

“Formation of a new paradigm of anti-money laundering: The experience of Ukraine”

AUTHORS

Sergij S. Vitvitskiy  <https://orcid.org/0000-0002-4884-1883>
Oleksandr N. Kurakin  <https://orcid.org/0000-0002-0274-6530>
Pavlo S. Pokataev  <https://orcid.org/0000-0003-3806-2197>
Oleksii M. Skriabin  <https://orcid.org/0000-0002-8915-5943>
Dmytro B. Sanakoiev  <https://orcid.org/0000-0002-6783-3168>

ARTICLE INFO

Sergij S. Vitvitskiy, Oleksandr N. Kurakin, Pavlo S. Pokataev , Oleksii M. Skriabin and Dmytro B. Sanakoiev (2021). Formation of a new paradigm of anti-money laundering: The experience of Ukraine. *Problems and Perspectives in Management*, 19(1), 354-363. doi:[10.21511/ppm.19\(1\).2021.30](https://doi.org/10.21511/ppm.19(1).2021.30)

DOI [http://dx.doi.org/10.21511/ppm.19\(1\).2021.30](http://dx.doi.org/10.21511/ppm.19(1).2021.30)

RELEASED ON Tuesday, 23 March 2021

RECEIVED ON Tuesday, 19 January 2021

ACCEPTED ON Thursday, 18 March 2021

LICENSE



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JOURNAL

"Problems and Perspectives in Management"

ISSN PRINT

1727-7051

ISSN ONLINE

1810-5467

PUBLISHER

LLC “Consulting Publishing Company “Business Perspectives”

FOUNDER

LLC “Consulting Publishing Company “Business Perspectives”



NUMBER OF REFERENCES

41



NUMBER OF FIGURES

1



NUMBER OF TABLES

0

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BUSINESS PERSPECTIVES



LLC "CPC "Business Perspectives"
Hryhorii Skovoroda lane, 10,
Sumy, 40022, Ukraine
www.businessperspectives.org

Received on: 19th of January, 2021
Accepted on: 18th of March, 2021
Published on: 23rd of March, 2021

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Sergij S. Vitvitskiy, Doctor of Law, Associate Professor, Rector of Donetsk Law Institute of the Ministry of Internal Affairs of Ukraine, Kryvyi Rih, Ukraine.

Oleksandr N. Kurakin, Doctor of Law, Associate Professor, Deputy Director for Educational and Research Activities of the Kryvyi Rih Educational and Scientific Institute of the Ministry of Internal Affairs of Ukraine, Kryvyi Rih, Ukraine.

Pavlo S. Pokataev, Doctor of Public Administration, Doctor of Laws, Professor, First Vice-Rector, Classical Private University, Zaporizhzhia, Ukraine.

Oleksii M. Skriabin, Doctor of Laws, Associate Professor, Criminal Law, Procedure and Criminology Department, Classical Private University, Zaporizhzhia, Ukraine. (Corresponding author)

Dmytro B. Sanakoiev, Candidate of Juridical Sciences, Associate Professor, Head of the Financial and Strategic Investigations Department, Faculty of Training for Strategic Investigations Units, Dnipropetrovsk State University of Internal Affairs, Dnipro, Ukraine.



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Conflict of interest statement:
Author(s) reported no conflict of interest

Sergij S. Vitvitskiy (Ukraine), Oleksandr N. Kurakin (Ukraine), Pavlo S. Pokataev (Ukraine), Oleksii M. Skriabin (Ukraine), Dmytro B. Sanakoiev (Ukraine)

FORMATION OF A NEW PARADIGM OF ANTI-MONEY LAUNDERING: THE EXPERIENCE OF UKRAINE

Abstract

The increase in the level of money laundering is associated with digitalization and technification of all spheres of society, the globalization of financial markets, the consequences of quarantine measures caused by the COVID-19 pandemic, and the new ways of committing money laundering crimes. The paper aims to identify the peculiarities of anti-money laundering activities in Ukraine and outline approaches to increase the effectiveness of combating money laundering in the country. The current state of the problem of money laundering is analyzed based on the study literary sources, regulatory framework and their discussion in the Ukrainian society. An attempt was made to systematize the factors influencing the increase in the level of money laundering. The consequences of increasing the level of money laundering for Ukraine have been determined: a shortfall in state budget revenues, a decrease in the level of the social sphere financing, reduced living standards of the population. It has been emphasized that there is a need for a comprehensive approach to the problem of money laundering, which will include ongoing training for financial audit specialists, the establishment of special units to investigate money laundering crimes, enshrining the classification of money laundering crimes in regulatory documents and the establishment of criminal liability for their commission.

Keywords

money laundering, international cooperation, Ukraine, criminal act, financial institution

JEL Classification

G15, K33, O17

INTRODUCTION

The level of money laundering is constantly growing. According to the statistical data of the State Financial Monitoring Service of Ukraine, the number of criminal offenses related to money laundering in 2016 was 159, and in 2018 – 242 crimes. In 2018, the amount of money laundered amounted to 103 million euros, and in early 2020 – 438, 7 million euros (according to the State Financial Monitoring Service of Ukraine).

At the same time, according to the information provided by the Prosecutor General's Office of Ukraine, the amount of criminal proceeds (according to the indictments of the Prosecutor General's Office of Ukraine) for the years 2016–2019 amounted to 213,48 million euros (Reports of the Prosecutor General of Ukraine on the form 1-LV, 2018). One of the factors influencing the growth of this money laundering is the COVID-19 pandemic, which contributes to the transition of public relations in all spheres of life online.

The rapid development of technology and the economy is contributing to the formation of new ways of money laundering. Financial institu-

tions introduce measures to control monetary transactions and customers' bases, but existing measures are outdated and do not meet modern requirements. On the one hand, the activities of financial institutions, public authorities, and international organizations in the field of anti-money laundering contribute to reducing the level of money laundering, and on the other hand, provoke a counter reaction. Financial institutions and banks may lose customers and their trust due to restrictions and controls of their activities.

Therefore, it is urgent and necessary to study anti-money laundering activities, especially in the context of current globalization of financial markets, in order to identify possible ways to optimize such anti-money laundering activities at the global and national levels.

The paper aims to identify the peculiarities of anti-money laundering activities in Ukraine and outline possible ways to increase the effectiveness of combating money laundering in the country.

1. LITERATURE REVIEW

The study of the problem of money laundering and combating crimes in this field is a subject area of juridical, social and economic science. Various aspects of anti-money laundering are currently being investigated. For example, the study of bank risk management (Bauer & Ryser, 2004), the study of the risk theory features (John H. Boyd & Gianni De Nicolo, 2005), consideration of bitcoin user identification in terms of identifying shortcomings in identification and transaction history (Reid & Harrigan, 2011), and studying the algorithms for detecting anomalies in customers' transactions in the field of banking and detecting illegal cash flows (Issa & Vasarhelyi, 2011). Improving public administration in the field of combating money laundering is an area of research for public administration and law professionals (Baranov, 2015; Bashtannyk, 2011).

Money laundering is a process of concealing the source of funds acquired illegally in order to demonstrate that such funds were acquired legally (Mekpor et al., 2018). Illegally acquired money goes through a chain of transactions to make their origin legal.

Another term related to money laundering is "displacement", which is used in the international organizations' activities in the field of anti-money laundering to denote this phenomenon. Another alternative term is "balloon effect," an analogy used to denote that the pressure exerted on one point of a balloon pushes air to another point (Mora, 1996). Similarly, the pressure exerted on

one form of money laundering forces this practice to spread to other forms of money laundering (Zagaris, 2001). In the case of money laundering, the argument in favor of expanding and covering the mechanisms for monitoring money laundering for additional forms of economic exchange (for example, real estate, online games or professional football) increasingly recognizes a shift of money laundering practice towards operations and places not covered by existing anti-money laundering supervision (Sheptycki, 2000; Sharman, 2011).

According to Isaac Ofoeda et al. (2020), money laundering has been studied in various aspects by Hendriyetty and Grewal (2017), who note that money laundering affects government revenues because tax evasion is a major crime related to money laundering. Another issue related to money laundering is the undermining of democratic governance as it leads to political disorders and social instability (Mohammad et al., 2016). According to Raweh et al. (2017), money laundering has gradually increased due to organized crimes such as human trafficking, gambling, drugs and arms trafficking. Money laundering has been recognized as a criminal offense (Rahman, 2015).

A study by Schwarz (2011) found that tax evasion and money laundering were additional offenses, indicating that some countries did not cooperate in applying regulations to identify the origin of money. This can destabilize financial institutions and entire financial systems. Among the other economic and financial crimes, money laundering has been more successful in penetrating to the economic and political structures of most developing

countries, which has led to cutback in economic activity and political instability. Although developing countries have responded and continue to respond with legislation to the threat of money laundering, at the national level, money launderers use regulatory support gaps and vulnerable financial systems. It should be noted that in developing countries there is a relation between corruption and money laundering (Aluko & Bagheri, 2012). It also leads to political problems on the part of governments and enterprises, as well as to exchange rates and interest rates instability (McDowell & Novis, 2001).

Lester and Roth (2007) found the weakest points among large American banks. The identified shortcomings in certain areas of banking are as follows: internal policies, procedures and control; compliance; preservation of documents and information; cooperation in investigations; risk management; identification and verification of clients; audit, monitoring and reporting on operations; continuous learning and improving knowledge. The identified shortcomings contribute to the study of money laundering and should be eliminated.

Analyzing the Bitcoins user identification system, Reid and Harrigan (2011) indicate that Bitcoin involves incomplete user's identification, but in most cases, users and their transactions can be identified. They found that public keys were tied to IP addresses receiving Bitcoins, which allowed them to detect previous transactions. Such incomplete identification can influence the increase in the level of money laundering through cryptocurrency, which is extremely popular and reliable due to political instability, the dynamics of changes in the foreign exchange market, and the effects of the COVID-19 pandemic.

The research conducted by a working group led by Unger (2007) is one of the large scale surveys concerning the money laundering impact on various spheres of social and economic life. The study was based on numerous publications of international organizations (IMF, OECD, FATF), as well as sources from the Econlit economic search database, which includes more than 750 journals and 44,000 scientific papers. Other materials were also studied, including the world's leading the-

matic publications such as the *Journal of Money Laundering Control* and the *Journal of Financial Crime*, from 1990 to 2004 inclusive.

It is established that significant inflows of funds laundered can cause a decrease in the exchange rate of the national currency (its depreciation) and/or a significant expansion of the national monetary base, which will result in rising prices (inflation) (based on the international research conducted at the request of IMF by a working group led by Tanzi, 1996).

Money laundering provokes interest because it is a major obstacle to the effective international financial system functioning and has a major impact on the global financial system (Buchanan, 2004). Money laundering can lead to the distribution of resources between productive sectors of the economy, which can affect a country's economic growth (Bartlett, 2002).

Analyzing the issue of money laundering combating, R. D. Lucian (2010) notes that globalization and regionalization have raised the issue concerning international organizations activities in terms of anti-money laundering among the international community of criminal gangs using sophisticated technological means and free borders. New communication systems and updated technologies have reduced the distance between countries, opened borders and created unimaginable opportunities for political and social interaction. "Globalization has allowed a qualitative leap of critical importance for the business of transnational organized crime, providing them not only with an ideal environment for business development, but also with the ways to obtain illegal goods or some of their production processes" (Lucian, 2010). Obtaining profits by countries, due to the opening of borders to trade flows, are balanced by the threat to human security. The basis of money laundering is bank secrecy, offshore accounts, and tax-free zones. There are also less sophisticated methods of money laundering, such as money laundering through the purchase of works of art, sophisticated transactions through fake courts, and money laundering through money carriers, allowing different amounts of money to be transported across borders. The anti-money laundering process requires special national regulations to be integrated

into the process of international cooperation. At the same time, there is a need to implement anti-money laundering activities at the societal level, in terms of raising public awareness and forming public opinion concerning these aspects.

Borlini (2008) notes that today there is a gap between the well-recognized need for coherent strategies aimed at anti-money laundering, the challenges posed by the transnational dynamics of money laundering, and the determination of some states to maintain their prerogatives. Thus, there are some more issues concerning the national definitions of predicate offenses. Indeed, in terms of common practice inducing criminalization of money laundering offenses involving “foreign” predicate offenses, the high demands of double crime, harmonized definitions of predicate offense are becoming essential. At the same time, such harmonization is not always easy to achieve mostly for economic reasons. The emergence of cause-and-effect chains extending across national boundaries of jurisdictions with consequences that transcend one or more national criminal law regulations creates serious challenges for jurisdiction. On this issue, the treaty mechanism seems to have given precedence to the freedom of the states tending in this matter, rather “than imposing binding obligations when the traditional approach to territoriality clearly fails, namely, when the crime is committed through corporate schemes having a lot of jurisdictions” (Borlini, 2008).

Harbovskiy (2018) notes that according to preliminary estimates of international experts, the amount of money laundered is hundreds of billions of US dollars per year, which is variously introduced into legal circulation in order to hide its criminal origin and further return to the world economic and financial systems. Such money or other property laundering is often a means of primary capital accumulating. The essence of the latter is the withdrawal of illegally obtained funds (dirty money) from the sphere of shadow capital into the sphere of their legal circulation. That is, the actual granting the status of legal property to monetary funds or any property of a certain legal entity or natural person. And as a result, due to illegal financial transactions, the true origin is hidden, and in

some cases the real owner of money, property or income from the use of such property is hidden. “Despite the sufficient number of international organizations, which are directly responsible for combating money laundering and a number of adopted international legal instruments, there is currently no unified system for preventing and combating money laundering”, which would become a universal reference point for all world countries (Baranov, 2018). Considering this fact on a global scale, it makes sense for each country to form its own system, taking into account its national specifics and the level of its development.

Today in Ukraine, measures to combat money laundering are enshrined in the “Strategy for the development of the system of prevention and combating money laundering, terrorist financing and financing of proliferation of weapons of mass destruction for the period before 2020” (Cabinet of Ministers of Ukraine, 2020) and the Law of Ukraine “On prevention and combating money laundering, financing terrorism and proliferation of weapons of mass destruction” (The Verkhovna Rada of Ukraine, 2020).

The practice of de-risking among banking institutions is an important condition for anti-money laundering. Utkina (2019) indicates that the FATF group expressed its concern for the first time about de-risking in October 2014 at a plenary session. Later, the International Anti-Money Laundering Group published the Guidance “Correspondent Banking Relationship” (2016), which explained this phenomenon as activities of financial institutions aimed at terminating or restricting business relationships with customers or customers categories, in order to avoid rather than manage risk».

In Italy, financial monitoring was previously carried out by the Ufficio Italiano dei Cambi (UIC), which was subordinated to the National Bank of Italy and performed the functions of financial intelligence. The main tasks of the UIC were to prevent and combat money laundering through financial analysis and intelligence. “It is required for financial institutions to inform of all suspicious transactions in the amount exceeding 12.5 thousand euros” (U.S. State Department of Staff, 2009–2017).

According to the Italian legislation, banks and other intermediaries are obliged to keep detailed records of the residents' foreign exchange transactions in order to prevent money laundering attempts. The Gamma-Vassali Act (1990) established criminal liability for "laundering" operations and for the first time in world practice, defined the concept of a "criminal organization such as mafia". As a result of changes in legislation in 1990, the state is obliged to perform monitoring in regards to the detection and cessation of money laundering attempts. The monitoring system stipulates that the transfer of any amount of money abroad is accompanied by a simultaneous declaration of income. Crimes related to money laundering are punishable by imprisonment for a term of 7 to 12 years and by a money penalty (Baranov, 2018).

L'Unità di informazione finanziaria per l'Italia (UIF) is a company, which has been operating in Italy since 2008 as an independent authority within the Bank of Italy.

For example, in 2000, the financial intelligence center (Financial Transactions and Reports Analysis Center of Canada (FinTRAC) was established in Canada, which is subordinated to the Ministry of Finance. Thus, Kobylanska (2015) notes that when there is a reasonable suspicion of money laundering, the data on the transaction are reported to the law enforcement agencies, where, if necessary, working groups consisting of accountants and prosecutors are created in the process of investigation.

In the United Kingdom, money laundering is considered to be a serious crime relating to drug pushing, terrorism, theft and fraud, robbery, fraud, extortion, illegal deposit use, blackmail, etc. Financial Monitoring is handled by the National Criminal Intelligence Service (NCIS), which is subordinated to the UK Treasury and cooperates with the National Investigation Service, the National Criminal Intelligence Service, and the Serious Fraud Office and Customs and Excise.

The main task of NCIS is to collect, process, store and analyze information about financial transactions that may be related to money laundering. Crimes related to money laundering are punish-

able by imprisonment for a term of 5 to 14 years (Baranov, 2018).

The Financial Crimes Enforcement Network – FinCEN, has been established in the United States, the main purpose of which is to protect the financial system from illegal use, combat money laundering and ensure national security. The FinCEN database includes: the Financial Data Base (FDB); a commercial database with information about corporations and individuals, the source of which is a database of commercial analytical centers and specialized services, as well as information from the Customs Service and the US Internal Revenue Service; a file of lawsuits of law enforcement agencies and information from the US Federal Intelligence Service, including databases of "dirty" money sources (Source Data Base); Undercover Money Laundering Investigations Data Base and Criminal Referral Data Base.

The peculiarity of the state policy of European countries in the field of anti-money laundering is that its formation took place under the influence of American policy to a greater extent. The criminalization of money laundering from drug business in Europe began in the latter half of the 1980s of the last century, when the relevant laws were adopted in Denmark, Britain, France and Norway (Baranov, 2018).

At the international level, the activities of the Financial Action Task Force of Money Laundering (FATF) are important for combating money laundering, whose documents are of interest for the international search, seizure and confiscation of criminally obtained money and property. This intergovernmental organization was founded in July 1989 in Paris, at the 15th Summit of Heads of States and Governments of the world's leading industrial countries (G7: America, Japan, Germany, France, Britain, Italy, Canada), and its main goal is the development and promotion of state policy aimed at combating money laundering.

To verify the implementation of the FATF Recommendations by countries, in 2013, a Methodology for assessing compliance with the FATF Recommendations and the effectiveness

of anti-money laundering and anti-terrorist financing systems was published.

Today FATF carries out the following activities:

- monitoring the progress of member states on the way of implementing measures to combat money laundering;
- review of trends and methods of money laundering, as well as countermeasures, and the formation of relevant reports;
- implementation of the FATF strategy in the field of combating money laundering all over the world (Baranov, 2018).

According to the data provided by the Association of Certified Anti-Money Laundering Specialists Dow Jones & ACAMS (2016), in 2016, 40% of respondents informed that their companies had partially or completely “gone out of whack” due to compliance risk of financial institutions and inability to manage it.

This trend constitutes a serious problem for relevant intergovernmental organizations, since de-risking may reduce the transparency of financial flows and the availability of financial services, which may increase the risks of money laundering and terrorist financing.

However, it makes sense to recognize that today there is a need to update existing theoretical developments with respect to the modern social realities, globalization of financial markets to identify problematic aspects of anti-money laundering, to identify ways to eliminate the detected shortcomings.

2. GENERALIZATION OF THE MAIN STATEMENTS

Money laundering may be extremely dangerous for the economic, political and social stability of each country individually, and it also constitutes a menace to the world economy and international relations. Therefore, the activities of the international communities, states, and intergovern-

mental organizations are aimed at implementing measures, both at the state level and at the international level, to combat money-laundering, as well as to reduce the level and complicate the procedure of legalization of such proceeds.

The legislation of European countries concerning liability for money laundering is characterized by the following features:

- the codification of criminal law raised the issue of competition between the provisions on money laundering and the provisions on complicity, the purchase of stolen goods and concealment of crimes;
- European regulations have a much higher level of generalization;
- the term (or amount) of punishment for money laundering is almost everywhere lower than in the United States, and does not exceed 10 years of imprisonment, fines are also widely applied;
- less frequently than in the United States, the subject of the crime covers non-income benefits (for example, the benefit from tax evasion);
- the Strasbourg Convention on Criminal Proceeds Laundering, Search and Seizure d/d November 8, 1990 significantly influenced the development of anti-legalization legislation in Europe;
- many European countries have criminalized the legalization of criminal proceeds not as a result of the objective development of national legal consciousness, but under the influence of external pressure, mainly due to the activities of the FATF (Chernukhina, 2005).

It should be noted that in their investment preferences, money launderers are guided by a desire to avoid control and detection rather than by maximizing their investment income. As a result, funds are redistributed in favor of those assets that generate insignificant business activity, employment and gross value added; income from long-term investments is transferred to the real sector of the economy and is trans-

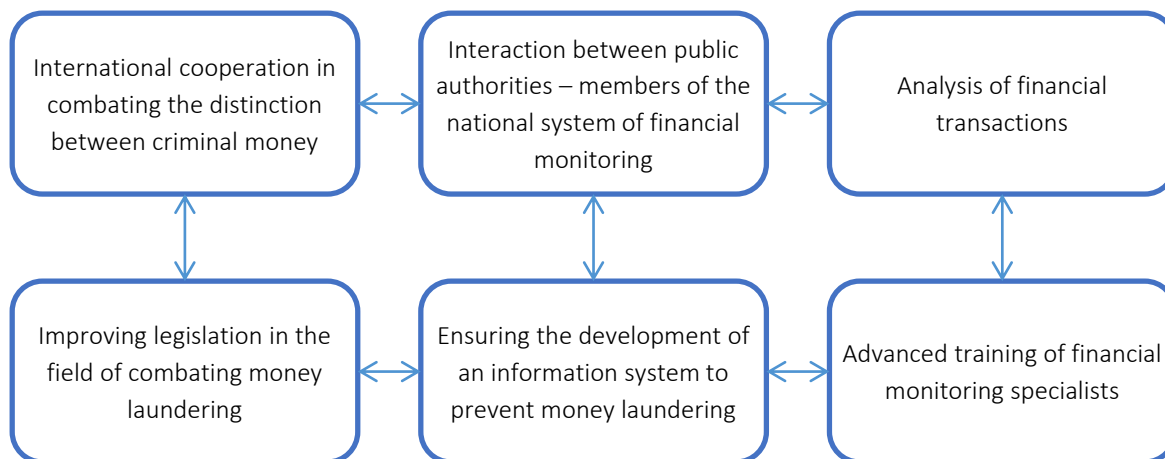


Figure 1. Anti-money laundering measures

formed to speculative, risky and low-quality (“junk”) assets (Brent, 2013).

The above is the main reason that capital is not placed optimally compared to the situation when the allocation of resources is carried out, taking into account the factors of fundamental analysis of investment objects. The speed of criminal proceeds circulation, the liquidity of the relevant forms of assets through which money is laundered, are crucial landmarks for criminals.

It stands to mention that as a result of illegal financial transactions, an owner and the true origin of the property or income obtained from the use of such property are hidden. Such a threat can lead to adverse effects for society, which are as follows:

- ineffective counteraction of the state and society in relation to money-laundering facilitates the enrichment of individuals and certain groups of people through crimes commission and makes criminal activity more attractive and cost-efficient;
- the possibility of using the money laundered not only to continue criminal activity, but also to invest in the most promising economic activities;
- due to concealment of information on income, there is a decrease in tax collection and allocation of funds for public needs, which threatens the financial system of the state as a whole and leads to the undermining of the national economy in particular;

- the use of “dirty” funds to bribe government officials, penetration of criminal elements into political institutions, and, in some cases, to organize and finance terrorism, which undermines the democratic system, makes a real threat of state control loss and consolidation of power by criminal elements (Garbovsky, 2018).

The level of money laundering is directly related to the level of corruption that is specific to the Ukrainian state. Therefore, anti-money laundering is inextricably linked to the anti-corruption activities of the state.

The issue of money laundering is also associated with online transactions, during which there is no complete identification of users, which offers opportunities to transfer large amounts of money of unknown origin.

3. DISCUSSION

To combat money laundering and an increase in the cost spent for criminal business operations, the activities and financial statements of enterprises are audited. Business entities provide information on their capital and current operating costs, while financial intelligence uses a system for assessing the risks of money laundering or terrorist financing by corporations and trusts, conducts client’s verification in a proper manner and holds consultations on corporate transparency.

However, not all financial institutions in Ukraine facilitate the conduct of their activities audit. Such a reaction to financial monitoring arises due to possible misunderstandings on the part of clients of financial institutions, since their personal rights may be violated. Financial institutions sometimes hide the existing shortcomings of their activities in order to maintain their customer base and the level of their credibility.

From this perspective, it is important to consider the possibility of improving Ukrainian anti-money laundering legislation. Introduction of crimes codification in the field of money laundering, their classification, the establishment of clear responsibility for their commission, complicity and covering up such crimes.

The current state of crime level in the field of money laundering in Ukraine may lead to the following consequences:

- reduced cash receipts in the state budget;
- a decrease in the amount of the allocated budget for developing the state's social and economic infrastructure;
- instability of UAH exchange rate;

- as a result, the living standards of the population may decline.

At the same time, in addition to the negative aspects in this situation, it is worth noting that there is the basis for further improvement of the anti-money laundering system and the development of Ukrainian society.

Continuous training and improvement of knowledge about possible money laundering methods and schemes of specialists in the field of financial audit and anti-money laundering will help to detect such crimes and prevent their commission in the future. The creation of special working groups, which will involve financial specialists, IT specialists and law enforcement officers, will allow investigating money laundering crimes faster and punishing the criminals in accordance with the law.

Conduct of audits at the Ukrainian financial institutions will make it possible to identify weaknesses in their activities, establish existing corruption schemes, identify areas of economic activity, which are not under control of anti-money laundering organizations, and it will help resolve these issues at the legislative level.

CONCLUSION

According to official statistics, the level of money laundering in Ukraine is growing every year. The increase in the level of money laundering is influenced by incomplete identification of users when using online banking and performing online transactions; evasion of financial institutions from conducting audits for fear of losing the credibility of clients; the gaps in the regulations used by criminals to commit money laundering crimes; corruption in the society. An increase in the money laundering level leads to the following consequences: capital in the country is not placed optimally; illegal funds are used to finance criminal activities and implement corruption schemes; cash receipts in the state budget are decreased; funding for social spheres of society is reduced; and the living standards of the country's population decline. Constant updating of money laundering methods and identification of economic activity areas that are not subject to financial monitoring and control by the state requires more effective legal regulation of money laundering. The possible ways to improve an anti-money laundering system in Ukraine are as follows: continuous training of specialists in the field of financial audit; creating special working teams to investigate money laundering crimes, which will involve IT specialists, law enforcement officers and financial specialists; regular audit performance of financial institutions activities and ensuring the preservation of customers' confidence; enshrining at the statutory level of money laundering crime classification and criminal liability for their commission; conducting anti-corruption policy in the state. A comprehensive approach to improving the effectiveness of anti-money laundering activities will help reduce the number of such crimes and increase the economic development of the state.

AUTHOR CONTRIBUTIONS

Conceptualization: Oleksii M. Skriabin, Oleksandr N. Kurakin.

Data curation: Pavlo S. Pokataev, Oleksandr N. Kurakin.

Formal analysis: Pavlo S. Pokataev, Oleksii M. Skriabin.

Investigation: Oleksandr N. Kurakin, Dmytro B. Sanakoiev.

Project administration: Sergij S. Vitvitskiy.

Resources: Pavlo S. Pokataev, Dmytro B. Sanakoiev.

Supervision: Sergij S. Vitvitskiy.

Writing – original draft: Oleksii M. Skriabin, Sergij S. Vitvitskiy.

Writing – review & editing: Oleksii M. Skriabin, Dmytro B. Sanakoiev.

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