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EFFECTIVENESS OF INTERNATIONAL ANTI-MONEY LAUNDERING LAWS IN THE BANKING SECTOR: A CRITICAL ANALYSIS

AUTHORED BY - AYUSH SOLANKI

INTRODUCTION

The international battle against money laundering and terrorism financing has emerged as the paramount concern worldwide. This illicit conduct jeopardises the stability of financial institutions and systems, amplifies the fluctuation of international capital flows and hinders corporations from making direct investments in other nations.¹ The primary objectives encompass safeguarding the stability and strength of the global financial system, severing the funding channels of terrorists and preventing criminals from generating illicit profits.² Perpetrators frequently exploit the financial system as a means for hiding illicit funds and finance acts of terrorism. Financial institutions are particularly susceptible to this. Consequently, it is imperative for financial institutions to have robust controls and procedures to prevent such forms of misconduct. Conducting comprehensive due diligence on both new and existing customers is a crucial aspect of these safety measures. This ensures that institutions are able to identify and comprehend their customers.

OVERVIEW

There are two types of money: illicit money and legitimate money³. Legal work generates 'legitimate income', often referred to as 'lawful income' whereas illegal work generates 'illicit income' also recognized as 'unlawful income'. Commissioned by RBI in 1998, the **Narasimham Committee on Banking Sector Reforms emphasised the need of tackling money laundering issues** inside the Indian financial system⁴. According to **Section 3 of PMLA**, it is unlawful to directly or indirectly aid, participate in, or attempt to participate in any process or activity related

¹ Lee, Jang-Yung. The ramifications of a sudden increase in capital inflows: existing instruments and the effects on the implementation of monetary policy, IMF (1996).

² Steven A. Meyerowitz, *Anti-Money Laundering*, 134 BANKING L.J. 67 (2017).

³ Mikhail Reider-Gordan, Joanna Ritcey-Donohue & Truman Butler, *International Anti-Money-Laundering*, 46 INT'L LAW. 375 (2012).

⁴ Edukemy, Examining the provisions of the Prevention of Money Laundering Act (PMLA), 2002 – UPSC, <https://edukemy.com/blog/introspecting-prevention-of-money-laundering-act-pmla-2002-upsc/#:~:text=Narasimham%20Committee%20Recommendations%3A%20The%20Narasimham,financial%20system%2C%20prompting%20legislative%20action> (Last visited 7th May).

to the profits obtained from criminal activities⁵. This includes concealing, possessing, acquiring, utilizing, or presenting them as legitimate assets. Engaging in any of these activities will result in being charged with the crime of money laundering. Money laundering, as defined by the **FATF**, refers to the act of concealing the illicit source of criminal proceeds with the intention of legitimizing the profits obtained via illegal activities. Money laundering is a financial crime. In essence, it refers to the act of discretely transferring unlawfully acquired funds or investments to an intermediary in order to conceal their original origin⁶.

An updated assessment indicates that approximately \$1 trillion is illicitly laundered annually on a global scale⁷. Typically, the process involves three steps: **placement, layering and integration**. During the initial phase, illicit monies are surreptitiously introduced into the legitimate financial system. Subsequently, the funds are redistributed to enhance intricacy. This is accomplished by transferring or transmitting the funds through many accounts. Ultimately, it is integrated into the financial system through additional transactions until the illicit funds appear legitimate⁸.

These illicit cash can be utilized by criminals to finance a diverse array of unlawful activities. In addition, money laundering fosters deceitfulness, distorts economic choices, exacerbates social issues and jeopardises the credibility of financial institutions. Financial institutions are increasingly recognising the need of monitoring suspicious transactions and assessing the effectiveness of anti-money laundering measures in identifying illegal activity.

To curb money laundering, banks internationally must follow strict rules set by regulators. This includes strong Customer Due Diligence (CDD) means, such as carefully checking out customers and keeping an eye on them all the time to lower the risk of money laundering⁹. Also, banks have to report any transactions or activities that seem fishy to the right officials right away and they have to keep detailed records of these reports. With a focus on a risk-based approach, banks must evaluate and deal with risks that are specific to their business, customers, goods and locations¹⁰. Not following the rules can lead to harsh penalties, damage to your image, and even legal action,

⁵ Prevention of Money Laundering Act, 2002, § 3 (India).

⁶ Financial Action Task Force (FATF), The FATF Recommendations 2021.

⁷ Ady, Money Laundering Stats and Data, DIRO, <https://diro.io/money-laundering-stats-and-data/> (Last accessed 7th May).

⁸ Naina Devi, The Critical Analysis of Menace of Money Laundering to the Indian Economy, ResearchGate, https://www.researchgate.net/publication/349718646_THE_CRITICAL_ANALYSIS_OF_MENACE_OF_MONEY_LAUNDERING_TO_THE_INDIAN_ECONOMY (Last accessed 7th May).

⁹ UNODC, Global Program against Money Laundering, <https://www.unodc.org/pdf/gtml.pdf> (Last accessed 7th May).

¹⁰ Truman Butler , Gerardo Calderon-Villegas, Emily Christiansen & Kayla McGee, *International Anti-Money Laundering*, 48 ABA/SIL YIR (n.s.) 409 .

which emphasizes how important it is to follow the rules.

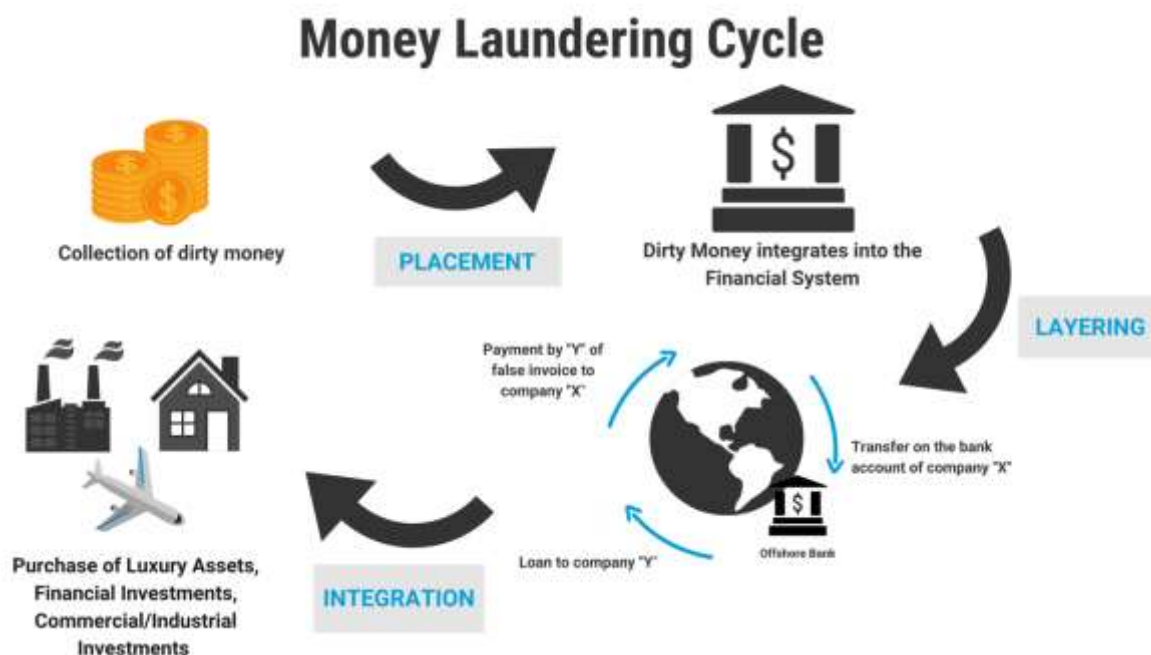
WHY IS MONEY LAUNDERED?

Individuals engage in money laundering for many purposes. Here are a few examples:

- **Wealth concealment:** Criminals have the ability to obscure unlawfully acquired funds in order to prevent government seizure.
- **Avoiding prosecution:** criminals can avoid being caught by refraining from handling illicit funds.
- **Tax evasion:** Criminals can evade the payment of taxes on their illicitly earned income.
- **Profit maximization:** Criminals can enhance their gains by reinvesting the stolen funds into other enterprises.¹¹
- **Legalization:** Criminals have the ability to utilize their concealed funds to establish a business that appears to be lawful.

MONEY LAUNDERING PROCESS

Multiple factors contribute to the process of transferring funds. The method consists of three primary stages. These processes can occur simultaneously within a single interaction, or they can manifest distinctly and sequentially.



¹¹ Antoinette Verhage, *Between the hammer and the anvil? The anti-money laundering-complex and its interactions with the compliance industry*, 52 CRIME L. & SOC. CHANGE 9, (2009).

PLACEMENT:

The individual engaged in money laundering channels illicitly obtained funds into the formal financial systems. In order to accomplish this, a substantial sum of money may be divided into smaller denominations, which would be less conspicuous, and then placed directly into a bank account¹². Alternatively, other financial instruments such as checks and bank drafts can be purchased and subsequently gathered and deposited into one or more accounts located in a different location.

CONSTRUCTING:

The second step in the process of money laundering involves the act of injecting additional funds. Typically, the Money Launderer engages in extensive financial transactions and transfers within the banking system, utilizing multiple accounts to obscure the origin of the money and prevent its return to its illicit source.¹³ The individual engaged in money laundering employs several methods to transfer funds, including the utilization of multiple bank accounts located in different global jurisdictions, particularly those that are uncooperative in investigations related to money laundering.

INTEGRATION:

After successfully completing the initial two steps of money laundering, the money launderer proceeds to the third stage, where the illicit funds are merged with legitimately obtained money and enter the legitimate economy¹⁴. The individual engaged in money laundering may thereafter opt to invest the funds in assets such as real estate, enterprises, luxury products, etc., in order to derive personal enjoyment from the money while mitigating concerns about law enforcement intervention.

EFFECTIVENESS OF INTERNATIONAL ANTI-MONEY LAUNDERING LAWS IN THE BANKING SECTOR

The FATF plays a crucial role in assisting countries worldwide in establishing robust financial intelligence units (FIUs). FIU facilitates the exchange of information between financial institutions and law enforcement agencies.¹⁵ They serve as the initial barrier to prevent money

¹² Derek Fincham, *Art, Antiquities, and Money Laundering*, 111 KY. L.J. 309 (2022).

¹³ *Id.*

¹⁴ *Id.* at 12

¹⁵ Emeka C. Adibe, Ndubuisi Nwafor & Chibuike Amaucheazi, *Information Technology, Terrorism Financing and Financial Institution's Role in Combating Terrorism*, 2 IRLJ 29 (2020).

laundering and the financing of terrorists. Financial institutions play a responsible role in combating unlawful financial activity by adhering to government laws and regulations that are supervised by each country's FIU.

In 2004, the **Unlawful Activities Prevention Act** (UAPA) of India was amended to criminalise the act of providing financial support to terrorists¹⁶. The implementation of PMLA, in conjunction with this, resulted in banks assuming greater accountability for the initiation and upkeep of customer accounts. Banks are required to adhere to the **Anti-Money Laundering** (AML) and **Combating Financing of Terrorism** (CFT) policies set by RBI¹⁷. These actions align with the recommendations made by the FATF and the Basel Committee on Banking Supervision¹⁸.

India was placed 75th out of 162 countries in terms of money laundering risk, according to the Basel's AML Index 2014. The country's risk score is 5.64, with 0 indicating little risk and 10 indicating extreme risk¹⁹. Nevertheless, RBI has observed that banks frequently fail to adhere to regulations regarding the establishment and maintenance of client profiles, classification of consumers based on risk, monitoring of accounts and deactivating alarms in accounts. Banks are exposed to operational risk as a result of this.

Over the past few years, RBI has imposed fines on multiple banks for violating Know Your Customer (KYC) regulations. This further substantiates the fact that Indian banks are struggling to adhere to anti-money laundering regulations. The government's efforts highlight the ongoing challenges and emphasise the significance of Indian banks enhancing their AML/CFT measures to adhere to global standards and effectively mitigate the risks associated with money laundering and terrorist financing.

CRITICAL ANALYSIS

Money laundering not only has detrimental effects on a country's financial stability, but it also undermines its dignity and independence. India's rapid economic growth and favourable position have posed challenges in combating money laundering and other financial crimes. In recent case

¹⁶ The Unlawful Activities Prevention Act, 1967, <https://www.mha.gov.in/sites/default/files/A1967-37.pdf> (Last accessed 7th May).

¹⁷ Master Circular – Know Your Customer norms / Anti-Money Laundering Standards/ Combating of Financing of Terrorism /Obligation of banks under PMLA, 2002, RBI.

¹⁸ Effective oversight of hazards associated with money laundering and the financing of terrorism, Basel Committee on Banking Supervision, <https://www.fsa.go.jp/inter/bis/20140121-1/02.pdf> (Last accessed 7th May).

¹⁹ **Basel AML Index 2014**, <https://baselgovernance.org/publications/basel-aml-index-2014>.

of **Manish Sisodia v. Union of India**²⁰, the issue is of Section 45 of the PMLA²¹, the case involves a fundamental concern in the Indian judicial system: the challenge of striking a balance between safeguarding individuals from financial offenses and upholding the principle of presumption of innocence. The requirement for the court to establish a “prima facie” case against the accused individual before granting them bail highlights the intricate and delicate nature of AML related legal procedures. One interesting thing about the case of Manish Sisodia is that the Court refused to give bail even though most of the charges brought by the Central Bureau of Investigation (CBI) and the Directorate of Enforcement (ED) were contested at the preliminary stage. This raises questions regarding the evidential robustness and the impartiality of the court’s decision making in such circumstances.

In another case, **Mallya’s extravagant way of living and unsuccessful ventures, such as the now-defunct Kingfisher Airlines, exemplify how influential individuals can exploit the financial system to amass personal wealth.** The ED investigated Vijay Mallya’s financial transactions in accordance with the PMLA. These investigations reveal the extent of his alleged illicit operations, including the utilisation of fictitious entities and offshore investments to conceal his actions²².

The subsequent extradition processes for Mallya exemplify the arduous nature of cross-border law enforcement in combating money laundering. The UK court’s ruling to extradite him represents progress in ensuring his accountability. However, Mallya’s assertion that his actions were motivated by political and economic factors highlights the challenges in prosecuting high-profile individuals for financial crimes.²³

Similarly, the case of Manish Sisodia shows how widespread money laundering is in business operations. The charges against him are being looked at very carefully, and the fact that he was not granted bail makes people worry about the strength of the evidence and fairness of the process in court cases involving fighting money laundering.

These instances demonstrate the Indian government’s commitment to utilising legislation such as

²⁰ Manish Sisodia v. Union of India, AIR 2023 INSC 956.

²¹ Prevention of Money Laundering Act, 2002, § 45 (India).

²² Patricia Fernandez Lorenzo, *Art as a Method of Money Laundering: The Malaya Case*, 26 J. ART CRIME 29 (2021).

²³ Nitin Joy, *The India-UK Extradition Treaty and How Can India Improve Its Extradition Success Rate*, 3 INDIAN J. INTEGRATED RSCH. L. 1 (2023).

the PMLA to prevent individuals from engaging in money laundering. However, these regulations lack effectiveness due to their difficulty in enforcement, allowing individuals such as Mallya to circumvent them. Furthermore, the ineffectiveness of measures such as demonetization in curbing illicit funds highlights the necessity for more targeted and comprehensive approaches to address the root causes of financial misconduct.

In general, high-profile instances such as those involving Mallya and Sisodia act as cautionary examples, while also highlighting the immense difficulty and complexity of combating money laundering in India. In order to obtain accurate solutions, it is imperative that we persist in enhancing the efficacy of regulations, simplifying their enforcement, and fostering transparency and accountability across all sectors of the economy.

Moreover, the regulatory climate in the United States is markedly distinct. The jurisdiction has stringent regulations and multiple mechanisms in place to ensure compliance. The standards governing anti-money laundering (AML) are explicitly outlined in legislation such as the **USA PATRIOT Act, 2001**²⁴ and the **Bank Secrecy Act**²⁵. These regulations are supported by a firmly developed framework of governmental supervision and implementation. **The Financial Crimes Enforcement Network (FinCEN) and the Office of Foreign Assets Control (OFAC) are two regulatory entities dedicated to detecting and preventing financial crimes.**²⁶ Their proactive approach enhances the effectiveness of these legislation.

Despite their differences, both India and the USA face challenges in combating money laundering and terrorism financing. These challenges encompass the necessity for enhanced international collaboration, the evolving nature of financial crime techniques, and the imperative to strike a harmonious equilibrium between concerns for security and the preservation of individuals rights and freedoms. In order to address these issues, it is imperative for government agencies, regulatory authorities, financial institutions and legal professionals to collaborate in a synchronized and comprehensive manner.

²⁴ Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT ACT) Act of 2001.

²⁵ Bank Secrecy Act (BSA), 31 USC 5311.

²⁶ Money Laundering Prevention, Financial Crimes Enforcement Network, U.S. Department of the Treasury, https://www.fincen.gov/sites/default/files/shared/prevention_guide.pdf (Last accessed 8th May).

CONCLUSION

India demonstrates a strong commitment to combatting money laundering and other associated financial crimes through its robust anti-money laundering (AML) regulatory system. The Prevention of Money Laundering Act, in conjunction with other relevant legislation, greatly facilitates the identification, tracing, and confiscation of illicit assets. Law enforcement authorities primarily implement AML standards through the utilization of state of the art technologies and international collaboration. The implementation of due diligence standards for customers and reporting requirements collectively contribute to enhancing the transparency and integrity of the financial system. India's proactive approach to curbing the financing of terrorists enhances its anti-money laundering endeavours. India actively collaborates with other nations in combating global money laundering by engaging in mutual legal assistance and cooperation. India remains vigilant and adaptable in its AML endeavours, committed to rendering financial systems less attractive to criminals amidst the evolving landscape of the financial world.

