

Money Laundering Prevention Measures among Commercial Banks in Malaysia

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Abstract

The main objective of this study is to examine a range of issues regarding compliance measures adopted by the Malaysian commercial banks. This study assesses the current state of compliance measures adopted by the Malaysian banks. This study also examines the critical success factors in ensuring successful implementation of money laundering and financial terrorism measures. Based on 39 respondents among compliance officers in commercial banks, this study found that commercial banks in Malaysia take responsibilities in money laundering and terrorist financing compliance measures seriously. However, further analysis revealed that there is a significant difference between level of perceived important and the actual level of anti money laundering prevention measures adopted. Such results indicate that despite perceiving the measures as an important tool to combat, detect, investigate and prosecute suspicious money laundering and terrorist financing, the actual level of implementation by the banks is significantly lower. Among the top factors perceived importance to ensure successful implementation of the money laundering prevention measures are support from top management, expert staff, technology infrastructure availability and existence of political influence.

Keywords: Money laundering and financing of terrorism, prevention measures, commercial banks, Malaysia

1.0 Introduction

Money laundering and financing of terrorism are global problems that not only threaten security but also jeopardising stability, transparency and efficiency of government systems, thus undermining economic prosperity (Quirk, 1997; Barrett, 1997; Paradise, 1998; Masciandaro & Portolano, 2003). Other group of researchers argued that money laundering and the financing of terrorism weakens the financial systems which are the main players for global financial transactions (Vaithilingam & Nair, 2007; Simwayi & Guohua, 2011). Of consequence, such scenario would jeopardise the socio-economic development of these nations. Money laundering is a complex highly-intelligent crime, which is of severe danger to the society (Bonnie, 2005). It is estimated that one-fifth of the global of money laundered occurred in the Asian region as \$200 billion (Bonnie, 2005). According to Bonnie (2005), some Asia-Pacific countries are still lacking of consistent anti-money laundering legislation. She argued that the Asia-Pacific region is a home to five of the six remaining non-cooperative countries and territories on the Financial Action Task Force's 2004 list.

The increasing concern on the catastrophic impact of money laundering and terrorist financing have influences many international communities to put great efforts to ensure that their organisation complies with the Financial Action Task Force (FATF) recommendations. FATF requires some measures to be taken by the international communities such as the AML legislation, setting up Financial Intelligence Unit (FIU). These communities focus on information disclosure and transparency in financial institutions and establish international co-operation and information sharing systems to combat, detect, investigate and prosecute suspicious money laundering and terrorist financing transactions (FATF, 2006) In realising the disastrous effect of money laundering and terrorist financing activities to the country's economy, the Malaysian government have made considerable progress in fighting money laundering and terrorism financing.

The introduction of the Anti Money Laundering Act 2001 and the establishment of the Financial Intelligence Unit of the Central Bank of Malaysia are two major steps aim at combating money laundering and terrorist financing. However, a decade after the passing of the Act, there seems to be a limited number empirical study in relation to money laundering and terrorism financing measures implemented by Malaysian commercial banks. This study hopes to fill this gap. This study explores a range of issues regarding compliance measures adopted, the gap between compliance measures perceived important and the actual level of implementation, relationship between level of risk and level of compliance measure adopted and identifying critical success factors to ensure successful compliance measures. The remainder of this paper is structured as follows. The next section provides a review of the relevant literature. Section 3 presents the research questions and followed by Section 4 that outlines the research design. The results are presented in section 5. A discussion of the results and their implications are provided in the last section.

2.0 Literature Review

The Malaysian anti money laundering Act 2001 defined money laundering as “the act of a person who:(a) engages, directly or indirectly, in a transaction that involves proceeds of any unlawful activity;(b) acquires, receives, possesses, disguises, transfers, converts, exchanges, carries, disposes, uses, removes from or brings into Malaysia proceeds of any unlawful activity; or (c) conceals, disguises or impedes the establishment of the true nature, origin, location, movement, disposition, title of, rights with respect to, or ownership of, proceeds of any unlawful activity”

Review of the literature discovered that money laundering is not a new phenomenon. The origins of money laundering can be traced back to as early as 1930s in organised criminal activities (Bosworth-Davies & Saltmarsh, 1994). However, after September 11, 2001, worldwide efforts to combat money laundering and the financing of terrorism have become prime importance¹. The FATF has established an international standard against money laundering and terrorist financing and produced recommendations that should be adopted. The FATF measures are viewed as the leading international anti-money laundering standards that provide an enhanced, comprehensive and consistent framework for combating money laundering and terrorist financing. This framework serves as an international benchmark for national governments to implement within their respective national jurisdictions, for the detection, prevention and suppression of money laundering and the financing of terrorism.

A group of studies have taken initiatives to examine the magnitude and scope of money laundering and terrorism financing problems (Schott, 2006; Biagioli, 2008; Zdanowicz, 2009; Walker & Unger, 2009) and investigated how the money is being laundered (Unger et al., 2006; Unger, 2007). Other studies focused on the role of technology in money laundering compliance (Reuda, 2001), money laundering techniques and typology (Ping He, 2010; Irwin, 2011) and money laundering focusing on Hawalla (Bala, 2005). Generally, the findings revealed that the banking sector is the most risky sector. Irwin et al. (2011) have examined the size of money laundering and terrorism financing problems, identifying threats and trends, the techniques employed and the amount of funds involved. The findings revealed that money launderers prefer to use techniques that maintain high levels of anonymity and appear innocuous. The sums of monies involved in money laundering and terrorism financing varies from AUD 68.5M for money laundering as compared to AUD 4.8M for terrorism financing cases.

A review of the literature shows that there is a dearth of studies that have empirically examined the issue of the compliance measures. Despite limited studies, some studies have examined the measures on combating money laundering and terrorism financing (He, 2007; Zhu & He, 2003). Ping He (2010) examined money-laundering techniques and he discovered that the ways money is laundered include cash smuggling, making use of banks or insurance company, or making use of shell-company or front-company. He also found that criminals often prefer to launder money through non-face to face transactions. Studies in relation to money laundering and terrorist financing in Malaysia tend to focus on the development of statutes, regulations and conceptual rather than the actual implementation of these measures (Bala & Thanasegaran 2008; Araujo, 2008). The empirical studies that have examined money laundering and terrorist financing often focused on factors that underpin the pervasiveness of money laundering (Vaithilingam & Nair, 2007).

¹ The International Bank for Reconstruction and Development and the International Monetary Fund (2003). Anti-Money Laundering and Combating the Financing of Terrorism

3.0 Research Questions

At present, there is much more pressure on countries to implement international standards on money laundering and terrorist financing measures to combat, detect, investigate, and prosecute suspicious transactions. Similar scenario occurs in Malaysia. The introduction of Anti Money Laundering Act 2001 is one of the major initiatives of Malaysian government to combat money laundering and terrorist financing. One of the most important contents of the FATF's guideline requires institutions to resume a set of obligations to prevent money laundering and terrorism financing. These obligations requires institution to implement measures such as:

- i. Appointment of a compliance officer
- ii. Allocate adequate amount of resources
- iii. Conduct client identification procedures
- iv. Conduct procedures to meet reporting requirements
- v. Conduct procedures to meet record keeping obligations
- vi. Conduct procedures for compliance review
- vii. Conduct procedures setting out how the risk assessment will be conducted
- viii. Conduct a periodic review to verify the effectiveness of the Compliance Program
- ix. Updating the Compliance Program, Monitor accounts for suspicious activity
- x. Provide training or guidance to employees
- xi. Share anti-money laundering information with federal law enforcement agencies and other financial institutions.

According to FATF on Money Laundering Report of February 1990, these recommendations constituted "a minimal standard in the fight against money laundering. However, a decade after the introduction of the Act, there is still a limited number of empirical studies that have been carried out to investigate the level of preventive measures implemented by Malaysian commercial banks. Hence, this study aims to investigate preventive measure that has been enforced in the commercial banks. These departments are at the forefront of efforts to combat money laundering and the financing of terrorism in Malaysia. In developing the list of preventive measures that should be adopted, this study relies on measures outlined by IMF, regional bodies like the Asian Pacific Group (APG), and Financial Action Task Force (FATF). Therefore, the following research questions are developed:

1. What is the extent of anti money laundering prevention measures adopted by the compliance departments in Malaysian commercial banks?
2. Are there any gap between perceived important and the level of adoption of the anti money laundering prevention measures?
3. Is there a relationship between the perceived level of money laundering and terrorist financing risk and level of anti money laundering prevention measures adopted by the Malaysian commercial banks?
4. What are the critical success factors in ensuring successful implementation of anti money laundering prevention program?

4.0 Research Methodology

4.1 Sample

The sample chosen in this study are the heads of compliance officers of all commercial banks in Malaysia. This sample is chosen due to the expectation that these officers would have adequate knowledge on the money laundering and terrorism financing and subsequently have knowledge on the prevention measures adopted in their organisations. Sixty questionnaires were distributed to the heads of compliance officers. Out of the 60 questionnaires, 39 questionnaires were completed and returned, representing a response rate of 65%.

4.2 Research Instrument

The questionnaire is divided into four sections. Section A comprises of questions related to respondent perceived important on the measures proposed by the international standard and to what extend the measures were implemented. For perceived important, respondents are requested to give their feedbacks on a five point scale ranging from "1" as being not important at all to "5" as extremely important. Whereas for the level of implementation, the respondents are requested to give their feedbacks on a five point scale from "1" as never practice to "5" as fully practice.

Section B requests respondent to assess the level of money laundering and terrorism financing risk faced by their organisation. The respondents are requested to rate the risk using 5 point scale ranging from “1” as no risk to “5” as extremely high risk. Section C requests respondents to provide their opinion on the factors considered important to ensure successful implementation of money laundering and terrorist financing measures. Section D requests the respondents to provide information on their demographic profile such age bracket, position, qualification and number of years in organisation.

5.0 Results and Discussion

Table 1 presents the descriptive statistics of the respondents in terms of age, number of years in organisation, position, and highest qualification. Panel A of Table 1 shows that out of the 39 respondents, 69.2 % is below 30 years old. This is followed by age group between 30 to 40 years which is represented by 23.1% of the total respondents. The remaining of 7.7% of the respondents is above 40 years old. Panel B exhibits the number of years that the respondents have been working in the organisation. A small number of the respondents have been working in the organisation for less than a year (2.6%), 43.5% for 1 to 3 years, 30.8% for 4 to 9 years and 23% have been working for more than 9 years. Panel C and D of Table 1 show that more than 90% of the respondents are from the lower to middle management and hold a university degree qualification.

Table 1: Demographic Profile

Item	Frequency	Percent
Panel A: Age		
Under 30	27	69.2
30 - 40	9	23.1
Above 40	3	7.7
Panel B: Number of years in organisation		
< 1 year	1	2.6
1 – 3 years	17	43.5
4 – 9 years	12	30.8
> 9 years	9	23
Panel C: Position		
Middle management	16	41
Lower management	17	43.6
Support staff	6	15.4
Panel D: Qualification		
University degree	36	92.3
Professional qualification	3	7.7

5.1 Extent of Anti Money Laundering Prevention

The first objective of the study is to examine the extent of anti money laundering prevention measures adopted by compliance departments in Malaysian commercial banks. Hence, the unit of analysis is department. The implementation of well designed money laundering prevention programme is central to any effective and comprehensive money laundering and terrorist financing regime (Quirk, 1997; Barrett, 1997; Paradise, 1998; Masciandaro & Portolano, 2003; Vaithilingam & Mahendhiran Nair, 2007).

To answer objective one, the respondents are requested to give their feedbacks on a five point scale from “1” as never practice to “5” as fully practice on the anti money laundering measures proposed by the international standard.. Table 2 exhibits the finding of the first objective of the study. Among the measures that are highly adopted are monitoring accounts for suspicious activity (mean score = 4.31, standard deviation = 1.127), conduct client identification procedures, inclusion of information requiring course of action to be taken when client refuses to provide information (mean score = 4.08, standard deviation = 1.306) and updating compliance program as necessary in line with the changes in laws or regulation (mean score = 4.00, standard deviation = 1.283).

The least measures implemented are provision of training or guidance to employees on identification of suspicious activity (mean score = 3.69, standard deviation = 1.173), conduct procedures for compliance review which include who should conduct, what should be focused and to whom the findings to be reported (mean score = 3.72, standard deviation = 1.376) and provision of training or guidance to employees on policies and procedures of anti money laundering (mean score = 3.74, standard deviation = 1.229).

Overall, the mean score for each measure ranges from the highest of 4.31 to the lowest of 3.69. This implies that the Malaysian commercial banks take their responsibilities in money laundering and terrorist financing compliance measures seriously.

Table 2: Anti money laundering prevention measures

Anti money laundering prevention measures	Rank	Mean	Std dev
Appointment of a compliance officer to manage and oversee the operation of the compliance program	5	3.90	1.273
Allocate adequate amount of resources, including staff and financial resources to manage the compliance program	6	3.87	1.260
Conduct client identification procedures, including the information required the course of action to be taken when client refuses to provide information	2	4.08	1.306
Conduct procedures to meet reporting requirements, including the designation of responsible employees, submission procedure and record retention	4	3.90	1.294
Conduct procedures to meet record keeping obligations, including the type of document, who has responsibility for the maintenance of files, confidentially, the type of information collected and the length of time each record is required to be kept.	4	3.92	1.156
Conduct procedures for compliance review, including who should conduct what should focused and to whom the findings will be reported	9	3.72	1.376
Conduct procedures on the setting out of how the risk assessments will be conducted, including what areas will be examined by whom, the methodology used in the assessments, and how the findings will be reported and implemented	5	3.89	1.085
Conduct periodic review to verify the effectiveness of the compliance program	6	3.87	1.234
Updating compliance program as necessary in line with the changes in laws or regulation	3	4.00	1.283
Monitoring accounts for suspicious activity	1	4.31	1.127
Provide training or guidance to employees on identification of suspicious activity	10	3.69	1.173
Provide training or guidance to employees on policies and procedures of anti money laundering	8	3.74	1.229
Share anti-money laundering information with federal law enforcement agencies and other financial institutions	7	3.85	1.204

5.2 Perceived important and Level of Adoption on Compliance Measures

The second objective of the study is to examine whether there is any gap between perceived important and the level of adoption of the anti money laundering prevention measures. A paired sample t-test was performed to determine whether there is any significant difference between the mean score of responses on perceived important and the level of adoption. Table 3 shows the results of the Paired Sample Test of compliance measures proposed by international standard in combating, detecting, investigating and prosecuting suspicious transactions. The mean score of these two variables were compared. The result shows that there is a significant difference between level of perceived important and the level of anti money laundering prevention program adopted. The results show that the average mean score for the money laundering and terrorist financing prevention program for the perceived level is significantly higher than the level of measure implemented.

This indicated that despite perceiving that the measures as important in combating, detecting, investigating and prosecuting suspicious money laundering and terrorist financing (mean score = 4.51, standard deviation = 0.59223, standard error = 0.09483), the actual level of implementation is significantly lower (mean score = 3.89, standard deviation = 1.12589, standard error = 0.18029) for all compliance measures proposed by international standard.

Table 3

<i>Overall Paired Sample Test</i>	Mean	Std. Deviation	Std. Error Mean	Sig
Perceived important	4.51	0.59223	0.09483	
Actual level of implementation	3.89	1.12589	0.18029	0.000

Further analysis for each measure indicates that for each measure, the perceived important is significantly higher than the actual level of measures implemented in their organisation. Table 4 provides the results of paired sample t-test for each measure proposed by the international standard. For each pair, the significant 2 tailed result shows p is lower than 0.05. Such result indicates that there is a significant difference between the perceived important and the actual level of measures implemented. It can be concluded that the respondents believed that the measures are important to combat money laundering and terrorist financing, but due to certain reasons the level of implementation is significantly lower.

Table 4: Paired Sample Test for each individual measures

	Paired Differences						t	Sig. (2-tailed)
	Mean	Std. Deviation	Std. Error Mean	95% Confidence Interval of the Difference				
				Lower	Upper			
Appointment of a compliance officer	0.769	1.087	0.174	0.417	1.122	4.418	0.000	
Allocate adequate amount of resources,	0.513	1.167	0.187	0.135	0.891	2.744	0.009	
Conduct client identification procedures	0.359	1.224	0.196	-0.038	0.756	1.831	0.075	
Conduct procedures to meet reporting requirements	0.615	1.091	0.175	0.262	0.969	3.523	0.001	
Conduct procedures to meet record keeping obligations	0.538	1.072	0.172	0.191	0.886	3.136	0.003	
Conduct procedures for compliance review	0.744	1.163	0.186	0.366	1.121	3.991	0.000	
Conduct procedures setting out how the risk assessments will be conducted	0.447	1.058	0.172	0.100	0.795	2.607	0.013	
Conduct a periodic review to verify the effectiveness of the compliance program	0.579	0.919	0.149	0.277	0.881	3.883	0.000	
Updating the compliance program as necessary	0.543	1.039	0.176	0.186	0.900	3.092	0.004	
Monitor accounts for suspicious activity	0.462	0.854	0.137	0.185	0.738	3.376	0.002	
Provide training on how to find identity suspicious activity	0.821	1.073	0.172	0.473	1.168	4.776	0.000	
Provide training on policies and procedures of anti money laundering	0.846	1.159	0.186	0.470	1.222	4.558	0.000	
Share anti-money laundering information other relevant institutions	0.615	1.042	0.167	0.278	0.953	3.689	0.001	

5.3 Perceived Level of Money Laundering and Terrorist Financing Risk and Level of Anti Money Laundering Prevention Measures

The third objective of the study is to examine whether there is a relationship between the perceived level of money laundering and terrorist financing risk and level of anti money laundering prevention measures adopted by the Malaysian commercial banks. Table 5 presents the result of the regression analysis. The finding shows that there is a significant positive relationship between perceived level of risk and level of anti money laundering prevention program adopted ($B=0.431$, $t = 2.908$ and $p = .006$). This provides an indication that there is a positive relationship between the level of money laundering and terrorist financing risk and the level of measures adopted by the organisations. Organisations that feel that their organization are exposed to a higher risk of money laundering and terrorist financing tend to adopt stronger measures of money laundering and terrorist financing prevention program.

Table 5: Regression analysis on the relationship between level of money laundering risk and the extend of measures implemented

	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	1.294	0.738		1.752	0.088
AML/CFT measures	0.531	0.183	0.431	2.908	0.006

5.4 Critical Success Factors to Implementation of Anti Money Laundering Program

The fourth objective of the study is to explore critical success factors in ensuring successful implementation of anti money laundering prevention program. Respondents were requested to provide their feedbacks based on a five point scale ranging from "1" as being not important at all to "5" as being extremely important. Table 6 exhibits the top five factors. Respondents believed that the most important factor to ensure successful implementation of anti money laundering program is top management support, followed by the availability of expert staff, IT infrastructure, budget allocation and existence of political influence. This finding is consistent to Berglund et al. (2008) that argued that the political players in transition countries have failed to draw a sufficiently firm line between their own private resources, their political party's resources and the state's resources. The authors further argued that politics can meet their personal interest under the so-called "legislative structure" by applying AML-related legislations as the instrument of dictatorship to economic areas. This in turn encourages commercial banks to seriously placed money laundering prevention program as their main agenda.

The findings of this section also provide an explanation to all four objectives of the study. The finding from objective one and two revealed that the Malaysian commercial banks take their responsibilities in money laundering and terrorist financing compliance measures seriously as the average mean score for each item is above 3. However, despite their beliefs that the measures are important to detect money laundering and terrorist financing, the level of implementation is significantly lower ($p < 0.05$). This is probably due to the fact that they perceived the level risk of money laundering in their organisation to be low which subsequently explains the finding from objective three. The finding shows that organisation tends to implement stronger measure of money laundering and terrorist financing prevention program when they feel that their organisation is at a higher risk to money laundering and terrorist financing activities. Based on the finding of objective four of the study, it can be implied that the reasons for low level of money laundering and terrorist financing measures adopted ia due to the lack of top management support, lack of expert staff, lack of technology infrastructure, inadequate allocation of resources, and lack of political support.

Table 6: Top five critical success factors for implementing compliance measures

Factors hinders	Ranking	Min	Max	Mean	Std. Deviation
Support from top level management	1	3	5	4.54	0.682
Expert staff	2	3	5	4.33	0.772
Technology infrastructure	3	3	5	3.97	0.843
Budget Allocation	4	3	5	3.95	0.857
Existence of political influence	5	1	5	3.49	1.233

6.0 Conclusion

It is generally agreed that a well designed money laundering preventing measures is pivotal to an effective money laundering and terrorist financing regime. The findings in this study revealed that the Malaysian commercial banks take their responsibilities in money laundering and terrorist financing compliance measures seriously. The mean score of each compliance measure is considerably high. Among the measures that is highly adopted by commercial banks in Malaysia are monitoring accounts for suspicious activity, conducting client identification procedures (that is the information required the course of action to be taken when the client refuses to provide information) and updating compliance program as necessary in line with the changes in laws or regulation.

The findings in this study also show that the Malaysian commercial banks placed least emphasised on measures such as conducting procedures for compliance review (that is who should conduct, what should be focused and to whom the findings need to be reported) and provide training (that is guidance to employees on policies and procedures of anti money laundering and on how to identify suspicious activity).

This study also discovered that there is a significant difference between the level of perceived important and the level of anti money laundering prevention measures adopted. This finding indicates that despite perceiving the measures as important to combat, detect, investigate and prosecute suspicious money laundering and terrorist financing, the actual level of implementation is significantly lower for all measures proposed by the international standard. The reasons for the low level of money laundering and terrorist financing measures adopted are due to lack of top management support, lack of expert staff, inadequate allocation of resources, lack of technology infrastructure and inadequate support from political influence. Hence, top management should shows support by allocating adequate level or resources in terms of appointing specific personnel as compliance officer, budget for training for all employees involved in prevention of money laundering and provide training and technical assistance necessary in building institutions capable of a sustained approach in the fight against money laundering. In addition, organisations must provide significant financial support for many of the anti-money laundering by investing adequate level of resources for IT infrastructure.

This study recommends that policies and program need to be developed that nurture in increasing the awareness of compliance measures. In addition, the Malaysian government should used political influence in making compliance measures as mandatory and this would ensure all relevant authorities to take their responsibility in money laundering compliance measures. Global cooperation is needed to address these threats. Hence, sharing of anti-money laundering information with federal law enforcement agencies and other financial institutions is important to ensure effective law enforcement.

In sum, it is well accepted that the money laundering and the financing of terrorism are problems of global concern. The scenario in Malaysia indicated that the action towards implementing compliance measures significantly related to level of risk and higher risk organisation tend to be more serious in implementing compliance measures. This finding provides an explanation on why commercial banks do not fully implement the preventive measures as the occurrences of money laundering and terrorist financing in Malaysia is currently perceived as not very serious.

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