

## THE PLACE AND THE ROLE OF FINANCIAL MONITORING IN ANTI-MONEY LAUNDERING SYSTEM

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### ABSTRACT

*Financial monitoring plays a pivotal role in the overall effectiveness of an anti-money laundering (AML) system. This article explores the place and role of financial monitoring in preventing and detecting money laundering activities. The authors highlighted the significance of effective financial monitoring in meeting regulatory compliance requirements. The definition of the role and place of financial monitoring in the fight against the legalisation of corruption proceeds are updated, considering the tasks and requirements set before Ukraine as a candidate country for the European Union and the challenges caused by the state of war. The article aims to analyse and provide an understanding of the importance of financial monitoring in the broader context of combating money laundering. The authors used different methods and approaches depending on the nature of the research, such as literature review, legal and doctrinal analysis, and comparative analysis<sup>6</sup> dialectical method, method of analysis and synthesis and method of terminological analysis. The findings of this research underscore the criticality of financial monitoring in safeguarding the integrity of the financial system and protecting economies from the harmful effects of money laundering. By understanding the place and role of financial monitoring within the broader AML framework, financial institutions, policymakers, and regulators can enhance their efforts to combat money laundering and ensure a safer and more secure economic environment.*

**KEYWORDS** anti-money laundering; money laundering; financial monitoring; financial system



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## INTRODUCTION

The dynamics of the integral indicator of the effectiveness of the financial monitoring system were: 2018 – 64.58%, 2019 – 62.8%, 2020 – 61%, and 2021 – 60.7%. For 2022, the integral indicator was not calculated. However, considering the martial law, it will be lower. Considering Ukraine's European orientations (the need to fulfil the requirements set before our state as a candidate country for the EU), the question of the effectiveness of countering legalization and strengthening the fight in the context of laundering corruption proceeds is being brought up to date. Financial monitoring is one of the effective means of combating the legalisation of corruption income; an essential component of its effectiveness is the organization of effective interaction of its subjects (Kuzmenko et al., 2021). Considering the status of Ukraine as a candidate country for the EU (Sapir, 2022), the issue of implementing several provisions of international acts and the general orientation to the recommendations of the FATF to effectively organize financial monitoring in the system of countering the legalization of criminal income is being updated. As a result, this will lead to the stabilisation of the financial and economic security of the state as a whole.

This study brings together multiple dimensions and provides fresh perspectives on financial monitoring in the anti-money laundering system. By incorporating novel aspects and addressing current challenges, it contributes to the existing body of knowledge and offers practical implications for stakeholders involved in combating money laundering. The article aims to analyse and provide an understanding of the importance of financial monitoring in the broader context of combating money laundering.

## RESEARCH METHOD

The authors used a complex interdisciplinary approach based on combined methods used in research in various fields (Creswell & Creswell, 2017). This made it possible to analyse and conduct research objectively and achieve the goal of conducting scientific research. It is worth noting that most domestic proposals for financial monitoring are based only on theoretical analysis. The method of analysis and synthesis, as well as the ascent from the abstract to the concrete, was directly used to determine the impact of money laundering on Ukraine's financial and economic security in the context of globalisation. The authors used the dialectical method to determine the methodological foundations of the study of existing ways of legalising corruption income, methods, and implementation of financial monitoring. It was used in combination with the method of terminological analysis and operationalisation to understand the purpose of studying and clarifying general theoretical provisions that reveal the essential nature and peculiarities of the views of representatives of the scientific community on defining the definitions of

"legalisation", "corruption proceeds", "financial monitoring", "financial monitoring entities". The method of creating a theory was used to generalise the research results, to find general patterns for the objects being studied.

## RESULT AND DISCUSSION

Financial monitoring plays an essential role in the complex system of combating the legalisation of criminal and corruption proceeds, financing of terrorism and weapons of mass destruction (Orlovskiy, 2023). The authors highlighted that such measures are important to the international fight against crime and terrorist financing. As Crossman-Smith noted, reducing financial crime is crucial, and regulatory expectations are high (Crossman-Smith, 2020).

One such crime is money laundering, a significant problem globally, with criminals using various techniques to conceal the origins of their illicit proceeds (Olujobi & Yebisi, 2023; Remeikienė et al., 2022). Money laundering is indeed a significant problem globally. Criminals employ multiple techniques to hide the true origins of their illegal proceeds and make them appear legitimate. Money laundering typically involves three stages: placement, layering, and integration. Ferguson (2019) described these stages in his book as follows:

- (1) placement – illicit funds are used to make a purchase in the legitimate economy;
- (2) layering – through repeated transactions, the source of the funds is concealed;  
and
- (3) integration – the funds are fully and untraceably integrated into the economy.

Albanese highlighted that money laundering is recognised as a type of “serious and organised crime”, and its primary objective is always to escape detection by law authorities (Albanese, 2021).

The global COVID-19 pandemic, the most significant public health crisis in modern times, has significantly accelerated the transition from in-person financial activities to online account opening, payments, and lending. This has increased the fraud risk for online financial services and commerce in general and led to a dramatic spike in the number of stimuli, healthcare, bank, elder, and government fraud schemes and scams exploiting the COVID-19 pandemic (National Money Laundering Risk Assessment, 2022). At the same time, the 2022 Russian invasion of the territory of Ukraine also influenced the given procedures.

Analysing legislative acts and specialised literature systematised the views of scientists, allowed the authors to outline the number of ways in which money laundering and terrorist financing harm society:

- (1) it facilitates and perpetuates crime and supports criminals;
- (2) it facilitates the commitment of atrocities at home and abroad;

(3) it undermines citizens' trust in financial institutions, negatively affecting market integrity and threatening the financial system's stability (Anti-Money Laundering and Countering the Financing of Terrorism, 2020).

The term “money laundering” first appeared in the USA in the 1930s in connection with adopting the country's law, which prohibited the free sale of alcoholic beverages. One of the negative consequences of this law was the smuggling of alcohol, the income from which was invested in developing a network of laundries, thus obtaining legal status. Since then, operations of this kind have received the figurative name “money laundering”. At this stage of development, “money laundering” is considered the process by which the proceeds of crime are sanitised to disguise their illicit origins and are legitimised. Money laundering schemes come with varying levels of sophistication, from the very simple to the highly complex (Anti Money Laundering Policy v3.0, 2022). Almost the exact definition of the notion of “money laundering” was given in the work of Kumar (2012), in which “money laundering” was defined as the process by which a large amount of illegally obtained money from drug trafficking. Tamplin (2023) mentions that “money laundering” is the process of making illegally earned money appear to be "clean," often through complex bank transfers and transactions.

The goal of a large number of criminal acts is to generate a profit for the individual or group that carries out the act. Money laundering is the processing of these criminal proceeds to disguise their illegal origin. This process is of critical importance, as it enables the criminal to enjoy these profits without jeopardising their source (Manual in Countering Money Laundering and the Financing of Terrorism, 2003).

Concluding the abovementioned definitions of the notion “money laundering”, the authors highlighted it as a criminal activity wherein illegally obtained funds or “dirty” money are passed through a sequence of transactions to make them appear as if they come from legitimate sources. This process effectively “cleans” the funds, giving them the appearance of being derived from lawful activities. The direct source of obtaining "dirty" funds is the shadow economy as a set of unaccounted-for and illegal types of economic activity.

The financial sector may get adverse effects from money laundering, especially financial institutions, including banking and non-banking financial institutions (NBFIs), and equity markets - may directly or indirectly be affected (Kumar, 2012). Preventing money laundering and terrorist financing is of utmost importance across the entire financial sector. Over time, its significance has significantly increased for financial institutions of all sizes and types, as well as for lawmakers, regulators, and supervisors. Ensuring that the financial system is not exploited for the purpose of disguising illegal funds or financing terrorist activities is a critical component of global efforts to mitigate the destructive impact of crime

and terrorism (Machine Learning in Anti-Money Laundering – Summary Report, 2018).

As the authors mentioned before in their research, countries began to install anti-money laundering regimes in the 1970s and 1980s crime-solving assistance, basically related to money laundering from drug trafficking and other organised criminal activities (Reznik et al., 2023). A key element in the fight against money laundering and terrorist financing is the need to monitor countries' systems for compliance with international standards (Hedziuk, 2018). The mutual evaluation conducted by the FATF and relevant regional organisations regarding the development of financial anti-money laundering measures, as well as the evaluations conducted by the International Monetary Fund and the World Bank, is an essential mechanism to ensure the effective implementation of the FATF Recommendations by all countries (The FATF Recommendations, 2012). The main functions of financial monitoring include detecting, tracking and analysing transactions and financial operations to identify signs of illegal activities. In the context of financial monitoring, it is possible to identify patterns and connections between various transactions. In turn, this helps to establish potential channels of financing criminal activities. In our opinion, this kind of data can be helpful for the investigation of organised crime, corruption, drug trafficking, smuggling, terrorism, and other criminal activities.

Kantsir and Bryts'ka (2019) gave their definition of “financial monitoring”, and they mentioned that it should be analysed in three areas:

- (1) as a system of measures of a financial, administrative, criminal and operational-investigative nature;
- (2) as a tool of state regulation;
- (3) as a mechanism for permanent monitoring of financial transactions.

At the same time, according to FATF Recommendations (2012), all procedures and methods of financial monitoring are reduced to solving three functional tasks:

- (1) identification of participants in a financial transaction;
- (2) recording information about suspected transactions and their participants;
- (3) informing a specially authorised body about suspicious transactions (in Ukraine – the State Financial Monitoring Service).

In general, the concept of “financial monitoring” in the context of defining a set of measures to prevent money laundering has emerged relatively recently. Until the beginning of this century, the term was used in the vast majority in its original semantic meaning – as a definition of some systematic, regular observations and actions based on them in the field of finance, regardless of the specific subject of their focus (Reznik et al., 2023). The authors proposed to understand “financial monitoring” as a complex of measures defined at the legislative level, carried out

by authorised subjects of primary and state financial monitoring and aimed at fulfilling the requirements of current legislation in the context of countering and preventing money laundering of criminal origin.

Financial monitoring and anti-money laundering (AML) are closely related concepts that work together to combat money laundering and other financial crimes. While financial monitoring refers to the broader process of observing and analysing financial transactions and activities, anti-money laundering focuses explicitly on preventing and detecting money laundering. Financial institutions and other regulated entities implement anti-money laundering measures as part of their compliance obligations. These measures include:

- (1) customer due diligence (CDD). Financial institutions must verify their customers' identities and assess the potential risks associated with their transactions. This involves gathering information about customers' identities, sources of funds, and the purpose of their transactions;
- (2) transaction monitoring. Financial institutions use sophisticated monitoring systems to track and analyse real-time transactions. These systems flag unusual or suspicious activities, such as large cash deposits, frequent transfers, or transactions involving high-risk jurisdictions or individuals;
- (3) suspicious activity reporting. When a financial institution detects suspicious transactions, it must file a suspicious activity report with the appropriate regulatory authority. Suspicious activity reporting provides detailed information about suspicious activity and enables regulatory bodies to investigate further;
- (4) compliance programs. Financial institutions establish robust anti-money laundering compliance programs to ensure adherence to applicable laws and regulations. These programs include internal controls, employee training, independent audits, and ongoing risk assessments;
- (5) regulatory oversight. Government agencies and regulatory bodies provide oversight and enforcement of anti-money laundering regulations. They conduct examinations and assessments to ensure financial institutions have effective anti-money laundering policies and procedures.

Analysing financial monitoring system in Ukraine, can be defined as two-level system which consists of the following:

- 1) state level (state financial monitoring) (represented by the State Service for Financial Monitoring and subjects of state financial monitoring);
- 2) the primary level (primary financial monitoring), represented by financial monitoring entities.

The following main functions characterise primary financial monitoring:

- 1) regulatory (organisational and managerial), based on current legislation, provides for the definition of the monitoring system and procedure, its executors, their tasks, duties, forms and means of financial monitoring;
- 2) control and supervision - implemented through the identification and study of the identity of the client who carries out a financial transaction, checking his activities, comparing the objects of transactions with them, concerning which financial monitoring is carried out;
- 3) operational-analytical – analysis of the content of the financial transaction and the likelihood of the risk of money laundering;
- 4) informational - involves the exchange of information between subjects of state and primary financial monitoring regarding suspicious transactions;
- 5) preventive - consists in preventing money laundering by subjects of state and primary financial monitoring (Rekunenko et al., 2020).

In general, financial monitoring and anti-money laundering efforts aim to prevent criminals from using the financial system to legitimise their illicit proceeds. By implementing anti-money laundering measures, financial institutions contribute to the overall global effort to combat money laundering, protect the financial system's integrity, and safeguard against other financial crimes, such as terrorist financing, fraud, and corruption.

## **CONCLUSION**

In the conditions of the globalisation of the world economy, the adequate protection of the national economy largely depends on the work carried out in combating the legalisation (laundering) of dirty funds by our state. Financial monitoring and anti-money laundering (AML) are closely related concepts that work together to combat money laundering and other financial crimes. While financial monitoring refers to the broader process of observing and analysing financial transactions and activities, anti-money laundering focuses explicitly on preventing and detecting money laundering. Financial monitoring is a complex of measures defined at the legislative level, carried out by authorised subjects of primary and state financial monitoring and aimed at fulfilling the requirements of current legislation in the context of countering and preventing money laundering of criminal origin.

The findings of this research underscore the critical role of financial monitoring in identifying suspicious transactions and patterns indicative of money laundering. Through techniques such as transaction monitoring, customer due diligence, and watchlist screening, financial monitoring acts as a crucial line of defense in detecting and reporting potential illicit activities. The article highlights the significance of information sharing and collaboration among financial institutions and regulatory authorities. Cooperation and coordination among

stakeholders are crucial in effectively combating money laundering, as they enable the exchange of valuable insights, in-telligence, and resources.

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