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MONITORING CONTRIVANCES ON MONEY LAUNDERING OCCURRENCES IN BANK AND FINANCIAL INSTITUTIONS

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Abstract

One of the stumbling blocks to maintain effectiveness of international financial systems is the money laundering activities. Money laundering is frequently connected to secretive economics and organized crimes and Malaysia has become highly exposed to money laundering. This study aims to examine the relationship between monitoring contrivances and money laundering occurrences (MLO) in 30 Malaysian east coast banks and financial institutions in Kuantan. Descriptive statistic, reliability test, normality test and correlation analysis by using Statistical Package for Social Science (SPSS) was employed to measure and analyse the data collected. This study found that there is significant positive relationship between monitoring contrivances that consist of internal control procedures (ICP), Anti Money Laundering Training and Awareness (AMLTA) programme, corporate governance (CG) and customer due diligence (CDD) and MLO. The significant positive relationship between monitoring contrivances and MLO may be explained weak ICP, technological advances or human intervention, the staff in the bank and financial institutions are not competent enough to control the occurrences of money laundering, and banks might potentially choose to implement only the minimum standards required in processing daily transactions. Thus, this study aligns with agency theory because the increase in the number of money laundering problems can lead to increase in agency cost.

Keywords: Money laundering, monitoring contrivances, internal control, anti-money laundering, customer due diligence, corporate governance.

1. Introduction

Banks have become the first line of contacts by the money launderer including offering numerous amenities and banks are the first interaction level by money launderer, by observing the money laundering's modus operandi. Money laundering risk has been assessed and mainly concentrates on organization-based role, in setting up bank organization, for example compliance policies of money laundering with the supervisory requirements (Raghavan, 2006; Simwayi & Guohoa, 2011).

In banking institutions, money laundering is one of the gigantic risks. Banks disburse significant payment for fines due to failed in assessing money laundering properly and the significant costs towards banks certainly affect the financial system.

2. Problem Statement

Money laundering are claimed to be part of hurdle which have caused problems in evolving an effective international financial system and it is challenging to arraign in the court of law (Buchanan, 2004). Money laundering is organized crimes and frequently associated to underground economics. Global money laundering transactions activities are estimated at 2% to 5% of global GDP annually (PwC's Global Economic Crime Survey, 2016) and any criminal activity that generates significant profit will create a need for money laundering (Astro Awani, 2016). Malaysia has become one of the leading Asian nations that exceedingly exposed to money laundering, largely due to extensive series of financial services available within its banking system and it costs Malaysia between RM15 billion and RM25 billion per annum.

According to Masciandra (1999), the preferred medium chosen by money launderers is the financial institutions. In June 2004, Basel II framework has been introduced to create an international standard that banking regulators can practice when forming rules on how much capital is maintain while at the meantime preserve sufficient consistency. However, Basel II fails to adhere the policies concerning operations risks as defined by Bank Secrecy Act (BSA), which would make banks using it vulnerable to money laundering (Verdana, Jinghua & Ping, 2012). This highlights the need to create awareness to provide strong monitoring contrivances of anti-money laundering for banks and financial institution.

3. Literature review

3.1. Internal control procedures and money laundering occurrences.

Internal control and risk management system act as a key role in the financial for business continuity and soundness of the financial system (Carlos, 2015). According to Rafal, Jan, and Wojciech (2010), banks must use intelligence system to trace any suspicious activities and assessment of money laundering risk is vital due to the nature of banking operation. Banking institution should be furnished with adequate infrastructure to screen money laundering risk and senior management shall be responsible to ensure that the bank has an effective internal control system including monitoring and reporting any suspicious activity (Okab, 2014).

H1: There is a significant relationship between ICP and MLO in Malaysian bank and financial institutions.

3.2. AML training and awareness program and money laundering occurrences.

Sufficient AML training and awareness programs supported with appropriate policies should be provided to relevant staff to enhance the competency in terms of money laundering risk assessment (Wan Nur Shawatul Aswal, 2014). According to Okab (2014), bank and financial institution bears responsibility to train its employees periodically and continuously at every administrative level and increase their awareness on Know Your Customer principles and money laundering operations. When the bank has a good policy for training and awareness program in AML, it will lead to positive impact on bank operations and minimize money laundering occurrences (Idowu & Obasan, 2012).

H2: There is a significant relationship between AMLTA programme and MLO in Malaysian bank and financial institutions.

3.3. Corporate governance and money laundering occurrences.

Various unlawful activities are connected with corrupt practices and lack of transparency, which will subsequently give rise to pathetic governance. According to Vaithilingam and Nair (2007), the pervasiveness of money laundering activities is lower when there is a decent corporate governance framework. Therefore, the board and senior management of bank and financial institution must bear higher standards of corporate governance and playing an important role in MLO (Aspalella, 2015).

H3: There is a significant relationship between CG and MLO in Malaysian bank and financial institutions.

3.4. Customer due diligence and money laundering occurrences.

The international standards for Anti-Money Laundering programs developed by Financial Action Task Force 1990 claimed that it is an obligation for financial institutions to identify all clients and to keep appropriate records. The implementation of procedures and policies based on Know Your Customer values are the best effective approach to combat money laundering if applied during the engagement phase to exercise judgement in assessing the customers, to trace the suspicious customer who might perform money laundering activities and to identify unusual or suspicious behaviour which may be an indication of money laundering (McLaughlin & Pavelka, 2013; Okab, 2014).

H4: There is a significant relationship between CDD and MLO in Malaysian bank and financial institutions. Therefore, agency theory serves to identify the issue and find solutions to curb the money laundering risk as much as possible and avoid the agents behave in an opportunistic way especially when they have better information than the principal.

4. Research Questions

In this study, there have a few research questions that arise which are

- Is there any significant relationship between ICP and MLO in Malaysian bank and financial institutions?
- Is there any significant relationship between AMLTA programme and MLO in Malaysian bank and financial institutions?
- Is there any significant relationship between CG and MLO in Malaysian bank and financial institutions?

▪ Is there any significant relationship between CDD and MLO in Malaysian bank and financial institutions?

5. Purpose of the Study

This study aims to examine the relationship between monitoring contrivances and MLO in Malaysian banks and financial institutions. Meanwhile, the specific objectives are:

▪ To examine the influence of ICP of Malaysian bank and financial institutions to control MLO.
▪ To examine the influence of AMLTA programs of Malaysian bank and financial institutions to control MLO.
▪ To examine the influence of CG of Malaysian bank and financial institutions to control MLO.
▪ To examine the influence of CDD of Malaysian bank and financial institutions to control money laundering occurrences.

6. Research Methods

This study focused on bank and financial institutions because bank and financial institutions is the first line of contacts by the money launderer before they commit money laundering activities. Purposive sampling method has been employed to determine the sample and Kuantan was selected as sample because it is the capital city of Pahang which known as the largest states in Peninsular Malaysia. 33 banks have been identified as population for this study consisting commercial bank, investment bank, Islamic bank and development bank. One questionnaire adapted from Wan Nur Shawatul Aswal (2014) enclosed with cover letter was distributed to each bank and financial institution for data collection and collected back in a week time after the questionnaire was distributed. This study manages to obtain 30 respondents which are acceptable level because 10% size of population is recommended for 30 to 500 populations (Hill, 1998). This study outlined four independent variables comprising ICP, AMLTA programme, CG and CDD and one dependent variable which is MLO to be measured. The respondents are required to answer the questionnaire using seven point Likert scale which is strongly disagree (1), disagree (2), slightly disagree (3), not sure (4), slightly agree (5), agree (6) and strongly agree (7) in order to measure contrivances of monitoring money laundering and it takes approximately 15-20 minutes to be completed. 20 questionnaires was distributed to the accounting and finance lecturers in Universiti Tenaga Nasional (UNITEN) Sultan Haji Ahmad Shah campus and potential respondents for pre-testing study to ensure the reliability and the validity of the elements used in this study. The questionnaire was revised according to the comments and recommendations from reviewers before it has been distributed to the respondents to meet the objective of this study. Statistical Package for Social Science (SPSS) version 22 was used to measure and analyse the data collected.

7. Findings

7.1. Descriptive statistic.

Based on Table 0.1, the result shows that the female respondents are more than the male respondents, with a frequency of 10 male respondents and 20 female respondents. From the age perspective, there are 11 respondents for both range of 31-40 years old and 41-50 years old. In terms of respondents'

qualifications, majority of the respondents, which is 15 in number, owned bachelor degree qualifications, followed by diploma, others and master degree which consist of 10, 4 and 1 people respectively.

The majority of the respondents are Malay, followed by Chinese, with frequency of 25 and 5 respondents respectively. Most of the respondents have been working in bank for 16 years and above, with 46.7 percent representing a total number of 14 people. There are only 1 respondent who are working for less than 1 year. A total number 7 people from the total respondents are working in the bank for 6-10 years. 3 people are working for 11-15 years in the bank. The respondents from this study comprise of 2 managers, 4 assistant managers, 19 executives, and 5 of other position. These respondents are in their position for numbers of years. 1 respondent is less than 1 year, 9 people for 1-5 years, 12 respondents for 6-10 years, 3 people for 11-15 years and last but not least, 5 people who have been 16 years and above sit in his/her position.

Regarding to the numbers of staff in the banks, there are 11 banks that consist of staff that less than 20 staff, 7 banks have 21-30 staff, 2 banks have 31-40 staff, 1 bank has 41 up to 50 staff and 9 banks obtain more than 50 staff.

Table 01. Descriptive statistics for respondent demographic profile

Demographic Factors		Frequency	Percentage (%)
Gender	Male	10	33.3
	Female	20	66.7
Age	20-30 years	5	16.7
	31-40 years	11	36.7
	41-50 years	11	36.7
	51 and above	3	10.0
Qualification	Master Degree	1	3.3
	Bachelor Degree	15	50.0
	Diploma	10	33.3
	Others	4	13.3
Race	Malay	25	83.3
	Chinese	5	16.7
Number of years working in bank	Less than 1 year	1	3.3
	1-5 years	5	16.7
	6-10 years	7	23.3
	11-15 years	3	10.0
	16 and above	14	46.7
Position	Manager	2	6.7
	Assistant Manager	4	13.3
	Executive	19	63.3
	Others	5	16.7
Number of years in the position	Less than 1 year	1	3.3
	1-5 years	9	30.0
	6-10 years	12	40.0
	11-15 years	3	10.0
	16 and above	5	16.7
Number of staff	20 and below	11	36.7
	21-30 staff	7	23.3
	31-40 staff	2	6.7
	41-50 staff	1	3.3
	50 and above	9	30.0

7.2. Reliability analysis.

Reliability test was performed to determine the internal consistency and stability of the measuring instrument before commencing to further analysis. According to Pallant (2013), the acceptable Cronbach's alpha coefficient of a scale should be above 0.700. However, values above 0.800 are preferable. A Cronbach's alpha test was performed to ensure that the questionnaire developed in this study is reliable. Table 0.2 shows Cronbach's alpha reliability coefficient for all variables is more than 0.8 which designates that the internal consistency for the five items in the questionnaire is reliable and good. Thus, this study concludes that all variables tested are at the acceptable level and according to Bonett (2010), the higher coefficient of the Cronbach's alpha, it shows the better measurement of instrument.

Table 02. Summary results for reliability analysis

Reliability Coefficient	Cronbach's Alpha
ICP	0.910
AMLTA	0.850
CG	0.863
CDD	0.860
MLO	0.890

7.3. Correlation analysis.

The normality test is conducted to identify whether the data collected is normally distributed or not normally distributed among the sample. Shapiro Wilk test was used for normality test since the data are less than 50 as proposed by Field (2009) and the results reported that the data is not normally distributed. Thus, the Spearman's rho correlation test was employed to test the hypotheses in this study for further analysis.

Table 03. Spearman's rho correlation analysis

Variables	ICP	AMLTA	CG	CDD	MLO
ICP	1				
AMLTA	0.556**	1			
CG	0.530**	0.870**	1		
CDD	0.599**	0.768**	0.675**	1	
MLO	0.513**	0.666**	0.614**	0.766**	1

Table 03 shows a statistically significant relationship between ICP and MLO at 0.05 levels. The Spearman's correlation of 0.513 indicates that the strength of relationship is strong and the direction is positive relationship. Thus, H1 is accepted. The significant positive relationship between ICP and MLO indicates that ICP affect the probability of MLO. This result is consistent with (Carlos, 2015; Johnston & Carrington, 2006; and Okab, 2014). Table 0.3 also shows a significant positive relationship between AMLTA programme and MLO which the p-value is significant at 0.05 levels. Hence, this study found that there is a significant relationship between AMLTA programme and MLO. The Spearman's Correlation results at 0.666 which higher than 0.5 indicates that there is a strong relationship between variables (Cohen, 1988). The result obtains from this study consistent with Wan Nur Shawatul Aswal (2014), Okab (2014) and Idowu and Obasan (2012). Therefore, H2 is accepted.

Next, the p-value for relationship between CG and MLO in table 0.3 is significant at 0.05 levels and the strength at 0.614 is considered strong relationship. Thus, H3 is accepted. This finding is consistent with the studies done by Vaithilingam and Nair (2007), Okab 2014 and Aspalella (2015). As presented in table 0.3, the significant value of CDD with MLO is significant positive at 0.05 level and it indicates that there is a statistically significance correlation between CDD and MLO. The Spearman's Correlation of 0.766 indicates a strong significant positive relationship between CDD practice and MLO in Malaysian bank and financial institutions. Therefore, H4 is accepted and it is consistent with McLaughlin and Pavelka (2013), Aspalella (2015), Johnson (2003) and Okab (2014).

8.   Conclusion

The objective of this study is to examine the relationship between monitoring contrivances comprising ICP, AMLTA programme, CG and CDD associated with MLO in 30 Malaysian east coast bank and financial institutions in Kuantan, Pahang. This study also included the demographic factors which are gender, age, qualification, position, years of working and number of staff in the bank and financial institutions. Four hypotheses were developed to examine whether MLO were significantly influenced by the monitoring contrivances. This study found that there is a significant positive relationship between ICP, AMLTA programme, CG and CDD and MLO. Thus, the H1, H2, H3 and H4 are accepted. The significant positive relationship between monitoring contrivances and MLO may be explained by the increase in monitoring contrivances may lead to the increase in MLO. The main reason for MLO because of weak ICP, technological advances or human intervention even though the organization has a good ICP. There is also possibility that management may overrule the internal control. Next, the significant positive relationship between AMLTA programme and MLO because of the staff in the bank and financial institutions are not competent enough in order to control the occurrences of money laundering even though they have attended AMLTA programme provided by the management. The significant positive relationship between CG and MLO because of the staff in the bank and financial institutions are not properly implement the best practices as the corporate governance is not compulsory for the entity. Lastly, although the organization has CDD guidelines, the banks might potentially choose to implement only the minimum standards required in processing daily transactions and some of the important guidelines were neglected. Therefore, this study aligns with agency theory because the increase in the number of money laundering problems can lead to increase in agency cost. Agency theory serves to identify the issue and find solutions to curb the money laundering risk as much as possible and avoid the agents behave in an opportunistic way especially when they have better information than the principal.

It is recommended to future researchers to perform a study with a larger sample size for all bank and financial institutions in Malaysia in order to obtain more desirable and generalise results of the study. Other than that, future studies may include more determinants variables as monitoring contrivances mechanisms used by bank and financial institutions in controlling MLO by conducting interview before constructing the questionnaire. Lastly, the future researcher may consider using content analysis method for data collection future studies as provided in any relevant and available written report.

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