

Legal regime for AML (Anti Money Laundering) in India

Dr. K.P. Krishnan,

Joint Secretary, Department of Economic Affairs,

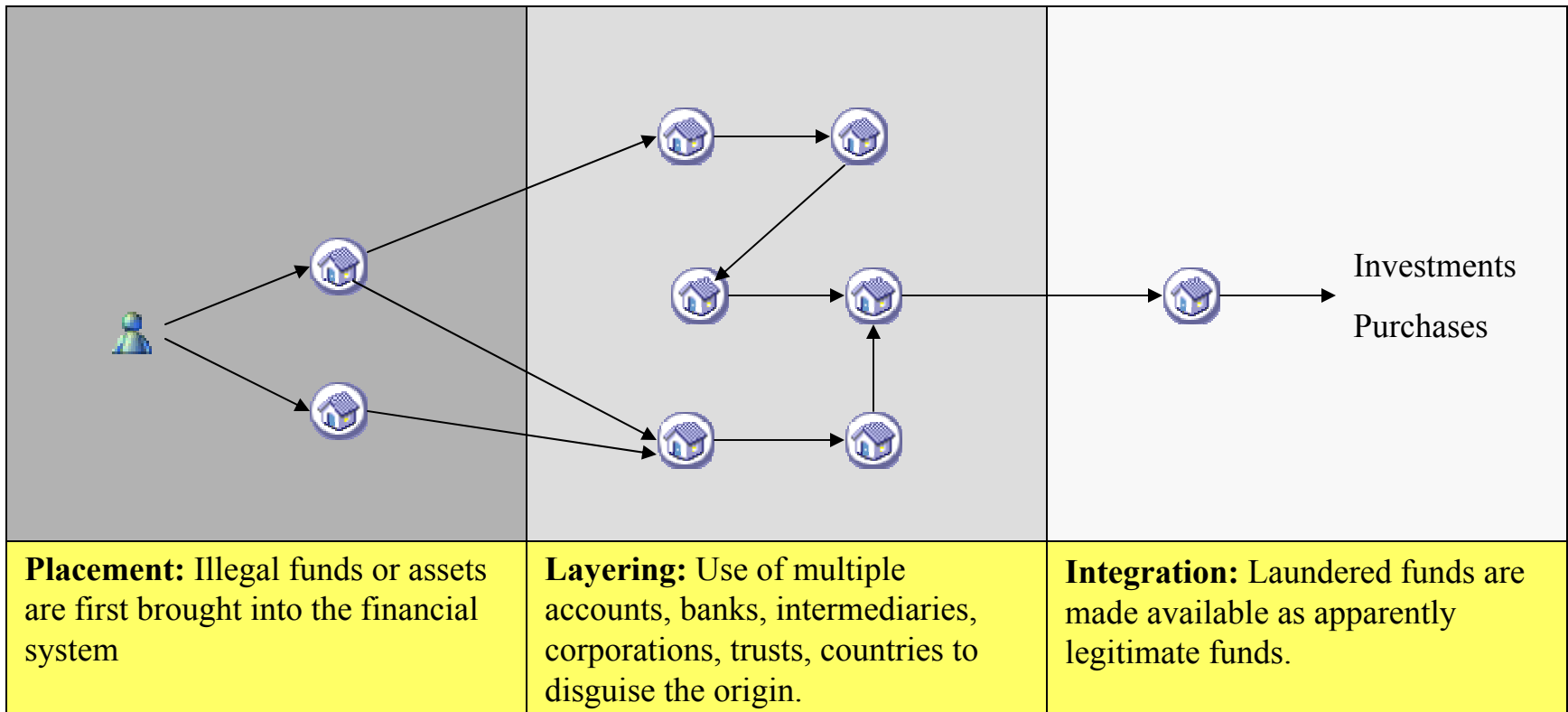
Ministry of Finance, Govt. of India



What is Money Laundering ?



Money Laundering is the process by which illegal funds and assets are converted into legitimate funds and assets.



***Important:** All money laundering transactions need not go through this three-stage process.*





- Anti Money Laundering Legislation in India
- Implications of AML/CFT Measures on the Financial Sector
- International Scenario
- Key Issues





- The Prevention of Money Laundering Act, 2002 (PMLA) enacted to prevent money laundering and provide for confiscation of property derived from, or involved in, money laundering
 - Enacted on 17th Jan, 2003
 - Brought into force from 1st July, 2005
- Administered by:
 - Financial Intelligence Unit for verification of identity of clients, maintenance of records and reporting
 - Enforcement Directorate for investigation of and prosecution for money-laundering offences





- Various Rules came into effect from July 2005
 - Rules detailing Powers of Director FIU & ED
 - Rules detailing the method of attachment of property, period of retention etc.
 - Rules detailing the receipt & management of confiscated assets
 - Rules relating to legal obligations of reporting entities





- Rules detailing the legal obligations of reporting entities:
 - Prevention of Money Laundering (Maintenance of Records of the Nature and Value of Transactions, the Procedure and Manner of Maintaining and Time for Furnishing Information and Verification and Maintenance of Records of the Identity of the Clients of the Banking Companies, Financial Institutions and Intermediaries) Rules, 2005





PMLA and the Rules impose obligations on

- banking companies
- financial institutions
- intermediaries of the securities market

to

- maintain records
- furnish information
- verify identity of clients





“Banking Company” under PMLA includes:

- All nationalized banks, private Indian banks and private foreign banks
- All co-operative banks viz. primary co-operative banks, state co-operative banks and central (district level) co-operative banks
- State Bank of India and its associates and subsidiaries
- Regional Rural Banks





“Financial Institution” under PMLA includes:

- Financial Institutions as defined in Section 45-I of the RBI Act namely EXIM Bank, NABARD, NHB, SIDBI, IFCI Ltd., IDFC Ltd., IIBI Ltd. and TFCI Ltd.
- Insurance companies
- Hire Purchase companies
- Chit fund companies as defined in the Chit Funds Act.





- Co-operative banks.
- Housing finance institutions as defined in the National Housing Bank Act such as HDFC.
- Non-banking financial companies as defined in section 45-I of the RBI Act such as private finance companies - motor and general finance companies, leasing companies, investment companies etc.





“Intermediary” under PMLA includes persons registered under Section 12 of the Securities and Exchange Board of India (SEBI) Act, 1992:

- Stock brokers
- Sub-brokers
- Share transfer agents
- Bankers to an issue
- Trustees to trust deed
- Registrars to issue
- Merchant bankers
- Underwriters
- Portfolio Managers
- Investment advisers
- Depositories
- Custodian of securities
- Foreign institutional investors
- Credit rating agencies
- Venture capital funds
- Collective investment schemes including mutual funds





- Appointment of Principal Officer:
 - Every reporting entity shall communicate the name, designation and address of the Principal Officer to the Director, FIU-IND

- Furnishing of information by the Principal Officer:
 - furnish the information referred to in the Rules to the authorities
 - retain copy of such information for the purposes of official record





Reporting of Cash Transactions:

- “All cash transactions of the value of more than rupees ten lakhs or its equivalent in foreign currency
- All series of cash transactions integrally connected to each other which have been valued below rupees ten lakhs or its equivalent in foreign currency where such series of transactions have taken place within a month”
- CTR should be filed by the 15th day of the succeeding month

Rule 3





- Reporting of Suspicious Transactions:
 - All suspicious transactions whether or not made in cash
 - STR should be filed with FIU within **seven** working days of establishment of suspicion at the level of Principal Officer.



Reporting obligations



- Suspicious transaction means a transaction whether or not made in cash which, to a person acting in good faith –
 - gives rise to a reasonable ground of suspicion that it may involve the proceeds of crime; or
 - appears to be made in circumstances of unusual or unjustified complexity; or
 - appears to have no economic rationale or bonafide purpose;

Rule 2(g)





- Records containing information for reporting purposes:
 - Nature of transaction
 - Amount & currency of transaction
 - Date of transaction
 - Parties to transaction
 - Manner as prescribed by the regulators (RBI/SEBI/IRDA)

- Maintain & retain reported records for 10 years from cessation of transaction between client & reporting entities (Rule 6)









- Verify identity of clients:
 - Identity of clients
 - Current and permanent address
 - Nature of business
 - Financial status

- Maintain records of the identity of clients for a period of 10 years from the date of cessation of the transactions with the client. (Rule 10)



Know Your Customer (KYC) Guidelines



	Customer Acceptance - Ensure that only legitimate and bona fide customers are accepted.
	Customer Identification - Ensure that customers are properly identified to understand the risks they may pose.
	Transactions Monitoring - Monitor customers accounts and transactions to prevent or detect illegal activities.
	Risk Management - Implement processes to effectively manage the risks posed by customers trying to misuse facilities.

Guidelines issued by RBI, SEBI & IRDA



Implications of AML/CFT measures on Financial Sector





Customer Acceptance -.

- Ensure acceptance of only legitimate and bona fide customers
 - Issue of mechanism to verify ID
 - Issue of Multiple IDs
 - Issue of list of suspects/criminals/unwanted elements
 - Awareness and training of staff

Customer Identification-

- Ensure that the customers are properly identified to understand the risks they may pose.
 - Background check of new customer
 - Background check of existing clients
 - Issue of List of suspects/criminals/unwanted elements
 - Awareness and training of staff





Transactions Monitoring-

- Monitor customers accounts and transactions to prevent or detect illegal activities.
 - Issue of Mechanism to verify financial details
 - Transactions inconsistent with customers profile (business)
 - Unexplained transfers between multiple accounts with no rationale
 - Sudden activity in dormant accounts

Risk Management-

- Implement processes to effectively manage the risks posed by customers trying to misuse facilities.
 - Categorization of customers: high/medium/low risk : a dynamic concept
 - Constant interaction between front desk and the compliance team required
 - Awareness and training of staff





- Set up processes and technology to **identify** and report suspicious transactions
 - Capture customer details
 - Generate alerts
 - Collect and analyse additional information
 - Decide whether transactions are suspicious
 - Ensuring reporting of quality data electronically
- Alignment of people, process and technology
- Confidentiality and Privacy





As on 31 December 2006

Financial Entity	Number of CTRs		
	Electronic	Manual	Total
Banks	12,31,945	55,103	12,96,274



Analysis and Dissemination



As on 31 December 2006

STR Received	440
Processed	305
Disseminated	220

Category	Number of STRs
Banks	269
Financial Insti.	15
Intermediaries	157

Dissemination	
Law Enforcement Agencies	173
Intelligence Agencies	53
Regulators	27



Categories of STRs received



As on 31 December 2006

Activity in the account	33%
Nature of the transactions	26%
Value of the transactions	20%
Identity of client	14%
Multiple Accounts	29%
Background of client	6%
Miscellaneous	5%



“Reasons for Suspicion” for banking companies



■ **Activity in accounts**

- Unusual activity compared with past transactions
- Sudden activity in dormant accounts
- Activity inconsistent with what would be expected from declared business

■ **Identity of client**

- False identification documents
- Identification documents which could not be verified within reasonable time
- Accounts opened with names very close to other established business entities

■ **Background of client**

- Suspicious background or links with known criminals

■ **Multiple accounts**

- Large number of accounts having a common account holder, introducer or authorized signatory with no rationale
- Unexplained transfers between multiple accounts with no rationale



“Reasons for Suspicion” for banking companies



■ **Nature of transactions**

- Unusual or unjustified complexity
- No economic rationale or bona fide purpose
- Frequent purchases of drafts or other negotiable instruments with cash
- Nature of transactions inconsistent with what would be expected from declared business

■ **Value of transactions**

- Value just under the reporting threshold amount in an apparent attempt to avoid reporting
- Value inconsistent with the client's apparent financial standing



Examples of Suspicious Transactions



- False Identification Documents
 - Welcome pack returned
 - No person found/address found to be false

- Identity Matching- Match with watch-lists
 - Name and DOB of account holder matched with INTERPOL most wanted list

- Transactions inconsistent with customers' profile (business)
 - Number of transactions in a period
 - Value of transaction (s) (Retired employee)
 - Turnover in Account



Examples of Suspicious Transactions



- Multiple cash deposits at various cities all over India
 - Nigerian student

- Outward remittance of cash deposits
 - 7 related entities deposited cash in their accounts
 - Claimed it to be sale proceeds of mobile phones
 - Entire amount remitted outwards for claimed import

- Non Financial Indicators
 - Usage of Lockers



Other Reporting Entities



■ Housing Finance Companies

- ❑ Foreclosure of home loan accounts by substantial cash payments (Rs 20 Lakhs)

■ Insurance Companies

- ❑ Purchase of 6 insurance policies by family members, each policy premium just below reporting threshold in cash (Rs. 9.95 lakhs)
- ❑ Doubtful source of large premium

■ Mutual Funds

- ❑ Multiple investments below Rs. 50,000 by same individual without PAN
- ❑ Multiple Folios

■ Depositories / Depository Participants

- ❑ Multiple Accounts
- ❑ Off Market Transactions



International scenario





- **Mid 1980s** - Growing concern of international community to deprive criminal elements of the proceeds of their crimes.
- **1989 – Financial Action Taskforce (FATF)** set up to ensure global action to combat money laundering.
 - Forty Recommendations - Complete set of counter-measures against money laundering
 - Nine Special Recommendations on Terrorist Financing
 - 33 members
- **1995 - Egmont Group** set up to stimulate international cooperation amongst FIUs. Best Practices for exchange of information.
 - 101 Members
- **1997- Asia/Pacific Group on money laundering (APG)** set up to create awareness and encourage adoption of AML measures.





40 Recommendations + 9 Special Recommendations on TF

- Legal System and Related Institutional Measures
 - R 1,2,3,26,27,28,30,32
 - SR II,III
- Preventive Measures – Financial Institutions
 - R 4,5,6,7,8,9,10,11,13,14,15,17,18,19,21,22,23,25,29,32
 - SR VI, IX
- Preventive Measures – Non Financial Businesses and Profession
 - R 12,16,20,24
- Legal Person and arrangements & Non-profit Organizations
 - R 33
 - SR VIII
- National and International Cooperation
 - R 31,32,35,36,27,38,39,40
 - SR V





- Extension of KYC, CDD & AML/CFT measures to other sectors, as mentioned under 40+9 standards, in case of India, such as:
 - ❑ Non-Designated Financial Businesses & Professions (NDFBPs) (R 12) : Casinos, Real estate agents, Dealers in precious metals and precious stones, Lawyers, notaries, other independent legal professionals and accountants, Trust and company service providers
 - ❑ Exchange Houses and money remitters (R 23)
 - ❑ Alternative remittances, Wire transfers, Non-Profit Organizations, Cash Couriers (SR VI to IX)



Salient Features of FATF Recommendations



- Criminalize ML to include all serious offences(R1)
- Follow standards set in Vienna & Palermo UN conventions for offence of ML(R2)
- Confiscate/attach laundered assets(R3)
- Secrecy laws should not prohibit sharing of information by financial institutions **(FI)**-(R4)
- Give special attention to business relation with countries, which do not or insufficiently apply FATF standards(R21)
- FIs should be subject to regulatory & supervisory measures through licensing, registrations etc. for AML purposes(R23)
- DNFBPs also be subject to similar regulations & supervision(R24)



Salient Features of FATF Recommendations



- FIs to follow CDD:- no anonymous accounts, verify identity of client & beneficial owner, CDD for politically exposed persons (PEP)(R5,6)
- CDD & Record keeping requirements for NDFBPs(R12)
- CDD for cross border correspondent banking(R7)
- Do not approve operations with Shell Banks(R18)
- FIs should develop AML/CFT Programme(R15):
 - Develop internal AML/CFT policies
 - Set screening standards while hiring employees
 - Train employees
 - Independent audit to test check the system
- Pay special attention to non face to face customers(R8)
- Apply similar standards to branches/offices abroad(R22)



Salient Features of FATF Recommendations



- Set up FIU, empower law enforcement agencies and competent authorities for AML/CFT(R26 to 32)
- Filing of STRs(R13)
- Provide legal immunities to financial institutions & their representatives for disclosures(R14)
- Maintain all necessary records(R10)
- Dissuasive civil/administrative/criminal sanctions for failing to comply with AML/CFT requirements(R17)
- International cooperation, mutual legal assistance, extradition & information exchange(R35 to 40)





- Special Nine Recommendations on Terrorist Financing (TF)
 - ❑ Ratify & implement UN instruments-SR I
 - ❑ Criminalize TF as ML offence-SR II
 - ❑ Freeze & confiscate terrorist assets-SR III
 - ❑ Report STRs on TF- SR IV
 - ❑ International cooperation on CFT- SR V
 - ❑ KYC/CDD & AML/CFT measure for- SR VI to IX:
 - Services involved in transmission of money/value
 - Wire transfers
 - Non-Profit organizations
 - Cash couriers



Key Issues





- To what extent should India be compliant with these 40+9 FATF recommendations?
 - No country fully compliant
 - These are ideal financial standards best suited for developed countries where formalization of economy is at an advanced stage
 - Non-membership likely to have consequences
- How best can these standards be adopted in India
- Issue of inclusion in formal economy
- Issue of intrusive regulations and supervision
- Issue of SROs



Questions & Comments

kpk1959@gmail.com

