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The interrelations between banking and insurance systems in the prevention of international financial abuse

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Content

ABSTRACT

The subject matter of this thesis is financial abuse. As this type of abuse goes beyond the state boundaries, i.e. the international aspect of financial frauds, this research predominantly addresses the phenomenon of money laundering, as a dominant type of international financial abuse, and particularly due to its high correlation with terrorism financing, which is one of the major challenges of modern civilisation. In the thesis we describe the institutions which are in charge of prevention, organization and fight against all types of financial abuse, particularly money laundering whose action rests precisely upon the discussed legal frameworks.

We present the main money laundering typology and point to the expected trends in the financial sector (banking and insurance sector). Afterwards, we highlight the importance of the international cooperation aimed at preventing and sanctioning the frauds in the two sectors: the banking and insurance sectors.

The thesis reiterates the international aspect of organised crime and underlines that financial abuse, particularly money laundering, is a problem of international character, suggesting that possible activities carried out in isolation i.e. at an individual country level, could have rather limited effects. In the thesis we highlight the social significance and the consequences of the financial crime for the country and society, the international aspect of frauds and we also provide the analysis of some specific examples from the practice.

The final chapter defines the Chart of the system for preventive actions in cases of financial abuse. The initial assumption is that a uniform, systemic solution, based on clear, methodological principles may act efficiently to prevent the occurrence of financial frauds. The thesis presents the four main components of the Chart and also describes all thirteen processes that connect the Chart components. The thesis stresses the international aspect as one of the two processes that connects all four components of the system (along with organisation and coordination). The proposed Chart is the main scientific and professional contribution of the thesis.

KEY WORDS: financial abuse, financial frauds, international financial abuse, money laundering, Chart.

1. Introduction

1.1. The subject matter and objective of the thesis

The subject matter of this thesis is financial abuse. As this type of abuse goes beyond the state boundaries, i.e. the international aspect of financial frauds, this research will predominantly address the phenomenon of money laundering, as a dominant type of international financial abuse, and particularly due to its high correlation with terrorism financing, which is one of the major challenges of modern civilisation. Virtually entire international legislation, recommendations and laws related to the area of financial abuse are directly linked to these areas.

The modern financial systems, typical of the current human development stage, consist of a combination of a number of institutions and participants (central bank, commercial banks, savings banks, savings-credit associations, pension funds, investment funds, insurance companies, intermediary organisations), financial markets (foreign currency market, money market, capital market etc.) and financial instruments (debt instruments, equity instruments, derivatives – derivative instruments).

Within such financial systems, banking and insurance are two particularly important segments, but also the two sectors with the highest exposure to the risks of abuse and fraud. Their roles in the economic system are irreplaceable. All the vital financial functions flow through the channels made available by the banking and insurance sectors – the function of payment, money creation, liquidity, crediting, savings, risk prevention, macroeconomy, transfer of resources through space and time, international payment transactions, foreign currency transactions, information providing and the like. Each one of these points carries a risk of errors, weaknesses, harmful actions, abuse, fraud or theft.

The most relevant features of modern financial systems are as follows:

- dynamics,
- openness, and
- complexity.

Dynamics comes as a result of the fact that the economic and financial systems are constantly experiencing changes and new events, thus exposing the system to temporary states of balance and imbalance. Financial system is not a static one and set for good. Modern financial systems are continuous, and operate 24 hours a day, 7 days a week, 365 days a year.

The **openness** comes as a result of the necessity of operations in the global market, i.e. the companies' natural need to embark on various forms of cooperation with business partners, outside the boundaries of their national economies. Banking and insurance, as well as the financial system as a whole, achieved a global character long ago. The international flows of financial assets and capital are at such scale that it is almost impossible to live and operate isolatedly from the international community.

Complexity of the financial systems comes as a result of the circumstances in which they comprise a large number of sub-systems and a series of participants, and are regulated by complex legislation, both at the national and international level, and they share the same fate and the consequences of the events at the global level.

Under the impact of the events at the international level, the emergence of the economic crisis and novel trends in the corporate world, there has been a rapid surge of financial frauds in the previous decade, which has forced the companies, international institutions and organisations to establish the new mechanisms, instruments, strategy and institutions to tackle the issues.

In the first line, these were directed towards domestic entities, aimed at increasing the efficiency of internal oversight, achieving the credibility of financial reporting, establishing the efficient external control, with a view to closing the channels for the leakage of funds, preventing the money laundering and disabling the direct financial crime, but the one craftily implementing the state-of-the-art technology as well. The abuse in this area has directly undermined the economic stability of the countries, slowed down the economic growth, increased the unemployment, encouraged political conflicts and intensified the social tensions. The accurate data is not available, yet it is estimated that thousands of billions of dollars have been withdrawn from the legitimate flows in these ten years, and transferred into the narcotics market and arms trade, trafficking in human beings and terrorism.

The second objective of actions against the financial frauds was directed towards the development of international cooperation, creation of new regional and universal institutions, upgrading the specific financial regulations and forming the global defence mechanism for the prevention of financial abuse. After the 9/11 events when the twin towers were destroyed in New York, the world realised that the terrorist actions, global crime and numerous conflicts around the globe were backed by the enormous financial resources, moved from the legal financial flows through the illegal channels, abuse, corruption and frauds in order to form their own interests, ambitions, armies, even territories.

In this respect, the prevention, suppression and hindering the financial abuse at the international scale has become a critical issue for the entire international security, and thereby for the protection of stability, integrity and independence of each international community member state. The leading international organisations, and primarily, the United Nations, the European Union, other regional organisations and institutions, specialised professional, expert and security associations have undertaken a series of activities to this end, but the financial abuse with the both global and individual effect has not been suppressed yet.

With the fast **development of information technology**, and the liberalisation of all kinds of communication and transport, with the development of new products in the banking and insurance industry, the additional room emerges wherein the individuals, groups and organisations with bad intentions seek to obtain illegal profit and commit frauds of all kinds. The entities and institutions involved in money laundering and terrorism financing attempt to abuse the free movement of capital and provision of financial services, which is a threat to the stability of every country's financial system.

This is the reason why the institutional and legal frameworks are constantly upgrading, at both the national and international levels, where it is becoming more and more evident that only through a closer cooperation, a more solid organisation and uncompromising relationship towards the perpetrators of abuse can this threat be defeated. The frauds in banking are predominantly in the sphere of identity theft and breaching the electronic security of bank accounts, while the insurance is increasingly dominated by a variety of false claims and fraudulent actions related to risk claims.

- Exploring, detecting, defining preventive operations concerning financial sector and insurance companies
- The goal is to determine protective systems by getting to know concrete misuse cases, which prevent further realization.
- This way we strengthen the security of the financial sector and reduce the danger to minimum.

Additional research objectives are:

- Overview and systematisation of the normative and institutional frameworks required for combating financial abuse
- Studying the main typologies and indicators of the financial frauds in the banking and insurance sectors
- Highlighting the importance of international cooperation in combating the financial crime
- Studying through the examples from the practice
- Highlighting the importance of certain activities not sufficiently emphasised in combating the financial crime, such as: staff training and improvement, communication and propaganda, organisation and coordination

The thesis gives particular importance to the legal and institutional framework in the field of international financial frauds, without which the proposed solution in the form of "Chart of the system for preventive action in cases of financial abuse" would not be applicable in practice. In addition, the thesis emphasizes the international dimension of cooperation between countries, which is analysed in a separate chapter but it also runs through all the chapters of the thesis. The central point of the thesis is the proposed "Chart of the system for preventive action in cases of financial abuse". The Chart is developed and tested on the basis of the data obtained by research work of the candidate and the mentor. The data encompass numerous cases of fraud in banking and insurance sector which the candidate analysed during his long career and which refer to the international environment which, apart from Serbia, include the other countries of the Western

Balkans as well as Hungary, Austria, Germany, Romania and Slovenia. The specific data have not been entered in the content of the thesis as in most of the cases the investigations or trials are still in progress.

1.2. Scientific hypotheses

The main assumptions which are the theoretic basis of the thesis research and refer to scientific contributions of the thesis are:

- It is possible to develop a uniform, systemic solution in the form of a Chart to the efficient fight against financial abuse. This solution must be based on clearly defined, science-based, methodological principles. Due to the complexity of the proposed solution, a multidisciplinary scientific approach is required and it includes **the following scientific fields: criminology, science of safety, statistics, information technology and communication science.**

  The proposed solution starts with the assumption that the Chart should be based on prevention which is the most efficient form of protection of the financial sector (primarily the banks and insurance companies) from frauds and abuse. This assumption is indicated by the results of previously conducted research in the field of international financial frauds in banking and insurance sector. [3], [5], [9], [14], [20], [37], [45], [60], [78], [79] [81], [84], [95], [99], [127], [132], [139]

- The main methodological principle the system is based on for the purpose of preventive actions in cases of financial abuse is that it must be based on risk assessment. [86], [97]. The system Chart, apart from the assessment of the risk of exposure to financial abuse, also implies the risk classification, within the existing fraud typology, as well as its materialisation in the form of suspicious transactions [5]

Additional hypotheses refer to the technical solutions, and to practical contributions of the thesis:

- The use of ICT facilitates combating the financial crime. Development of new technologies, especially computer science, presents a new domain for development of new techniques of financial frauds, however, on the other side technologies also

present a powerful tool in the fight against financial crime. Big Data, Cloud technologies and similar enable collecting, storage, processing and analysis of large amounts of data.

- International cooperation is a necessary condition for the efficient prevention of financial abuse. No solution in the fight against financial fraud can be sustainable unless a continuous system of international exchange of data, experiences and solutions is implemented.
- All the employees tasked with the prevention and fight against the financial frauds need to undergo continuous training. The proposed Chart requires continuous work with employees who will work on its implementation, and their education in all fields necessary for the functioning of the Chart through seminars, trainings, workshops.
- The awareness of the general public needs to be raised in terms of the importance and consequences of financial abuse, so as to ensure the preventive actions. The general public should understand that the fight against financial abuse is of the greatest social importance and it is necessary to establish a communication strategy and formal communication channels to communicate with the broader social community.

1.3. Research methods

For developing this thesis, the following scientific methods were applied:

- The first part of the thesis makes use of the collection method and the analysis of the existing scientific results and achievements.
- For developing the Chart of the system for preventive actions in cases of financial abuse (hereinafter the Chart), the following were used - the case study method, the best practices techniques, process analysis, business intelligence techniques, and risk analyses.
- The methods for Chart development, collection and data analysis methods were used.

- For the implementation of the Chart, the research methodology was used, along with the appropriate methods and techniques: data collection, data processing and analysis method, concluding method.

The research results are presented in a narrative, descriptively, and through a number of tables, figures and graphs with the comparative results. The research is interdisciplinary, as it involves the methodology, criminology, information science and other areas of science.

Based on the analysis presented in the thesis, it may be concluded that the applied scientific methods and techniques are suitable, in terms of their relevance and structure, for the topic and the research performed.

2. Legal frameworks

2.1. Introductory review

Fight against crime is among the fundamental principles upon which the European Union rests. In his paper, *Europe in 12 lessons,* Pascal Fontaine states that European citizens are entitled to live in freedom, without fear of persecution or violence, anywhere in the European Union [24] yet his paper emphasises that international crime and terrorism are among the greatest concerns of European citizens. It is stated that organised crime is becoming more sophisticated and that it regularly uses European or international networks for its activities.

Terrorism has clearly showed it knows no boundaries. In order to respond to the highly intertwined organised crime and terrorism, authorities in charge of combating and fighting crime established the Schengen Information System (SIS), which was set up at the EU level. SIS comprises a large number of mutually connected databases which allow the police and judicial authorities to exchange information on persons or objects missing, e.g. data pertaining to stolen automobiles, works of art, persons wanted for arrest or extradition purposes. New generation database (SIS II) will have a greater capacity and will provide for the storage of new types of data, in accordance with the new concepts in informatics (Big Data, Data Mining etc.).

The paper also argues that one of the best ways of catching criminals is to track the movement of the proceeds they generated from crime. To this end and with a view to hindering the financing of criminal and terrorist organisations, the EU implements the laws on the prevention of money laundering. The most important step taken in this field in recent times, concerning cooperation among bodies in charge of internal affairs (police) was the creation of the European Police Office (Europol), which is headquartered in The Hague and which employs police and customs officers. Europol handles a whole number of international crime forms: drug trafficking, trade in stolen vehicles, trafficking in human beings, sexual exploitation of women and children, child pornography, counterfeiting, trade in nuclear and radioactive substances, terrorism, money laundering and euro counterfeiting.

The EU has taken a clear standpoint on the manner in which the organised crime must be combated, by adopting the strategy entitled *The Prevention and Control of Organised Crime: a European Union Strategy for the Beginning of the New Millennium,* published in the Official Journal of the European Union on 3 May 2000. [132]

Building on the largely accepted opinion that "the primary motive of much organised crime is financial gain", the strategy concludes that effective prevention and control of organised crime, therefore, "would focus on tracing, freezing, seizing and confiscating the proceeds of crime". [87]

This chapter of the thesis provides an insight into legal frameworks governing financial institutions in the context of prevention of international financial abuse, by discussing international regulations safeguarding the field of fight against money laundering and terrorism financing, as well as related conventions, recommendations and directives. The end of the chapter will provide an illustration of the legal framework of the Republic of Serbia.

2.2. Conventions

Acts of financial abuse at an international level usually relate to money laundering and terrorism financing. A large number of initiatives have been launched under various international organisations so as to set up universally accepted standards in this field. Such standards are set forth by:

1. Conventions
2. Recommendations
3. Directives

Illicit activities including drug manufacturing and trafficking are among the activities in which organised criminal groups first engage, i.e. they are the primary source of funding of organised crime. It is clear that such illegal activities deteriorate the legal and economic system of the society as a whole and of individual citizens, while threatening political stability and state sovereignty in the long run. Moreover, such activities endanger persons who are exposed to the detrimental influence of narcotics and their families, as well as healthcare, social, education, legal and other systems. On the other hand, these unlawful activities generate substantial profit which is accrued through the means of illicit trafficking, allowing for different sorts of manipulation and fraud, primarily money laundering and other unlawful activities, and quite often – terrorism. Upon grasping the global scale of the problem and seeing that organised crime knows no bounds, it was soon realised that response must also be searched for on a global level. The inescapable conclusion that followed was that a set of "harsh, comprehensive and international measures" has to be introduced, which will, through solving the drug trafficking problem, lay the foundations of the fight against other unlawful activities, primarily against money laundering. [78]

The United Nations (UN) adopted the most important convention entitled **Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances** (hereinafter: the UN Convention), also known as the UN Vienna Convention [134], on 19 December 1988 in Vienna.

The UN Convention recognises the need to strengthen and amend the measures envisaged by the 1961 Single Convention on Narcotic Drugs and the 1972 Protocol amending it, as well as by the Convention on Psychotropic Substances from 1971, in order to fight against the scale and scope of illegal trafficking and its severe consequences. [71]

The Convention is the first international agreement envisaging punishment of money laundering (although it only governs drug trafficking) from which the illegal money stems from. This is particularly important given that this UN Convention binds over 160 countries, all of which are UN Member States, whereby each signatory party is obliged to prohibit any activities of drug trafficking by the virtue of law, including association or conspiracy to commit, attempts to commit

and aiding, abetting, facilitating and counselling the commission of the criminal offence of narcotic drugs use. The convention also provides a comprehensive definition of money laundering as the foundation of the later legislation. [15]

Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime (hereinafter: the CoE Convention) was adopted in Strasbourg in 1990. It aims to facilitate greater unity when pursuing the mutual criminal policy directed at combating serious criminal offences and seizing proceeds generated from crime.

The necessity to adopt CoE Convention lies in the fact that the main goal of the UN Convention was restricted to prohibiting illicit drug trafficking and expressing a clear need for additional instruments that would bring together mechanisms of mutual legal assistance, temporary measures and confiscating and seizure of proceeds of crime, in the context of preventing money laundering.

In some of its provisions, such as the broad description of criminal offence of money laundering, the CoE Convention builds on the UN Convention, which is undoubtedly a significant step towards the integration of certain forms of cooperation between states when compiling provision on extradition, transfer of minutes and mutual legal assistance, as well as the newest modalities of cooperation regarding seizing and confiscating of property. [126]

The CoE Convention is a comprehensive system of rules that govern numerous procedural aspects pertaining to money laundering – from the initial investigation to the very confiscation. "Such approach provides special mechanisms which require highest degree of international cooperation, simultaneously preventing criminal organisations the access to money laundering instruments and proceeds of crime." [82]

Main goals of the CoE Convention primarily relate to achieving higher unity among Member States in pursuing mutual criminal policy. Prevention of serious criminal offences is extensively becoming an international problem which requires the use of modern methods at an international level [13]. These methods by and large relate to efficient international cooperation and legal assistance in criminal proceedings and investigation of criminal offences, as well as tracking down, seizing and confiscating ill-gotten proceeds. The Convention highlights the significance of cooperation in investigations, gathering of evidence and unprompted delivery of data to another Member State, while removing the notion of banking secrecy. It also lays down

temporary measures such as bank account freezing and temporary seizure of property, with a view to seizing ill-gotten proceeds and effecting the confiscation order, i.e. national steps towards confiscation requested by another Member State [21].

Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime and on the Financing of Terrorism (Warsaw Convention) was adopted on 16 May 2005 in Warsaw. [16] Main reasons for the adoption of the Warsaw convention are amendments and updating to the CoE Convention, development of methods and money laundering techniques, and particularly stronger terrorist activity on a global scale. The Warsaw convention does not differ significantly from the CoE Convention, as it still focuses on measures of investigation, freezing, seizing and confiscation of proceeds gained from crime, criminal offence of money laundering, an2d emphasises international cooperation, while brining certain novelties [13].

In the very preamble, and later in the first chapter that clarifies the Warsaw convention terms, such novelties pertain to the problem of terrorist acts that pose a threat to international peace and security, defining terrorism financing as a criminal offence, the significance of prevention of money laundering and terrorism financing, and defining financial intelligence unit (hereinafter FIU).

In the preamble, FIU is defined as a central, national agency responsible for receiving (and, as permitted, requesting), analysing and disseminating to the competent authorities, disclosures of financial information

- concerning suspected proceeds and potential financing of terrorism, or
- required by national legislation or regulation in order to combat money laundering and financing of terrorism [16];

It may be gathered that the Warsaw Convention is a comprehensive document with detailed elaboration on freezing, seizure and confiscation at a national and international level. Furthermore, this Convention obliges signatory parties to undertake measures prohibiting money laundering, including other international norms such as FATF recommendations, to be discussed in more detailed later in the chapter.

2.3. FATF Recommendations

Financial Action Task Force on Money Laundering (FATF) is an inter-governmental body tasked with the development and enhancement of international activities in the fight against money laundering and terrorism financing. Established in 1989 by the Group of 7 most developed countries in the world, the FATF sets standards, develops and promotes policy for combating money laundering and terrorism financing. It currently comprises 33 members: 31 states and government and two international organisations [1]. It has over 20 observers: five regional bodies similar to FATF and over 15 other international organisations or bodies [73].

Apart from the aforementioned conventions, the single most important document that defines standards in this area is 40+9 FATF Recommendations. Although they could be perceived as one of the sources of the soft law, i.e. as international legal norms that are not directly legally-binding for the states, the authority behind this document renders these recommendations an international standard observed both when drawing up conventions and other legally-binding acts and during the assessment of acts and measures implemented by the states in their fight against money laundering, which is conducted by various international organisation, such as the Council of Europe, International Monetary Fund, the World Bank etc. [77]

The FATF establishment came as logical response to ever sophisticated organisation of criminal groups in committing criminal offences of money laundering. Drastic changes have been noticed in regard to organisational, technical and staffing orchestration of criminal groups and individuals involved in money laundering. These criminal groups are becoming a serious problem to countries worldwide, as they manage to find adequate ways to keep up with the introduction of new manners and methods of prevention of money laundering, by using new techniques for money laundering and rather successfully applying all new technical achievements that assist them.

New people, both competent and educated are being recruited into the ranks of these criminal groups, both in the field of finance and technological inventions that enable them to implement brand new technologies for the purposes of money laundering.

Recommendation entitled *International standards on combating money laundering and the financing of terrorism & proliferation of weapons of mass destruction* were adopted at the FATF plenary meeting held in Paris on 16 February 2012.

New recommendations combine the previous 40 recommendations for combating money laundering and 9 special recommendations for combating terrorism financing, introduce the recommendation for national risk assessment, and deals with the issue of proliferation of weapon of mass destruction.

Following the terrorist attack on New York New, new revisions to the recommendations were adopted in 2001, giving them a new dimension called terrorism financing. In addition to the existing 40 recommendations, FATF also adopted 9 special recommendations that deal with financing terrorism from illegal activities and money laundering activities. The underlying postulate of the 9 new recommendations was that all sources of terrorism financing, and the related money laundering activities, should be monitored under universal international standards.

2.4. Directives

The adoption of fundamental conventions (UN Convention, Convention of the Council of Europe, FATF 40 Recommendations which together make the systemic foundations of the combat against money laundering) [28], was followed by directives regarding prevention of use of the financial system for the purpose of money laundering. Three such directives have been issued until now.

The first such directive is the **Council *Directive 91/308/EEC*** *of 10 June 1991* on prevention of the use of the financial system for the purpose of money laundering, published in the Official Journal L 166 *28/06/19* [17]. This (first) directive is a comprehensive preventive approach to the issue of money laundering. The first directive ends where the CoE Convention begins, i.e. with criminal investigation. The first directive was partly a piece of evidence testifying that freedom of capital movement and global economy advantages did not fuel up organised crime, i.e. they did not bring about higher mobility of proceeds outside the borders of countries of origin. In this sense, the directive aimed "to disable certain states to implement measures contrary to free and single European financial market" [126], and to enable adoption of provisions primarily intended to combat money laundering and shield public confidence in the overall financial system [13].

Directive 2001/97/EC which amends Council Directive 91/308/EEC was adopted a decade after the First directive [22]. The scope of this (second) directive extended to branches of

credit and financial institutions, which were obliged to report any suspicious transactions to competent authorities, exchange offices and money remittance offices and investment funds. Given that all such entities are exposed to dangers of money laundering, it was necessary to include them and thus encompass the financial sector in the widest extent possible.

The directive also expanded the scope of predicate offences, i.e. the definition of criminal activity, which in addition to criminal offences within the meaning of Article 3, paragraph 1 of the UN Convention, included the activities of criminal organisations, fraud, corruption and criminal offence which may generate substantial proceeds which is punishable by a severe sentence of imprisonment in accordance with the penal law of the Member State [13].

The third directive, DIRECTIVE 2005/60/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 26 October 2005 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing [22] is still in effect.

The main reason for the adoption of the third directive (hereinafter Directive) was to harmonise legislation in the field of combating money laundering and terrorism financing. The Madrid bombings in 2001 also marked the beginning of a more determined fight against terrorism, reinforced the motivation of European lawmakers to address organised crime. The list of predicate offences was additionally expanded, and the directive also addressed the issue of customer due diligence and determining the beneficial owner in detail.

The Directive states that money laundering and terrorism financing often occur on a transnational level, thereby emphasising the importance of international cooperation and underlining that measures implemented at a national level or at the Community level would have limited effects, unless coordination and international cooperation are taken into account.

Consequently, the measures adopted by the Community in that context should be aligned with the action taken at other international forums. When taking measures at the Community level, FATF Recommendations should still be specially regarded [22].

Member States were obligated to adopt laws, regulations and administrative provisions necessary for the harmonisation with the Directive by 15 December 2007. After that, they had an

obligation to forthwith communicate to the Commission the text of those provisions along with a table showing how such provisions of this Directive correspond to the national provisions adopted.

Proposal for a fourth directive, i.e. DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing) is still deliberated in awaits its effectuation [44].

2.5. National legislation – CS: Republic of Serbia

Essential steps that each state should take towards a sustainable system against financial abuse and fraud lie within the harmonisation of national legislation with all relevant international standards. This harmonisation primarily refers to the field of money laundering and terrorism financing and fight against corruption. As regards the Republic of Serbia, the following laws govern and concern such fields:

- Law On Restrictions on Disposal of Property ON RESTRICTIONS ON With the Aim Of Preventing Terrorism [102]
- Law On Preventing Money Laundering and Terrorism Financing [124]
- Criminal Code [121]
- Criminal Procedure Code [119]
- Law On Financial Leasing [114]
- Law On Companies [110]
- Law On Auditing [105]
- Law On Accounting [106]
- Law On Banks [115]
- Law On Investment Funds [112]
- Law On Associations [113]
- Law On Capital Market [103]
- Law On Seizure and Confiscations of the Proceeds from Crime [104]

- Law On the Liability of Legal Entities for Criminal Offences [108]
- Law On Insurance [118]
- Law On the Procedure of Registration with the Serbian Business Registers [123]
- Customs Law [116]
- Law On Voluntary Pension Funds and Pension Schemes [121] Law On Agency for Fight Against Corruption [122].

The umbrella law in this field is the Law on the Prevention of Money Laundering and Financing of Terrorism (hereinafter: the Law). By adopting this Law, and establishing the Administration for Prevention of Money Laundering (hereinafter: the Administration), as a law enforcement body within the Ministry of Finance (FIU), the Republic of Serbia undoubtedly expressed its interest to become an active participant alongside the international community in the international system of combating financial fraud, primarily money laundering and terrorism financing.

The Republic of Serbia has in place several national strategies related to fight against financial abuse and fraud, namely: National Strategy against Money Laundering and Terrorism Financing adopted in 2008 (hereinafter Strategy 08) [107], National Strategy against Money Laundering and Terrorism Financing adopted in 2014 [117], National Judicial Reform Strategy containing recommendations regarding the work of prosecution, courts and other state authorities [109] and the National Anti-Corruption Strategy [101].

Bylaws adopted pursuant to the Law on Prevention of Money Laundering, Law on Banks and Law on Foreign Exchange Operations are:

1. Rulebook on Methodology for Implementing Requirements in Compliance with the Law on the Prevention of Money Laundering and Terrorism Financing (RS Official Gazette, Nos59/06 and 22/08);

2. Decision on Minimal Content of the "Know Your Client" Procedure (RS Official Gazette, No 57/06);

3. Decision on Conditions and Manner of Maintaining Non-residents Account (RS Official Gazette, No16/07);

4. Decision on Terms of Opening and Manner of Maintaining Non-resident Accounts (RS Official Gazette, No 67/06).

In addition to the Law on Prevention of Money Laundering and Financing of Terrorism, the Administration abides by a number of bylaws – rulebooks and other laws, among which are the following: [4]

- Rulebook on Methodology for Implementing Requirements in Compliance with the Law on the Prevention of Money Laundering and Terrorism Financing (RS Official Gazette, Nos 7/10 and 41/11);

- Rulebook on Reporting the Transfer of the Physically Transferable Means of Payment via State Border (RS Official Gazette, No 78/09); - Law on State Administration (RS Official Gazette, Nos 79/05, 101/07, 95/10 and 99/14)

- Law on General Administrative Proceedings (RS Official Gazette, No 30/10);
- Law on State Administration (RS Official Gazette, Nos 20/92, 6/93 – Decision of the Constitutional Court of the Republic of Serbia, 48/93, 53/93, 67/93, 48/94, 49/99 – other law, 79/2005 - other law, 101/2005 - other law and 87/2011 – other law);

- Law on Free Access to Information of Public Importance (RS Official Gazette, Nos 120/2004, 54/2007, 104/2009 and 36/2010);

- Law on Personal Data Protection (RS Official Gazette, Nos 97/2008, 104/2009 other law, 68/2012 – Decision of the Constitutional Court and 107/2012);

- Data Secrecy Law (RS Official Gazette, No 104/09);
- Law on Privatisation (RS Official Gazette, No 83/14); - Law on Civil Servants (RS Official Gazette, Nos 79/05, 81/05 – correction, 83/05 – correction, 64/07, 67/07 – correction, 116/08, 104/09 and 99/14);

- Law on Public Procurements (RS Official Gazette, No 124/12);

- Law on the Budget of the Republic of Serbia; - Law on the Budget System (RS Official Gazette, Nos 54/09, 73/10, 101/10, 101/11, 93/12, 62/13, 63/13 – correction, 108/13 and 142/14).

2.6. Institutional framework for combating financial abuse – CS Republic of Serbia

Institutional framework for combating financial abuse in the Republic of Serbia has been defined in a manner presented in the National Strategy against Money Laundering and Terrorism Financing which lists the main institutions involved in these activities (fig. 2.1): [86]

- Ministry of Finance
- Administration for the Prevention of Money Laundering
- Public Prosecutor's Office
- Courts
- Police
- Military Security Agency
- Military Intelligence Agency
- Security Information Agency
- National Bank of Serbia
- Securities Commission
- Market Inspection Sector,
- Administration
- Tax Administration
- Anti-Corruption Agency
- Judicial Academy and Criminalistic and Police Studies Academy
- Serbian Association of Banks
- Serbian Bar Chamber

- Journalists and
- Non-Governmental Sector

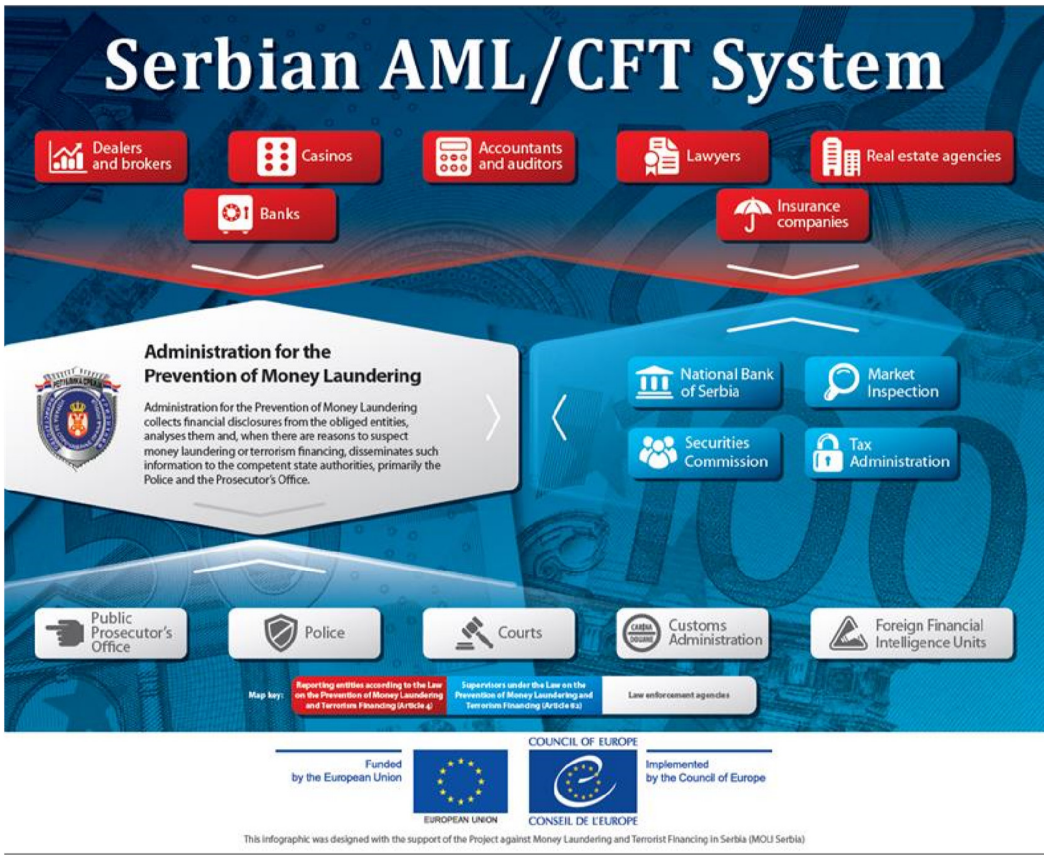

Fig. 2.1. Overview of the Serbian AML/CFT system [86]

Administration for the Prevention of Money Laundering (hereinafter: the Administration) is the financial-intelligence unit (FIU) of the Republic of Serbia, set in accordance with the global standards. The Administration collects, analyses and keeps the data and the information and if it finds reasonable grounds to suspect money laundering, the Administration notifies the relevant state authorities (police, judicial and inspection bodies) for undertaking the measures from their competences.

International legal framework for the establishment and operation of the Administration is DIRECTIVE 2005/60/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 26 October 2005 on the prevention of the use of the financial system for the purpose of money

laundering and terrorist financing [22]. Under this Directive, each Member State is obliged to establish Financial Intelligence Unit – FIU, so as to engage in an efficient combat against money laundering and terrorism financing.

The Law on Prevention of Money Laundering and Financing of Terrorism [124] from 2014 (hereinafter Law) and the National Strategy against Money Laundering and Terrorism adopted in the same year [120] comprise the fundamental national legal framework.

The Law on Prevention of Money Laundering (RS Official Gazette, No 101/05) which became effective on 10 December 2005 established the Administration for Prevention of Money Laundering as a law enforcement body within the Ministry of Finance, thus gaining autonomy and the status of legal entity. From 1 July 2002 to 10 December 2005, the tasks which are much similar to the tasks now carried out by the Administration for Prevention of Money Laundering were within the competence of Committee for Prevention of Money Laundering. Funds for work and operation of the Administration for Prevention of Money Laundering as a direct budget beneficiary are provided for from the budget of the Republic of Serbia [37].

Through cooperation with other state bodies and obligors, the Administration also undertakes to determine the need for further professional education, pursued through various seminars and workshops, which aims towards a more successful implementation of the law in all its aspects. By cooperating with state bodies, the Administration strives to help strengthen the system for detecting and preventing money laundering in Serbia and preserve the integrity of the financial system of the state.

In terms of combating financial crime, money laundering and terrorism financing, the **police force** is, as a part of the Ministry of Interior (hereinafter: MOI), in charge of investigations relating to money laundering and terrorism financing [63]. Money laundering investigations fall under the competence of the Criminal Police Department (CPD) which has its seat and 27 regional police departments (fig. 2.2): [86].The CPD is responsible for the on-going status and organisation of operations to identify and suppress all forms of organised crime, prevent and suppress other forms of crime and is tasked with related planning and organisation of timely information sharing and reporting and coordination of services, while carrying out and organising intelligence and counter-intelligence tasks, implementing operational, technical and tactical measures aimed at

revealing and documenting all criminal offences, in accordance with law. The Service for Combating Organized Crime, which is part of the CPD, as well its organisational units, namely the Department for Suppression of Organised Financial Crime, Department for Suppression of Organised General Crime and Financial Investigations Unit [86] have an important role to play.

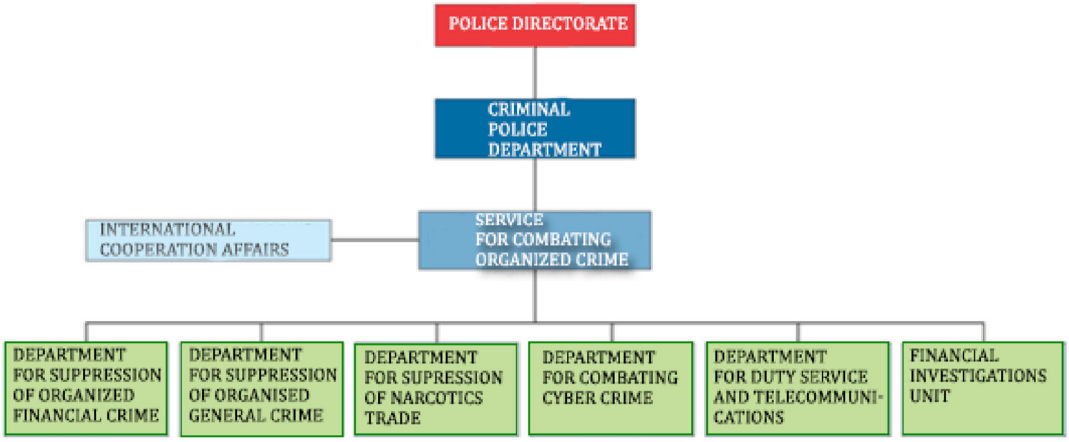

Fig. 2.2. General organisational scheme of the Ministry of Interior of Serbia [86]

When cases of money laundering and terrorism financing have an organised crime dimension, they fall under the competence of the Section for Suppression of Money Laundering, which is a part of the Department for Suppression of Organized Financial Crime. Each of the 27 regional departments also has a specialised section for the suppression of financial crime. The Financial Investigations Unit was founded under the Law on Seizure and Confiscation of Proceeds from Crime [108] as a specialised organisational unit of the Ministry of Interior in charge of financial investigations. Its main task is tracing the proceeds from crime.

The **Military Security Agency** (hereinafter MSA) is in charge of security and counterintelligence tasks relevant for the defence system of the Ministry of Defence and the Army of the Republic of Serbia, and as such it performs security, counter-intelligence and other activities of importance for the defence of the Republic of Serbia, in accordance with law and ensuing regulation [70]. The normative-legal framework of the MSA stems from the Constitution of the Republic of Serbia, Law on Defence, Law on Army of the Republic of Serbia, Law on Bases regulating Security Services of the Republic of Serbia, Law on Military Service Agency and

Military Intelligence Agency, Criminal Code, Law on Criminal Proceedings and other laws of immediate significance for the work of the MSA [24].

Among other tasks that fall under its competence, the MSA is charged by virtue of law to detect, trace and prevent intelligence operations, subversive and other activities performed by foreign countries, foreign organisations, groups or persons targeting the Ministry of Defence and the Serbian Armed Forces.

According to law, the MSA *inter alia* detects, monitors and disrupts internal and international terrorism and detects, investigates and gathers evidence in cases of crime against the constitutional order and security of the Republic of Serbia, organised crime cases, money laundering offence and crimes of corruption directed against the commands, institutions and units of the Serbian Army and the ministry competent for defence. Having in mind the MSA's competences, as defined by law, prevention of money laundering and terrorism financing is one of the most important tasks in protecting the defence system. The MSA has set up a special organisational unit whose tasks also include detecting, investigating and documenting money laundering and terrorism financing crimes. This unit receives analytical support from a special MSA unit. The MSA has legal power to apply special procedures and measures for covert collection of data of preventive nature, as well as special investigative techniques in detecting, investigating and documenting the crimes of money laundering or terrorism financing, within its competences. A legal mechanism that is in place ensures that the information collected in this way is considered as having full credibility at trial in criminal procedural terms [86].

As a security service of the Republic of Serbia, the Military Intelligence Agency is competent for intelligence tasks relevant for defence, including collection, analysis, evaluation, protection and dissemination of data and information about potential and actual threats, activities, plans and intentions of foreign states and their armed forces, international organisations, groups and individuals, having a military, military policy or military economic dimension, and also related to terrorist threats, directed from abroad against the system of the Republic of Serbia [70]. The Constitution of the Republic of Serbia, Law on Military Security Agency and Military Intelligence Agency build the most important normative legal framework of the Military Intelligence Agency.

The **Security Information Agency** (hereinafter BIA) is a special organisation established under the Law on the Security Information Agency [111] holding the status of a legal entity. It is a part of a single security-intelligence system of the Republic of Serbia.

BIA also performs the tasks related to countering organised international crime. These tasks include detecting, investigating and documenting the most serious forms of organised crime with international dimension, e.g. drugs smuggling, illegal migration, and human trafficking, arms smuggling, money counterfeiting and money laundering, as well as the most serious forms of corruption linked to international organised crime. Special BIA activities and tasks are related to the prevention and suppression of internal and international terrorism. BIA has set up a unit against international organised crime dealing also with the prevention of money laundering and terrorism financing [86].

2.7. Indicators for recognising suspicious transactions for banks

With respect to combating financial crime, the banking sector of a country operates within the domestic legislative framework which undergoes the harmonisation with the international legal norms and standards on a daily basis. Legislative frameworks and standards are defined at the international level with a view to achieving a single international cooperation system, both in terms of prevention and repression.

At the EU level, each country is obliged to adopt the necessary legal and other measures which should ensure that immediate action is undertaken by the FIUs, or if necessary, by any other competent authority or body, in case of the existence of suspicion that a transaction is related to illegal financial activities, and money laundering, in particular, or that such transaction is suspended and prohibited for realisation, for the purposes of analysis and assessing the justifiability of the suspicion. Each EU country may limit such a measure to the cases where the suspicious transaction was reported on. Determining a maximum duration for any such suspension or prohibition of realisation is subject to relevant provisions of the domestic legislation.

At the EU level, FIUs are obliged to develop the lists of indicators for identifying suspicious transactions related to terrorism financing, as well as the indicators for identifying the grounds of suspicion of the potential money laundering or terrorism financing (hereinafter: the

indicators), for bankers, obligors. These indicators are adopted and passed in a form of legal documents (typically, decrees) based on an umbrella law regulating the prevention of money laundering and terrorism financing.

CS: Republic Serbia: *Indicators for recognising suspicious transactions for banks*: [37]

1. Money deposits in the banking sector for which the obligor, in accordance with the Law on the Prevention of Money Laundering and Terrorism Financing [70] (hereinafter: the Law) has no convincing information on the origin of the client's money (the obligor has not been delivered convincing information and the data by the client, or as indicated by the risk assessment);

2. A client deposits the money for performing the investment-based transactions, in terms of purchasing the real estate, shares in a company, privatisation and the like, where the obligor possesses no convincing information on the origin of the money (or the client failed to submit these information to the obligor);

3. Cash or non-cash payments of natural persons in favour of natural persons, where one can conclude that such transactions lack the logical or economic justification, or the convincing information on the origin of the money;

4. Cash transactions carried out by a legal person for which there are reasons the suspect the origin of the money, based on the risk assessment performed by the obligor, in accordance with the Law;

5. The clients performing cash transactions suspected of evidently not being in the client's interest, and the origin of the money is subject to suspicion;

6. Cash depositing or providing security for a third person by providing guarantees which lack convincing information or the origin of the money is subject to suspicion;

7. Transactions (cash and non-cash) where the money is transferred from the accounts of the legal persons to accounts of natural persons, withdrawn in cash immediately and the origin of money is subject to suspicion.

8. Transactions on basis of provided, received and repaid advance payments, where the client does not have substantial evidence on the origin of funds in accordance with the Law (e.g. advanced repayments justified by non-performed purchase and sales agreements);

9. A client is unemployed or has a bad reputation, yet is in possession of funds in the accounts or performs transactions for various purposes, and lacks appropriate evidence of the origin;

10. A client deposits cash and constantly provides the same explanation for the origin of these deposits, (revenues from sales of property, lease of business premises) when the purpose of the deposits and the origin of this money are suspected of being untruthful;

11. A client personally, or through third parties, carries out the cash payments into the company account, by means of 'the founder's loan for liquidity', or by increasing the nominal share, which is contrary to the company operations or lacks any economic justifiability, and the origin of the money for investment is subject to suspicion.

12. Money transfers abroad from the clients' accounts, in cases when the account balance is the result of cash depositing, lacking sufficient and appropriate information on the origin of the money;

13. A client withdraws the money from the account transferred from the countries where the standards on money laundering and terrorism financing are not applied, or the zone where the strict rules on the confidentiality and bank secrecy are in place, and where it is difficult to identify the real origin;

14. Transactions relating to payment for and collection of services, at prices significantly different from the regular prices, and which lack economic justifications, as well as the transactions relating to the companies whose main business activity involves providing the professional and consulting services, where this particularly applies to the cash payments for the provision of services, followed with the transfer of money to the accounts of other companies (legal persons) or the transfer of money abroad on the basis of services received;

15. Transactions carried out through a number of accounts or participants (orders and originators), particularly if the participants in these complex transactions are from the countries where the standards relating to money laundering and terrorism financing are not applied, or from the countries where the strict rules on the confidentiality and bank secrecy are in place, and where the real origin of the money is subject to suspicion, or potential suspicion of money laundering;

16. A client carries out transactions with persons from countries widely known for massive production and/or trade in narcotics (e.g. Afghanistan, Columbia, etc.) and where the origin of the money is difficult to identify;

17. A client provides securitization funds (e.g. guarantees, letters of credit, deposits) issued by an offshore bank, a bank with dubious creditworthiness, or a bank from a country which does not implement AML/CFT regulations;

18. The originator or beneficiary of a bank wire transfer is a citizen of a country which does not implement AML/CFT regulations or is present on the consolidated list of the Security Council Sanctions Committee, pursuant to Resolution 1267. The list of those countries can be found on the following website:

    http://www.un.org/sc/committees/1267/aq_sanctions_list.shtml

19. Clients who avoid to give information relating to the transaction, proxy, identity and the like, and who offer potentially false documents or provide false data or carry out the transactions accompanied by other people, or attempt to prove their identity in some other way except by giving their personal identification document;

20. The situations when the nominee are hired for handling all issues relating to bank safes;

21. A foreign official, their family members or associates (nominees to accounts) carry out transactions and bank safe deposit boxes are used, either personally or by nominees, whereby the origin of the money is unknown or impossible to identify;

22. Acting upon the Law, the Obligor recognises, based on the client risk assessment, that the client carries out unusual transactions of the money whose real origin is difficult to identify, and which are inconsistent with the usual transactions from the client's business activity, such as depositing or withdrawing of money, which are significantly different from the client's usual transactions and are inconsistent with the inflow and outflow (account turnover) and the client's business activity, and the legal person thus becomes a 'fictitious channel' for the distribution of money;

23. Acting upon the Law, the Obligor recognises, based on the client risk assessment, that the client has had 'passive' (inactive) accounts for a longer period of time and keeps opening new accounts which unexpectedly record income and use them to withdraw or transfer the money on the basis of transfer codes inconsistent with the client's business activity to date;

24. Acting upon the Law, the Obligor recognises, based on the client risk assessment, that the client has recorded a sudden increase of cash deposits into the account of the company which does not use cash in its operations, due to the nature of its business, or the client frequently and solely carries out the transactions in the equal (rounded) amounts to/from the business partners, on various bases, which indicates the fictitious transactions.

Banks are obliged to adhere to these guidelines and react in case of suspicion for any of the indicators above.

Amended list of indicators for recognizing suspicious transactions related to terrorism financing is published on the website of the Administration for the Prevention of Money Laundering. In line with Article 23 of the Rulebook on Methodology for Implementing the Law on the Prevention of Money Laundering and Terrorism Financing, the obligors are required to include the indicators which are the integral part of this Directive into the list of indicators they develop pursuant to Article 50, paragraph 1 of the Law on the Prevention of Money Laundering and Terrorism.

2.8. Indicators for suspicious transactions in the insurance sector

In 2004, the International Association of Insurance Supervisors (IAIS) published a list of indicators for suspicious transactions (transactions which are a part of the money laundering process) in the insurance sector [33]:

- A potential insurance beneficiary comes from a very distant area where there are other operating insurance companies, but this beneficiary requests services from an insurer at this distant location without a valid reason;
- A potential insurance beneficiary wants to insure himself from the risks which are not specific for the type of activity he/she is engaged in;
- A potential insurance beneficiary is not providing the requested information, or is prolonging the delivery of information relevant to the insurance contract signing;
- A potential beneficiary accepts unfavourable insurance conditions (e.g. health insurance is not in accordance with beneficiary's health, or age);
- The insured person pays premiums upfront in an uncommonly frequent manner;
- Unusually high premiums of the insurance beneficiary, which are not in accordance with the beneficiary's income; influx of money to insurance broker accounts via non-resident accounts;
- Insurance request does not have a clear basis – a potential beneficiary does not wish to reveal the reason for insurance;
- Cancellation of the insurance contract before its realization occurs;
- Not informing the insurer about the change of the insurance policy beneficiary;
- A change of the insurance policy beneficiary and declaring a new beneficiary who is completely unrelated to the insured person; A potential beneficiary already has several insurance policies with other insurers;

- Purchase of an insurance policy with a large insured amount, followed by a policy buyout after a very brief period;
- The beneficiary requires the maximum loan amount based on the policy shortly after the contract signing;
- The beneficiary is not available for any contact, via phone or e-mail

Suspicious transactions also include cases where the beneficiary is more interested in the conditions for cancelling a contract, than the actual insurance benefits. Also, special attention should be given to payment of premiums from off-shore locations.

Based on this list, it is clear that the presented set of indicators complies with international legislations and recommendations. The most important thing is that all PIRA should closely follow legal instructions and adequate procedures. This requires training of all actors in the insurance sector, to ensure that there are no unintentional omissions and disregard of legal procedures. It is also very important that the general public is informed and educated about the risks of financial fraud and its consequences. In this way, the power of prevention is also strengthened, and general conscience and awareness are raised among persons who must be engaged as actors in fraudulent activities by money launderers, without them being aware of the procedure that they are a part of, and its consequences.

3. International financial abuse

3.1. Introduction

Financial crime is one of the most severe problems encountered by all the economies around the world. In times of financial crisis and recession, the risk of frauds and fraudulent financial reporting is even more on the rise. Money laundering and terrorism financing are global problems affecting the economic, political, security and social structures of any country. The following are ramification of money laundering and terrorism financing activities: undermined stability, transparency and efficiency of the financial system of a country, economic disorders and instability, jeopardized reform programs, fall in investments, deteriorated reputation of the country as well as endangered national security.

The International Monetary Fund estimates that a total volume of money laundering throughout the world constitutes 2 to 5 percent of the global total gross domestic product. The amount corresponding to this percentage is USD 590 billion to 1.5 trillion USD per year. Given the secrecy of money laundering and its inherent nature, the above data give us only an indication of the size of this problem. [86]

A question emerges as to whether objective or subjective factors further contribute to committing financial frauds. The objective factors should certainly include the readiness and skilfulness of the criminogenic groups for constant invention of new forms of fraud, whereas the subjective factors include everything else: potentially inadequate legislation, institutional organisation, insufficient and insufficiently skilled staff and lack of understanding of the economic aspects of financial crime by the judiciary and general public. The organisational factor should be included, as well, as it pervades all the stages in combating the financial and organised crime and is reflected in better communication, coordination, use of the latest scientific achievements and information-communication technology. The initial premise is beyond any doubt that the modern crime, including the financial one, as well, goes beyond the traditional boundaries, and, the fight against it must therefore be perceived as transnational, highlighting the importance of the solid organisation which should primarily demonstrate a preventive role in combating the financial frauds, money laundering and terrorism financing.

The following forms of financial abuse are most often found in theory and practice: frauds in financial statements, tax fraud (evasion) and money laundering. While frauds in financial statements primarily relate to the frauds with no international exposure, tax fraud and money laundering are most frequently the global issues. Money laundering is the result of main illicit activities around the globe, which, in a nutshell, take place through the three following activities: organised crime, manufacturing and traffic in narcotic drugs and terrorism financing.

Given the contents of the thesis, this is the main reason why the text below will to the largest extent address the phenomenon of money laundering and so-called “tax havens”, the notions very often closely intertwined.

This chapter aims to examine the exposure of the modern society to the risk of financial crime, identify the characteristics and occurrence of frauds, in particular of money laundering, and

their modalities. The text below presents the main forms of financial frauds affecting the social, economic and security systems of any country, highlighting the international aspect. Particular attention was given to the banking and insurance systems, by presenting the main types of frauds in these sectors. The chapter ends discussing the issue of tax evasion and the role of offshore business in the process of financial abuse.

3.2. Money laundering

The phenomenon known as money laundering has gained significance in the recent period, particularly following the intensified terrorist activities by various extremist groups worldwide. The term "money laundering" originated in the United States of America during the prohibition period (the period of banning the sale of alcoholic beverages) in 1920s and directly relates to the organised crime, when the mobsters presented the money earned from illegal manufacturing and bootlegging as the profit generated from the chain of laundries and car wash services [14]. This coinage was subsequently promoted by the London daily *The Guardian* in 1973, directly linking it to the Watergate affair, and the amount of USD 200,000 meant for financing the American election campaign in favour of the republicans. The notion was first introduced in the legislation in the Bank Secrecy Act of 1970, and was first criminalised by the adoption of the Money Laundering Control Act of 1986. [75]

In early 1980s, the term money laundering was used in the United Nations Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances, Palermo Convention, The

Council of Europe Convention 141 on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime, FATF recommendations, and the Council Directive 91/308/EEC on prevention of the use of the financial system for the purpose of money laundering and terrorism financing.

In simplest terms, money laundering may be defined as the transformation of the illegally acquired money into the money which appears legal in the eyes of the law [14]. Money laundering is a process of disguising the illegal source of money or proceeds originating from crime. When proceeds are generated through the commission of a criminal offense, the perpetrator, or the organised criminal group, seek ways to use this money without attracting the attention of the

competent authorities. That is why they carry out a series of transactions whose purpose is to show the money or assets generated as legitimate. In this process, the money frequently changes its shape and transfers from one place to another [37].

Money laundering is a process of transforming the illegally acquired money in cash into the regular money in financial institutions. In the broadest sense, such money tends to originate from grey economy, irregular activities, illegal work in the areas of agriculture, building and construction, catering business, private transport companies, hotel and tourist facilities, commissions from trading with countries under embargo, dealings with mafia, smuggling, trafficking in human beings and organs, protection racket, predatory lending, trade in arms and radioactive material, ordering of murders and other criminal acts. [99]

The literature lists a number of methods and techniques used for money laundering. The following are the ones most common in theory and practice:

- Washing machine method,
- Smurfing technique,
- Import and export missing voicing,
- Trade-based money laundering techniques,
- Bartering,
- Cash couriers,

Each method will be briefly addressed in the text below.

3.2.1. Washing machine method

According to this Chart, the one most frequently referred to in the literature, money laundering process is the generic Chart, typically consisting of three stages [18]:

1. stage: Placement
2. stage: Layering
3. stage: Integration

The stage of **placement** (also referred to as „pre wash stage“[14]) is the physical disposal of cash, i.e. the termination of the direct link between the money and the illicit activity through which it was generated. This is the stage where the illegally acquired funds are introduced into the financial system, primarily, the banks. Money is deposited into bank accounts, most frequently using a legitimate activity where payment is carried out in cash. One of the ways to do it is by setting up a fictitious company that has no business activities but serves only for depositing 'dirty' money or structuring large amounts of money and then its depositing into the accounts in amounts that are not suspicious or subject to reporting to the competent bodies. [37]

The above stated leads to a conclusion that banks successfully recognized the situations which raise suspicion that a client carries out its business activities in the so-called grey or black area, since tax crimes were recognized as ones of the most risky in the national risk assessment. However, it is important to pay attention in the future to other manifestations of money laundering and terrorism financing which banks are required to report.

Transactions related to sales of goods and services also require attention, since their purpose is not tax evasion but depositing and integrating money from other illicit activities into the legitimate financial system. Cash deposits not accompanied with a known source of funds definitely pose a higher risk.

In this stage, an important role is also given to the list of indicators for recognising the suspicious and illogical transactions.

The second stage: „**layering,** „disguising" or „structuring" (also referred to as „main wash"[14]) is the process of transferring the funds across various accounts in order to disguise their origin. After the cash somehow entered the legal financial system and became the bank deposit, the next step in the money laundering process is layering. Layering is carried out by transferring the money from an open account into the accounts worldwide, usually into the various bank accounts around the world, fictitious companies and other financial institutions, with the purpose of disguising the original source and destination of the initial illegal capital. The money is transferred by numerous transactions, many of which lacking any economic or business justification, but aimed at concealing the link between the money and the criminal activity it was derived from, i.e. concealing the cash flows and hampering anyone who is trying to identify the source of the money.

Concealing the real purpose of such transactions can be achieved by transferring the money for the goods or services allegedly provided abroad. In order to eliminate any doubt from transferring the money abroad, "money launderers" often set up companies abroad, which serve as suppliers. These companies then send fraudulent or over-valued invoices to the company where the "dirty" money had been deposited, yet the exchange of goods or services either fails to occur, or occurs in inappropriate amount or quality, with the money being the only thing that goes from one place to another, and seemingly transferred abroad for performing the legitimate activity. In addition, there are many other ways for the money deposited into the account to be transferred for the purpose of concealing its origin. When the money is deposited into the account, it is invested in virtually anything that can disguise its origin. This is the stage where the insurance policies, works of art, luxuries items (cars, yachts…) are purchased, as well as racing horses, shares in companies, investment funds, other companies, loans for borrowing and the like.

The third stage: „**integration**" (also referred to as drying/centrifugation/recycling [14]) is putting the 'cleaned' funds into the legitimate flows. This is how the money launderers integrate their funds into the financial system and combine them with the regular funds, hampering the detection of the real origin of the money. This basically means that the 'dirty' money appears as the money derived from a legitimate activity.

Purchasing the business facilities, warehouses or residential buildings is a method frequently used to integrate 'dirty' money into the legal financial system. Renting real estate is a legitimate business while profit from renting is not suspicious. Money is frequently invested in companies having difficulties after which they continue operating while the dividends and managers' salaries paid out are legitimate proceeds. The following combination is also applicable here: a 'cooperative' seller of real estate agrees to report the purchase below the actual value, yet receives the remaining sum 'under the table' (tax fraud is committed, as well), and after some time, a new owner sells the property at actual value, thereby legalising the 'difference in price.'

Overall, in the 'washing machine' method, '**the pre wash stage**' usually takes place in the countries with extremely poor foreign exchange controls, and with strict principles regarding confidentiality and bank secrecy. In the countries with poor foreign exchange controls, current and savings accounts are opened, whereas in the countries with strict principles regarding confidentiality and bank secrecy, fictitious companies are established.

„**Wash stage**“ usually takes place in the countries with poor foreign exchange controls, disguised as privatisation process. In the countries with strict principles regarding bank secrecy, depositing of illegally acquired money is now visible. This is how, in the final instance, the process of legalising the funds is carried out (and the money gains legitimacy).

Finally, in the „**recycling stage“** (performed only in the countries with poor foreign exchange controls) fictitious investments in the economy of such country are made by transferring the money through current accounts and, most commonly, returning it to the country it derived from. This is performed with the 1-10% for each service, although real money laundering costs in the range of 20-50% of the total value of the money laundered. [99]

When the money reaches this stage, it is very difficult, perhaps impossible, to identify its illegal origin.

3.2.2. Smurfing technique

This technique involves the so-called smurfing, where a large number of small amounts of money is deposited in a large number of small, unrelated banks. [75] There is a deposit limit in the world (up to EUR 20,000 in Germany, USD 10,000 in the USA and EUR 50,000 in France) over which the bank controllers do not allow payments of deposits into the bank accounts (without the evidence of the origin of the money). These deposits are made into various unrelated financial institutions, and are then ‘pooled’ by transferring them into the master account. Account are often opened under a false name.

By ‘structuring’ the transactions below the specified level of the transfer of funds through a network of ‘smurfs’ and by transferring the funds through a number of bank accounts, the trail of the origin of the money is lost (fig. 3.1.). This is how the owners of the dirty money obtain the legitimate money, and the smurfs get the reward for the work done. Purchasing bank notes, letters of credit and travellers cheques is also considered smurfing.

Money laundering is also performed through the so-called shell companies, particularly for larger sums of money [52]. This is realised by transferring the dirty money to an attorney or a company which serves as a screen, in a country which is not too investigative about the origin, or which is not yet strict in terms of banking secrecy. This company transfers the money to another

company, typically located in an off-shore centre, represented by formal owners or local lawyers, and then the money is transferred to a bank located in some of tax havens. As a final step, the money is invested into a legal activity, or into a respectable financial institution, often located in the country the dirty money has derived from.

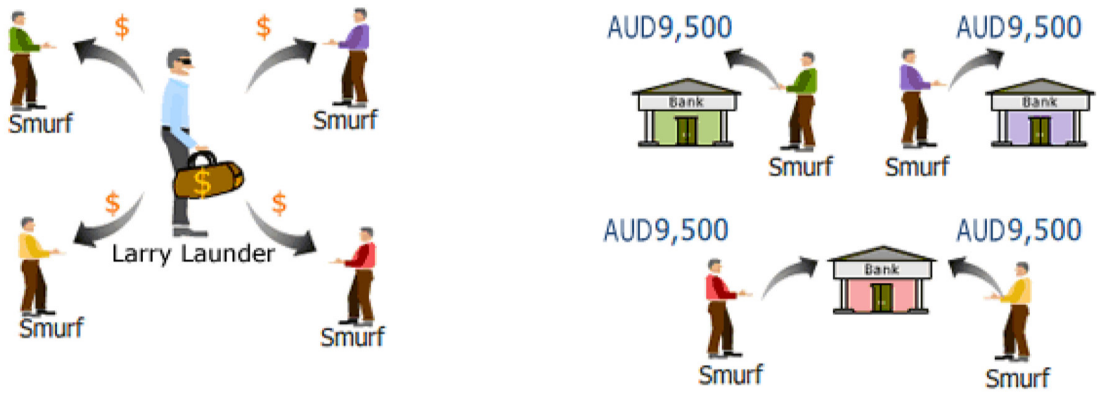

Fig. 3.1 Smurfing technique [38]

The more companies and banks are involved and the more transfers from one account to another have been performed, the harder it is to trace the origin of the money. The key role is played by shell companies, which have no real business activity, rather, they are used only for opening the accounts in different banks, and later on, they serve to show that the funds have derived from legal transactions, through fictitious operations. The documentation accompanying these transactions (loan agreements, bank guarantees, purchase contracts, letters of credit etc.) is typically false or legally incomplete.

3.2.3. Import and Export Misinvoicing

Import and export misinvoicing and counterfeiting the information in the international trade instruments and customs declarations has a major role in the international financial fraud system, whereby the developing countries are most affected (fig. 3.2). These frauds also include the issuance of false invoices for the service or goods not provided or delivered, or significantly below the real price.

Here should also be included the damage insurance claims for the goods that has never existed. Also, in insurance operations, a well known method is purchasing the insurance policy with the dirty money, where it is possible to make early cashing in of the insurance policy, with the discount for the 'clean' insurer's cheque, or use it as a collateral for a bank loan.

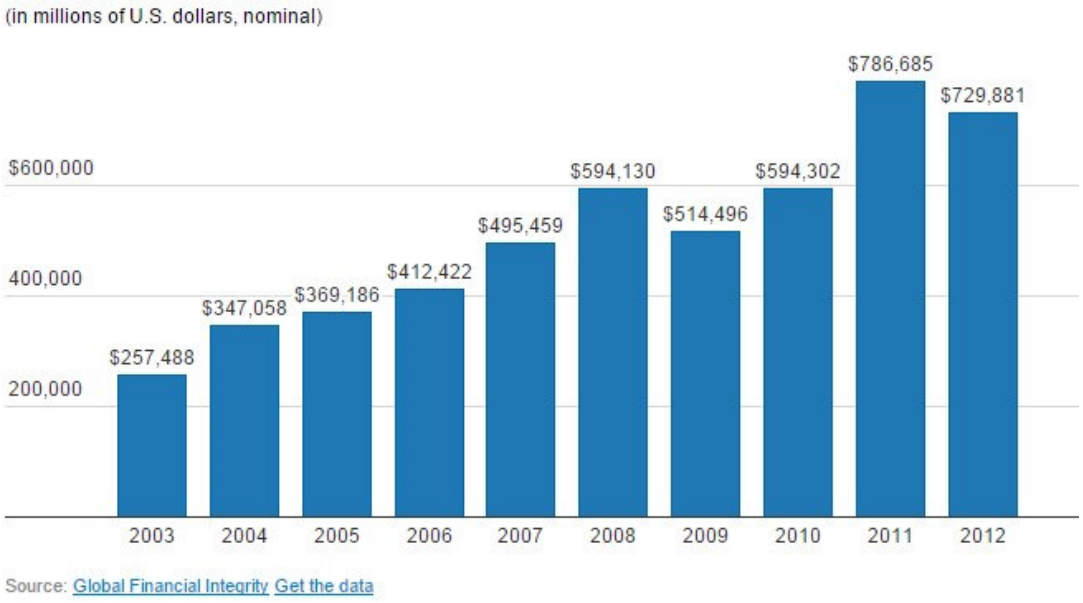

Fig. 3.2 Trade Misinvoicing Outflows from Developing Countries, per years, in millions USD [48]

Using the example of the import of used cars, we will demonstrate how this misinvoicing technique works in practice (fig. 3.3). In this case of import over-invoicing, the Indian importer illegally moves $500,000 out of India. Although he is only buying $1 million worth of used cars from the U.S. exporter, he uses a Mauritius intermediary to re-invoice the amount up to $1,500,000. The U.S. exporter gets paid $1 million. The $500,000 that is left over is then diverted to an offshore bank account owned by the Indian importer.

Fig. 3.3 An example of misinvoicing fraud [Ibid]

3.2.4. Trade-based money laundering techniques

Trade-based money laundering techniques of the FATF are one of the main methods used by criminal organisations and terrorist financiers for laundering the illegally acquired money, by concealing its origin and integrating it in the formal economy. [9] Trade-based money laundering techniques belong to a group of the so-called 'simple frauds' and range from the misrepresentation of the price, quantity or quality when invoicing, to the complex network of trade and financial transactions as ordered.

Trade-based money laundering techniques include the following illegal activities: [129]

- Over- and under-invoicing of goods and services
- Multiple invoicing of goods and services
- Over- and under-shipments of goods and services
- Falsely described goods and services.

3.2.5. Bartering

This form of money laundering is not too sophisticated but is still in use [50]. There is a number of individual techniques and the following are the most common:

- Bartering the domestic stolen goods for legal assets abroad with the appropriate discount
- Purchasing the securities and other financial derivatives through a broker is a simple and equally 'clean' transaction. After the prices have been set, one need only to draw up a contract on the purchase and sales of futures and record it with the 'cooperative' broker, thereby creating a seemingly legitimately acquired profit.
- Purchasing the gambling chips in the casinos for cash, and afterwards, their exchange for the cheque at the casino cash desk, without playing, or after spending an insignificant amount of money

- Purchasing foreign currency in small amounts for travelling purposes and getting them abroad through a network of ‘tourists’
- Overpaying the credit card deposit or creating high ‘credit balance’ easily transferred into cash at any time and place, where the reputation of the credit card issuer does not raise suspicion.

3.2.6. Cash couriers

Cash carrying into a country which is not too investigative about the origin is perhaps the most risky money laundering technique, yet is still performed [53].

Cash has become attractive and this is why there has been a rapid rise in the number of countries where transactions are made in cash (and not by credit and debit cards, cheques, wire transfer…). After a multiple turnover of cash, the owners aim to transfer the ‘laundered’ money into the country with a highly developed practice of using cards (the USA, for instance), due to a popularity of payment cards, credit and debit, plastic cards. This is the reason why the money is transferred ‘at all costs’ into the bank to enable its further transfer worldwide. This is the socalled first stage in money laundering. However, the second stage of money laundering has now emerged where the money is used for purchasing an entire bank and for establishing a new bank. The Russian mafia was among the first in the world to purchase the bank in Antigua, headquartered in Moscow, for money laundering for the Russian mafia. Also, in early 1999, the Italian mafia purchased an entire island of Aruba in the vicinity of Venezuela coast, for the purpose of finding ‘new areas’ for laundering enormous amount of dirty money from around the world. [99]

However, ‘money launderers’ in the financial world make use of not only the banks, but non-banking institutions, as well, such as: insurance companies, mortgage corporations, leasing companies, companies involved in the issuance of credit cards, factoring and forfeiting companies, companies involved in trade and interest arbitration, exchange activities etc.

3.3. Tax evasion

Financial frauds, and particularly money laundering and tax evasion pose a major threat to global financial flows, as the amount of transactions involving the illegal, dirty money, is constantly increasing. The two processes, tax evasion and money laundering, are significantly interrelated and are virtually impossible to segregate and analyse separately [84].

The tax system in a country is an indicator of its national sovereignty in terms of leading its own policies and strategies [84]. Although the tax system in the EU countries is characterised by variety, the EU fiscal policy refers to the following two main areas: 1) direct taxes (under sole competence of the EU member states) and 2) indirect taxes (which directly affect the free movement of goods and services). Unlike the direct taxes where the countries make independent decisions and undertake measures with a view to preventing tax evasion and double taxation, the harmonisation of indirect taxes is regulated by transnational (European) regulations and falls within the competence of the EU institutions (Council of the European Union, European Commission, European Parliament and European Economic and Social Committee). The most relevant **direct** taxes include: company income tax, income tax, interest and dividend income tax for natural persons, while the most relevant **indirect** taxes are: value added tax (VAT) and excise tax. [76]

Taxation leads to a number of socio-economic consequences at the state level: of economic, social and political nature. Taxation takes away a portion of taxpayers' income, thereby affecting their economic strength. Therefore, depending on the taxation policy, the taxpayers are likely to avoid paying taxes in the entirety, or to a certain extent. In the financial theory, this phenomenon is termed tax fraud (avoidance) or tax evasion. [77]

The measures resorted to by the taxpayers to avoid or reduce the effect of the tax on their income are numerous. One of the most important consequences relates to the country's macroeconomic stability when the tax evasion by the taxpayers leads to a departure from the projected fiscal policy, i.e. insufficient revenues in the budget, which has far-reaching adverse socioeconomic and political consequences.

Regarding the international financial frauds, an important role is given to the double taxation problem, also closely related to the tax evasion. Double taxation lacks a single, generally

accepted definition. Double taxation can be internal – within a country, and international (external), when a taxpayer pays the same tax, or the tax of the same kind, for a property to two member states for the same time period. All the definitions have one taxpayer in common who is subject to at least two tax authorities, to which he/she is obliged to pay the same or similar tax, ending up with the amount of tax higher than if taxed by one tax authority only. Generally, double taxation occurs when a taxpayer is taxed twice for the same property or income. [74]

This thesis considers the double taxation as a result of international activities. The consequence of international double taxation is that taxpayers are under a heavier tax burden than if they settled the tax liability in one country only. The consequences affect the persons whose business and/or life interests are in a way related to foreign countries. For instance, a person may conduct his/her business operations in one country, but live in other. In situations like these, a person may be subject to corporate income tax in his/her country of residence, and in the country the business operations are conducted, as well. Some countries have double taxation treaties in place, enabling the taxpayer to settle the tax liabilities in their countries of residence and enjoying the tax relief in other country. A measure for avoiding double taxation may be that the tax liabilities are settled in the country where income is generated.

This, however, may pave the way for tax evasion. By introducing the term 'international double taxation', it is possible to devise an analogy with the term internationally-organised tax evasion. Tax evasion may be, in part or whole, carried out without the violation of the positive legal regulations (the so-called lawful or legitimate tax evasion), or with the violation of the positive legal regulations (the so-called unlawful or illegitimate tax evasion).

Tax evasion with no formal violation of legal regulations is based on the fact that the taxpayers are exposed to tax legislations of a number of countries and are able to find the so called loopholes in laws. Due to the existence of different tax systems, and consequently, the minimum tax rates, the lowest tax amount may be paid in a number of ways, regardless of the country where the taxpayer has founded the company, or where he/she has generated the income. This could even lead to a complete tax evasion. If a taxpayer is operating at the international level, the tax authority of his/her country of residence is usually unable to obtain the data relevant for determining his/her tax liability, which is provided for in the worldwide income/profit principle, as the data which could facilitate the control of the taxpayer is under the jurisdiction of another country. Regarding

the protection of taxpayer rights, the taxpayers are entitled to protection of secrecy of certain categories of data, relating to their life and business activities. This is why the analysis of the data exchange issue is predominantly oriented towards examining the authorities and restrictions of tax authorities in the data exchange procedure, both in the formal (with respect to procedural rules) and material aspect (with respect to the types of data subject to exchange). During the data exchange, however, there is a certain danger of violating the rights of the taxpayers, with respect to the secrecy of particular data. The commitment on the protection of secrecy often leads to a conflict between the signatory countries, due to their efforts to identify the data which could enable them to calculate and collect the tax liability in the full amount. [77]

Countries are particularly motivated to prevent the tax evasion. However, the competition between the national legislations may lead to a situation where the tax authorities belonging to different areas of tax environment impose the tax for the same property subject to tax liability (double taxation), or fail to impose the tax at all (tax evasion). Nearly all the European countries are at loss due to tax evasion: in Great Britain, for instance, the annual tax evasion or tax avoidance amounts to around GBP 25 billion, and only around GBP 2.5 billion is returned into the legal financial flows by implementing the tax evasion suppression measures [99]. The solution lies in the formal adoption of the legislation addressing the double taxation, by inserting the provision on the mandatory exchange of taxpayer data, thereby providing the conditions for the prevention of the tax evasion. One of the fundamental principles in force in most countries states that an income should not be subject to tax twice. This has lead to a network of bilateral agreements concluded between the countries, aimed at avoiding the double taxation in one country, if the income is already subject to tax liability in another country. In practice, these agreements may be in a form of bilateral double tax avoidance agreements and multilateral double tax avoidance agreements.

3.4. Tax havens

The very term ‘tax haven’ speaks of the place which may serve as a resort to the companies and citizens aiming to save money, in terms of tax liability on the one hand, and generate bigger profit and increase of capital, on the other. This is the reason why the tax haven countries have gained popularity, as they offer very low, or non-existant, tax rates, as the transfer of capital and property is of great significance for the taxpayers. The taxpayers want to move outside the

countries where the legislation imposes high tax liabilities, where the chances for generating bigger profits, production growth and development, and consequently, placement of high quality products at affordable prices seem almost impossible.

According to the definition of the United Nations, a tax haven country is any bank in the world that accepts the deposits which may be considered as security for the delivery of goods, and that manages the assets expressed in a foreign currency in favour of a person whose permanent residence is elsewhere, which further implies that this basically involves offering certain advantages to non-residents. [77]

Off-shore can be defined as a legal area which differs from the rest of the country. Offshore represents a specific territorial location, as a special entity established for performing particular activities, for which the main country decided to be exempted (in part or whole) from its legislation, otherwise applicable for the rest of the country. In this respect, off-shore implies a substantial inflow in the life of the state system: off-shore is nothing but the division of the country into two legislative areas, i.e. into the interrelatedly relative areas. Due to these characteristics, off-shore centres are potential targets of money launderers. Potentially suspicious transactions are possible in offshore countries, and especially with the non-supervised and poorly-supervised banks.

The literature offers the following critera which make the tax havens attractive for the persons involved in financial frauds: [136]

- High GDP (gross domestic product) per capita,
- Bank Secrecy Act,
- the Government's position on money laundering,
- membership in SWIFT (Society for Worldwide Interbank Financial Tele-communication),
- lack of conflicts (riots and guerrilla wars) and
- no corruption.

Some time ago, relevant international institutions, along with the tax administrations of some countries, developed the list of countries and tax havens, known for accepting the dirty money, lack of tax liability and lack of investigation about the origin of the money. OECD list of harmful preferential tax regimes. [54] The OECD report also proposed the identification of harmful preferential tax regimes' of OECD member countries.

3.5. Non-financial frauds

Modern society is not only affected by financial frauds. Non-financial frauds, and in particular, corruption, smuggling and counterfeiting, cause severe economic damage in many countries worldwide. Corruption constitutes a very important area of frauds, taking into account its presence, scope and occurrence, as well as its effect on the economic development of any country. It is not irrelevant to say that corruption also undermines the democracy and jeopardises the social justice and the rule of law.

The EU member states are not immune to corruption, as well. Its appearance and scope vary depending on the country, yet it pervades all the member states. The cost of corruption for the taxpayers amounts to billions of Euros, and corruption is often used for financing the activities of organised criminal groups across Europe. Corruption also tends to pave the way for financial frauds, money laundering, in particular, as the corruption process often ends in illegal financial proceed for the bribe recipient.

It is estimated that the EU economy is losing EUR 120 billion annually only due to corruption, the amount slightly lower than the EU annual budget (fig. 3.4) [91]. Combating corruption and frauds is the responsibility of individual states. The EU member states have largely harmonised and introduced a majority of required legal instrument and established the institutions for the prevention and suppression. As the EU countries manage 80% of the EU funds, they are responsible for conducting investigations and prosecution of corruption cases and frauds pertaining to the EU budget. The EU member states are also assisted by the European Anti-Fraud Office OLAF in their investigations. [42]

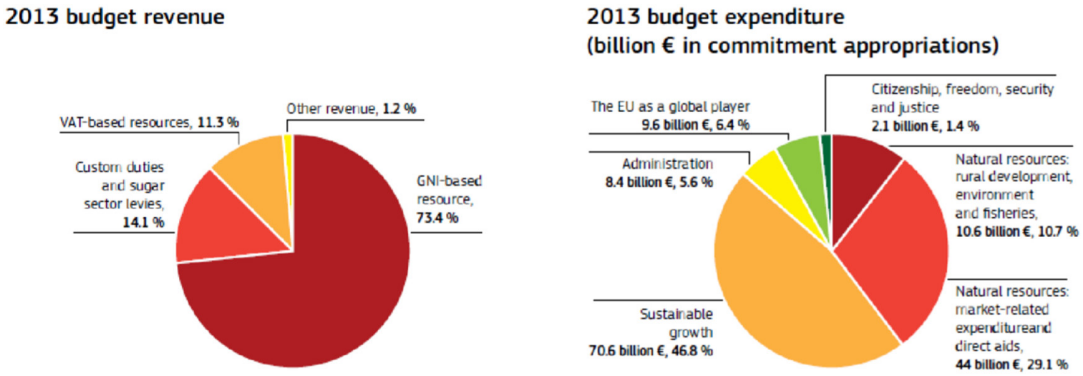

Fig. 3.4 Structure of the EU budget [91]

4. Financial frauds in the banking sector

4.1. Introduction

Modern financial institutions and organised crime share the common objectives: to develop, bend the regulations, suppress the state control and make enormous profits. Financial frauds and money laundering, in particular, pose a serious threat to the integrity of financial institutions, banks and significantly hinder, perhaps, neutralise the successful management of financial and banking sector. All these activities lead to a general abuse of financial systems and terrorism financing.

Money laundering always means that, in one of the phases, the assets must go through a bank account. Therefore, increased offer of banking services and different payment instruments provides many different options for their abuse. The easiest form of legitimising the illegally acquired funds is by depositing the money into the bank, without proving the origin. Money is frequently invested in companies having difficulties after which they continue operating while the dividends and managers' salaries paid out are legitimate proceeds. When the money reaches this stage, it is very difficult, perhaps impossible, to identify its illegal origin.

It is also important to mention the existence of 'fictitious banks', established by the organised criminal groups. Although there are certain formal requirements to be fulfilled for establishing a bank in these countries, in practice, there are numerous irregularities in their operations, starting from insufficient nominal and share capital, lack of competent management

and solid supervision. The American bank supervision service (Comptroller of the Currency, Washington) occasionally publishes the warning lists, stating the names of fictitious banks around the globe, due to their involvement in the financial crime and money laundering. In late 1980s, the fictitious banks were founded in Nauru, Samoa and Vanuatu. Fictitious banks are not the subject matter of this thesis, yet their role in international financial frauds should also be taken into account.

The main types of financial and non-financial frauds (money laundering, tax evasion, smuggling, corruption…) were defined in the previous chapter. This chapter will analyse the role of the banking sector in financial frauds, particularly highlighting the prevention measures, arising from the international legal norms and implemented through the development of a set of national indicators. The chapter ends with a typology of financial frauds and money laundering in the banking sector.

4.2. Role of the banking sector in financial frauds

Due to the fact that the banks are important factor of the economic and financial stability of each country, it is important for them to prevent money laundering. Money laundering always means that, in one of the phases, the assets must go through a bank account. Therefore, increased offer of banking services and different payment instruments provides many different options for their abuse. During the last few years, the banking sector has been experiencing major turbulences. In order to overcome the financial crisis, banks offer many new products and services, which could potentially be used to place illegally gained money in the financial flows. The criminals have tendencies to attempt and invest illegally gained assets in the banking sector by purchasing the shares of the banks, and, thus directly or indirectly, take part in the management of a bank and design of its business policy. Such activities should be prevented by strict application of the legal solutions related with the ownership of the banks and participation in the management structure. This is important for the banks, as associating them with the financial frauds would definitely jeopardize their reputation. [80]

In the domain of the banking sector, a very significant role is assigned to private banks. Some analysis refocuses attention on the critical, often unsavoury role that global private banks

play. A detailed analysis of the top 50 international private banks reveals that at the end of 2010 these 50 collectively managed more than $12.1 trillion in cross-border invested assets from private clients, including via trusts and foundations. Consider the role of smaller banks, investment houses, insurance companies, and non-bank intermediaries like hedge funds and independent money managers in the offshore cross-border market, plus self-managed funds, and this figure seems consistent with our overall offshore asset estimates of US 21-32 trillion. [56] The First Directive already provides an answer to the concerning trends in the area of money laundering, which undermine the stability and reputation of the financial sector, primarily of the banking one. [17] The EU member states were requested to strictly prohibit money laundering, whereby the obligation of prescribing and implementing the measures for the prevention of money laundering was primarily imposed to the banking sector. The aspect of prevention was highlighted, and the role of banks was stressed in six out of ten most significant rules relating to preventive measures: [72]

1. Banks must cooperate with other relevant institutions in the fight against money laundering, particularly in the field of investigations, in other words, banks must not be accomplice to the money launderers;

2. Banks must have a complete identification procedure in place so that they could verify the data of the persons who want to open the account and confirm their identity;

3. Banks must safeguard the data and participate in the efforts of the relevant state authorities to prevent money laundering;

4. Banks must regularly report on the suspicious parties and transactions;
5. Bank secret shall not be applicable to the transactions indicating money laundering;
6. Bank must have the internal procedures in place, educate its officials and establish the internal control of operations.

The importance of preventions in the banking sector is also highlighted by the Basel Principles. In 1988, Basel Committee on Banking Supervision, published a declaration on the principles of Prevention of Criminal Use of the Banking System for the Purpose of Money-Laundering. [8]

The Third Directive highlights the importance of customer due diligence [22]. In fact, this Directive introduces the following two terms: 'due diligence' and 'Know Your Customer', laying down the main principles of suppressing money laundering. Bank staff shall gain knowledge on the identity of the persons appearing as parties, and pay particular attention to all complex and unusual affairs, as well as to unusual business activities having no apparent economic or visible lawful purpose [13].

More specifically, the banks are obliged to identify the parties in the following cases: upon opening the account, for all large transactions, for related transactions, when transferring a large amount of money into several accounts in different banks, etc. [27] Immediate scrutiny of the background of these affairs is required, the results gained should be recorded in writing, and the banks should refuse any business cooperation with suspicious parties and close their accounts.

The Third Directive states that 'customer due diligence' may be simplified and enhanced, depending on the assessment of the risk of money laundering and terrorism financing. In **simplified customer due diligence**, customers are not subject to customer due diligence measures by the bank or some other financial institution, in case of low risk of money laundering and terrorism financing. **Enhanced customer due diligence** of the customers or business relations implies additional measures related to an increased risk of money laundering and terrorism financing.

It is, therefore, evident that the banking sector is the first line of defence and may have a significant contribution to precluding the money laundering process at the very beginning, during the placement stage. To this end, each financial organisation must develop its internal procedures for recognising the suspicious and unusual transactions and their reporting (as early as possible) to the Administration for the prevention of money laundering (FIU) or to some other relevant institutions, pursuant to the prescribed instructions and indicators. This is how the banks will adhere to the positive laws and regulations and participate in the money laundering prevention process, at the same time preserving their own reputation.

4. 3. Typology of financial frauds in the banking sector

This chapter will present the typology of financial frauds in the banking sector. The basis of the typology is the OEBS document published at the website of the Administration for the Prevention of Money Laundering in the Republic of Serbia. [80] This document contains the following typologies:

- Money laundering typologies in the banking sector,
- Money laundering typologies through the exchange transactions
- Money laundering typologies by the attorneys or law firms
- Money laundering typologies in the accounting sector
- Money laundering typologies in the auditing sector
- Money laundering typologies on the capital market Money laundering typologies in the insurance sector, and Money laundering typologies in the real-estate sector.

So far, based on the experiences of the Administration, the most frequents ways to use legally defined banking services to integrate "dirty" money in the banking system are:

- **Loans with 100 per cent deposit** as security or prepayment of loans,
- **High cash payments** without real grounds or payments which are unusual for the client (very often, "other transactions" is stated as the basis for the payment, or different transactions for "placement" of illegally gained money),
- **Payments based on the turnover of goods,** especially services with **the off-shore companies** (frequent successive payments based on providing of services of market research, consulting, marketing, attorney's fees or accounting fees, purchase of real estate etc**.**),
- **Payment based on services to newly founded domestic companies**,
- **Cash payments as a loan of the founder for solvency** of a company (the founders of legal entities abuse this legally allowed basis for payment for integration of "dirty"

money, since the origin of the assets is not questioned, there are no limits in regards to the amounts of cash payments and these amounts are not a subject to tax payment).

The following risk aspects were highlighted regarding the money laundering typology:

- **Risk of the transactions** (fictitious, withdrawal of money on different grounds, deposits, loans, mortgage transactions, different placements, service transactions, liens, etc.)
- **Risk of the offered bank products** (cards, mortgages, loans for different purposes, certificates of deposit, custody services, safe deposit boxes…),
- **Risk of the clients** (relations, knowing, identification, discovery of real owner)
- **Risk of the bank as a financial** institution (persons who could influence the bank policy related with the application of legal standards on the prevention of money laundering and financing of terrorism are included in the ownership structure of the bank, through off-shore companies, custody accounts or investment funds).

5. Financial frauds in the insurance sector

5.1. Introduction

Financial crime is most commonly manifested as money laundering within the banking system, more specifically – as the deed of placing dirty money on the bank accounts. It is predicted that the insurance industry, which was previously not very appealing to the 'money launderers', will gradually gain importance, since there has been a stricter control in banks, as well as the increasingly sophisticated methods used by the 'launderers', and due to the new products which are about to be placed by the insurance sector. This means that we are facing a considerable risk of money laundering in the insurance sector, which stems from disputable policy beneficiaries' identifications, payment of premiums of third entities etc.

In the second chapter of this thesis, we stated that the European Commission officially introduced a proposal for the fourth Directive for the prevention of money laundering back in 2013.

[44] From the perspective of the insurance sector, this Directive proposal is very important, given the fact that it takes into account the specific nature of the insurance sector, and the specific risk profile related to this type of service, which functions on a rule-based system.

The academic community has criticized the proposal for the new directive, stating that the roles of certain actors have not been clearly defined, and that there is some confusion about the guidelines which should be developed by the European agency for the development of banking, the European agency for insurance and pension fund monitoring, and the European agency for securities and the securities market, and which are related to the risk factors and measures that need to be taken during the process of the 'customer due diligence'. This analysis can be simplified or enhanced, depending on the assessment of risk of money laundering and terrorism financing. A simplified customer due diligence process is performed if there is a low risk of money laundering. Nevertheless, the proposal for the new Directive points out that a simplified due diligence process is carried out as ad hoc analyses, taking the relation with a client and a type of transaction into consideration. However, experience has shown that in that case there would be no difference between a simplified and an enhanced check of the client's credibility. [31]

Certain negative remarks also refer to the client identification process. It is a well-known fact that the owner of an insurance policy can be changed multiple times, and in some countries it is not obligatory to define the policy beneficiary. However, a change of the policy beneficiary can be one of the indicators for money laundering only in the case when the insured case happens – that is, the policy beneficiary definition is not suspicious when a life insurance policy is signed; but it does become suspicious in the case of a premature realization (pay-out) of insurance. Therefore, a common opinion is that the policy beneficiary should not be identified before the pay-out of insurance. [Ibid]

The proposal for the new Directive includes a provision wherein the financial institutions of the member countries will require an identity check of the life insurance policy beneficiaries, and of the beneficiaries of other investment-related policies, either determined or determinable, at the time of policy pay-out. Experts object to the fact that the Directive proposal fails to include a definition of the life insurance policy beneficiary, as specified by the FATF recommendations.

This is important because the meaning of a 'beneficiary' may differ depending on the circumstances. A life insurance policy beneficiary, and other investment-related policies, is a natural or legal person who will receive a certain insured amount of money in the case of the realization of the insured case. [67]

There is a new element in the Directive proposal, which proposes that the insurers need to take certain 'sensible measures' to determine whether the policy beneficiary is a politically exposed person, not later than by the moment of pay-out. A logical question that arises, and has failed to be answered, is the definition of those "sensible measures" and the appropriate risk level. In the end, it is important to point out that the Directive proposal only refers to the insurance sector actors who work with life insurance policies, but not to those offering other types of insurance. The idea here is that other types of insurance are exposed to a smaller risk of money laundering.

In this paper, we will consider the following actors a part of the insurance sector:

- Insurance companies,
- Insurance mediation companies,
- Natural persons – entrepreneurs (insurance agents),
- Agencies which offer other insurance services,
- Other economic agencies and legal persons that have a specially organized part for offering other insurance services

In the following part of the thesis, all of these actors will be jointly referred to as: persons performing insurance-related activities (PIRA).

As noted in the previous chapter, where we discussed the money laundering typologies in banks, the banking sector has a clearly defined role in financial crime. In this thesis, we will not be covering all possible types of fraud which are specific to the insurance sector, but demonstrate and analyse the function of money laundering in the insurance sector instead, following the international aspect of fraud, within the purpose of this paper. As with the banking sector, we will demonstrate lists of indicators which can help PIRA in identifying suspicious transactions, as well as the basic typologies of financial frauds related to money laundering.

5.2. Role of the insurance sector in financial fraud

First of all, it is important to point out that life insurance is not the primary channel through which money laundering is performed, but reports of insurance companies (agents) are very valuable because they indirectly lead to persons who are connected to criminal actions, and indicate a possibility of money laundering through further analysis. [67] Analyses and performed surveys of the Administration for the Prevention of Money laundering of the Republic of Serbia indicate a far greater danger of money laundering through the non-life insurance sector, because the risks of fraud that the beneficiaries are facing are much greater, and there is a great probability that there is 'dirty money' involved (fictitious insurance and deliberate arson, fake car accidents etc.). The value of paid premiums in the non-life insurance sectors greatly exceeds the value of paid premiums in the life insurance sector in the Republic of Serbia. [37]

Of course, this does not mean that the insurance sector is also not prone to financial fraud in the money laundering domain. The main reasons which attract money launderers to the insurance sector are: the size of the premium which is paid upon the contract signing, the simple procedure of insurance contract signing, easy accessibility and variety of insurance products (portfolios) [23]. Also, the insurance sector is interesting to criminal groups and individuals because of the non-existent (or insufficient) actions towards the prevention of money laundering. The main culprits for this situation are intermediaries and agents that do not give enough attention to identifying potential products and transactions that could lead to money laundering – which, for the most part, is a consequence of the fact that beneficiaries are not well informed about money laundering in the insurance sector. Insurance companies mostly focus on fraud and pay-outs based on fraudulent actions (car insurance, arson, theft...), which does not leave enough room for preventive actions in the domain of other types of financial fraud, such as money laundering.

The insurance policy beneficiary is most commonly not the signer of the contract (the person who pays the premium), which is convenient for those who are trying to present illegally acquired money as legal. Also, insurance policies often change beneficiaries before it becomes available for pay-out. [34]

The insurance sector offers possibilities for investment and savings, because many insurance products contain these possibilities:

- Policies have depository possibilities (collateral)– which are used as guarantees for obtaining loans and purchasing of real -estate,
- Cash deposits that are especially encouraged in situations when the premiums are used as savings or pension stimulus.

Which also stimulates money launderers to engage in this type of fraud. The role of intermediaries (brokers, agents, representatives...) is especially important here. Many life insurance contracts which were signed for money laundering purposes, were signed through an insurance mediator. An indicator of suspicious transactions is a situation where insurance contracts are exclusively signed through a single intermediary. In an attempt to earn as much money as possible, intermediaries often connect with criminal groups, and therefore they can be considered the weakest 'link' which leads to defraudment of insurance beneficiaries, and consequently – money laundering [85].

Generally speaking, there are different modes of money laundering in insurance.

Laundering begins with the „placement" phase, in which money is placed on the bank accounts, and in the case of insurance this means buying insurance policies (life or non-life insurance). Insurance is usually purchased through an insurance intermediary (broker), over whom the insurer rarely has any control. [33]

In October 2004, the IAIS [33] issued a Guidance Paper on Anti-Money Laundering and Combating the Financing of Terrorism. This comprehensive guidance paper sets out an analysis of the vulnerabilities of the insurance industry to money laundering, control measures to prevent and detect money laundering and details of the role of supervisors. In this document, the following modes of financial fraud in the money laundering domain are listed: [79]

- Life insurance
- Non-life insurance
- Intermediaries

- Reinsurance
- Return premiums
- Overpayment of premiums
- Pensions
- Claims and assignment of claims
- Fraudulent claims

We will take a closer look at each one of these, starting with life insurance. Life insurance is attractive for the launderers for multiple reasons:

- Large yearly premiums,
- The possibility of single premium payments,
- The possibility of early insurance buyout,
- The possibility of referring the payments to a third party.

One of the most common money laundering techniques is based on buying life insurance with dirty money. Soon after the purchase of insurance policies, launderers demand a policy buyout, even though they receive a much smaller amount of money compared to the premium which they would receive upon the policy realization. This is simply a necessary expense for the money laundering process. Of course, an early buyout of the life insurance policy can be a clear indicator for the insurer that money laundering is taking place.

Besides the so-called traditional types of life insurance contracts, as a consequence of fierce competition in the insurance market and the global economic crisis, a new type of product has emerged – the insurance package. These new insurance packages have automatically become appealing to a wide audience of potential clients (policy holders), but also to money launderers, who are following the insurance trends and constantly creating new, innovative techniques. By mentioning insurance packages, we primarily refer to the so-called hybrid life insurance contracts, such as unit-linked life insurance contracts, which have the characteristic of very complex financial products; term life insurance policies, combined insurance, life annuities etc. [67]

Furthermore, we already pointed out that the buyer of the policy is often not the insured person or the insurance beneficiary. There are often a number of actors in the chain of policy purchasing, in order to hide the origin of the money and deceive the insurer about the real intention behind the purchase of the insurance policy.

Launderers pay „dirty money“ as an input in the form of a premium, and receive output in the form of an insured amount of money, or buyout value (if a buyout was demanded), or an annuity which can be paid right away or in instalments (fixed or variable). This money is then invested further – sometimes in the same country, more commonly abroad, via a third party (such as investment advisors) in order to conceal the origin of the money. However, as much as the inclusion of more actors in insurance makes the control process harder, insurance intermediaries and representatives also have a very important role in the financial fraud prevention mechanism, especially when in terms of money laundering. They are the first who directly come into contact with persons trying to launder money, and therefore present an important part of the integral programme for the prevention of money laundering.

It is possible that an intermediary is not aware that he/she helped the criminals in the money laundering process. These cases arise as a consequence of the inadequate training of PIRA, and present a direction in which stronger actions need to be taken in the future.

Money laundering aside, financial fraud is generally dominant in the non-life insurance sector. However, even in these cases there are subjects trying to perform money laundering by submitting false indemnity requests (claims for much greater compensation compared to the actual damage).

There were also cases of policy cancellation, after which the beneficiary would perform a much larger premium payment than necessary, in order to subsequently demand the return of the excess amount of money, while also instructing that this excess amount is paid out to a certain third party.

There are, however certain generic factors that do make the non-life insurance sector attractive to money launderers, namely: [79]

- Lack of awareness of risk. This is a particular problem in the non-life sector as it is excluded from the scope of the FATF Methodology. This in turn means that non-life

insurance is frequently not subject to mandatory Anti-Money Laundering and Terrorist Financing (AML/CFT) controls.

- International scope. The non-life sector is much more open to international business than the life sector. The nature of some risks mean that claims can arise in a separate jurisdiction to the writing of the risk. Furthermore, the need to spread risk requires reinsurance and the reinsurance industry is cantered in a number of international financial centres.

  Intermediaries. It has been noted above that many insurance companies market their products through independent intermediaries. The vulnerability of sales through intermediaries is compounded by the fact that

  - distribution chains can be long and complex, involving a number of intermediaries in differing jurisdictions;
  - Some jurisdictions do not require the regulation of non-life insurance intermediaries;
  - Intermediaries can receive substantial commissions as a percentage of the premium, providing an added incentive to arrange the policy of insurance;
  - The initial relationship with the customer will be through the intermediary, although the insurance contract is direct with the insurer. The intermediary may remain the primary point of contact with customer.

- Speed of inception. Some classes of insurance are legal requirements and may be required to be in place by a specific date. As a consequence of this it is recognised that there may not be sufficient time to conduct full due diligence on the policy holder.

- In addition to the imperative to have insurance in place by a defined date the nature of non-life insurance products is that only a certain proportion of policies written will give rise to a claim. Furthermore, in the event of a claim arising full due diligence will normally be conducted around the circumstances of the claim. It is therefore normal

practice that due diligence does not normally take place at the inception of the policy and, indeed, it may be impractical to do so.

- Regular claims payments to third parties. In the event of a claim arising there may be unrelated third parties involved (e.g. victims of motor accidents, etc.) to whom payments need to be made. Furthermore, payments may be made to repairers, loss adjusters and other persons not involved in the original policy.

- Criminal familiarity with the product. The compulsory nature of some classes of insurance (e.g. motor) means that criminals may be more familiar with insurance products than with savings and investment products.

Under-insurance is also very convenient for money laundering. Given the fact that in under-insurance the financial amount is smaller than the value of insured property, a criminal (insured person) can demand from the insurer that he (insured person) pays the necessary difference in the form of a premium, and that the insurance amount increases. [67]

Reinsurance is also a common target of financial fraud. Some examples of financial fraud and money laundering are: [33]

- Illegal, dirty money acquired through crime, which the insurer receives in the form of premiums, and it partly transfers (above the reinsurance limit of the insurance) to the reinsurer;

- Creation of fake insurance companies in order to transfer a part of the money to the reinsurer;

- Creation of fake reinsurers.

It is important to point out that in reinsurance there is no direct connection between an insured person and an insurer, but only between the insurer and the reinsurer, so it's practically impossible of the reinsurer to authenticate the identity of every insured person (insurance beneficiary). This creates a very convenient setting for criminals, and additionally increases the necessity for preventive actions in the phase of signing the contract between the insurance beneficiary and the insurer.

- Private pensions can also be considered a part of the insurance sector, and there are certain money laundering-related types of fraud which can be performed in this sector. As stated in the Money report [79]: „The vulnerabilities of pensions are similar to those of life insurance policies although there are certain unique features, as set out below, which have been identified. It is particularly noted that third tier pensions have a very similar risk profile to life insurance products:

- Payments by legal persons, in particular putative employers into occupational pension schemes;

- Transfer of pensions under the second pillar to funds that are related persons to the employer;

- Transfer of pensions under the second pillar to new employers on change of employment;

  Funds paid into occupational pension schemes are fungible and are therefore not susceptible to confiscation;

- Ability to top up pensions with advanced voluntary contributions; it is noted that in some jurisdictions it is possible to obtain tax relief on voluntary contributions".

Electronic communication channels present an additional problem in fraud identification and prevention in the insurance sector – an insurance contract can be signed via the internet. This is also a case where technology has a double role – on the one hand, the Internet provides a 'disguise' for potential criminals and financial frauds, but on the other it serves as an access point for experts who can, with sufficient knowledge, organization and communication skills, follow traces of criminals on a worldwide scale and act to prevent, and even enforce punishment for, financial fraud.

5. 3. Financial frauds typology in the insurance sector

Following the previous section and the basic typology of financial frauds in the banking sector in the Republic of Serbia, we discuss typology of the financial frauds in the insurance sector

in this section. These frauds mostly refer to the money laundering ones, and their typology has been based on the document drafted by OSCE and published on the website of the Administration for the prevention of money laundering of the Republic of Serbia. [80] This document consists of the following typologies:

- Large insurance premiums,
- Policy beneficiary – non-related natural person,
- Payment of policy to the benefit of a third party,
- Capital of a suspicious origin, and
- A short termination period.

6. International cooperation in prevention of financial abuse

6.1. Introductory notes

Financial abuse, particularly money laundering, poses a global problem that not only threatens the stability of the financial system of individual economies, but acts as a serious threat to the EU which strives to ensure the highest possible degree of integrity of its market in accordance with its fundamental principles. As financial crime is well organised and, at a national level, difficult to fight through the established legal norms in this area which are binding for all EU Member States, it is necessary to act by taking preventive measures at a supranational level. Fight against financial abuse calls for cooperation among states, not only within the EU, but on a global scale.

Activities and measures taken exclusively at a national or EU level would have rather restricted effects and produce only partial results, unless organisation, coordination and cooperation are ensured at the broadest international level. It is therefore crucial that all measures taken on an international level are harmonised with actions taken at other international forums. To achieve this, one should primarily be mindful of the FATF Recommendations as an international, intergovernmental body in charge of prevention of money laundering, which is a leading international institution in the fight against money laundering and terrorism financing. FATF Recommendations are regularly revised and updated, and they were last changed in February 2012.

[34] The last (fourth) EU directive in this area from 2014, awaiting its soon adoption, was drawn up in accordance with these international standard. [44]

Almost all countries acknowledge and accept international standards in the fight against money laundering and terrorism financing. Based on the data held by international organisations and data held by the APML, the only countries that do not apply them are Iran and People's Democratic Republic of Korea (Northern Korea). On the other hand, countries which apply AML/CFT standards at the European Union level or higher, are as follows: [125]

1. European Union member states;

2. Republic of Argentina, Australia, Federative Republic of Brazil, Japan, South Africa, Canada, United States of Mexico, New Zealand, Russian Federation, Republic of Singapore, Hong Kong, Swiss Confederation, United States of America.

Generally speaking, the problem of financial abuse may be observed at two levels: local (national) and international (transnational) level. At a national level the problem should be solved through efficient implementation of legislation safeguarding this area, while its solution on an international level may only be sought after on an international scale. This clear-cut division fails to address the synergic effect of some forms of financial abuse that trespass state borders, such as money laundering and terrorism financing. The failure of this scope is the inefficient fight against organised crime.

Hence, we should begin by assuming that fight against organised crime within the area of financial abuse, particularly money laundering and terrorism financing, is of international character. Any implementation and limitation of preventive activities and investigation to a national scope will necessarily limit the maximum effect of both prevention and sanctioning of criminal offences in this area. The degree of economic advancement, financial and legal system development should also be taken as a limitation, given the wide discrepancy from state to state in this respect, and it cannot be expected that each state would have an equal capacity to formally undertake same measures to prevent financial abuse, particularly money laundering and terrorism financing.

The second chapter of this thesis addressed the institutional framework for fight against financial abuse at a national level. The example of the Republic Serbia illustrated the current situation at an institutional level, with a notice that it very much resembles its regional peers. This chapter elaborates on the international framework for fight against financial abuse, with an emphasis on fight against money laundering that is predominant in international terms, and as such, regulated most tightly in terms of legislation and institution-wise. The chapter gives an overview of the FATF (Financial Action Task Force) Recommendations which govern international cooperation, while describing the role of Moneyval system, Egmont group, International Association for Insurance Supervisors (IAIS), Basel Committee on Banking Supervision and the Wolfsberg group. It also presents the principles of international cooperation laid down by the Warsaw Convention in terms of prevention of financial abuse, which is primarily established through institutional intertwining of financial intelligence units of the Member States. In its final part, the chapter casts some light on the experience of the Republic of Serbia in respect to international cooperation, primarily within the scope of the Administration for Prevention of Money Laundering.

6.2. Institutional framework

6.2.1. FATF – International aspects

The FATF determines key principles that countries should incorporate into their national regulations, as shown in the second chapter of the thesis. In this part we will deal only with the FATF Recommendations that pertain to international cooperation (Section G: International cooperation), and these are recommendations 35 - 40: [34]

36. International instruments

Countries should take immediate steps to become party to and implement fully the Vienna Convention, 1988; the Palermo Convention, 2000; the United Nations Convention against Corruption, 2003; and the Terrorist Financing Convention, 1999. Where applicable, countries are also encouraged to ratify and implement other relevant international conventions, such as the Council of Europe Convention on Cybercrime, 2001; the Inter-American Convention against

Terrorism, 2002; and the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime and on the Financing of Terrorism, 2005.

37. Mutual legal assistance

Mutual legal assistance Countries should rapidly, constructively and effectively provide the widest possible range of mutual legal assistance in relation to money laundering, associated predicate offences and terrorist financing investigations, prosecutions, and related proceedings. Countries should have an adequate legal basis for providing assistance and, where appropriate, should have in place treaties, arrangements or other mechanisms to enhance cooperation. In particular, countries should:

a) Not prohibit, or place unreasonable or unduly restrictive conditions on, the provision of mutual legal assistance.

b) Ensure that they have clear and efficient processes for the timely prioritisation and execution of mutual legal assistance requests. Countries should use a central authority, or another established official mechanism, for effective transmission and execution of requests. To monitor progress on requests, a case management system should be maintained.

c) Not refuse to execute a request for mutual legal assistance on the sole ground that the offence is also considered to involve fiscal matters.

d) Not refuse to execute a request for mutual legal assistance on the grounds that laws require financial institutions or DNFBPs to maintain secrecy or confidentiality (except where the relevant information that is sought is held in circumstances where legal professional privilege or legal professional secrecy applies).

e) Maintain the confidentiality of mutual legal assistance requests they receive and the information contained in them, subject to fundamental principles of domestic law, in order to protect the integrity of the investigation or inquiry. If the requested country cannot comply with the requirement of confidentiality, it should promptly inform the requesting country. Countries should render mutual legal assistance, notwithstanding the absence of dual criminality, if the assistance does not involve coercive actions.

Countries should consider adopting such measures as may be necessary to enable them to provide a wide scope of assistance in the absence of dual criminality.

38. Mutual legal assistance: freezing and confiscation

Countries should ensure that they have the authority to take expeditious action in response to requests by foreign countries to identify, freeze, seize and confiscate property laundered; proceeds from money laundering, predicate offences and terrorist financing; instrumentalities used in, or intended for use in, the commission of these offences; or property of corresponding value. This authority should include being able to respond to requests made on the basis of non-conviction-based confiscation proceedings and related provisional measures, unless this is inconsistent with fundamental principles of their domestic law. Countries should also have effective mechanisms for managing such property, instrumentalities or property of corresponding value, and arrangements for coordinating seizure and confiscation proceedings, which should include the sharing of confiscated assets.

39. Extradition

Countries should constructively and effectively execute extradition requests in relation to money laundering and terrorist financing, without undue delay. Countries should also take all possible measures to ensure that they do not provide safe havens for individuals charged with the financing of terrorism, terrorist acts or terrorist organizations.

Each country should either extradite its own nationals, or, where a country does not do so solely on the grounds of nationality, that country should, at the request of the country seeking extradition, submit the case, without undue delay, to its competent authorities for the purpose of prosecution of the offences set forth in the request. Those authorities should take their decision and conduct their proceedings in the same manner as in the case of any other offence of a serious nature under the domestic law of that country. The countries concerned should cooperate with each other, in particular on procedural and evidentiary aspects, to ensure the efficiency of such prosecutions. Where dual criminality is required for extradition, that requirement should be deemed to be satisfied regardless of whether both countries place the offence within the same category of offence, or denominate the offence by the same terminology, provided that both countries criminalise the conduct underlying the offence. Consistent with fundamental principles of

domestic law, countries should have simplified extradition mechanisms, such as allowing direct transmission of requests for provisional arrests between appropriate authorities, extraditing persons based only on warrants of arrests or judgments, or introducing a simplified extradition of consenting persons who waive formal extradition proceedings. The authorities responsible for extradition should be provided with adequate financial, human and technical resources. Countries should have in place processes to ensure that the staff of such authorities maintain high professional standards, including standards concerning confidentiality, and should be of high integrity and be appropriately skilled.

6.2.2. Other forms of cooperation

40. Other forms of international cooperation

Countries should ensure that their competent authorities can rapidly, constructively and effectively provide the widest range of international cooperation in relation to money laundering, associated predicate offences and terrorist financing. Countries should do so both spontaneously and upon request, and there should be a lawful basis for providing cooperation. Countries should authorise their competent authorities to use the most efficient means to cooperate. Should a competent authority need bilateral or multilateral agreements or arrangements, such as a Memorandum of Understanding (MOU), these should be negotiated and signed in a timely way with the widest range of foreign counterparts. Competent authorities should use clear channels or mechanisms for the effective transmission and execution of requests for information or other types of assistance. Competent authorities should have clear and efficient processes for the prioritisation and timely execution of requests, and for safeguarding the information received.

6.2.3. MONEYVAL system

The Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism – MONEYVAL (formerly PC-R-EV) is a committee of the Council of Europe in charge of evaluation of the system for fight against money laundering and terrorism financing. It was established in 1997 and its functioning was regulated by the general provisions of Resolution Res (2005)47 on committees and subordinate bodies, their terms of reference and

working methods. At their meeting of 13 October 2010, the Committee of Ministers adopted the Resolution CM/Res (2010)12 on the Statute of the Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (MONEYVAL). [96] This new statute elevates Moneyval as from 1 January 2011 to an independent monitoring mechanism within the Council of Europe answerable directly to the Committee of Ministers. [41]

Moneyval gathers experts who assess compliance of the member states with all relevant international standards for fight against money laundering and terrorism financing in the legal, financial and law enforcement sectors through a peer review process of mutual evaluations. The compliance assessment rests on the principle of **mutual evaluation** of member states.

The aim of Moneyval is to ensure that its member states have in place effective systems to counter money laundering and terrorist financing and comply with the relevant international standards in these fields. These standards are contained in the recommendations of the FATF, including the Special Recommendations on Terrorist Financing, the 1988 United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances, the United Nations Convention against Transnational Organised Crime, the 1999 United Nations International Convention for the Suppression of the Financing of Terrorism, the Directive 2005/60/EC of the European Parliament and of the Council of 26 October 2005 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing and the relevant implementing measures and the Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime, concluded within the Council of Europe.

Moneyval also conducts typologies studies of money laundering and terrorism financing - their methods, trends and techniques. Moneyval reports provide highly detailed recommendations on ways to improve the effectiveness of domestic systems of measures and actions of individual states used to combat money laundering and terrorist financing and states' capacities to co-operate internationally in these areas. If, based on the reports adopted at the plenary meeting, Moneyval establishes that significant deficiencies exist in the system of a certain state, the Council of Europe may decide to use diplomatic, political and other pressures at its disposal so as to rectify deficiencies and harmonise such system with international standards.

The IMF and World Bank conduct a number of Moneyval or FATF evaluations in a given evaluation round, and present the report for adoption at Moneyval and FATF Plenaries to vote; the common methodology enables the mutual recognition of evaluations, and thus avoid repeating evaluations in the same countries and overloading national authorities with these exercises;

Moneyval used to be an observer to the FATF and as of June 2006, it has become an Associate Member. There are several benefits arising from this new status – including the opportunity for more countries within Moneyval to attend and actively participate in FATF meetings as part of the Council of Europe/Moneyval delegation

6.2.4. Egmont Group

Egmont Group was established in Egmont Arenberg Palace in Brussels where several financial intelligence units (FIUs) gathered in 1995, having recognised the importance of a network and mutual cooperation among financial intelligence units of different countries. The meeting decided to establish an informal network of FIUs with the task to foster international cooperation among these units. Egmont Group members hold regular meetings to enhance the existing and find new ways of cooperation, especially in the areas of information exchange, training and sharing of expertise regarding prevention of money laundering and terrorism financing. [43]

Financial frauds, money laundering and terrorism financing are primarily international phenomena; hence a successful combat against them cannot be designed without efficient and swift international cooperation, and so the Egmont group currently comprises 139 members worldwide who are engaged in prevention and detection of money laundering (picture 6.1).

Fig. 6.1 Egmont Group members [43]

One of the key results of the Egmont Group is the establishment of an information system which provides the members with two functions: secured web communication and use of operational analytics and visualisation, with the ultimate goal of detecting suspicious transactions through certain indicators and providing notifications on suspicious transactions to competent state authorities for further handling, connecting suspicious transactions with criminal actions of an individual, group or an organisation, including the familiar methods for money laundering.

Egmont's international Secure Web system (ESW) permits members of the group to communicate with one another via secure e-mail, allowing for practical and swift exchange of information in fight against money laundering. Although it does not replace traditional channels that provide evidence to initiate court proceedings, this communication can secure information that may prove useful to competent authorities in the course of investigation. Therefore, Egmont group aims to facilitate secure, swift and legal exchange of information which will serve in the fight against money laundering and seek to establish a network of international cooperation of FIUs. Striving for a more massive flow of information that would contribute to the detection of money laundering, a number of memoranda of understandings have been signed with FIUs from Slovenia, Belgium, Italy, Czech Republic, Panama, Lithuania, Macedonia, Lebanon, Israel, Bulgaria, Romania, Australia, Lichtenstein, Albania, Bosnia and Herzegovina, Montenegro, Poland, Croatia, Georgia and Ukraine.

6.2.5. International Association for Insurance Supervisors (IAIS)

The International Association of Insurance Supervisors (IAIS) is a voluntary membership organisation of insurance supervisors and regulators. Established in 1994, the IAIS represents insurance regulators and supervisors of more than 200 jurisdictions in nearly 140 countries, constituting 97% of the world's insurance premiums. [49]

The IAIS is the international standard-setting body responsible for developing and assisting in the implementation of principles, standards and other supporting material for the supervision of the insurance sector. The IAIS also provides a forum for Members and stakeholders to share experiences and understanding of insurance supervision and insurance markets. The IAIS is routinely called upon by the G20 leaders and other international bodies who value the collective expertise of its Members.

The IAIS is a non-profit organisation formed under Article 60 of the Swiss Civil Code, domiciled in Basel, Switzerland. Its organisational chart is illustrated in Picture 6.2. [130] The mission of the IAIS is to promote effective and globally consistent supervision of the insurance industry in order to develop and maintain fair, safe and stable insurance markets for the benefit and protection of policyholders, and to contribute to global financial stability. [30]

Fig. 6.2 IAIS organisational structure [49]

Activities undertaken in furtherance of its mission can be divided into three categories: [30]

- **Standard setting**. The IAIS develops supervisory material (principles, standards and guidance) for effective insurance supervision. The IAIS also prepares supporting papers that provide background on specific areas of interest to insurance supervisors.

- **Implementation**. The IAIS actively promotes the implementation of its supervisory material. Working closely with international organisations, regional groups and supervisors, it supports training seminars and conferences and addresses financial inclusion. Also, the IAIS conducts assessments and peer reviews of Members'

observance of supervisory material, consistent with the Financial Sector Assessment Program (FSAP) conducted by the International Monetary Fund (IMF) and the World Bank.

- **Financial stability**. The IAIS plays a central role in financial stability issues, including developing a methodology for the identification of global systemically important insurers (G SIIs) and policy measures to address systemic risk in G-SIIs. It also assists its Members in developing enhanced macro prudential surveillance tools.

The IAIS coordinates its work with other international financial policymakers and associations of supervisors or regulators, and assists in shaping financial systems globally.

6.2.6. Basel Committee on Banking Supervision

The Basel Committee on Banking Supervision (BCBS) is the primary global standard-setter for the prudential regulation of banks and provides a forum for cooperation on banking supervisory matters. The BCBS does not possess any formal supranational authority. Its decisions do not have legal force. Rather, the BCBS relies on its members' commitments to achieve its mandate. Its mandate is to strengthen the regulation, supervision and practices of banks worldwide with the purpose of enhancing financial stability. BCBS members include organisations with direct banking supervisory authority and central banks. The Committee reports to the Group of Governors and Heads of Supervision (GHOS). The Committee seeks the endorsement of GHOS for its major decisions and its work programme. The Committee's Secretariat is located at the Bank for International Settlements in Basel, Switzerland, and is staffed mainly by professional supervisors on temporary secondment from member institutions (picture 6.3.). In addition to undertaking the secretarial work for the Committee and its many expert sub-committees, it stands ready to give advice to supervisory authorities in all countries [39]

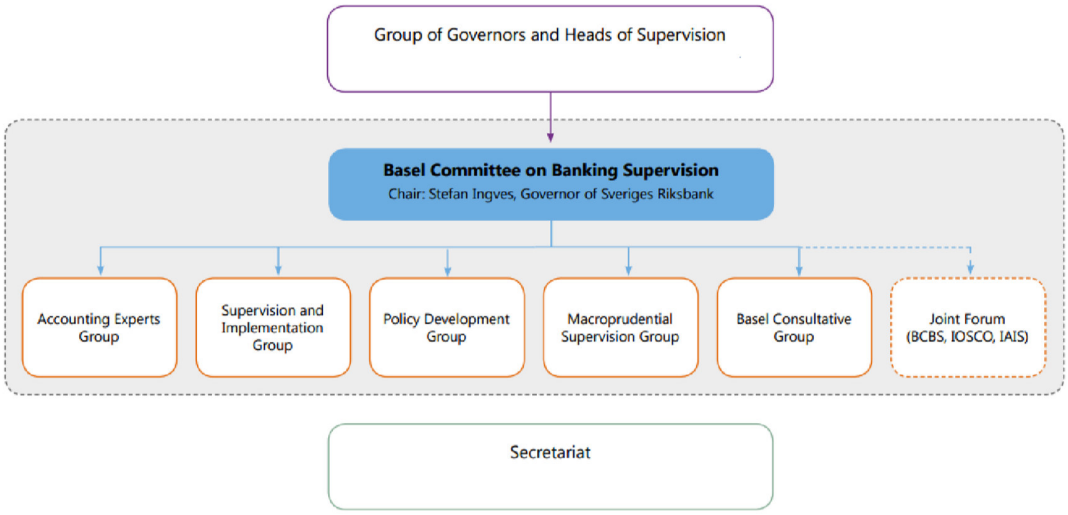

Fig. 6.3 BCBS organisational structure [39]

BCBS members are committed to: [39]

- work together to achieve the mandate of the BCBS;
- promote financial stability;
- continuously enhance their quality of banking regulation and supervision;
- actively contribute to the development of BCBS standards, guidelines and sound practices;
- implement and apply BCBS standards in their domestic jurisdictions (Domestic should be read as regional if applicable) within the pre-defined timeframe established by the Committee;
- undergo and participate in BCBS reviews to assess the consistency and effectiveness of domestic rules and supervisory practices in relation to BCBS standards; and
- Promote the interests of global financial stability and not solely national interests, while participating in BCBS work and decision-making.

The BCBS sets standards for the prudential regulation and supervision of banks. The BCBS expects full implementation of its standards by BCBS members and their internationally active banks. However, BCBS standards constitute minimum requirements and BCBS members may

decide to go beyond them. The Committee expects standards to be incorporated into local legal frameworks through each jurisdiction's rule-making process within the pre-defined timeframe established by the Committee. If deviation from literal transposition into local legal frameworks is unavoidable, members should seek the greatest possible equivalence of standards and their outcome.

Also, the BCBS cooperates with other international financial standard setters and public sector bodies with the purpose of achieving an enhanced coordination of policy development and implementation. In carrying out their responsibilities to support this cooperation, the Chairman and the Secretariat will pay particular attention to the need to comply with the BCBS's due process and governance arrangements.

The BCBS is a member of the Financial Stability Board (FSB) and participates in the FSB's work to develop, coordinate and promote the implementation of effective regulatory, supervisory and other financial sector policies.

6.2.7. The Wolfsberg group

The Wolfsberg Group is an association of eleven banks (Banco Santander, Bank of Tokyo-Mitsubishi UFJ, Barclays, Citigroup, Credit Suisse, Deutsche Bank, Goldman Sachs, HSBC, J.P. Morgan Chase, Société Génerale, and UBS) that took its name from the Château Wolfsberg where the banks held their first meetings and where they continue to hold their annual forum. The Wolfsberg Group has neither a written constitution nor any formalised set of rules or statutes. It has developed its practices and procedures over the course of its existence, although it has not put in place a monitoring mechanism or sanctions for omissions by its members. From the outset, it was considered important to gather on a regular basis. It was agreed this would be quarterly and that the member banks would take it in turns to host the meetings at their respective headquarters. This arrangement has permitted the group to refrain from charging membership fees as each member has born its own share of the hospitality costs. [26]

The Wolfsberg Group is an association which aims to develop financial services industry standards, and related products, for Know Your Customer, Anti-Money Laundering and Counter Terrorist Financing policies. In response to increasing regulatory focus on the risks associated with

Correspondent Banking, The Wolfsberg Group (2014) is prepared revised Anti-Money Laundering Principles for Correspondent Banking, Frequently Asked Questions on Correspondent Banking and Wolfsberg Group Anti-Money Laundering Questionnaire. [59]

6.3. International cooperation in prevention of financial abuse – Experience of the Republic of Serbia

In addition to international cooperation in the area of the exchange of information with authorities of other countries, which directly contributes to the analytical work of the APML as its basic task, the APML also participates in other forms of international cooperation important for the system for fight against money laundering and terrorism financing as a whole. [37]

The global network for combating money laundering and terrorism financing consists of 194 jurisdictions and territories which are grouped in the above mentioned FATF-Style Regional Bodies – *FSRBs.* Regional bodies Chartled after FATF are: Eurasian Group (EAG), Asia/Pacific Group on combating money laundering (APG), Caribbean Financial Action Task Force (CFATF), Committee of Experts on the Evaluation of Anti_Money Laundering Measures and the Financing of Terrorism of the Council of Europe (MONEYVAL), Eastern and Southern Africa Anti_Money Laundering Group (ESAAMLG), Financial Action Task Force on Money Laundering in South America (GAFISUD), Intergovernmental Action Group against Money _Laundering in West Africa (GIABA), Middle East and North Africa Financial Action Task Force (MENAFATF).

As the Republic of Serbia is a permanent member of the Committee on the Evolution of Anti-Money Laundering Measures – Moneyval Committee, Serbian system falls under its assessment. In addition to its membership in Moneyval, the Administration acts an observer in Eurasian Group for fight against money laundering and terrorism financing (EAG).

Furthermore, given that the Administration for Prevention of Money Laundering (Administration) is the financial intelligence unit of the Republic of Serbia, it became a member of the Egmont Group in July 2003. This membership is to confirm that the Administration has met internationally recognised criteria and to witnesses its capacity to exchange financial intelligence information in an efficient and secure manner with similar institutions the world over. All data

exchanged are treated as official secret and may only be used for the purposes and in the manner stipulated by law. [37] In 2013, the representatives of the APML took part in the meeting of Working Groups in Ostend, Belgium, in the period 21 – 25 January and at the Plenary and WG meetings in San City, South Africa, in the period 1 – 6 June. The APML constantly contributes to aims of the Egmont Group by participating, within the scope of its capacities, in the projects of the Operational Working Group and other activities of various Working Groups in the Egmont Group. [95]

The Administration maintains active cooperation with OSCE Mission to Serbia and with the United Nations Security Council Counter-Terrorism Committee (UN SC CTC).

The Republic of Serbia contributes significantly to regional cooperation and regularly participates in annual meetings of Heads of FIUs of the region (Slovenia, Croatia, Bosnia and Herzegovina, Serbia, Montenegro, Macedonia and Albania). Representatives of FIUs from other countries, such as Italy and Greece, also participate at these meetings as observers.

Moreover, representatives of the Republic of Serbia attended a regional conference on money laundering and assets recovery with representatives of the Ministry of Justice of the USA, the FBI, relevant state authorities of Serbia, Bosnia and Herzegovina, Montenegro and Macedonia, who exchanged experiences and best practices in the field. There are also a number of activities carried out at a bilateral level. Namely, such activities come as a response to functioning of the organised crime in the region - organised criminal groups from the Republic of Serbia establish frequent functional links with similar groups from abroad, in particular from the neighbouring countries, including Macedonia, Montenegro, Bosnia and Herzegovina (BiH), Croatia, Romania, and Bulgaria, primarily in order to execute their joint plans using the international routes for drug trafficking (FYRM, Montenegro, Bosnia and Herzegovina, Croatia, Bulgaria), illegal migration (Romania, Bosnia and Herzegovina, Croatia), money counterfeiting (Bulgaria, Bosnia and Herzegovina), and illegal arms trade (Bosnia and Herzegovina). [86]

Bilateral additional activities also include workshops, study visits etc.

Finally, within relevant international activities in this filed one should mention Project against Money Laundering and Terrorist Financing in Serbia (MOLI-Serbia). The source of its funding comes from the IPA funds approved by the European Commission to Serbia. Its overall

objective is to contribute to democracy and the rule of law through prevention and control of money laundering and terrorist and other forms of economic and financial crime in Serbia. The purpose of the Project is to enhance the capacities of the anti-money laundering and counterterrorist financing system in Serbia in terms of legislation, operations and capacities. [41]

7. Chart of the system for preventive action in cases of financial abuse

The previous chapters of the thesis pointed to the main regulations addressing the frauds in the financial sector, the institutional framework for combating financial frauds, the main fraud typologies in the banking and insurance sectors, which are most affected by frauds. The previous chapters also highlighted the social significance and the consequences of the financial crime for the country and society, the international aspect of frauds and also, the analysis of some specific examples from the practice was provided. The comprehensive picture of the examined issue was thus obtained. One aspect remained, however, which includes the proposal of the Chart solution for the prevention of financial abuse.

This final chapter defines the Chart of the system for preventive actions in cases of financial abuse. The initial assumption was that a uniform, systemic solution, based on clear, methodological principles may act efficiently to prevent the occurrence of financial frauds. The main components and the corresponding processes of the Chart are shown below.

7.1. Main system assumptions

The problem of financial frauds escalated when the individuals or organised criminal groups, alongside their regular criminal actions aimed at illegitimate acquisition of financial or material assets, included the fraud or abuse, as a new criminal Chart.

The Charts of financial frauds constitute a complex system which is developing at a steady pace and repeatedly involves the new techniques, following the development of science and technology, and the financial criminals themselves are becoming more sophisticated. This is the reason why the prevention measures are critical for the successful fight against money laundering,

and particularly the ones referring to the analysis and risk assessment. The risk-based system of analysis opposes the rule-based system. The rule-based system was in force since passing the First Directive on the prevention of money laundering from 1991. The implementation of such system was also envisaged by the Second Directive from 2001. The Third Directive from 2005 introduces the risk-based system. The compliance with this principle was also included in the 2012 FATF Recommendations. This system was also adopted in the proposal for the new Directive on the prevention of money laundering from 2013. The proposal for the new Directive highlights the importance of coordinated actions by the supervisory authorities both at the level of EU and the national level. [67]

The main objective of the thesis is to determine protective systems by getting to know concrete misuse cases, which prevent further realization. [5], [9], [20] [68], [88.]This way we strengthen the security of the financial sector and reduce the danger to minimum. In order to achieve this objective and construct a single and universal Chart of the system which would act in cases of financial abuse, it is necessary to define a uniform methodological basis as a foundation for such a system. The starting point was the main assumption in this thesis stating that the most efficient form for safeguarding the financial sector (primarily the banks and insurance companies) from frauds and abuse is particularly the prevention. We have therefore reached the main requirement of the system – protection through prevention, and we have defined the systemic solution titled: Chart of the system for preventive action in cases of financial abuse (the Chart). The main components and processes of the Chart are shown below.

7.2. The main components of the Chart

For the purpose of defining the Chart of the system for preventive action in cases of financial abuse, and based on the theoretical and practical research, as well as the analysis of the cases from practice, the main components and corresponding processes of the Chart have been listed.

The Chart is presented in two levels and involves a local (state) and international dimension, which fully reflects the subject matter and the main assumptions of the thesis, and

relates to the frauds in the area of money laundering, which are, beyond any doubt, internationally-oriented (fig. 7.1).

Components of the Chart:

- Legal frameworks,
- International institutions,
- National legislation and
- State institutions.

The components above are virtually set in two levels: international and local (state) level. The ties between these are bidirectional and continuous, as the required dynamics of mutual communication must be permanent and undisturbed.

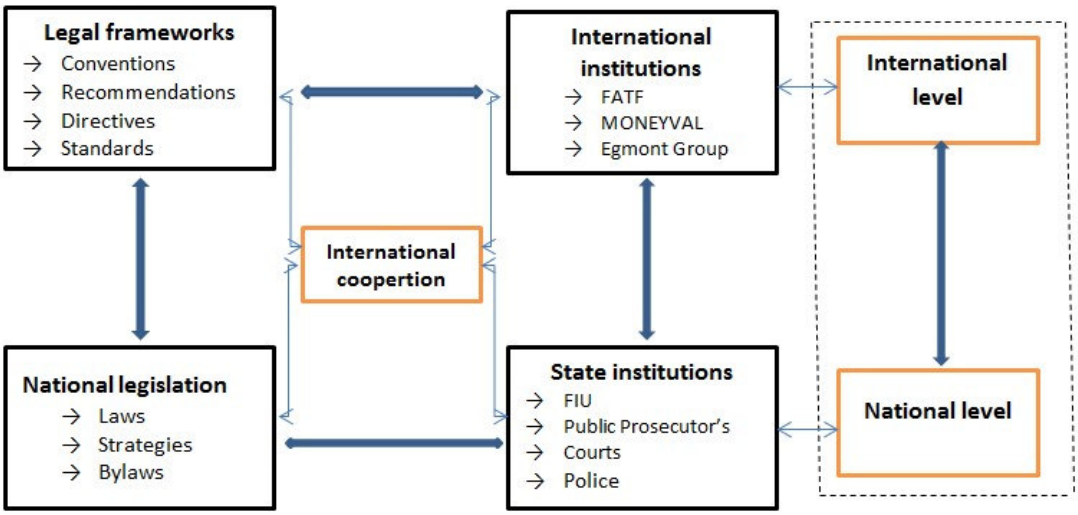

Fig. 7.1 Main components of the Chart

Each of the four proposed components of the Chart has been described in detail in the previous chapters:

- The first component of the Chart: **Legal frameworks** – covers the international conventions, recommendations, directives and standards addressing the financial frauds, predominantly oriented towards the issue of money laundering (Chapter 2 of the thesis: Legal frameworks).

- The second component of the Chart: **International institutions** – covers all international stakeholders that prescribe and pass the legislation regulating the area of financial abuse, as well as the institutions tasked with its prevention and identification (Chapter 6 of the thesis: International cooperation).

- **National legislation -** Legislation at the level of individual country – constitutes the third component of the Chart. Legal norms must be fully and timely harmonised with the existing international legislation. The national legislation in the area of financial abuse, based on the example of the Republic of Serbia, has been presented in the Chapter 2 of the thesis.

- **State institutions** are all the institutions in charge of the prevention of money laundering and precluding the direct financial crime. As such, they constitute the fourth component of the Chart, headed by the Administration for the prevention of money laundering (FIU). Chapter 2 of the thesis – Institutional frameworks for combating the financial abuse, presents the situation at the institutional level of the Republic of Serbia, noting that this institutional framework bears strong resemblance to the ones in the neighbouring countries.

However, the importance of a uniform approach, better organisation and international cooperation aimed at prevention and identification of abuse in the financial sector has been repeatedly insisted on. This implies that these components of the system cannot be static, but must be perceived as dynamic ones, by means of introducing the appropriate processes which would raise the level of the system efficiency.

7.3. Processes within the Chart

The processes which are included within the Chart, and which complete the system are the following (fig. 7.2):

P1: Methodological (theoretical) set up of the research into the financial abuse (risk analysis included)

P2: Identification of all forms of financial crime in banking and insurance,

P3: Implementation and evaluation of the proposed methodology through reviewing the existing methods and techniques of financial abuse,

P4: Reviewing and expanding the indicators for fraudulent actions

P5: Innovation of the fraud typology

P6: Completion of the legislation – amending the criminal legislation,

P7: Training of police and investigative methods,

P8: Harmonising the penalty and judicial policy,

P9: International cooperation,

P10: Continuous education,

P11: Communication and promotion,

P12: Use of information-communication technologies (ICT) and

P13: Organisation and coordination.

It is important to highlight the dynamic component of the system – none of the above processes is completed. The processes change around in a circle and are constantly updated with the results from the previous processes, thereby making the system sustainable in the ongoing fight against the criminals and fraudsters, who are incessantly examining and introducing the new methods and techniques of financial frauds, by using the latest technical and technological achievements.

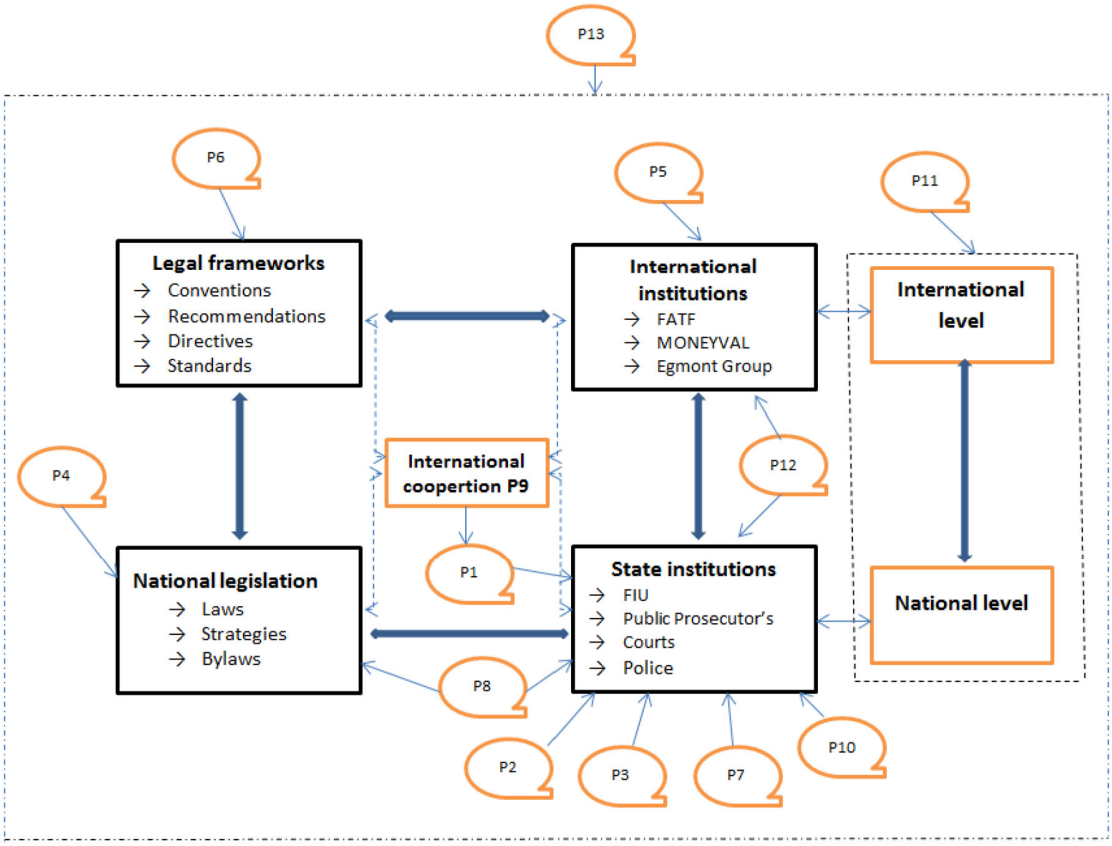

Fig. 7.2 Chart of the system for preventive action in cases of financial abuse

The chapter will further describe the main processes of the Chart. Particular attention was given to the processes and the activities within, which have not been covered in the first part of the thesis: the use of information-communication technologies (ICT), continuous education and promotional activities.

P1: Methodological (theoretical) set up of the research into the financial abuse

The main fight against the financial crime takes place at the level of each individual country. It is necessary, however, to achieve a synergistic effect through the inter-state exchange of data and information, but the knowledge, as well. Countries must direct their joint efforts towards a comprehensive, theoretical and practical research into the methodology and technique of financial abuse, reviewing and expanding the indicators for fraudulent actions, developing and innovation of the fraud typology, identification of all forms of financial crime in banking and insurance, completion of the legislation, amending the criminal legislation, training of police and

investigative methods, harmonising the penalty and judicial policy, and a number of other activities, such as the education of the employees and the coordinated media action for educating the general population – the citizens. At the same time, all these activities are of both the legal and economic character, as the financial frauds simultaneously undermine the legal system of the country, as well as its economic stability. These processes take place within the Fourth component of the Chart: State institutions.

One of the main contributions of the thesis is reflected exactly in the implementation of the Chart for the preventive action in cases of financial abuse, based on the application of the scientific approach, i.e. a clearly defined methodological procedure for the detection of frauds and risk analysis. Therefore, the institutions responsible for the suppression of financial abuse at the level of each individual country must engage in networking, especially in the area of banking and insurance, and in particular, by using the advanced ICTs. The networking system must also be ensured between the countries, by establishing and maintaining the international cooperation.

The main methodological principle the system is based on for the purpose of preventive actions in cases of financial abuse is that it is based on risk-assessment. The Chart of the system, apart from the assessment of the risk of exposure to the financial abuse, also includes the risk classification, within the domain of the existing fraud typology, as well as its materialisation in the form of suspicious transactions.

FATF recognises three stages in the implementation of the system based on risk-assessment, as follows:

- risk detection,
- risk assessment,
- risk management strategy development, and
- risk minimisation.

The three risk categories are also recognised:

- low risk,
- high risk and

- Innovation, such as technological innovation. [12]

The methodology the Chart is based on follows and builds on the FATF rules which provide for the mechanisms to be implemented for the analysis of the procedures applied and deciding on the risk level. Risk assessment must be applied for each client and each product (service). Risk-assessment starts from the analysis of all the relevant facts, and the collected information which might point to the suspicious financial transactions. This especially relates to all the complex and unusual parts of the transaction with no visible economic or legitimate logic.

The efficient use of the system requires: a detailed definition of the suspicious transactions, efficient supervision and reporting on the suspicious transactions which needs to be done not only by the banks, but other obligors, as well.

P2: Identification of all forms of financial crime in banking and insurance

The process of the identification of all forms of financial crime in banking and insurance logically relates back to the previous process which involves the theoretical concept of investigating frauds in the financial sector. The output of the process is a list of all the forms (methods and techniques) occurring in the international practice, i.e. a typology of frauds in the banking and insurance sectors, as well as the list of corresponding indicators. The typologies of frauds in the banking and insurance sectors are presented in Chapters 5 and 6 and constitute the basis to be updated after the new forms of financial abuse have been identified (Fourth component of the Chart).

P3: Implementation and evaluation of the proposed methodology through reviewing the existing methods and techniques of financial abuse

After establishing the existing typology of fraudulent actions (during the previously described process), the next step should be its examination, which implies the research into the existing methods and techniques, their evaluation and the proposal of measures for their identification and suppression, prevention and sanctioning. To this end, it is necessary to identify the appropriate fraud indicators, as envisaged in the following process (Fourth component of the Chart).

P4: Reviewing and expanding the indicators for fraudulent actions

The development of indicators for recognising the suspicious transactions is significant for both the direct effective recognition and prevention of money laundering and terrorism financing, and the training of staff in banks and other entities which are obliged to undertake the measures for the prevention of these criminal offences. When new indicators are identified in the course of the previous process, these need to be tested and included into the list of the existing indicators. This requires carrying out the appropriate legal procedure and organisational support for the application of the new list (Third component of the Chart: Legislation at the level of individual country).

Case study – Republic of Serbia: Project Group consisting of representatives of the Administration, Tax Administration, National Bank of Serbia and of AML/CFT compliance officers in commercial banks, Post of Serbia and money transfer agents, has developed a list of indicators for recognizing suspicious transactions related to terrorism financing. The indicators start to apply as of 1 June 2015. All the obligors referred to in the AML/CFT Law are required to include the indicators into the list they themselves develop. You can download the list of Indicators here. [37]

P5: Innovation of the fraud typology

The fraud typology needs to be regularly updated and exchanged with other countries, through FIUs which should have the standardised mutual communication in place. Institutional networking at the international level is critical for achieving this objective (Second component of the Chart: International institutions).

P6: Completion of the legislation – amending the criminal legislation

Amending the fraud typologies, introducing the new indicators, amending the international standards, requirements for the harmonisation of legislation are just some of the activities demanding the change of the legislation at the level of individual country (Third component of the Chart: Legislation at the level of individual country). All the amendments to be introduced need to comply with the international legal norms (First component of the Chart:

Harmonised legislation).

P7: Training of police and investigative methods

Police and judiciary have a significant role in identifying and prosecuting the criminal offences in the area of financial frauds. This is the reason why the knowledge and skills in this area must be constantly updated and upgraded. This process stresses the importance of international cooperation and sound organisation and coordination in these services (Second and fourth component of the Chart).

P8: Harmonising the penalty and judicial policy

What is relevant for other criminal offences is also relevant for the area of financial frauds. It was common that the judiciary failed to respond appropriately, by imposing the sanction which had no detrimental effect for the future offenders. The repressive aspect of the system is reflected in the criminal prosecution and sanctioning of the criminal perpetrators. The penalties for money laundering in all the countries around the world are severe and often exceed the penalties prescribed for the criminal offences committed for obtaining the money which is being 'laundered'. In the Republic of Serbia, the penalty prescribed for money laundering is the imprisonment in the duration from 6 months to 5 years. If the amount which is the subject matter of the offence exceeds one million dinars, the penalty is up to 10 years of imprisonment. The penalty for terrorism financing prescribed by the Criminal Code of the Republic of Serbia ranges from 1 to 10 years of imprisonment. Also, in case of tax evasion, if the amount subject to evasion exceeds 7.5 million dinars, the perpetrator will be sentenced to the imprisonment in the duration ranging from two to ten years and a fine. [19]

Apart from the imprisonment, all the money or assets which are the subject matter of the criminal offence shall be seized. The main reason for introducing the criminal offence into the legal systems is preventing the criminals from using the ill-gotten proceeds in a legitimate manner. (Third component of the Chart).

Apart from the repressive aspect, the Chart also envisages the proactive, preventive actions in the domain of raising awareness of not only the professional community of the dangers and

consequences of financial abuse, but of all the groups of citizens (general public). This is where the role of the media should be emphasised, as well as of the appropriate promotional activities which constitute the independent process covering all the components of the Chart.

P9: International cooperation

Virtually the entire text of the thesis highlights the importance of international cooperation, as critical to the efficient fight against the financial abuse. International cooperation is present across all the four components of the Chart and constitutes one of the basic hypothesis on which the entire system of preventive actions in cases of financial abuse is based.

P10: Continuous education

The importance of training and education of all the staff involved in the fight against financial frauds and money laundering is strong, particularly if one considers the overall assessment in the 2009 National Strategy for Fight against Organized Crime in the Republic of Serbia, stating that all government authorities with jurisdiction to combat organized crime are characterized by insufficiency of staff, both in numbers and quality. [113] This is followed by the note saying that there is a tendency of drain among quality and experienced staff towards other Government bodies and the private sector, made attractive by incomparably better salaries, while there is no developed training system that would enable continuous learning and acquiring of required competences. It is being performed periodically through seminars, round tables, practical trainings, study visits etc. This is the reason why it is stated that, in the first place, it is necessary to provide the best possible training to the authorised persons in the entities obliged to undertake the measures of prevention of money laundering and terrorism financing, as well as their assistants, who are obliged to pass the professional exam and obtain the certificate for performing the duties of authorised persons (Fourth component of the Chart).

More specifically, regarding the Administration for the prevention of money laundering in the Republic of Serbia and its annual reports, the importance of further training of staff in obliged entities is clearly emphasised, as a contribution to a more effective identification of suspicious transactions and prevention of money laundering. Possible drain of some staff from the Administration for the prevention of money laundering towards other employers, due to the

reasons of higher salary and better work conditions, undoubtedly hinders the effectiveness of the Administration further on, and therefore special attention should be given to the appropriate recruitment of the staff for the Administration, and to their work training which should be as efficient as possible. [37]

P11: Communication and promotion

Communication takes place both *within* the components 2 and 3 of the Chart (internal communication) and *between* these components (external communication). It is necessary, therefore, to communicate with the public: domestic and international. This form of communication is performed via the media, in a formal manner, by conducting the promotional activities. [93]

The role of the media in combating the financial frauds is enormous and two-fold: the media may give negative and positive publicity in relation to the activities directed towards the fight against the financial abuse. The example of the negative publicity is presenting the statistical data in the media detailing the large backlogs in the work of state bodies, ministries, agencies, police, in other words, all those in charge of law enforcement and judiciary.

Slow progress in processing the initiated proceedings may create a public image denoting that the majority of fraud crimes end up with no formal conviction, or with an absence of criminal proceedings, in other words, the accused remain unpunished. It is obvious that this is not an appropriate message to the citizens and potential perpetrators or participants in financial fraud crimes.

Based on the Chart of the System for preventive action in cases of financial abuse (fig. 9.2), the importance of promotional activities is clearly visible, where all the components and processes of the system are included. Nonetheless, this process will lack the sufficient efficiency unless it is sufficiently well set up – primarily, in the methodological sense. Promotional activities must follow all the rules of the profession.

Promotion is a legitimate act of the preventive fight against all forms of crime, including the financial one. It is necessary to develop a sound campaign which will be on at all times in order to take stock of all the activities relating to the area of financial frauds. As a minimum, through

the PR (public relations) activities, the adverse effects of all forms of financial frauds must be highlighted as well as the potential threats arising from the involvement in this form of crime, whether due to bad intentions or ignorance.

CS Serbia: Within the project Moli, the better visibility needs were identified. Specifically, the Administration emphasised the need for a better web site so as to make it more user-friendly, for the benefit of the public, or to enable a better information flow for the services it cooperates with.

P12: Use of information-communication technologies (ICT)

Information-communication technologies have an increasingly important role across the society, of a two-fold nature: as a tool for committing the fraud and as a tool for its suppression. [94] As a tool for committing the financial frauds, ICT primarily relates to computer crime. The possibilities of ICT as a tool for the suppression of frauds will be presented in a case study – Information system of the Administration for the Prevention of Money Laundering in the Republic of Serbia.

P13: Organisation and coordination

Process, P10: Use of information-communication technologies (ICT), covers the entire component K4: State institutions, headed by the Administration. The conclusion is clear: sole reliance on ICT may not contribute to the successful fight against the financial crime. ICT is only a tool serving for the purpose of one, albeit important, component of the System for preventive action in cases of financial abuse. It is necessary to develop and maintain the other components of the system, as well, and the processes connecting them or those reliant upon them. Therefore, only an integral solution, which would undergo a dynamic improvement, may lead to full success in combating the frauds in the financial sector. This also calls for an excellent organisation and perfect coordination between all the components in the System.

8. Conclusion

8.1. Concluding observations

Fight against international crime is one of the key guidelines upon which the EU rests. International crime and terrorism are among the problems that pose the greatest concern to European citizens. Organised crime is being constantly improved, regularly using European or international networks for its activities. Terrorism has clearly shown it knows no borders. One of the most significant sources of terrorism financing is directly co-related with financial abuses, chiefly money laundering. Therefore, preventing financial abuses includes a security-related concept, wider than socio-economic and political dimensions which are also very important.

Numerous authors point out that financial abuses and illegal money flows cause vast socio-economic and political disruptions in a country - they undermine macroeconomic stability, transparency and efficiency of a financial system of the country, give rise to economic disruptions and instability, threaten programmes of reforms, reduce investments, tarnish the reputation of the country and undermine national security. The most important consequences to macroeconomic stability relate to: [133]

- investing in sectors with lower risk of detection, instead into the ones that yield higher profit;
- increase in prices, especially real estate prices;
- consumption growth;
- rise in consumer goods imports;
- fall in exports;
- occurrence of unfair competition;
- negative impact on foreign direct investments due to undermining of the real sector and inflating of some other sectors;
- strengthening suspected proceeds and distribution of wealth and
- Corruption.

As regards the legal frameworks that buttress the fight against financial abuses in the sense of prevention of international financial abuses, the emphasis is placed on international regulations that govern money laundering and terrorism financing. These regulations include conventions, recommendations and directives. The thesis elaborates and analyses the legal framework at both the international and local (state) level.

Legal measures aim to intensify the actions that should act preventively in order to fight the most frequent criminal offences of financial abuse, such as money laundering. It is necessary to constantly enhance the international legal instrumentation that will lead to better coordination and international cooperation, given that the problem of organised crime has long ago trespassed national borders. This also entails improving cooperation of all competent institutions at the local (state) level.

An important prerequisite for the prevention of money laundering and terrorism financing is studying the forms of manifestation of these criminal acts. In this sense, there are many significant activities of a large number of international institutions and organisations, such as: Inter-governmental body - FATF (Financial Action Task Force), Moneyval system, Egmont group, International Association for Insurance Supervisors (IAIS), Basel Committee on Banking Supervision and the Wolfsberg group.

In both theory and practice, the most frequent forms of financial abuses are financial statement frauds, tax evasion and money laundering. Unlike financial statement frauds that generally do not have an international character, tax evasion and money laundering can often have an international dimension. Money laundering comes as a consequence of main illegal activities around the world, which can be brought down to the following three activities: organised crime, manufacturing and transfer of narcotic drugs and terrorism financing.

As a part of further activities against the financial frauds, the states should first establish the cooperation with the neighbouring countries, regardless from their political differences and enmity, and afterwards at the regional level, so that they could use this standpoint to form a common ground for global security aimed at combating the financial abuse. The countries must not forget that the criminals and criminal organisations are only limited by their own imagination, and not by international boundaries. Therefore, if the countries remain oriented towards their own

laws and state borders, they will fail to undertake measures against the financial abuse of the international nature.

The countries must direct their joint efforts towards a comprehensive, theoretical and practical research of the methodology and techniques of financial abuse, reviewing and expanding the indicators related to wrongful acts, development and innovation of typology of frauds, identification of all forms of financial crime in banking and insurance, finalising the legislation, supplementing the criminal legislation, advancing the police and investigative methods, harmonising the penalty and judicial policy in this respect, and a series of other measures possessing both the legal and economic dimension, as the financial frauds undermine every country's legal system as much as they undermine the country's economic being. The countries must network their institutions for combating the financial abuse, and particularly the ones in the area of banking and insurance.

The thesis presents the main forms of financial abuses which touch the social, economic and security system of any country, while focusing on the international aspect. Particular emphasis is placed on banking and insurance through an illustration of main types of financial abuses in these sectors. The thesis also looks into the problem of tax evasion and the role of the offshore business in the process of financial abuses.

It is evident that a satisfactory level of prevention of financial abuses and money laundering can be achieved solely through adoption of an appropriate normative-legal framework. Even the best of laws remain dead letters lest appropriate conditions for their implementation are secured, primarily staff and financial prerequisites. In case of prevention of financial abuses, there is a wide circle of subjects and activities on which the success depends. The FIU (Administration for Prevention of Money Laundering) is only one of the most important subjects in the fight against financial abuses, but it *de facto* holds the second line of defence. The front line is occupied by obligors (banks, insurance undertakings and other institutions set forth by law), i.e. their staff who carry out these activities (persons and authorised persons and their deputies). It is they who play the key preventive role in taking customer due diligence measures and protecting secrecy of data on the supervision over transactions and business activities of the customer.

In studying financial abuses it is important to underline the multidisciplinary approach. Through analyses of legal frameworks, documented sources, theoretical papers and case studies, at both the local and international level, we have reached a solution proposal that is based on the Chart of the system for preventive action in cases of financial abuses (Chart). The proposed Chart comprises two levels, given that it spans local (state) and international dimension, which is completely in accordance with the subject matter and main assumptions of the thesis, regarding abuses related to money laundering which are undoubtedly of international character. Financial crime and money laundering amid globalisation and liberalisation have come to be a problem that requires cooperation among countries and adoption of appropriate measures for its prevention, not only on a national, but also on an international legal and supranational scale.

The thesis has presented the four main components of the Chart: harmonised regulations, international institutions, national legislature and state institutions. It has also described all thirteen processes that connect the Chart components. It has particularly shown the significance of the local FIU and importance of creating environment necessary for their efficient work i.e. IT, educational and promotional environment. The thesis stresses the international aspect as one of the two processes that connect all four components of the system (along with organisation and coordination). The proposed Chart is the main scientific and professional contribution of the thesis.

8.2. Scientific and professional contributions of the thesis

The thesis has achieved its primary goal: it has examined the exposure of the contemporary society to financial crime risk, identified characteristics and the extent of financial abuses, particularly money laundering and its modalities, and suggested the Chart system for preventive action. The thesis has particularly focused on banking and insurance, by presenting the main types of frauds in these sectors.

The most important **scientific contribution** of the doctoral thesis is that it provides a systemic solution, i.e. it builds a Chart system for preventive action in cases of financial abuses that rests on a scientific approach, i.e. a clearly defined methodological procedure for detection of frauds and analysis of risk of frauds. The construction of this Chart started from the assumptions defined. Based on the analysis of components and the processes of the Chart, we arrived at the

conclusion that the fourth component of the Chart – national institutions, particularly the competent FIU, shoulders the major burden. Continuous investing is therefore necessary, particularly in the FIU, police and the justice system. However, investing in institutions means investing in human resources (education and training with financial support so as to prevent the outflow of competent staff). Countries need to connect their institutions for the prevention of money laundering, particularly in banking and insurance, primarily by using advanced ICTs. Furthermore, it is important to further develop international cooperation, as the system cannot survive separately without interaction with the environment. It requires excellent organisation and perfect coordination of all components in the system.

Professional contribution of the thesis is a systematic, comprehensive and critical overview of regulations and institutional frameworks for fight against financial frauds, at both the national and international level.

Additional contribution of the thesis is that it points to further directions in the combat against financial crime – strengthening activities which are defined by processes P1 to P3 of the Chart. Particular emphasis is placed on the significance of international cooperation, education, promotional activities and the use of ICT, while proposing further steps and activities on this path.

The listed contributions of the thesis clearly indicate that all the listed assumptions which are itemized in the introduction of the thesis are accomplished, and it can be concluded that the proposed **Chart of the system for preventive action in cases of financial abuse** presents multidisciplinary scientific solution, applicable in practice. It is recommended that it's testing and implementation at the level of individual state, institutionally through the work of FIU. It is particularly important to emphasise the importance of data which are included in the Chart, since it is necessary to be continually updated. The data should be timely and accurate. Given that the data are not publicly disclosed they should be collected, processed and stored for analysis, and the data are not publicly available (from police and investigative procedures).

8.3. Future research and recommendations

Eurostat, the statistical directorate of the EU adopted in 2013 the European System of National and Regional Accounts (ESA 2010), which is the newest internationally compatible EU accounting framework for a systematic and detailed description of an economy [35]. The ESA 2010 was published in the Official Journal on 26 June 2013. It was implemented in September 2014; from that date onwards the data transmission from Member States to Eurostat is following ESA 2010 rules [42]. Among other things, ESA 2010 envisages presenting income from illegal activities in GDP, under the item "services", whereby estimated revenues from prostitution are presented on the supply side, and drug trafficking on the demand side. Without looking into the motives of such a decision, it should be noted that in this manner European countries can represent higher level of their GDP.

As regards the challenges that the banking sector faces, the already cited publication, entitled Money Laundering Typologies in the Republic of Serbia has raised the following questions related to the banking sector: [80]

An increasing offer of services and products provided by the banks will change in the future. The development of infrastructure and technology will result in priority of the e-banking over conventional modes of banking.

There are two key reasons why banks are interested in e-banking:

1. Users' demographics - Internet and smartphones users are mostly young people with higher degree of education and higher income than an average client.

2. Internet and local wireless networks are a very efficient and cheap distribution channel.

Fighting for the clients, the banks expand the portfolio of their services and offer the products which rely more on Internet and mobile phones, therefore, the increased offer of services over so-called virtual counters is expected, as they are used today when applying for an online loan.

The PayPal system enables transactions, via Internet or by using bank cards, directly from a PayPal account, which is not subject to strict procedures for client identification and for determining the origin of funds, as well as sending money to anyone with an e-mail address.

Applications which are currently developed are moving into two directions: traditional ebanking systems (or internet banking), intended for desktop computer users, and m-banking. Ebanking is a package of modern services which enables simple use of banking services by the clients, using the most common channels of communication – Internet, mobile phone, land phone. Major advantages of these services are their lower cost, significant saving of time and the possibility of performing transactions 24 hours a day, 7 days a week, 365 days a year. With the M-commerce service, the client is able, at any time, using his mobile phone, to give an order to his bank to transfer funds in a small amount, from his account to a different one, from which the funds can be further transferred or withdrawn in cash or with a bank card. It is anticipated that m-banking will see a stronger expansion than e-banking. This is already coming true given that the number of mobile phone users by far exceeds the number of internet users.

However, it is these very characteristics, which come as an advantage for the clients that may cause potential danger of financial abuses, given that the client is spatially remote from the bank, thus hindering the identification procedure. This gives rise to new possibilities for money laundering, which should be timely foreseen, prevented or recognised.

The question is how banks will fight against alternative modes of payment via Internet, which already exist, such as “cyber cash”. A card with a chip contains cash which can be withdrawn by phone or from ATMs, and the cash can also be transferred from one card to another. There is no way to track down these card transactions, because there is no registry of transactions, as it exists with Visa or MasterCard credit cards.

When it comes to other financial sectors, and the insurance sector as well, the global economic crisis from 2007, which brought about the dramatic drop in value of shares worldwide, led to an increased demand for gold and other precious metals, which are currently very interesting for investments and trade.

There is also an opinion, advocated by large banks, that the future belongs to huge financial institutions which will provide investors with various services ranging from insurance, car loans, to airplane tickets. On the other hand, the lobby led by the giants of the ICT, such as Apple, Google and Microsoft, believes that the future belongs to the companies that will, with the development and application of new technologies, offer investors the maximum control over their finances,

through sophisticated products that balance risk and profit. The idea behind the revolution in technology of banking is that technology and finances have become one and that the difference between the software and money is disappearing. [80]

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