

ICPS newsletter

Newly adopted law aimed at fighting illegal money laundering: good news or bad news?

On 28 November 2002, the Verkhovna Rada of Ukraine passed the Law of Ukraine "On preventing and counteracting the legalisation (laundering) of incomes acquired by criminal means". This is connected to the threat of FATF sanctions being imposed upon Ukraine starting from 15 December 2002. Opinions regarding the usefulness or danger of the new law vary, though most experts believe that a "lean peace is better than a good war" with the international community, which can accuse Ukraine of unwillingness to address the problem of preventing dirty money laundering

On 30 November 2002, the International Centre for Policy Studies, jointly with the Coordination and Analysis Centre of the Entrepreneurs' Association of Ukraine and supported by the Centre for International Private Enterprise (CIPE), held a roundtable on "Combating Illegal Money-Laundering and Ukrainian Business", under the framework of the "Evaluating Changes in Economic Legislation" project. Attending government officials, representatives of non-government organisations, commercial banks, and the mass media discussed the following issues:

- Why is Ukraine accused of illegal money laundering?
- What is money-laundering: FATF viewpoint and the ideology of the Law of Ukraine "On preventing and counteracting the legalisation (laundering) of incomes acquired by criminal means"?
- Is it true that money laundering in Ukraine is large-scale?

- What is currently being done in Ukraine to meet FATF requirements?
- Does the Ukrainian government actively and efficiently shield national interests?
- What needs to be done right away in order to ward off sanctions?
- What will be the positive and negative implications of the new law?

Ukraine blacklisted along with "island havens"

In autumn 2001, Ukraine was blacklisted by the Financial Action Task Force on Money Laundering (FATF). This list comprises countries which, according to this organisation, create an auspicious environment for the turnover of criminal capital. Starting from 15 December 2002, the FATF promised to impose economic sanctions upon Ukraine. Until now, no precedent of FATF sanctions being imposed upon any country has been reported. ICPS experts believe that such sanctions can take the following form:

What is FATF?

FATF (Financial Action Task Force on Money Laundering) is an inter-governmental body, founded at the G7 summit in 1989, whose purpose is the development and promotion of policies to combat money laundering at national and international levels.

The FATF devised "Forty Recommendations on Measures to Combat Money Laundering" and "Special Recommendations on Terrorist Financing".

- scrutiny of payments originating from Ukraine, which will slow down money transactions;
- restriction of the rights of Ukrainian citizens to make payments abroad;
- higher prices on foreign transactions, due to the tighter scrutiny of transactions from Ukraine by Western banks;
- partial blocking of correspondent accounts of Ukrainian banks.

Such restrictions could trigger the following adverse effects:

- curtailed foreign direct investments to Ukraine;
 - Ukraine's credit ratings deteriorated by international rating and investment companies;
 - increased cost of attracting money from abroad by Ukrainian financial institutions;
 - shrunk volumes of lending and technical assistance to Ukraine from the international community;
 - restrictions of Ukraine's activity in international markets, whereby Ukraine would be forced to shift its foreign trade towards countries whose governments do not consider FATF ratings to be important criteria when selecting trade partners;
- Countries that were identified as not cooperating with the FATF, apart from Ukraine, included the Cook Islands, Egypt, Grenada, Guatemala, Indonesia, Myanmar, Nauru, Nigeria, Philippines, and Saint

Briefly about the new law

On 28 November 2002, two weeks before possible sanctions would enter into effect, the Verkhovna Rada adopted the Law of Ukraine "On preventing and counteracting the legalisation (laundering) of incomes acquired by criminal means". The law envisages the obligatory financial monitoring of non-cash transactions in amounts of over 300,000 UAH and cash transactions in amounts of over 100,000 UAH. Responsibilities of the controlling agency are granted to the State Financial Monitoring Department, founded in January 2002 within the Ministry of Finance. Thus, the law implements a two-level system of financial control, wherein commercial banks are charged with the functions of primary monitoring. Previously undertaken measures of the government of Ukraine aimed at enacting the "FATF Forty Recommendations" included the following: (1) laying responsibility for the organisation of processes to combat money laundering on the management of commercial banks, which tightened control over cash transactions; and (2) formulating requirements for notifying agencies in charge of combating organised crime about cash transactions in amounts of over 50,000 euro.

Vincent and the Grenadines. Till recently, Russia figured on this list; in October 2002 it was struck off, after it adopted recommended measures. Among such measures the FATF lists the implementation of legislative norms to combat illegal money laundering and creation of a supervisory body of the executive government to monitor dubious transactions.

When discussing the issue of accusations against Ukraine, roundtable participant Mr. Oleksii Berezhnyi, State Secretary of the Ministry of Finance and Head of the Financial Monitoring Department, emphasised that the FATF had never accused Ukraine of money laundering acquired by criminal means, only remarked on the absence of a special law or a monitoring agency in Ukraine. Representatives of non-governmental organisations attending the discussion declared that among the key reasons of claims made against Ukraine was its overall negative image in the international arena, due to the high level of the shadow economy, accusations of government corruption, and political instability. It was particularly noted that the Ukrainian authorities, unlike Russian ones, did not undertake any active moves to persuade FATF representatives of the viability of measures applied by Ukraine in order to prevent dirty money laundering and financing of terrorism.

Banks labeled as accomplices in money laundering

Representatives from commercial banks disagreed with the idea of the banking system playing a key role in illegal money laundering. Mr. Yuri Blaschuk, chairman of the management board of VABank, believes that despite the fact that the banking system acts as a primary link in money legalisation, the banks' role in illegal money laundering is seen from a very narrow perspective, because other concurrent factors are ignored, particularly smuggling, inefficient usage of budget funds, etc.

In the matter of illegal money laundering, Ukraine's commercial banks have come under special scrutiny; after Ukraine was added to the list of countries not cooperating with the FATF, many domestic commercial banks felt that foreign

counteragents started to be suspicious of them. Foreign banks requested confirmation of Ukrainian banks' existence, and special questionnaires were sent requiring answers to questions pertaining to their activity—specifically, whether they had accounts belonging to Ukrainian government officials.

Will the war against terrorism risk bring tax dodgers into the line of fire?

Representatives of small business and business associations voiced their concern over the vague distinctions between the notions of "shadow" and "criminal" money. It was emphasised time and again that the tools of financial monitoring can be used to replenish the State Budget and tackle tax evasion instead of fighting lawbreakers.¹ Many participants in the roundtable expressed the opinion that the ideology of the law "On the prevention and counteraction of the legalisation (laundering) of incomes acquired by criminal means" fails to distinguish between these two notions, which can significantly expand the scope of its application, and, hence, implies a grave potential threat for Ukrainian business.

The participants of the roundtable also named the following other flaws of the law:

- vague criteria for determining dubious transactions, which carries the potential threat of subjective interpretation of the law by officials from the Financial Monitoring Department, as well as the risk of corruption;
- the possibility of using the information acquired by the Department and other agencies of the executive government, particularly tax ones, that could transform the newly established agency into a prior control agency in tax investigations;
- given the sizable number of state-owned enterprises in Ukraine, information can be used to the detriment of non-state competitors in order to gain additional advantages in the market;

¹ The FATF's sole mission is to tackle the criminal economy (illegal trade in arms, drugs, humans, etc.), has nothing to do with financial frauds or tax evasion, and does not cooperate with tax agencies.

- the possibility of a selective approach, that is, application of the law to exert pressure on certain individuals or enterprises;

- additional tax pressure is imposed on commercial banks by administrative methods, which obliges them to finance primary monitoring and upkeep corresponding personnel from their own funds.

A civilised law necessitates civilised legal frameworks

The envisaged responsibilities of the Financial Monitoring Department with regard to measures which can be applied to enterprises whose transactions are deemed shady, are limited to reporting such events to investigating and court agencies. The furnished statistics regarding the activities of the corresponding agency in Russia, where the banking system is much larger compared to Ukraine, show that since February 2002, 120,000 bank notifications about suspicious transactions were reviewed, of which 64 instances triggered investigations and 14 cases were brought to court. Nonetheless, many participants stressed the fact that due to the faulty extant legislation on property right protection, the law fails to guarantee that enterprise goods will not be seized, bank accounts frozen, or other obstacles to their activity raised under the guise of an all-out war with international terrorism, because of the mere suspicion of being involved in money laundering activities.

The chief outcome of the roundtable was that representatives of different public interest groups were brought together at the discussion table to exchange opinions on the recently adopted law. The abovementioned drawbacks and risks will become in future the focus of special attention by both government officials and business representatives, which will inspire much more confidence in the system of monitoring and reduce rent-seeking possibilities. ■

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