Every year tools and methods used by criminals become more and more sophisticated. Almost every bank uses special systems to uncover simple AML breaches but those methods are useless for more advanced money laundering operations (Buehn, 2011).

Public identification belongs to the most effective tools used by FATF to persuade countries to join AML fight. So-called process of “naming and shaming” has proved itself as leverage to force countries to make urgent actions in order to strengthen AML measures. If countries are not eager to undertake reforms with aim to eliminate weaknesses and loopholes in their framework it can lead to being labeled as a country with weak AML/ CFT (counter-terrorist financing) framework. As a consequence countries may face additional measures that will apply to transactions with this country. Accordingly, transaction costs for trading partners of this country will increase what would obviously affect their eagerness to continue trading relations (Dyck, 2010, p. 2213).

Around 70% of ‘named and shamed’ countries have rapidly have brought their AML systems in compliance with FATF recommendations.

While we are talking about tools of improving whistleblowers’ defense it is very important to understand what motives these people have. What kind of persons are they? In most cases they are idealists who couldn’t witness anymore, when the values they appreciate are misused. Responsible people want to work for responsible companies in accordance with their ethical beliefs and when people see that company has compromised itself they endeavor to restore the balance. In combating money laundering authorities and international organizations should rely on motivated people who are not indifferent to what is going on around.

Power of some corporations can be compared with power of a small country. Of course, individuals are afraid for their lives and lives of their families if they oppose the company. If authorities learn how to protect the whistleblowers, if they invest in it, more responsible people can help them to disclose crimes within corporations.

One of the popular methods among criminals is to use both normal and shell companies. Consequently, it is very difficult to identify what part of transaction was illicit and what funds very legitimate. Without strengthening of technical base authorities can't fight it.

Financial inclusion is identified as one of major problems in developing countries. It means to grant access to financial services for everyone. If FATF succeeds to combine financial inclusion and AML/CFT, millions of people will be able to use formalized financial services instead of cash payments. AML controls should be simplified, because without clear guidance chaos can appear and it would hinder further development. This will bring new opportunities while shadow economy will begin to slowly lessen.

Scholars Bester, Chamberlain and collective have identified main drivers that essentially influence the process of usage of financial services. Among them are:

- Value. Financial products like savings accounts that are offered to clients should not be unaffordable according to their income but should bring them some value;
- Unwillingness to use documentation. Some individuals are unwilling to be under government's supervision.
- Hassle factor. People don't want to fulfill extra documentation but to solve everything via, for example, phone call.
- Perception. Low-income individuals feel themselves intimidated while communication with financial service providers.

Other important drivers are costs, familiarity, transaction culture and others.

But this process will be accompanied by unavoidable risks: extra compliance costs for providers of financial services will decrease their interest in cooperation, moreover, financial inclusion customers are price sensitive. Additionally, all new models are based on technologies.

In my opinion, the most effective tool to improve AML regulation is achievement of global uniformity. Failures and loopholes appear because of lack of

uniformity. Additionally, verification of financial intermediaries with requirement of identity proofs is a necessary tool to improve AML procedure.

Conclusion

Money laundering disrupts the very basis of financial stability of the world economy.

In my thesis I have put forward two hypotheses. The first one was to prove that efficiency of anti-money laundering mechanisms is not satisfactory at the present time. Current AML combating is based on not preventing but on learning from criminals. Loopholes in legislation and in AML mechanisms are rectified only when some corruption scheme was disclosed after being successful for several years or decades. Afterwards, criminals invent new ways and find new gaps how to launder their proceeds and successfully do so for some period time before being caught. Identification of new money laundering risks for monetary system is one of key priorities of FATF, which is obviously not fulfilled properly. In my opinion, at the present time, AML mechanisms are not effective enough to prevent money laundering on a great scale.

Also, there still are no operative mechanisms in offshore jurisdiction and tax havens where the biggest number of anonymous accounts are based. Among the reasons named in the third chapter were: lack of transparency, unification and cooperation between both financial and non-financial institutions, poor involvement of developing countries and offshore jurisdictions, lack of highly skilled personnel in AML sphere, high costs of implementation, negligence of due diligence, lack of integrity among domestic institutions etc. Therefore, I consider that the first hypothesis was proved.

Second hypothesis was to prove that human factor is of the highest significance in combating money laundering. Scarce qualified human resources are a real obstacle that doesn't allow to achieve significant progress. When people who are part of AML mechanism don't know their job or have no incentive to search for truth, even the most up-to-date technical base will not help. Additionally, as I wrote above, I think that role of whistleblowers is very sufficient in AML procedure, because insiders can save years for investigator by providing them with relevant information.

Moreover, considering HSBC case, European savings directive that aimed to fight against tax evasion applied only on proceeds of individuals not companies. Naturally, HSBC offered its clients to transfer their money to company accounts. Technically it would be money of a shell company registered somewhere in the offshore jurisdictions. In my opinion, specialists that were working on the structure of the directive should have forecasted that this limitation will not bring expected results.

Bank just needed to renew bank account of their loyal clients using new companies. I consider second hypothesis to be proved.

Cases as Petrobras scandal also show us that in some money laundering schemes hundreds of people can be involved.

FATF Recommendations are considered to be a soft law, compliance is desirable but not mandatory. Accordingly, they don't have the force of law and in some cases failed to be implemented. Meanwhile, governments are looking for a possibility how to decrease their expenses on both compliance or breach of FATF Recommendations. It appears that partial compliance is cheaper.

In accordance with Europol representative, there is "no strong regulations or checking principles as there is in banking to prevent such activities as money laundering". This phrase considered carbon emissions branch but it is also acceptable for other non-financial spheres.

In the beginning my goals were ambitious and I wanted not to make just an overview of effectiveness of FATF Recommendations and AML mechanisms but to make a survey on exact sufficient changes that happened during the last decade. I expected to find data on particular countries with brightly emphasized progress.

In reality I faced huge and vague reports that included enormous number of recommendations but didn't really reflect to what extent they were already implemented or what progress was achieved. When I compared publications of 2002-2005 with articles and reports from 2013-2017 I didn't find much progress. The key problems like lack of transparency and unification are still the most relevant.

In my opinion, fight against money laundering and terrorism financing will be lost if not to change system of a soft law into obligatory mechanisms. Until that time criminals will outrun the authorities.

To conclude, at the present time, when huge amounts of money evaporate from budgets or simply didn't reach them and terrorist attacks occur almost every week the necessity of implementation of money laundering mechanisms is of the highest significance. Unfortunately, nowadays there are more theoretical essays than practical successes. But still huge work was done to identify and systematize risks to the world's financial system and more and more economic subjects begin to implement money laundering standards as inevitably necessary mechanisms.

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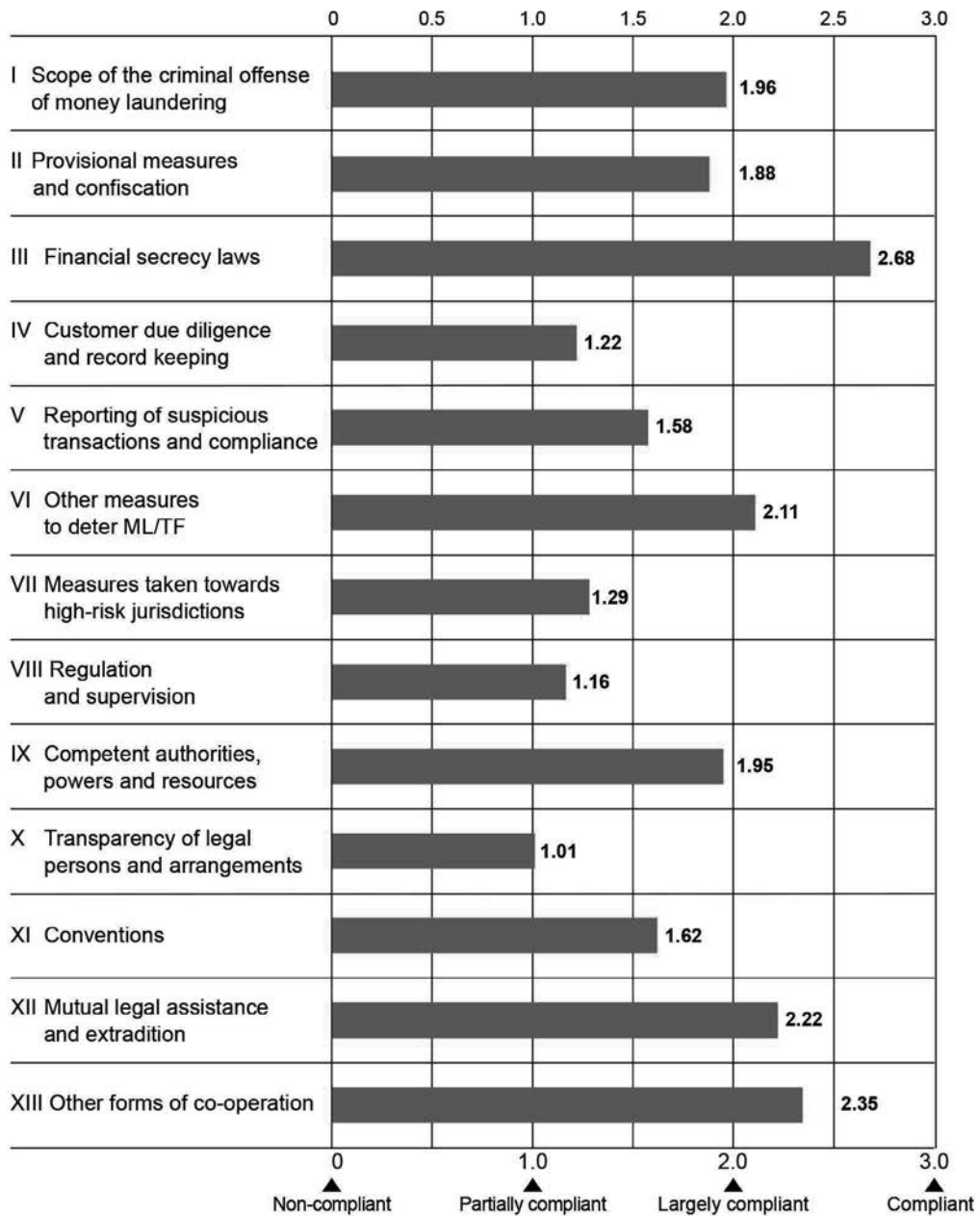
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Abbreviations

AML	Anti-money laundering
CDM	Clean Development Mechanism
CER	Certified emission reduction
CFT	Counter-terrorist financing
ERU	Emission reduction units
EU	European Union
FATF	Financial Action Task Fo
ICIJ	The International Consortium of Investigative Journalists
JI	Joint Implementation
RMU	Removal unit
UNODC	United Nations Office on Drugs and Crime

Appendix 1

OECD Members' compliance with FATF Recommendations (OECD, 2014)



Appendix 2.

40 FATF Recommendations with a level of compliance (OECD,2014)

