The Impact Of Money Laundering On The Operations Of Banks In Iraq

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Abstract

Money laundering is classified as a punishable crime under Iraqi law due to its negative impact on the national economy. Therefore, this study aimed to define the role of the Central Bank of Iraq (CBI), as the primary monetary authority charged with combating money laundering. To achieve this goal, a descriptive and analytical approach was used. The study concluded that the crime of money laundering has long been deeply rooted in the Iraqi economy, and that the CBI contributed to its consolidation after the issuance of Law No. (39) of 2015 on Combating Money Laundering and the Financing of Terrorism. This was due to its role in mitigating the negative effects of this phenomenon, which included distortions in spending and consumption patterns, an increase in the balance of payments deficit, a liquidity crisis, and a collapse in stock markets. Ongoing studies have recommended strengthening international cooperation, investigations, and prosecutions related to money laundering, the extradition and prosecution of those wanted in money laundering cases through Interpol, and the conclusion of security agreements with countries, particularly regional and international ones. It is also recommended to adopt a policy of periodic reporting on banking activity, analyzing its results, and taking immediate action if any project or issue is reported to the relevant regulatory authorities.

Keywords: *Money Laundering; Banks; Iraq*

1. Introduction

In recent years, the banking and financial sector has witnessed a continuous development in modern and sophisticated methods and systems, leading to an increase in the flow of money across borders, including contaminated and illicit funds. This has been achieved through the use of banking and financial transactions and money laundering through the financial and banking system to conceal its illicit sources, while attempting to conceal its criminal nature and give it a commercial appearance.

The term "money laundering" emerged in the 1970s in America, when drug dealers noticed that drug dealers who sold drugs to civilians by dumping small denominations of paper and metal money at the end of each day. They would then head to money laundering locations near residential areas to exchange the small bills for larger denominations, which they deposited in nearby banks. Therefore, money laundering is not a modern phenomenon. On the contrary,

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some trace the term back to 1931, when Al Capone, a member of the Mafia, was convicted of tax evasion. However, after this date, mafia gangs began establishing or acquiring legitimate businesses to divert major projects or huge profits from their criminal operations. These activities included establishing and acquiring laundries or cleaning facilities. Among the most significant dirty money laundering activities are those undertaken by criminal enterprises to conceal the source of illicit funds and convert them into funds that appear legitimate. Since then, the term "money laundering" has come to apply to the processes undertaken by criminal enterprises to conceal the source of illicit funds and convert them into funds that appear legitimate. Since then, money laundering has increased in the global financial and banking system, with some estimates indicating that the volume of these operations exceeds one trillion dollars annually. This poses a threat to the stability of the global financial and banking system, given its negative impact on countries' economies, weakening the ability of authorities to implement economic policies.

2. Methodology

2.1 The Research Problem

The research problem stems from the growing size of the parallel economy, which has become an integral part of the economy of many countries and is growing over time. This has led to an increase in illicit funds in the illicit sector of the economy, whose owners resort to money laundering to legitimize them. This requires addressing this phenomenon to uncover its various aspects with the aim of combating it. Given the importance of this crime and the difficulty of combating it, the research problem crystallizes in answering the following questions:

1. What are the economic and social impacts of money laundering?
2. What are the methods of this phenomenon?
3. What are the most important international bodies and organizations combating this phenomenon?

2.2 The Importance of the Research

1. The importance of this research lies in the increasing activity of financing money laundering operations and the complexity of this criminal activity, which we witness in our contemporary reality. This phenomenon is considered a crime that threatens the economic and political integrity of the state.
2. The importance of the research is evident in the sensitivity of the topic it addresses, as money laundering operations are witnessing a steady growth globally.
3. This research contributes to defining this phenomenon in terms of its concept, procedures, and international efforts to combat it.
4. The scarcity of studies addressing the economic and social impacts of money laundering.
5. This research contributes to identifying the role of certain economic activities in combating money laundering.

2.3 Research Objectives

Several objectives can be identified for this research, including:

1. Study the effects of money laundering on the reputation and credibility of banks in Iraq.
2. Analyze the impact of money laundering on the financial and operational performance of banks in Iraq.
3. Evaluate the mechanisms used by Iraqi banks to reduce and develop the phenomenon of money laundering.
4. Analyze the importance of implementing anti-money laundering laws and regulations in improving the performance of banks in Iraq.
5. Identify the factors influencing the spread of money laundering in Iraqi banks and identify ways to mitigate these factors.
6. Study the impact of money laundering on the financial system in Iraq and provide the necessary proposals to improve the situation.

2.4 Hypotheses

Banks have a significant and effective role to play in reducing and curbing the crime of money laundering.

3. Literature Review And Hypothesis Development

3.1 Literature Review

The term money laundering refers to any act or attempt to conceal or disguise the nature of the proceeds of illegal activities, so that they appear to come from legitimate sources. This allows these proceeds to be used in legitimate activities within or outside the country (Awad, 2004, p. 15). The Central Bank of Jordan defines money laundering as the process of concealing the true source of illicit funds (derived from an illegal activity) or providing false information about them by any means, or transferring or exchanging funds for the purpose of concealing or disguising their source, or possessing, retaining, using, or employing illicit funds by any means to purchase movable or immovable assets or to conduct financial transactions (Al-Zoubi, 2004, p. 1917). In another definition: Money laundering, as a newly emerging criminal phenomenon, has cast a shadow over the jurisprudential and legal environment when attempting to define the meaning of the term money laundering as a newly emerging crime. Therefore, the definitions given to other criminal phenomena, whatever their name, the advanced methodology confirms that these definitions often belong to one of two groups, whether it is the group of expanded definitions, i.e. those that include money laundering operations in general, regardless of the issue of determining the nature of the original crime from which the laundered money was obtained (Dr. Mahdi, 2005: 6-8).

There are several indicators that help us understand the phenomenon of money laundering, the most important of which are (Al-Maghribi, 2008: 27):

1. Withdrawing funds shortly after their creation, especially if they are not related to the customer's primary business.
2. The customer's lack of a logical reason for choosing a bank branch to conduct business.
3. Sudden and unjustified activation of a dormant account after a period of inactivity.
4. Providing false or misleading information to the bank or refusing to provide it without justification.
5. Depositing unusually large amounts of cash.
6. A person depositing large amounts of cash without clear justification, then using them for purposes unrelated to the account.
7. Replacing a large amount of small banknotes with large banknotes.
8. Heavy activity on the account and a low balance.
9. Names of unrelated guarantors who are difficult to contact or identify.
10. Accounts created by multiple people using the same account.

The money laundering process is divided into three stages: creation and placement, assembly, and consolidation. Each of these stages paves the way for the next, leading up to the final stage, in which the funds are completely separated from their criminal sources. At this point, the money laundering process is complete.

First: Placement Stage: This stage involves introducing illicit funds into the financial cycle. It is the most difficult stage due to the direct relationship between the money launderer and the money laundering institutions. It may sometimes require relocation to cities or developing countries. This placement aims to convert illicit funds, represented by securities, into bank deposits and investments in multiple bank accounts (Al-Maghribi, 2008: 19-23).

Second: Consolidation Stage: In this stage, suspicious funds are separated from their sources through complex processes aimed at concealing the origin and sources of these funds. At this stage, suspicious funds are integrated into a series of complex and sensitive financial transactions, with the aim of stealing funds by depositing them in financial institutions, using the names of unsuspecting individuals and companies, which may be fictitious (Al-Hamdan and Al-Sayed, 2007: 8).

The Third Stage: Integration: The integration stage represents the ultimate goal of money laundering and aims to legitimize the laundered funds. In this stage, illicit funds are integrated into the financial system and mixed with completely legitimate funds, or funds generated from legitimate economic activities. These funds then acquire a legal appearance and circulate in the formal economy. This stage is considered the least risky and easiest for money launderers. Money launderers exploit banks and other financial institutions as conduits for illicit funds in the financial system, so that no one doubts their legitimacy. This stage is the final stage after the funds are completely separated from their illicit source and no longer considered legal. The laundered funds return to the economy as legitimate funds (Al-Sheikh, 2001: 35).

Banking supervision is represented by the combination of the terms "supervision" and "banking," resulting in the term "banking supervision." The latter can be defined by referring to the above. Banking supervision is a set of rules, procedures, and methods followed or adopted by monetary authorities, central banks, and banks with the aim of maintaining the soundness of the financial position of banking institutions. This leads to the construction of a sound and strong banking system that contributes to economic development and protects the rights of depositors and investors (Salah, Sadiq, 2011: 358). Furthermore, banking supervision ensures the proper implementation of laws, regulations, and instructions issued by the competent authorities, represented by the Bank of Algeria, as the bank of banks. Its effectiveness is assessed by identifying the strengths and weaknesses of the banking system and finding solutions to them through the enactment of legislation consistent with the reality of each banking system (Farida, 2018: 21).

The Importance of Banking Supervision: The issue of central bank supervision of commercial banks has gained particular importance since the inception of banking. This interest has increased with the development of the banking sector, to the point that the issue of supervision itself has become a global issue that receives the attention and support of international banking institutions. While supervision is of paramount importance to all financial institutions, it is even more important for commercial banks for the following reasons: (Abdul Qader, 2010: 31)

1. Banks are the place where society deposits its funds, and therefore it is essential to provide protection, guarantees, and security for these funds through supervisory mechanisms.
2. Commercial banks are financial institutions with continuous and widespread public contacts, which necessitates strict supervisory systems. Mistakes can affect a bank's reputation with its customers, and the foundation of a bank is its good reputation.
3. One of the characteristics of the banking sector is its significantly low investment risk. Therefore, it is essential to monitor its investments.
4. Given the important role of banks in financing economic development projects with their own funds, monetary authorities in various countries around the world intervene, directly and indirectly, in directing banks' investments of the funds they collect. (Bilal et al., 2019: 44)

Despite the differences in banking supervision systems around the world, there is a general agreement on specific and fundamental objectives of banking supervision, which we summarize as follows: (Samiha, 2014: 25)

First: Protecting Depositors and Investors

1. Depositor Protection: This includes protecting the funds of depositors and other creditors. This means ensuring the return of deposit assets, regardless of the bank's operating results. One method used for this purpose is deposit insurance, which guarantees the return of all or some deposits in the event that a bank ceases to operate due to default or complete bankruptcy. This is achieved through supervisory authorities' intervention to control potential risks to

funds and take appropriate mitigating measures in the event that credit institutions fail to fulfill their obligations to depositors, particularly those related to asset safety.

2. Investor Protection: As the parties most exposed to risks associated with a bank, their success or failure is linked to the bank's success or failure. Therefore, ongoing banking supervision of banks enables current and potential investors to evaluate available investment opportunities and make trade-offs.

Second: Monitoring, supporting, assisting, and coordinating banks and financial institutions

1. Monitoring banks and financial institutions: i.e., ensuring their compliance with applicable legislative and regulatory provisions from their establishment until the commencement of banking operations, and imposing penalties for any breach of these obligations.
2. Supporting, Assisting, and Coordinating the Work of Banks:

This means encouraging cooperation between banks and financial institutions through banking supervision, by providing the necessary support to detect errors and violations and avoid crises.

Third: Maintaining the stability of the financial and banking system and ensuring its efficient operation. We will discuss this in detail later (Fatima Al-Zahraa, Iman, 2017: 27).

1. Maintaining the Stability of the Financial and Banking System: This includes avoiding the risk of bankruptcy by monitoring banking practices, ensuring that banks do not default, and protecting the banking system and the financial system as a whole.
2. Ensuring the efficient operation of the banking system: This is achieved by examining bank documents and accounts to ensure the availability of assets and avoid their exposure to risks, evaluating banks' internal operations, analyzing key financial elements, and ensuring that banks' operations comply with the general framework of applicable laws. This is also achieved by assessing the financial position of banks to ensure their ability to meet their obligations, with the aim of maintaining the financing of some vital and important economic activities and institutions that the private sector cannot fully finance. Fourth: An Effective Banking Supervision Environment Effective supervision ensures that banks operate safely and securely, and that they have sufficient capital reserves to address the risks arising from their banking operations. Effective banking supervision is a public good, given that financial stability is an indispensable public good.

Banking supervision is divided into three types: quantitative supervision (first), qualitative supervision (second), and direct supervision (third). These can be explained as follows: (Saeed, Muhammad, 2010: 153).

First: Quantitative Supervision: This includes supervision of the quantity and price of credit. This includes the limits that commercial banks adhere to regarding the amount of loans they grant and the interest rate at which they lend. It aims to influence the quantity of money or the volume of credit within a group, regardless of its intended uses.

This type of supervision takes one of the following forms:

1. Discount Rate Policy: This policy involves the central bank raising the discount rate when it wants commercial banks to collect the credit they extend to their customers, and lowering it when it wants banks to grant this credit.
2. Open Market Policy: This policy involves the central bank entering the market as a seller or buyer of all types of securities, especially government bonds with various maturities. The central bank's sale of these securities reduces the cash balances of commercial banks, while its purchase of them increases their balances.
3. Cash Reserve Policy: Commercial banks are required to deposit a certain percentage of their assets with the central bank. The central bank has the right to increase or decrease this percentage. The purpose of this reserve is, first, to ensure the bank's liquidity and, second, to monitor the credit expansion of commercial banks.

Second: Qualitative Control: This control represents a number of measures aimed at distinguishing between different types of loans based on the priorities set by the monetary authorities. The subject of qualitative control is bank credit itself, not the cash reserves upon which credit is granted. Qualitative control relies on distinguishing between transactions subject to different types of qualitative control: (Mohammed, 2007: 46).

1. Setting different interest rates according to the type of loan.
2. Setting specific quotas for each type of loan, such as increasing loans directed to industry at the expense of consumer loans.
3. Distinguishing between loans based on the principal provided as collateral.
4. Determining different maturity dates for loans according to their intended purpose.
5. Obtaining the approval of the Central Bank for commercial bank loans exceeding a certain amount. The success of qualitative oversight depends on borrowers' use of the loans in the specified and agreed-upon ways.

Third: Direct oversight: These are the orders and instructions issued by the Central Bank to commercial banks, individually or collectively. Direct oversight includes the Central Bank's ability to persuade commercial banks to adopt policies consistent with its objectives. This can be achieved through the guidance and advice it provides to commercial banks regarding the policies they must follow in conducting their activities, or through conferences in which the Central Bank invites bank managers to exchange views and review various perspectives(Ahmed, 2014: 17).

First: Money Laundering Methods

Given the enormous revenues generated by illicit activities, finding a practical way to convert these vast sums into legitimate assets and funds is a challenge. Therefore, it has become necessary to find a way to transfer and circulate these funds in legitimate markets without the knowledge of official authorities of their sources. There are many methods and techniques used in money laundering operations, the most important of which are (Barhoum,2020: 8):

A. Traditional Methods: These methods include money laundering through:

1. The collusion of money launderers with bank employees and management, in addition to smuggling and currency exchange.
2. The use of shell companies: This includes the use of legal companies that do not engage in any real activities or projects, where accounts are opened in the company's name locally and internationally in countries that lack oversight or maintain the confidentiality of banking operations.

B. Commercial Methods: These methods include:

1. Parallel Market Operations: This includes exchanging suspicious dollars for foreign currencies and using them in buying and selling transactions.
2. Insurance Companies: Money brokers accept cash from drug dealers to purchase large life insurance policies from insurance companies, then return the money and recover its value through the insurance companies (Salah al-Din,2011: 35).

C. Advanced Technological Methods:

Advanced technological methods have emerged as a rapid means of money laundering operations, weakening the ability to trace the source of these funds. The importance of advanced electronic methods, which emerged as a result of the communications revolution and the development of its network, is highlighted by comparing traditional and modern methods in the stages of money laundering operations. Traditional methods rely on innovation in banks and unsecured cross-border smuggling operations, while modern methods, such as smart cards, computer credit cards, and the internet, use protection and encryption systems to ensure the confidentiality of deposit transactions (Al-Abd,2003: 96).

Regarding recruitment, traditional methods include money transfers or non-cash payment methods such as traveler's checks and bills drawn on foreign banks. Electronic methods involve a series of complex and rapid transactions that can be separated from their illicit source. The integration phase, in traditional methods, includes fictitious transactions, forged invoices, and the operations of gambling houses and brokers. Electronic methods include the purchase of physical assets and gambling using credit cards, using a personal computer without a banking intermediary. These methods are carried out with precision, speed, and high secrecy, making them difficult to trace. There are many technological methods used in money laundering, the most important of which is the electronic check transfer system (Taher,2004: 17).

Money launderers use a variety of tools, ranging from simple traditional methods to technological means that assist them in the money laundering process. These tools include (Taher,2013: 34):

a. Illicit trade, including the trafficking of drugs, unlicensed weapons, substandard medicines, and others.
b. The use of a group of financial institutions that facilitate money laundering operations and provide legal cover for their financial activities.
c. Real estate leasing, which relies on the use of illicit capital in a group of real estate investment projects that purchase and then rent out properties.
d. Real estate investment projects, which purchase properties and then rent them out to individuals and institutions, thus exchanging illicit funds for legitimate funds.
e. Loans are one of the most common money laundering methods.
f. Usury-based loans, which result in the provision of illicit funds in the form of loans, then collecting a percentage of interest on their value after a specified period.
g. Internet technology, which relies on converting illicit funds into other financial investments, such as stocks and bonds, through the use of websites that act as financial intermediaries, facilitating the investment of illicit funds.

Regarding anti-money laundering methods, combating money laundering requires strong international cooperation. The world has witnessed the conclusion of numerous international treaties and agreements, and the enactment of numerous national laws to address this phenomenon, starting in 1980, which witnessed the first real international effort to combat money laundering. This took place at the meeting of the Committee of Ministers of the Council of Europe on June 27, 1980. The meeting discussed measures to combat the financing and deposit of -criminal proceeds, such as the smuggling of contaminated funds from one country to another for laundering and reintroduction into the financial market. The meeting concluded with recommendations that emphasized the important role that the financial and banking sector can play in preventing money laundering through cooperation with judicial authorities and other relevant bodies. This led to the issuance of Security Council Resolution 1373 on September 28, 2001, which stipulates the fight against money laundering. To develop a strategy to limit the leakage and exploitation of these funds in Iraqi banks, the necessary measures must be taken, both at the level of financial institutions and at the legislative level, to limit this phenomenon, and possibly eliminate it (Sulaiman, 2001, pp. 17-19).

Among the most important means or methods used by banks to combat this phenomenon and limit its growth (Al-Zoubi, 2004: 67) are the following:

1. The necessity of setting a maximum withdrawal limit not exceeding a certain amount, and monitoring any withdrawals below the permitted limit, collecting, monitoring, and tracking them to prevent the exploitation of this authority for money laundering operations.
2. Banks must pay attention to certain transactions that deviate from the normal pattern of account activity, such as transactions involving very large sums or those involving small sums, but at regular intervals, without a clear purpose.

3. Providing programs to monitor all banking operations and report unusual transactions and transfers.
4. If there is any doubt about the reliability of the data and information provided by customers, the relevant bank employee must verify its accuracy by appropriate means. In general, sufficient information should be obtained about the commercial nature of the customer's activities.

The Economic Effects of Money Laundering

1. The successful infiltration of laundered funds into the national economy distorts spending and consumption patterns, leading to a shortage of investment resources and thus depriving important economic activities of investment that benefits society (Abdul Mawla, 1999, 327).
2. The successful exit of laundered funds from the national economy of countries leads to an increase in the balance of payments deficit and a foreign currency liquidity crisis, threatening the country's foreign exchange reserves held by the central bank.
3. A study conducted in the United States showed that money laundering leads to an average 27% decrease in productivity, as the informal economic sector grows at a faster rate than the formal sector.
4. Money laundering is associated with increased irrational spending, leading to higher domestic prices and inflationary pressures in the national economy.
5. Money laundering leads to an imbalance in the distribution of national income, widening the gap between the rich and the poor (low-income segments of society), which in turn leads to social instability and the potential for class conflict and violence (Awad, 1997, 14).
6. The infiltration of laundered money into the national economy may prompt governments to impose new taxes or increase their high tax rates to cover the gap between available resources and investment needs after smuggling the money abroad, increasing the burden on income-earning individuals in society.
7. Money laundering disrupts the implementation of public financial policies through tax evasion, negatively impacting the public finance balance and, consequently, the resources available to the government to meet its obligations, as well as its economic and social performance (Zayed Center, 2002, 14).

4. Conclusions

1. There is no doubt that money laundering crimes undermine the prestige of the state and its political system, as well as the national economy and the private business sector. This crime also undoubtedly undermines the moral foundation of society, as those who traffic in dirty money become masters of it thanks to their wealth and direct influence.
2. Money laundering activities extend to drugs, organized crime, illegal arms trafficking, administrative corruption, political and financial corruption, human organ trafficking, the enslavement of women and children for prostitution, and other activities.
3. The phenomenon of money laundering leads to the spread of crime and insecurity, placing financial burdens on governments to maintain security, which is one of the fundamental pillars of prosperity and development.
4. There are methods to combat money laundering crimes implemented by the relevant security and banking authorities. However, money launderers seek to innovate new methods and means, which require updating existing methods and developing methods suitable for the world of tomorrow.
5. The means and methods of money laundering are not always easy. There are legal, administrative, banking, and administrative penalties and difficulties that must be considered to move from an abstract theoretical approach to a crime-fighting plan to practical mechanisms that address a changing and highly complex reality.

5. Recommendations

1. The need to activate international cooperation in the field of combating money laundering, and maximize the benefit from the experiences of some developed countries that have achieved remarkable results in this field. Money laundering scandals must also be exposed and raised internationally, especially those committed by transnational or multinational companies.

2. The need to enact a national law to combat money laundering crimes, stipulating the complete confiscation of dirty money and its instruments, and imposing strict criminal penalties on perpetrators, their collaborators, companies, and shareholders of public and private banks.
3. The need to subject bank managements, especially private banks, to the rule of law that criminalizes money laundering crimes and punishes them by prioritizing the national interest over the private interest of the bank. These crimes are committed by criminals who disregard the state's financial and banking institutions. They manipulate or transfer funds illegally, or obtain banking facilities that do not lead to the collapse of the borrowing bank itself.
4. The burden of proving the legitimacy of confiscated funds falls on the owner. If the owner proves, through legal documents, that the funds resulted from legitimate and reasonable business activities, then these funds are genuine and legitimate. Otherwise, the activity constitutes a money laundering crime.
5. The phenomenon of money laundering leads to the spread of crime and insecurity, which means that governments bear financial burdens in an attempt to maintain security, as it is one of the fundamental pillars of prosperity and development.

6. Conflict of Interest

The authors declare that they have no conflict of interest.

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