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# Transaction Monitoring (TM) System as a Tool for Combating Money Laundering & Financial Terrorism in the United States Financial Industry: A Literature Review Perspective

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**Abstract.** This study examines the concept of transaction monitoring (TM) system and the necessity for it to be strictly and diligently embraced in the United States financial industry as an antidote for money laundering and financial terrorism. The methodology adopted in the study is based on the desktop research methodology by carrying out reviews of the selected existing literature on the issue of transaction monitoring. The reviews discovered that TM remains an effective tool towards combating money laundering, financial terrorism and other related crimes in the United States financial sector since criminals are not shackled by data privacy, international boundaries and transaction monitoring. It is therefore recommended that all the compliance professionals should play important roles in helping to reduce human suffering and combat these criminal activities. Firms must also collect and analyze large amounts of data about their customers in order to be able to spot potential money laundering and financial terrorism activities in the United States financial industry on a timely and accurate manner.

**Keywords:** Transaction Monitoring, Anti-money Laundering, Anti-Terrorism Financing, Counter Terrorism Financing, United States, Canada, Financial Intelligence Unit, compliance, Regulators

## Introduction

The accelerated trend in fraud risk, money laundering and financial terrorism resulting from cross-border transactions across the globe has triggered serious concerns amongst the academia, researchers and practitioners. Given this background, the United States Financial sector is not an exception to this global phenomenon. It therefore remains unraveled as to whether transaction monitoring (TM) can be adopted as an effective tool towards combating these criminal activities in the financial industry in the United States of America. In this study, we review the concept of transaction monitoring and the kind of objectives a TM system should meet, how to identify unusual and suspicious activity and the potential problems that may be encountered.

According to the existing studies, transaction monitoring refers to the monitoring of customer transactions or activities, including assessing historical and current customer information and interactions to provide a complete picture of customer activity in the financial industry. This can include transfers, deposits, withdrawals, loans and even at the stage of establishing a financial relationship with new clients at different levels through the onboarding process into the financial system environment. Most financial firms use software to automatically analyze these data. In practice, transaction monitoring involves scrutinizing customer accounts for a range of indicators, including: Unusual transaction frequency or volume; Transactions with high-risk countries; Transactions with sanctioned customers and countries; Transactions with politically exposed persons (PEPs); Adverse media stories involving customers. The topic of the present paper is thus methodology which can identify the very few suspicious/fraudulent transactions from the very many legitimate transactions.

**Literature Review**

Studies reveal that financial institutions in Canada and US face constant challenges when it comes to meeting their anti-money laundering (AML)/anti-terrorist financing (ATF) obligations. They must work with ever-changing domestic and international regulatory environments while coping with increased pressures to operate cost-effectively. Financial institutions also need to continually monitor the adequacy and effectiveness of their AML/ATF program. This study reviews some of the requirements set forth by the financial intelligence unit as well as how an effective transaction monitoring process combined with risk intelligence data can identify unusual transactions that warrant further investigation; provide input into and improve the effectiveness of an AML/ATF program; be used for risk scoring; assist with profiling customers and understanding their unique risks; and ease the burden of compliance and reporting to regulators (Simpson, 2018-2019).

Gerlings, Loanna & Constantiou (2022) posit that financial Industry holds a societal responsibility and regulatory requirements to mitigate the risk of financial crimes. Risk mitigation primarily happens through monitoring customer activity through Transaction Monitoring (TM). The true extent of money laundering transactions is unknown and uncertain, potentially because financial firms lack incentive and tools to estimate the extent of money laundering in their accounts Reuter and Truman, (2004). In an old report to US Congress (1995), it was estimated that about 0.05-0.1per cent of the transactions through the Society for Worldwide Interbank Financial Telecommunications system involved money laundering. A meta-analysis by United Nations Office on Drugs and Crime (2011) estimates that the total amount of money laundered through the financial system is equivalent to about 2.7 per cent of global gross domestic product, or US$1.6tn in 2009, while Walker (1999) estimates money laundering to account for US$2.85tn worldwide. As financial fraud to such an extent is a serious threat to societies and economies all over the world Schott (2006). It is therefore crucial to detect as many fraudulent transactions as possible.

Banks and other financial institutions are traditionally measured as pillars of economic prosperity. The best banking system will be able to ensure good production in all sectors of the economy. Money laundering is the process of providing legitimate appearance to the illegally gained revenue. Money Laundering has the tradition of eroding financial institutions and weakening the financial sector's role in economic growth. It has the habit of facilitating corruption, crime and other illegal activities at the expense of countries development and can increase the risk of macroeconomic instability. Banks and other financial institutions are at the forefront of the battle against the money launderers. The negative economic effects of money laundering on economic development are difficult to quantify. International society expects every bank to perform customer identification and due diligence as it is the important control measure in preventing criminals from entering the legitimate economy. The cost involved in combating money laundering and terrorist financing transactions are increasing largely on yearly basis however unable to eradicate them (Sundarakani & Ramasamy, 2013).

This article presents research into very specific matters and issues of creating and further improvement of Anti-Money Laundering and Combating the Financing of Terrorism system (abbreviated as AML/CFT) in the USA. It contains a precise analysis of key elements of this system, as well as a deep look into the nature and purposes of financial intelligence “FinCEN”. Strong emphasis is laid on The US Foreign Account Tax Compliance Act (FATCA) because, according to this Act, any foreign financial institution is legitimately forced to sign a special agreement with The US Internal Revenue Service (IRS), giving the Service power to maintain control over any American asset within its equity. The latter is understood as a legal right to investigate not only the accounts and property of American taxpayers, but to investigate any account or capital of any foreign institution having American shares or stocks (Larin & Popova, 2016).

Recent developments in cloud-based systems, Big Data and machine learning are transforming the anti-financial crime technology landscape. These technologies are making it easier to develop improved solutions for detecting, managing and investigating financial crime. As a result, the anti-money laundering (AML) software market is expected to grow by over US$1bn in the next four years, as traditional vendors compete with new players to exploit these new technologies. This environment is leading to exciting innovation in anti-financial crime technology with both software vendors and financial institutions challenging each other to develop the next leading AML solutions. It discusses how new technologies can and will help to make AML solutions more effective and that will have a positive impact on financial industry (Bostel & Ashley, 2021).

## Methodology

The study adopted desktop research methodology by carrying out the reviews of few selected existing literatures on the issue of transaction monitoring and other related criminal activities in the United States and Canada.

## Findings

Most financial firms use software to automatically analyze their data. In practice, transaction monitoring involves scrutinizing customer accounts for a range of indicators, including: Unusual transaction frequency or volume; Transactions with high-risk countries; Transactions with sanctioned customers and countries; Transactions with politically exposed persons (PEPs); Adverse media stories involving customers.

The transaction monitoring process plays a vital role in combating money-laundering and terrorism financing. The Dutch trust service providing companies are dealing with the execution of the transactions on daily basis and are required to implement proper, defined and uniform policies procedures in order to be able to timely detect the possible unusual and/or suspicious transactions and report them to the national Financial Intelligence Unit.

## Recommendations & Conclusion

The effective transaction monitoring policies should contain systematic controls, processing of data, analyzing and matching such data with possible risk factors, certain measures for detecting and preventing the transaction being executed. The financial Industry should integrate such transaction monitoring policies in their daily business and consider such compliance policies as integral part of the business (Liepa, 2017).

Using best practices for transaction monitoring can be time- and resource-intensive and can often result in false positives or, worse, false negatives if implemented incorrectly. Adding to the challenge is the fact that firms must maintain transaction monitoring standards on an ongoing basis, managing changing levels of customer risk, emerging criminal threats and the introduction of new AML/CFT legislation.

This study therefore concludes that criminals are not shackled by data privacy and international boundaries, transaction monitoring and all compliance professionals play an important role in helping to reduce human suffering and combat these criminal activities.

Transaction monitoring is a requirement for AML/CFT programs around the world and a vital tool in the fight against money laundering and terrorism financing. Using transaction monitoring best practices allows banks, financial institutions and other obligated entities to detect, report and ultimately prevent criminals from using their services to launder money.

Transaction monitoring can be a challenging compliance obligation: firms must collect and analyze large amounts of data about their customers in order to be able to spot potential money laundering activities in a timely and accurate manner.

At the risk of costly compliance penalties and to ensure their AML/CFT response is ready for a variety of criminal methodologies, it is important that firms are familiar with a range of transaction monitoring best practices'.

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