

UDC 341.233.11(477)

**B. I. Sjurkalo, Ph.D., Associate Professor of Finance,
State University "Ukrainian Academy of Banking
of the National Bank of Ukraine"**

THE SYSTEM OF STATE FINANCIAL MONITORING IN UKRAINE

The quality of functioning of the existing system of the state financial monitoring is examined, the major drawbacks as to its functioning are specifically mentioned, a scientific approach to the mechanism of the financial monitoring in the context of the risk-oriented concept of the existing system is suggested.

Keywords: monitoring entities, counteraction to legalization of proceeds from crime (money laundering), financial monitoring, prevention of the terrorist financing.

Problem statement. According to the national legislation, money laundering is not only considered as a criminal act, but also as a systematic risk to both financial markets and the corporate sector as a whole.

The fact of such legalization is a complex phenomenon in the negative profit (loss) of the financial system.

The thing is that, besides the actual increase in the economically unproductive monetary base, the risk of these funds transfer through the bank system (or other area of financial relations) significantly increases and aims to these costs further growth, and simultaneously and in proportion to this process the level of social responsibility is reduced.

Such a difficult task of illegal money detecting is being directed not only to law enforcement agencies, but also to financial institutions.

Analysis of the latest publications. Scientific papers of O. M. Bandurko, A. M. Berezhnoi, S. A. Boutkevitch, S. O. Dmitrov, I. I. D'yakonova, A. V. Yezhov, V. A. Zhuravel, V. S. Zelenetsky, O. V. Kravchenko, I. P. Prykhodko, V. V. Kovalenko, I. V. Kolomiets, V. L. Krotiuk, V. A. Nekrasov, V. A. Timoshenko, D. A. Fire and others' are devoted to varied issues of the financial monitoring of Ukraine. However, nowadays the state financial monitoring is not considered by scholars from a position of a system analysis, and on the other hand, the state financial monitoring represents in itself not only a complex phenomenon, but consists also with a set of the state bodies of supervision. Another issue is the formalization of methods for classifying objects according to the supervision needed. The object, principles and functions of the entities of state financial monitoring are still remaining insufficiently examined. Also, the analysis of the existing system of financial monitoring efficiency requires a separate study.

The main aim of the article is to analyze the existing system of financial monitoring and to elaborate the ways of its improvement.

Main results of the study. Taking into account the main drawbacks of the current anti-money laundering system in Ukraine, it could be highlighted that the basic drawback for building an effective system of the regulatory policy is the absence of an effective financial and economic mechanism of the national counterwork in the sphere of proceeds from crime legalization. The current system of anti-money legalization is not indefectible from the standpoint of a single financial supervisor existence, which determines the legality of transactions that fell under the financial monitoring.

The lack of a single and affordable methodology for monitoring financial transactions is one of the main reasons for the existence of a large number of operations with signs of uncertainty. Thus, subjective evaluation of an official entity of the financial monitoring in current practice is a defining moment in associating operations with internal financial monitoring. This approach complicates the work of the financial supervisor.

The only solution to these problems is to create a mechanism for the state system of counteraction to legalization of illegal proceeds.

The mechanism of the state system of counteraction to illegal proceeds legalization, as a part of regulatory policy, should include such items as regulatory and legal framework, organizational and informational support, administrative tools, financial and economic tools and methods of counterwork.

Nowadays, the most effective tool against the legalization of illegal proceeds is to introduce the financial monitoring. The financial monitoring is an activity of identifying transactions that are subjects of mandatory controls, and other transactions with monetary funds or other property related to the legalization (laundering) of proceeds from crime.

Considering the above mentioned, the financial monitoring of counterwork with legalization (laundering) of proceeds from crime is considered as a subject of control, as part of the internal control system, organized under the laws of Ukraine.

By the moment, terms of the internal financial monitoring in Ukraine are based on the following regulations:

1. The law of Ukraine “On prevention of legalization (laundering) of proceeds from crime” from May 21, 2010.
2. The law of Ukraine “On Banks and Banking Activity” from December 7, 2000, and with amends from February 6, 2003 and May 22, 2003.
3. The law of Ukraine “On Financial Services and State Regulation of Financial Markets” from July 12, 2001, with amends from February 6, 2003.

4. The Forty Recommendations of the Financial Action Task Force (FATF), put into the effect jointly by the CMU and NBU in August 28, 2001, № 1124.
5. “Regulations on the implementation of financial monitoring by banks”, approved by the NBU Board on May 14, 2003, № 189.
6. Other legal acts.

The basic principle of rules and programs of financial monitoring development and implementation is to ensure the participation of employees of the subject of control (within the limits of their competence) in the detection of financial transactions that may be related to legalization (laundering) of proceeds from crime or terrorist financing.

The rules should be designed to meet the following needs:

- confidentiality of information according to the Law of Ukraine “On information” about customers and their operations, and other information that is a trade secret;
- preventing the involvement of bank employees to the legalization (laundering) of proceeds from crime.

Customers’ research and identification during the operations under the legislation of Ukraine and the rules of international practice are the keys to an effective financial monitoring.

According to the decree of the President of Ukraine “About measures on development of the system of combat against legalization (laundering) of proceeds from crime and terrorist financing” from July 22, 2003, № 740/2003, in the organizational structure (interagency working group) of methods and tendencies’ research in the field of money from crime laundering, representatives from the State Department for Financial Monitoring, State Tax Administration of Ukraine, Ministry of Internal Affairs of Ukraine, State Commission for Regulation of Financial Services of Ukraine, State Commission on Securities and Stock Market, Security Service of Ukraine, Ministry of Justice of Ukraine, Ministry of Foreign Affairs of Ukraine, Ministry of Economy and European Integration of Ukraine, State Customs Service of Ukraine, the Cabinet of Ministers of Ukraine, Ukraine’s presidential administration should be included, involving representatives of the National Bank of Ukraine, the Prosecutor General of Ukraine, financial experts, – in order to analyze the effectiveness of measures taken for prevention and counteraction of legalization (laundering) of proceeds from crime.

Also, according to the Law of Ukraine “On prevention of legalization (laundering) of proceeds of crime”, financial monitoring system consists of two levels – primary and state ones. Thus, the state control has considerable potential in combating money income, considering the number and responsibilities of financial monitoring entities. However, the complexity and the

depth of cautions to an effective application of the national anti-money laundering laws in the absence of a single national risk assessment methodology for legalization, and the lack of a single database of customers' reputation.

It means that informational support has a weak disposition for the classification and identification of operations and objects of financial monitoring. To build an effective system of combating money laundering, it is necessary to implement a centralized system of objects of risk level evaluation control. This system has to be primarily built on the basis of such criteria as the type of a customer, its location (country of registration), activity (goods and services) generated by the financial flow, taking into account the horizon of time-weighted return of activity and general terms of business. These criteria are difficult to keep for all customers from a position of the subject control. Therefore, the obvious need is to use the levels of risk in terms of which these criteria should be calculated. The division into three risk levels is sufficiently representative: maximum risk, likely risk, poor risk. When it comes to the maximum risk, there appears a high probability of identifying a transaction as the subject of financial monitoring. And that is why it is important to pay attention to the subject of uncertainty of transactions and calculate rates according to the above criteria. A probable risk indicates the possibility of suspicious transactions, and depraves the client's reputation. Criteria calculation must also be carried out during the monitoring period to determine the economic content of the operation and its purpose, to maintain the data of the operation – the reputation of the subject of control. However, it is necessary to take into account that a coincidence with the specified level of risk may indicate an imperfect work of the company's management, and not only on its questionable intentions. Poor risk shows high rates of return of the object of control compared to the industry, or it indicates the appearance of some extraordinary operations for the company. The calculation of criteria should not be provided constantly, but the regular occurrence of these transactions may increase the risk of the object of control. All other customers must have an impeccable reputation.

Also, the system of indicators for identifying suspicious transactions is raw. There are only specified marginal operations that are subjects to financial monitoring, and it is mentioned about internal monitoring that the operation should have signs of uncertainty in the presence of "motivated suspicion". That is why, clear criteria for assigning operations to the internal monitoring are actually missing. That, in turn, is directly related to the mechanism of the national anti-laundering proceeds from crime. The legislation clearly outlines only the signs of uncertainty of transactions, but there are no well-defined criteria or indicators of a clear classification of such transactions for monitoring.

We suggest using a system of indicators for initial monitoring subjects. This system of indicators will not only confidence in attributing specific operation to the monitoring system, but also it will facilitate the work of a specialized body of financial control, shorten periods of operations' processing, and create opportunities for pre-automated processing of transactions for the purpose of financial monitoring.

According to the indicators suggested, the following ratios could be elaborated:

- the amount of a transaction to the daily amount of proceeds from the sale;
- the transaction amount share in the annual income from sales;
- the amount of monthly income to the transaction amount;
- a transaction amount to the daily (monthly) cash flow;
- a transaction amount to the cost of products manufactured per month.

Such correlations are neither a commercial nor banking secrets and can be used by entities of initial financial monitoring without limitations.

At the level of monitoring by initial subjects, using a single information database, which displays the reputation of contractors, will allow on-line risk track, and using the above mentioned criteria will make it possible to determine the doubtfulness of an operation in the form of a formula. This approach will get rid of subjective evaluations, and combat money laundering at a new level with the use of quantitative indicators.

Administrative tools, according to the established law on the prevention of legalization, are effective ones for revitalizing the financial monitoring entities. The peculiarity of this element of the mechanism of the national system of counteraction is that inaction in combating money laundering is considered as the act which causes the suspension or dissolution of the entity of initial financial monitoring.

The next components of the mechanism of the national system of counteraction with legalization of illegal proceeds are financial and economic instruments. These instruments include rules and regulations, incentives and sanctions, limits and preferences. The criteria for classifying transactions as subjects of mandatory and internal financial monitoring are specified in the legislation as norms. To the present moment the following standards are set: the equivalent of 150 000 UAH for normal operations, and 13 000 UAH for transactions that pass through the gambling establishments and casinos.

It could be concluded that the range of standards is somewhat narrowed. According to the law, the penalties are imposed in the form of administrative fines on officials for inaction in the field of prevention of legalization of proceeds from crime. Currently, the minimum fine equals

to 100 tax-free income parts of a citizen. Incentives in this area are not provided at the moment. Limits – restrictions are applied to activities of objects under the control, preferences for any object even with an impeccable reputation are not provided.

Particular attention should be paid to methods of financial control. In our view, the current system of legalization uses only a method of monitoring and some methods of analysis at the level of initial control subjects. It means that if the signs of uncertainty determined by a bank appear, suspended operations are being stopped until the bank gets a permit from a specialized body of financial control. In fact, the method of analysis is divided into two stages and has a significant time gap between them and thus the effectiveness is lost in favor of information preserving.

Considering above mentioned, among the existing methods of management the one of planning is not currently used. Since only one operation is controlled without considering its economic content and peculiarity of the main activity of the business entity. The above mentioned method may be described as the transition from monitoring transactions to monitoring activities and financial work and storing the information which indicates an impeccable reputation of counterparty. The following transition should be realized: from analysis and monitoring to the planning some defined boundaries of possibilities for the financial activities of business entities. In such a case, the State control in financial flows will be personalized and quite transparent.

The suggested mechanism of the national anti-money laundering uses the sequence of methods such as analysis of operations, planned versus normative indicators' check, risk operations' assessment and transmitting the most risky operations to specialized financial supervisor, the control (cancellation) of the operations and recording the results database of entities' business reputation.

All the necessary elements of the financial mechanism of the national system of combating money laundering have been indicated, and now it should be noted that the proposed mechanism would be effective if all of the above methods are united. The common use of all the methods and tools is possible only if the concentration of all functions of supervision and control is provided by a single supervisory center. To date, the state service for financial monitoring has no such an extended power. Schematically, the organizational structure of financial control can be displayed by the following pattern.

All the elements of an effective mechanism for the national counterwork with legalization of illegal proceeds have been determined, and the algorithm of its work may be suggested.

To find out the main differences between already existing and the proposed mechanism we have elaborated a scheme of the current anti-money laundering in Ukraine.

It is evident that today a single entity, the State Committee for Financial Monitoring of Ukraine, operates in doubtful transactions' analysis and in providing its conclusions as to the classification of such transactions. The main problem that exists today is the low efficiency of the State Service for Financial Monitoring, related to the complexity of inspection (audits) entities in non-banking sector. The main workload falls on the State Tax Service. The suggested algorithm of the national anti-money laundering mechanism is based on a clear formula, which determines the category of uncertainty for the entities of initial monitoring.

In order to clarify the main differences between the existing and the proposed mechanism we also construct an algorithm of the current anti-legalization of illegal income in Ukraine.

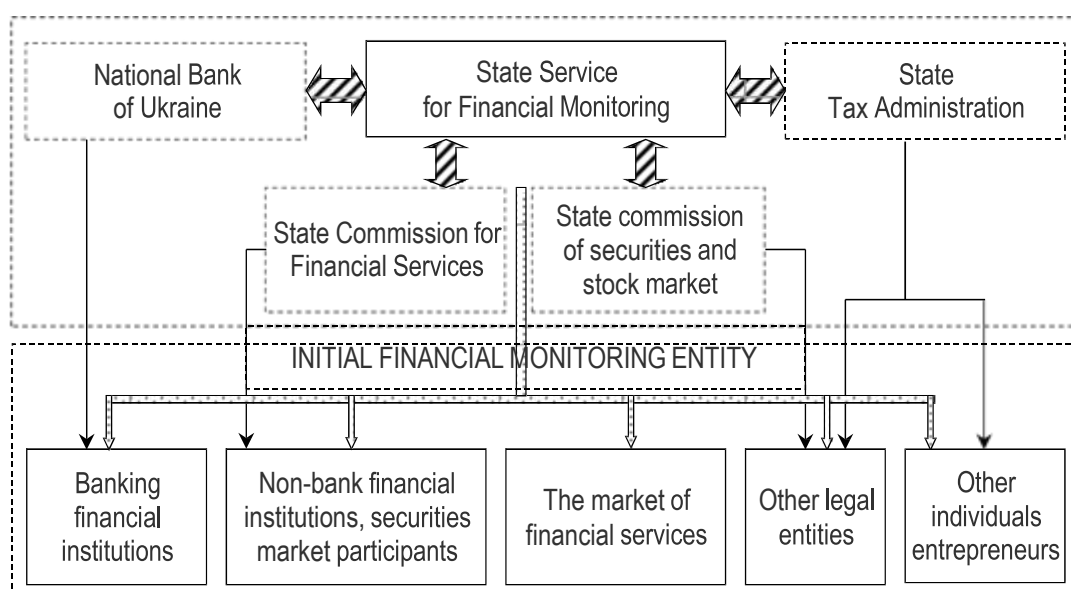


Figure 1 – The national system of financial control

The above circuit current anti-legalization of illegal income in Ukraine is built in Figure 2.

Thus, to date, only one body – the State Committee for Financial Monitoring of Ukraine operates with an analysis of operations and the development of conclusions regarding the reference to a dubious category. The main problem that exists today is the low efficiency of the State Committee for Financial Monitoring, due to the complexity of inspections (audits) entities in the non-banking sector. The main burden falls on the State Tax Service.

To assess riskiness of the operation to date in world practice, there are several approaches.

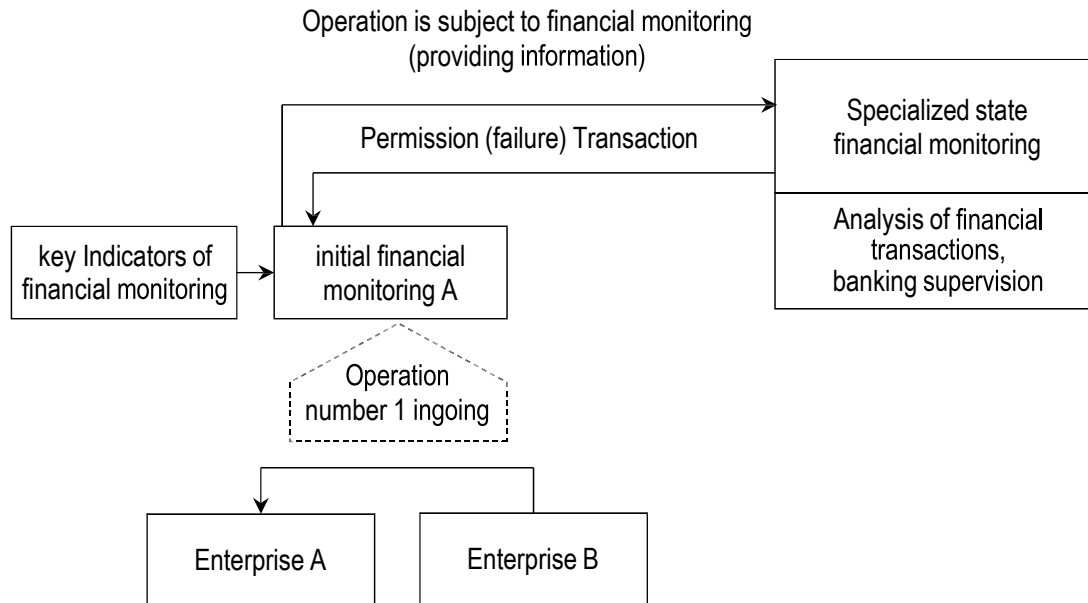


Figure 2 – The algorithm of the present system of counteraction to legalization of proceeds from crime in Ukraine

One, it is an approach based on a comparison of the present value of income from real volume purchases of goods and receipt of the paid services across the country or region, as well as individuals. It is also called the method of analysis of the cash flows. This method is regarded as sufficiently accurate, since it is not limited to only one count of illegal proceeds arising from smuggling and drug trafficking. It allows varying degrees of precision to establish the upper limit of laundering of “dirty” money. Its essence is to analyze the phenomenon of the so-called excess cash in certain regions or in certain banks. In the algorithm suggested, every single cash flow transaction of the object of control is directed to the specialized agency, which, in turn, must create a database of business reputation of the counterparty.

Based on the framework of the algorithm and initial financial document, it appears possible to classify the category of transaction immediately, and to provide information about the selected solution. In this case, the workload on the central body of financial control will be reduced, and its main function will narrow banking supervision in combating money laundering. Also, maintaining reputation and credit history databases will create conditions to ensure financial discipline in enterprises as a whole.

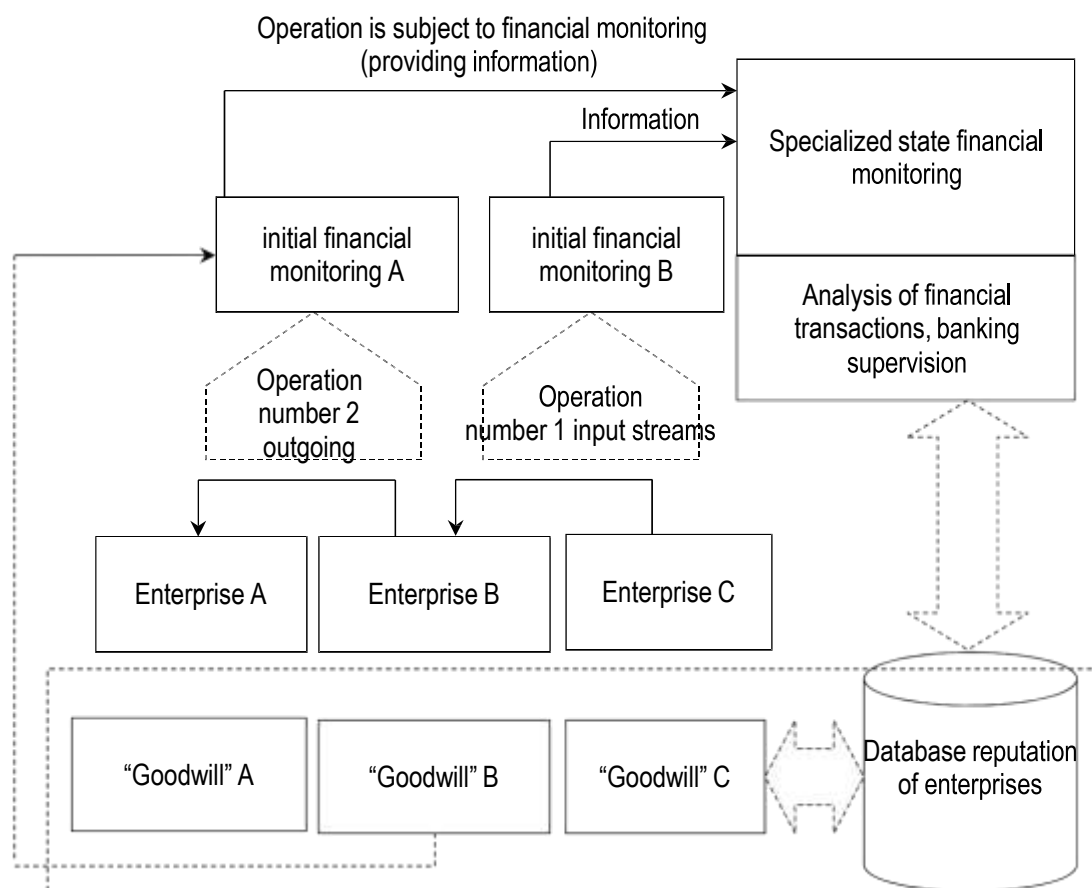


Figure 3 – The algorithm proposed by the author of the national anti-money laundering system

Monitoring is an integral part of the national economy and its separate sectors. Its role in the transition to a market economy may be determined not only by the need to eliminate mistakes in the economic management, the existence of shortcomings in financial practices, ineffective spending of funds, private property theft and especially the state corruption, but also by the importance of development of regularity and complexity of commercial and economic ties. In particular, the state institution should be formatted on new basis, according to which the institute's functions will include the total budget control to ensure the tax and financial legislation, legitimacy and efficiency of public spending, budget or personal financial resources, the mechanism of their formation, distribution and redistribution in terms of entities. Today, the practice of modern management system does not provide any other effective way to monitor financial and business activities of enterprises, institutions and organizations than conducting audits (inspections) by state regulatory authorities. Unlike the Western practice in the domestic legal framework the retrospective form of control is prevailing.

However, the effectiveness of this measure is much lower compared to the previous and current forms of control. Audit of budget efficiency, actively introduced in Ukraine is only the front part of preventive control forms, and does not perform today one of the main functions of the financial control – the warning one.

The use of outdated forms of financial control does not allow the state to influence the processes taking place in the economy efficiently and effectively, leading to a decrease in the state control functions, which are highly important in terms of financial market instability. The further development of the financial control as a full-scale activity with other management functions, covering the interests of the state and its citizens in the sphere of finance, needs to cultivate a new concept of mechanisms and instruments for its implementation, improvement of its constituent elements, including not only the goals, objectives, objects, methods and forms of control, but also the newest methods, subjects, tools and instruments of the control procedures.

The main problems that hinder the effectiveness of the state control actions by today are: a significant focus on the retrospective form of control and the lack of legal backing and enforcement. The greatest results in the prevention of violations of laws have been made in fiscal (tax) activity, the cash performance of the state budget and in banking services.

Thus, according to the statistics from the State Service for Financial Monitoring the banks' notice made 96,35 % against 97,04 % in the II quarter from the III quarter, 2010, the share of financial transactions from quarter 2010, in the total amount of financial transactions provided to the State Financial Monitoring by business initial financial monitoring subjects, and decreased by 0,69 % compared to the previous period.

Also, criminal actions, under art. 205, part 2 of the Criminal Code of Ukraine (fictitious business), are performed in the case of cash flow determined without articles of merchandise. However, the stock market remains outside the control of the operation, where the cash flow without articles of merchandise is present, in other words a change of the CF's owner takes place.

To ensure accountability of cash flows data in the field of prevention of legalization of proceeds from crime, and taking into account above mentioned problems, we have elaborated the following measures along with the development of concept components and algorithm of the mechanism of the national system for combating money legalization:

1. To provide significant oversight powers in the field of non-banking financial operations to the State Service for Financial Monitoring by expanding the legal boundaries in the context of the law on inspections (audits) for reporting entities, as well as to increase the use of sanctions for violations of established norms.

2. To make the transition from retrospective control operations to the control of the initial placement of funds in the financial system.
3. To apply the method of control to the subjects of transaction rather than to the transaction itself, as provided by the recommendations of Egmont group. To create a single database, which will indicate the business reputation of an entity, to introduce three levels of business reputation:
 - flawless (no risk);
 - under control (likely or poor risk);
 - doubtful (maximum risk).
4. To keep the history of the financial discipline of the subjects of observance and to provide their ranking.
5. To use such tools as “uncertainty of the criteria” to determine the feasibility of financial transactions.
6. To use the following leverages:
 - operations’ control (monitoring) and assigning the results to the categories of business reputation;
 - preventive measures usage for suspicious transactions, such as limiting the volume of transactions, both in terms of time and by volume;
 - the introduction of legal responsibilities for violation the monitoring by the subjects of initial control;
 - the introduction of a significant size penalty for officers, and the control over the quality of their work implementation.
7. To separate approaches for the control of quantitative and qualitative indicators, to focus activities on internal financial monitoring and quality performance indicators of the contents of business operations and its compliance with core business entity.

Conclusions. An efficient, effective, impartial and forehanded state financial monitoring should play the leading role in solving problems of prevention of the legalization, and the objectives and principles of which should be enshrined in legislation. In addition, we believe that the effective measure is to examine institutional and legal framework of financial monitoring within a particular discipline in higher education institutions of economic and legal orientation.

In such a way, it can be highlighted that the current and present financial and economic mechanism of the state system of counteraction to legalization of proceeds from crime is based on the model of the banking counter and actually does not consider other ways of legalization of illegal incomes. Based on our research, the following could be concluded: the suggested mechanism will enable not only the initial monitoring, but also it

will ensure the effective implementation of the strategy of financial control in the financial sector based on the extended powers of a single financial supervisory authority in the field of combating money laundering, the conduct of a single reputation database of enterprises and organizations, as well as the use of an absent by today method of planning the implementation of control procedures.

The direction for further research in the context of combating legalization (laundering) of proceeds from crime and terrorist financing prompts building an organized (clearly subordinated) interaction of supervisors, as well as elaboration of possible typologies and patterns of initial allocation of capital in the financial system. The lack of a sufficient regulatory framework is a sufficient drawback in the development of these areas.

References

1. Voronova L. K. Financial Law in Ukraine : textbook / L. K. Voronova. – K. : Precendent, My Book, 2006. – 448 p.
2. Butkevych S. A. Some Aspects Legal Responsibility for Violations of the Law on Prevention and Counteraction to legalization (laundering) of proceeds of crime / S. A. Butkevych // Actual Problems of Legal Regulation Activities in Contemporary Ukraine: materials of intercollegial scientific and practical conference (city of Simferopol, Dec.19, 2008). – Simferopol, KRK “Publishing house Pedagogical Studies of Crimea”, 2008. – P. 246–250.
3. Djakonova I. I. The essence and value of financial monitoring in banks / I. I. Djakonova // Bulletin of the Academy of Customs Service of Ukraine. – 2008. – № 1(37). – P. 7–14.
4. Kravchenko O.V. Financial monitoring in banks: substance, significance, regulation / O. V. Kravchenko // Socio-economic problems of the modern period of Ukraine. The financial market of Ukraine: stabilization and European integration: Digest of scientific publications / National Academy of Sciences of Ukraine. Inst. of Regional Studies. – Lviv, 2010. – Vol. 1(81). – P. 270–276.
5. Code of Ukraine on Administrative Delinquencies: from 07.12.84, № 8073-X // Gov. of Ukrainian SSR. – 1984. – Supplement to number 51. – Art. 1123.
6. Financial monitoring in the bank. Study Guide. – Ed. S. O. Dmitrov, V. V. Kovalenko. – For economists, professors and university students. – University book, 2008. – 336 p. – ISBN 978-966-680-406-1.

Отримано 29.11.2013

Анотація

Розглянуто якість функціонування існуючої системи державного фінансового моніторингу, виокремлено основні застереження щодо її функціонування, визначено наукові основи побудови механізму державного фінансового моніторингу в контексті управління на основі ризик-орієнтованого підходу.

Наукове видання

ПРОБЛЕМИ І ПЕРСПЕКТИВИ РОЗВИТКУ
БАНКІВСЬКОЇ СИСТЕМИ УКРАЇНИ

Збірник наукових праць

Випуск 38

Відповідальний за випуск

Т. М. Петренко

Редагування

Н. М. Середа

А. О. Карпенко

Технічне редагування

І. О. Кругляк

Комп'ютерна верстка

В. А. Івакін

Відповідальність за фактичні помилки, достовірність інформації та точність викладених фактів несуть автори. Статті опубліковані мовою оригіналу.

Усі права застережено. Посилання на матеріали збірника обов'язкові.

Збірник наукових праць затверджено постановою президії ВАК України від 10.02.2010 № 1-05/1 як наукове фахове видання України

Підписано до друку 18.03.2014. Формат 60x90/16.

Обл.-вид. арк. 23,14. Ум. друк. арк. 25,75. Папір офсетний.

Гарнітура Times. Тираж 300 пр. Вид. № 1325

Видавець і виготовлювач

Державний вищий навчальний заклад

“Українська академія банківської справи Національного банку України”,
вул. Петропавлівська, 57, м. Суми, 40000, Україна, тел. 0(542) 66-51-27

Свідоцтво про внесення до Державного реєстру видавців, виготівників і розповсюджувачів видавничої продукції: серія ДК № 3160 від 10.04.2008