

Navigating Anti-Money Laundering: Integration of Knowledge Management and Ethical Culture in Banking Operations

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Abstract: As illicit financial activities become increasingly sophisticated, understanding, and addressing the multifaceted challenges posed by money laundering cases have become paramount to preserving the integrity and stability of economies on a global scale. In the realm of financial crime prevention, the effectiveness of anti-money laundering (AML) measures hinges on the judgement and proficiency of bank officers as the first line defence of money laundering threat. This study investigates the interplay between knowledge sharing management, ethical culture and the judgment levels of bank officers when assessing money laundering cases. The data collected through 5-point Likert scale vignette-style questionnaire survey from 110 banking offices of various banking institutions in Malaysia. Moreover, we extend our inquiry to examine the moderating effect of ethical culture on this relationship. Our findings reveal that a strong ethical value amplifies the influence of knowledge sharing management on judgment levels, emphasizing the pivotal role of ethical considerations in bolstering the effectiveness of AML initiatives. We established a positive and significant relationship between knowledge sharing management practices and the judgment levels exhibited by bank officers. This highlights the need for banking institutions to not only prioritize knowledge sharing management but also foster a culture of ethical conduct among their officials. This research contributes to the growing body of knowledge on effective AML practices within the financial sector, providing empirical evidence of the direct impact of knowledge sharing management and ethical culture on AML assessment. Practically, our results underscore the imperative for financial institutions to integrate knowledge sharing management initiatives with a commitment to ethical conduct. By recognizing the synergistic interplay between knowledge sharing management, ethical culture, and judgment levels, financial institutions can fortify their defenses against the perpetration of money laundering activities. Limited to the context of practices in Malaysia, this study founded a paramount basis for future study to explore on different factors or perhaps at different nations as extensions to this research.

Keywords: Knowledge Sharing Management, Judgment Level, Anti-Money Laundering, Bank Officers, Ethical Culture.

1. Introduction

In the constantly changing realm of global finance, the effectiveness of measures against money laundering (AML) serves as a crucial element in protecting the integrity of financial institutions and maintaining the stability of economies worldwide. The importance of robust AML practices cannot be overstated, especially in emerging economies like Malaysia, which have witnessed a rapid expansion of financial services and an increased vulnerability to financial crimes (Tan, 2020). With the escalating sophistication of money laundering schemes and the continuous evolution of regulatory frameworks, bank officers are confronted with a formidable task: the accurate assessment and judgment of potential money laundering activities. Money laundering risk is the risk that threatens the financial institutions to be the intermediate entity for the criminals to launder their illicit money. As for banking institutions and money service businesses, they will face the risk of money

laundering through their financial services for the money launderer to placing or layering their illegal funds. Financial institutions may be fined or imprisoned by the authorities if they do not implement AML properly, in addition to the risk of security breaches. According to Deloitte (2014), the risk of money laundering to an organization involves negative publicity, damage to corporate reputation and loss of goodwill, and legal and regulatory sanctions, an adverse effect on the bottom line. These are all possible consequences of an organization's failure to manage the risk of money laundering. Despite the crucial role played by bank officers in detecting and preventing money laundering, empirical evidence suggests that they face significant challenges in effectively navigating the intricate landscape of AML compliance (Ismail & Abdullah, 2018). The flourishing volume of transactions, coupled with the intricate web of global financial networks, has elevated the complexity of discerning suspicious activities from legitimate transactions. Furthermore, the dynamic nature of AML regulations demands a comprehensive understanding of not only procedural compliance but also a nuanced grasp of the underlying principles and evolving tactics employed by money launderers (Abdul Wahab et al., 2019). This multifaceted demand places bank officers at the forefront of the battle against financial crime, necessitating a nuanced exploration of the factors that influence their judgement capabilities. The amount of money laundered globally is estimated to be around 2 to 5 per cent of global GDP or between US\$800 billion and US\$2 trillion per annum (Deloitte, 2020). Malaysia's illicit financial outflow amounted to a whopping US\$30.7 billion in 2018 (Global Financial Integrity, 2021). According to Basel Anti Money Laundering (AML) Index, from 2015 to 2020, there was an increasing trend of money laundering risk in Malaysia from 2015 to 2017, while there was a slightly decreasing trend from 2018 to 2020 (Basel Institute on Governance, 2015, 2016, 2017, 2018, 2019, 2020). Yet, the decreasing trend is not necessarily a good indicator since Malaysia is still at a medium-high risk in money laundering cases. Worst case, the Basel AML Index in 2020 mentioned that Malaysia is considered a major money-laundering destination apart from China, Hong Kong, Indonesia, Laos, Macao, Myanmar, Philippines, Thailand, and Vietnam. Anti-money laundering studies are still scarce in the context of Malaysian individual practitioners at financial institutions. As most previous studies emphasise an organisation-based role in determining money laundering risk, this study aims to contribute a new paradigm of knowledge in the research. The objective of the research is to identify the factors that directly and indirectly influence the level of judgement of banking officers in deciding on money laundering risk threat in banking institutions in Malaysia.

Literature Review

The battle against money laundering presents a multifaceted challenge for banking institutions. Rapid globalization, intricate financial networks, and the proliferation of digital transactions have intensified the complexity of detecting illicit activities (Leong, 2018, Singh et al, 2022). As money launderers employ increasingly sophisticated tactics, the task of identifying suspicious transactions becomes more arduous. Managerial judgement is the linchpin of successful AML efforts. Bank officers, armed with specialized knowledge and expertise, are on the front lines of evaluating transactions for potential money laundering indicators. Their ability to discern anomalies and exercise sound judgement is critical in preventing illicit funds from entering the financial system (Cai, Zhang, & Lee, 2019). However, a survey of bank officers in the South Asian region evidenced the challenges of the bank officers in the AML compliance since 80% of them are still manually processing the data (Deloitte, 2020). The rate represents issues in technical competency, and the number is quite unpleasant. More findings from that survey have also shown that of all the important measures to manage AML compliance, communication is the lowest point to be practiced by the officers in the region. Linking to the knowledge sharing matters, where communication is the main platform for sharing knowledge, it reflects that bank officers have issues in their individual (personal) factors. Many practitioners have technical competency issues and fail to communicate and seek help. It is more disappointing that some of the industry players are rigorous with their self-development and reluctant to share knowledge.

Knowledge Sharing Management at Banking Institutions

Knowledge is a resource for creating value [...], and it allows for high marginal rates of productivity. This is due to knowledge's main feature: it appreciates in value over time as it is used and shared, rather than deteriorating in value like tangible goods or natural resources depreciate (Bornemann and Sammer, 2003, p. 21). Knowledge management (KM) encompasses the systematic acquisition, organization, and application of knowledge within an organization (Alavi & Leidner, 2001). In the context of banking, KM involves the processes and strategies employed to identify, capture, and disseminate critical information and expertise to enhance decision-making and operational efficiency. Within financial institutions, KM plays a pivotal role in leveraging intellectual capital to gain a competitive edge (Durst & Edvardsson, 2012). Effective KM practices empower banks to harness their collective knowledge resources, fostering innovation, improving customer service, and bolstering risk management.

The critical process of knowledge management in enhancing a company's competitiveness is knowledge sharing (Susanty et al., 2016; Sangkala, 2007; Susanty & Wood, 2011). Knowledge sharing has a significant impact on the development of a learning company culture, as well as knowledge and creativity (Susanty et al., 2016; Setiarso et al., 2009; Casimir, 2012). There is still few research on the relationship between knowledge sharing and judgment, particularly in the areas of money laundering risk judgments, where there are significant disparities. The knowledge of bank officers is a crucial measure in the component of ensuring excellent AML compliance. Alzeban (2015) found a link between knowledge and auditing standards compliance, concluding that audit committee members with accounting and auditing knowledge are more likely to promote internal audit compliance with the International Standards for the Professional Practice of Internal Auditing (ISPPA). This indicates that the auditor's performance is influenced by their knowledge.

Ethical Culture at Banking Institutions

Ethical conduct is fundamental to the integrity of banking operations. It shapes the decision-making process, influencing how managers evaluate and respond to potentially dubious transactions (Klapper & Panos, 2013). Banks that prioritize ethical behaviour foster a culture of compliance, instilling confidence in stakeholders and regulatory bodies. Additionally, those officers have a different ethical environment that could contribute to a different level of judgment and decision-making. The ethical environment is believed to improve compliance officers' ability to comply with the AML regulations. The stricter the ethical environment surrounded by the compliance officers, the more careful they are to judge money laundering risk. Findings from BNM supervision detected weaknesses in the board oversight functions among financial institutions' practices in Malaysia (BNM, 2017). This finding reflected the lack of emphasizing ethical conduct among compliance officers to other staff and subordinates. A firm's culture of ethics and compliance with the law must be built and promoted at all levels of the corporation and compliance structures, policies, and procedures (U.S Department of Justice, 2020). The criminal division of the U.S. Department of Justice highlighted that establishing a compliance culture from the middle to the top requires a high-level commitment from corporate leadership.

Judgement Level in AML Compliance

Individual variables identify the characteristics of the decision-maker that can influence task execution, such as expertise, experience, capacity, information processing abilities, use of decision aids, and prior beliefs based on previous experiences (Loibl et al., 2020; Mala & Chand, 2015; Nelson & Tan, 2005). Since these individual variables are associated with cognitive limitations, the decision-maker is vulnerable to judgmental bias (Nelson and Tan, 2005). Individual variables are the 'anchor' determinants of judgment and decision-making, as they are personal characteristics that shape an individual's behaviour while performing assigned roles (Fathil & Schmidtke, 2010; Herranz et al., 2018). Individual variables are examined in this study because banking officers must constantly rely on their personal qualities in exercising sound judgment.

Conceptual Framework and Hypotheses Development

Based on the previous discussion, Figure 1 depicts the conceptual framework to illustrate the model of the study. The model integrates the knowledge management, ethical culture, and level of judgement in the context of anti-money laundering compliance (MohdSanusi et al, 2021; Jamil et al, 2023). In the field of AML compliance it is crucial for bank officers to use their judgment and make decisions regarding money laundering risks. Previous studies (Jamshed & Majeed 2019; Dong et al., 2017; Bock et al., 2005; Tippins, 2003) consistently highlight the connection, between sharing knowledge and individual performance in problem solving. Building on these findings this research expands its focus to money laundering. It suggests that a greater willingness among bank officers to share their knowledge about AML compliance with the Board of Directors Senior Management and Front Officers will lead to a level of confidence in their decision making abilities (Ross & Hanan 2007; Bock et al., 2005; Dong et al., 2017). The expectations set by BNM for Bank Officers to share their knowledge as outlined in the AMLA (BNM, 2019) are believed to contribute to officer's ability to perform their duties. However there has been exploration of the relationship between knowledge sharing and judgment in the context of money laundering risk. Given these gaps, in research this study presents the following hypotheses;

H1: Knowledge sharing management (KSM) affects level of judgment (JL)

Not only compliance officers need to have a high integrity (BNM, 2019, p. 26), the whole organizations must have a good ethical environment in their daily operations – from the front desk officers to the board of directors, all must obey to the standards and regulations of the AMLA. The Bank have described the roles and responsibilities in the financial institutions to fulfil the AML Compliance programs required (BNM, 2019, p.21). Complying to the roles and responsibilities will enhance the ethical environment in the organizations.

Previous studies have found the evidence on the significance of ethics to the auditor judgment (Cohen, 2013; Craft, 2013; Fatemi et al., 2014; Pflugrath et al., 2007), yet very few have focus on the impact of ethical environment towards money laundering risk judgment among compliance officers at banking institutions and MSBs in Malaysia. Thus, based on the above arguments, the following hypothesis is proposed:

H2: Ethical culture (EC) positively influences level of judgment (JL)

The final hypothesis focusing on the moderating effects of ethical culture on relationship between knowledge sharing management and level of judgment. Idris et al. (2019) which analyzed the moderating effects of knowledge towards ethical judgment had a positive relationship, while Hollingworth and Valentine (2014) found significant impact of moderating variable of organizational ethical context to judgment. In contrast, Douglas et al. (2001) found no relationship between measures of ethical climate, code of ethics and ethical culture towards ethical judgments. The divergence of findings has led some scholars to acknowledge a lack of consensus over which components of ethical reasoning are (most) influenced by organizational ethics (see Craft 2013; O'Fallon & Butterfield 2012). More broadly, a lack of consensus in research raises significant questions regarding the influence of organizational ethical context/climate on ethical reasoning. As such, based on the above arguments, the following hypotheses to prove the moderation effect of ethical environment on the relationship between knowledge sharing and money laundering risk judgment are proposed as follows:

H3: The effect of knowledge sharing management (KSM) on level of judgment differs significantly between strong ethical culture vs weak ethical culture

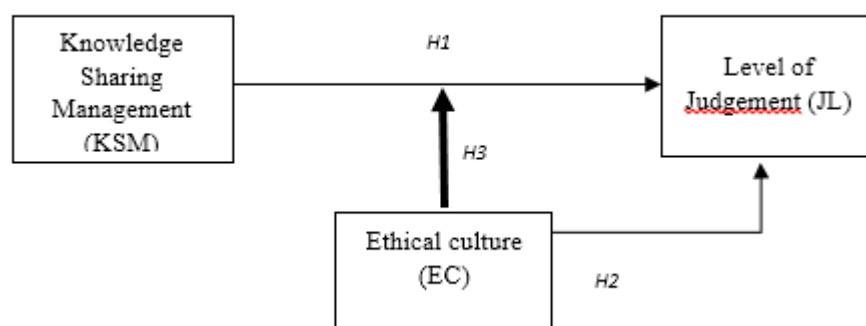


Figure 1: Conceptual framework

2. Methodology

Research Design and Instrument

This study employed quantitative analysis using SmartPLS software. The study examine the cognitive factors influencing money laundering risk judgment performance via survey. The study targeted banking officers in Malaysia. The PLS-Sem approach was utilized to analyze the study. By using vignette-style survey questions, the bank officers must perform their judgment in assessing money laundering risk. The dependent variable (level of judgment) is denoted by statements that require respondents to respond using the seven-point Likert scale provided through vignette questions. The independent variables (knowledge sharing, ethical culture) are denoted by statements that require respondents to respond using the seven-point Likert scale provided. All data collected in this study was analysed using a 7-point rating scale in order to increase the variability in the measures as well as to maximise the reliability and validity of the constructs (Krosnick& Presser, 2015). This survey approach is inspired from previous studies on judgment performance (Jamil et al, 2023; Mohd-Sanusi et al, 2022; Mat Isa et al, 2021; Johari et al., 2019). The exploratory nature of the study, which is primarily meant for causal- predictive analysis, is well-suited to the PLS-SEM qualities (Urbach and Ahlemann, 2010). PLS-SEM is widely utilised in social science research and is increasing popularity, particularly in the fields of marketing and information systems (Coelho & Henseler, 2012; Djajadikerta et al., 2015). This is backed by the fact that many constructs in social science are latent, meaning they cannot be directly observed or measured, especially in a complex model with several constructs and interacting effects. According to Hair et al. (2013), the PLS-SEM application was used in 204 research published in 30 top-ranked marketing journals over a 30-year span (1981-2010). The objectives of the study is to investigate the significance of the relationship between the independent factors and the causal impact on money laundering risk judgment. As a result, PLS-SEM is

recommended. The population for this study is bank officers in Malaysian banking institutions. The bank officers are the front-line defense in charge of monitoring the transactions to detect any suspicious criteria among their customers and transactions. Banking institutions are chosen for this study since they are among the top vulnerable financial institutions that faced the threat of money laundering risk (BNM, 2017; 2021).

3. Results and Discussions

Data analysis

This study was examined by using the SmartPLS V.3.3.3 (Ringle et al, 2015). The analysis and estimation of the measurement and structural model were conducted via PLS-SEM adoption (Hair et al, 2017). The analysis of the full model included direct effect of KMS towards JL and moderating effect between EV and KMS towards JL.

Analysis on Measurement model

This study conducted data analysis through path modelling of partial-least squares (PLS) using SmartPLS software as mentioned by Ringle et al (2005). The analysis began with the assessment of measurement models (Hair et al, 2017). An essential benefit of the Partial Least Squares (PLS) approach, in contrast to covariance-based structural equation modelling, lies in its capacity to handle scenarios where information about the distribution of latent variables is limited, necessitating adherence to criteria concerning the proximity of estimates to the data. In our research model, all constructs are defined with reflective indicators. The findings indicate the reliability and validity of all reflectively measured constructs (refer to Table 1). All Cronbach alpha showed high reliability which surpass the threshold of 0.8, and the Average Variance Extracted (AVE) exceeds the critical value of 0.5. The composite reliability (CR), all surpass the 0.7 benchmark (Sarstedt et al., 2017).

Tables 1 comprehensively present the measurement validity and reliability. Following the criteria proposed by Hair et al. (2020), the measurement is considered valid when the AVE exceeds 0.5, and reliability is affirmed when the CR surpasses 0.7 (Sarstedt et al., 2017). As depicted in Table 1, the AVE and CR values for all measurements consistently exceeded 0.5 and 0.7, respectively, across all variables. These results signify the validity and reliability of the applied measurements.

Construct	Items	Scale	Cronbach's Alpha	CR	AVE	VIF
Knowledge Sharing Management	KSM1	Reflective	0.720	0.840	0.640	1.190
	KSM2					1.813
Ethical culture	EV1	Reflective	0.820	0.860	0.600	1.470
	EV2					1.780
Judgment Level	JL	SIM	1.000	1.000	1.000	1.000

Table 1: Convergent validity for measurement model

Analysis on Structural model

Consistent with the structural model evaluation protocol delineated in Hair et al. (2017a), our initial step involved scrutinizing the variance inflation factor (VIF) values for all predictor constructs in the model to assess potential collinearity issues. Given that all VIF values remain below the more conservative threshold of 3.3 (Diamantopoulos and Siguaw, 2006), we infer that collinearity is not reaching critical levels (refer to Table 1). The structural model was evaluated using the bootstrapping Smart PLS procedure with 110 samples. Primary assessments of the PLS structural model included R², the goodness-of-fit (GoF) index, and the Stone–Geiser Q² test for predictive relevance (Hair et al., 2014; Sarstedt et al., 2014). Chin (2010) considered R² values of 0.25 as acceptable. Despite the model fit being relatively modest by absolute standards (Hair et al., 2017, Chapter 6), it is deemed suitable for this study due to its low complexity. Additionally, the standard root mean squared residual (SRMR) met the minimum requirement (SRMR < 0.08), indicating satisfactory model fit (i.e., 0.079), in line with Hu and Bentler's (1999) criterion, providing evidence for a good model fit and confirming the theory-data alignment. The parameter estimation results from the bootstrapping procedure on SmartPLS are presented in Table 2, indicating support for two out of three hypotheses. Knowledge sharing management (KSM) significantly and favourably influences judgement level (JL) ($b = 0.195$, $p < 0.05$), aligning with hypothesis H1. On the other hand, ethical culture (EC) was not significantly affected the judgement level (JL) ($b = -0.020$, p

>0.10) and concludes H2 as not being supported. This surprising results might be the main reasons that lead to the H3. The results shown positive outcome when the moderating role of ethical culture significantly influence the relationship between knowledge sharing management and level of judgments. Specifically, it reveals that strong ethical culture have a greater impact on the relationship between knowledge sharing and judgment levels as compared to weak ethical culture at the banking institutions.

Hypothesis		β	SD	p -values	Sig	
H1	KSM \rightarrow JL	0.195	0.097	0.020	$p < 0.05$	Supported
H2	EC \rightarrow JL	-0.020	0.099	0.420	$p > 0.10$	Unsupported
H3	KMS \times EC \rightarrow JL	0.143	0.070	0.022	$p < 0.05$	Supported

Table 2: Bootstrapping procedure for structural model

4. Conclusion

Summary of Research

Examining the impact of knowledge sharing management and ethical culture on level of judgement in money laundering perspective, surveys were conducted among 110 banking offices in Malaysia. The results indicate that banking officers tend to make high level judgement when they have higher knowledge sharing in their bank. Conversely, they apply low level judgments when they are lacking in sharing knowledge. However, how ethical is their culture does not directly influence the bank officers' level of judgment. Nonetheless, the ethical culture of the bank significantly influence the judgment level of banking officers on money laundering risk when the they are having a greater knowledge sharing practice. The study contributes to the literature on knowledge sharing management at financial institutions, highlighting the mixed results from empirical research on the effectiveness of knowledge s. The study also addresses significant gaps reported by the Bank Negara Malaysia (BNM) between compliance and risk management functions at Malaysian financial institutions (FIs). It emphasizes the average marginal quality of Suspicious Transaction Reports (STR), reflecting the quality of ML risk judgment. While the findings suggest that regulatory enforcement influences ML judgment, the study does not support the notion that enforcement alone can elevate COs' judgment quality from poor to good. The study advocates for comprehensive measures beyond fines and punishment to achieve excellent judgment quality and reporting of suspicious transactions. Recommendations include increasing competency and training, educating cOs, providing industry support and incentives, embracing digitalization, enhancing public awareness, and standardizing policies. The study proposes a new enforcement concept that goes beyond penalties, punishments, and fines. In conclusion, the study recommends researchers delve into ML control literature to develop effective theories, mechanisms, and formulas to enhance industry compliance in combating ML. Recognizing the limitations of the study, future research is encouraged to explore comparative analyses between different financial sectors, incorporate additional variables such as technical competency and ethical issues, and employ a broader sample size for more comprehensive results in understanding COs' sound judgments and decision-making related to ML risk.

Limitations and Future Research

Hence, the research was limited to the evaluation of money laundering risks without incorporating other important parts in the context of money laundering practices such as the risk-based approach, law enforcement, customer due diligence, or AML Fintech solutions. Other contributing factors towards making a correct judgment of money laundering risks also needs to be examined. Additionally, the study only investigated a small section of the institutions where perhaps other research could extend to population sectors other than banking institutions. Moreover, the perspective of AML officers was lacking since their target population was banking officers. Therefore, such input from the AML officers must be included in any subsequent research. As for methodology, more research should be carried out concerning money launderer's judgmental decision using a case study technique with qualitative approach. It would certainly help expand the amount of knowledge within this area of research.

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