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DUAL ROLE OF BANKS IN MONEY LAUNDERING

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Abstract

Money laundering is a global phenomenon adversely affecting the economic, social and political stability of all countries. The definition of money laundering is not the same in all countries. It is used to describe the modes of transfer of money from illegal sources to legal source so that its original source cannot be traced.In India, money laundering is popularly known as "Hawala transactions".This mechanism facilitates the conversion of money from black into white. Money laundering forms a heavy burden to both developed and developing countries. Banks as an intermediary in finance dealing are one of the important pillars in money laundering. It is estimated in a study that nearly 48% of money laundering is done through the financial sector. Banks accept the money from the legal economy in the form of deposits, and at the same time accepts money illegally on the assumption that the money has not been reported as suspicious transactions and transfers the money to other banks including local and international banks thus legitimizing the illegal money.The advanced banking technologies especially electronic banking services has helped in spreading the crime of laundering. Since most of the crime is made through banks they are burdened with the duty to fight against money laundering. This article discuss about the positive and negative role of banks in money laundering.

KEY WORDS: Banks, Money Laundering, Illegal,Global Crime

INTRODUCTION

Money laundering and anti-money laundering (AML), continues to be a hot topic, especially within businesses, large corporations and government agencies. The term "money laundering" is said to have originated from the mafia ownership of Laundromats in the United States[1]. Money-laundering is the method by which criminals disguise the illegal origins of their wealth and protect their asset bases, so as to avoid the suspicion of law enforcement agencies and prevent leaving a trail of incriminating evidence[2]. It is a ubiquitous practice happening in almost every country in the world, and it involves transferring money through several countries in order to obscure its origins. Money laundering is the act of making money that comes from illegal source look like it comes from legal source. The

[1] . http://www.quadrisk.com/how-money-is-laundered-in-india
[2] . https://www.unodc.org/unodc/en/money-laundering/

objective of money laundering is to make it difficult to identify the original party to the transaction, known as the launderer, even though at the ends of the transaction the funds ultimately return back to the launderer. Unless the money is laundered it is not possible for the criminals to use the money, because they cannot explain where it came from. When the scheme of laundering turns successful they can spend the tainted money as legal money. Mostly drug traffickers, embezzlers, corrupt politicians and public officials, terrorists have the need to launder money. . The estimated amount of money laundered globally in one year is 2 - 5% of global GDP, or $800 billion - $2 trillion in current US dollars[3]. India has been ranked 68th with a score of 5.28 in the Anti-Money Laundering (AML) Basel Index 2018.[4]

STAGES OF MONEY LAUNDERING

Money laundering is a crucial step in the success of drug trafficking, terrorist activities and white collar crime. There are countless ways to launder money. The basic money laundering process has three stages:

1. **Placement stage:** this is the initial stage where the illicit money enters into the financial system. This is often in the form of cash deposits in banks. It relieves the money from the hands of the criminal and places it in the legitimate financial system. This is the riskiest stage of the laundering process due to the fact that placing (depositing) bulk of cash into the banks may raise suspicions and banks are required to report high-value transactions. '***Smurfing'***, also known as structuring, is one of the popular method used to launder cash in the placement stage.By this method large amount of money is broken into number of small deposits and deposited in the banks through multiple transactions. Some other common methods of placement are: gambling, currency exchanges, currency smuggling, loan repayment, insurance policies and blending funds.

2. **Layering stage**: the layering stage is the complex stage which involves the international movement of funds. The primary purpose of this stage is to separate the illicit money from its source. This is done by sending money through various financial transactions to change its form and make it difficult to follow. consist of several bank-to-bank transfers; wire transfers between different accounts in different names in different countries; making deposits and withdrawals to continually vary the amount of money in the accounts; changing the money's currency; and purchasing high-value items to change the form of the money.

3. **Integration stage**: This is the final stage of money laundering. At this stage, the money re-enters the mainstream economy in legitimate-looking form. The major

3. ibid
4. https://index.baselgovernance.org/

objective at this stage is to return the money to the launderer in a manner that does not draw attention and appears to result from what seems to be a legitimate source. Now the criminal proceeds are fully integrated into the financial system and can be used for any purpose by the criminal without being caught. It's very difficult to catch a launderer during the integration stage if there is no documentation during the previous stages.

BANKS AS A TOOL TO LAUNDER MONEY

Banks are vulnerable to money laundering by means of the very nature of their services (handling of public money) offered by them in the financial sector. Though criminals may be able to successfully launder money without the assistance of the financial sector, in reality annually hundreds of billions of dollars of criminal money is laundered through financial institutions only. In recent years, there have been a number of high-profile Western bank scandals over money laundering. Most notably, HSBC admitted to violating the Bank Secrecy Act by failing to monitor over $200 trillion in wire transactions between its Mexico and U.S. subsidiaries, among other crimes. $881 million in drug money from the Sinaloa and Norte de Valle drug cartels were found to have been moved through HSBC-Mexico’s accounts to HSBC-USA via the unmonitored wire transactions. In 2012, the British bank Standard Chartered was accused, by New York's Department of Financial Services (DFS), of helping the Iranian government to circumvent US money laundering regulations to the tune of an estimated £191.8 billion over 10 years.[5]

In India, the practice of money laundering is rampant across the country. The series of investigative reports of ***Cobrapost*** (an investigative website), codenamed Operation Red Spider I, II, and III have clearly revealed how the country’s large and small private banks and the nation’s most trusted public sector banks are engaging in money laundering practices[6].In Dec 2016 the income tax officials raided the Axis Bank and unearthed a massive of Rs.100 crores deposited in 44 fake accounts which raised questions against the integrity of banks. Recently, Punjab National Bank, India`s second-biggest state-run lender, stunned the country`s financial sector this month when it announced it had discovered an alleged fraud worth Rs 11, 400 crore ($1.8 billion) at a single branch in Mumbai. The CBI in its charge sheet alleged that the former MD and CEO of the Punjab National Bank and some other senior bank officials were aware of the fraudulent dealings but kept misleading the RBI.[7] This incident also led the RBI to issue a ban on banks from issuing LOU and Letters of Comfort for trade purposes.

[5] . https://www.int-comp.com/ict-views/posts/2016/07/22/top-5-money-laundering-cases-of-the-last-30-years/
[6] . https://www.cobrapost.com/blog/
[7]. https://www.ndtv.com/india-news/pnb-scam

In Nov 2016, the Government demonetized 500 and 1000 Rupees note to crack down black money. But in 2017 August RBI in its annual report stated that 99 percent or around 15.28 trillion rupees ($238.7 billion), of demonetized cash was deposited in legitimate bank accounts[8], raising questions if the exercise enabled criminals to launder money into the banking system. The ED carried out a "risk assessment" after the demonetization and found that 43 per cent of financial crimes were carried carried out by perpetrating bank frauds and cheating financial institutions through a maze of shell firms. The Agency also reported that it is investigating, over 3,700 cases of money laundering and hawala transactions, involving tainted assets worth Rs 9,935 crore, as part of its action against black money post demonetization[9].

Some of the transactions used to launder money through banks and financial institutions are given here:

- Structuring or Smurfing is the act of breaking of large amounts of money into multiple small transactions, often spread out over many different accounts.
- Utilizing counter cheques or banker's drafts drawn on different institutions and clearing them via third-party's accounts. For example, LOC and third party cheques. These are negotiable in many countries so difficult to detect.
- Depositing bogus salaries, commissions or other cash bonuses into bank accounts and withdrawing them afterwards through various intermediaries.
- Depositing a huge amount in a bank account under the pretence of winning a fictitious lottery with a condition that a portion of the money to be transferred to another account.
- Credit cards can be used to launder money. Large sums of money are deposited in the balance of the card and then cash can be withdrawn wherever in the world.
- Transaction laundering or Payment aggregation has become a recent trend in laundering. This occurs when a merchant processes unknown transactions on behalf of another business. This is a streamlined form of money laundering used to surreptitiously process credit card payments.

BANKS ROLE IN COMBATING MONEY LAUNDERING

Most of the world now faces the problem of money laundering. Anti-Money Laundering gained its importance only after 1988. Since then fighting against this menace was become one of the top priority of all countries. A series of instruments elaborated since the 1980s have laid the foundations of modern AML systems. They are -

8 . https://rbidocs.rbi.org.in/rdocs/AnnualReport/
9 timesofindia.indiatimes.com/business/india-business/ed-probing-over-3700-laundering-hawala-cases/

- ***The Basel Committee on Banking Regulations and Supervisory Practices***is one of the important initiatives to fight against money laundering. The Basel Statement of Principles does not restrict itself to drug-related money laundering but extends to all aspects of laundering through the banking system. The core Principles are, Customer identification, Training of Staffs, Adherence to the principles, implementation and compliance with laws. The Basel Committee established a comprehensive Regulatory Consistency Assessment Programme (RCAP) in 2012 to monitor and assess the adoption and implementation of its standards, while encouraging a predictable and transparent regulatory environment for internationally active banks[10].
- The ***Financial Action Task Force [FATF]*** set up in 1989 is an international body of governments that sets standards for combating money laundering and it promotes the implementation of these standards. The objectives of the FATF are to set standards and promote effective implementation of legal, regulatory and operational measures for combating money laundering, terrorist financing and other related threats to the integrity of the international financial system[11]. It pointed out 40 recommendations as the international standard for money laundering measures. First issued in 1990, the FATF Recommendations were revised in 1996, 2001, 2003 and most recently in 2012 to ensure that they remain up to date and relevant, and they are intended to be of universal application[12].Though the recommendation of the FATF is not a binding law, many countries implemented it in their legal system to fight against the offence of laundering. India is one of the members of FATF from 2010.
- ***Wolfsberg AML Principles 2000*** are formulated by a German NGO in collaboration with private banks contains important global principles for sound business of the private banking sector. These principles are revised in 2002. Some of the cardinal principles are: Client identification, Risk assessment, Training and Education, Record maintenance[13].

In India, ***The Prevention of money laundering Act 2002*** was enacted to prevent and control the crime of laundering. The Act specifies statutory duties for Banking Companies, Financial Institutions and Intermediaries. Under **Section 12 of PMLA**, there is a mandate on all Banking Companies, Financial Institutions and Intermediaries to maintain records of all transactions, including information relating to transactions for a period of 5 years, in such manner as to enable the investigating agency/Court to reconstruct individual transactions and find out criminality. are required furnish to the concerned Authorities under PMLA, all information relating to such transactions, whether attempted or executed; the nature and value of such transactions; verify the identity of its clients and the beneficial owner, if any; and

[10]. /www.bis.org/bcbs/
[11]. http://www.fatf-gafi.org/
[12] . http://www.fatf-gafi.org/
[13] . www.wolfsberg-principles.com/

maintain record of documents evidencing identity of its clients and beneficial owners as well as account files and business correspondence relating to its clients.[14] The ***PMLA Rules*** specify the procedure and manner for the maintenance and retention of records. ***Rule 3*** requires every reporting entity to maintain records of all transactions including receipts by non-profit organisations of value above rupees ten lakhs or its equivalent in foreign currency, all cross border wire transfers of value above five lakhs rupees or its equivalent in foreign currency, all purchase of immovable property valued fifty lakh rupees and all suspicious transactions.[15] Based on the above Act and Rules ***Reserve Bank of India (RBI),*** the authority regulating the banking sector laid down certain guidelines to banks and other financial institutions for the first time vide circular no: DBOD.AML.BC.18/14.01.001/2002-03. These norms were revised from time to time. The objective of KYC/AML/CFT guidelines is to prevent banks from being used, intentionally or unintentionally, by criminal elements for money laundering or terrorist financing activities. KYC procedures also enable banks to know/understand their customers and their financial dealings better which in turn help them manage their risks prudently[16]. According to the KYC regulations banks should frame their KYC policies incorporating the following four key elements:

1) Customer Acceptance Policy;
2) Customer Identification Procedures;
3) Monitoring of Transactions;
4) Risk Management.

In June 2012 RBI made it compulsory to all banks the Unique ***Customer Identification Code (UCIC)*** so that customers do not have multiple identities within a bank, across the banking system and across the financial system. Further to prevent terrorism financing (CFT) RBI periodically circulates lists of terrorist entities notified by the Indian Government to banks to detect transactions by such entities.

The ***Financial Intelligence Unit (FIU-IND)*** was established in the year 2004 by the government of India to safeguard the financial system from the abuse of money laundering, terrorism financing and other economic offences. This body receives, analyses, and process information relating to money laundering and reports directly to the Economic Intelligence Council headed by the Finance Minister.

[14] . sec 12 of PMLA 2002
[15] . Prevention of Money Laundering (Maintenance of records) Rules 2005
[16] . www.rbi.org.in

CONCLUSION

Preventing money laundering is not easy. The use of the Internet allows money launderers to easily avoid detection. The rise of online banking services, peer-to-peer transfers using mobile phones and the use of virtual currencies have made detecting the illegal transfer of money ever more difficult. Moreover, the use of proxy servers and anonymous software, it is almost impossible to detect, as money can be transferred or withdrawn leaving little or no trace of an IP address. Prevention is a crucial element to combat money laundering. Though there are many rules and regulations strict adherences to those rules are necessary otherwise it is difficult to prevent it. Banks should identify the high risk groups and relate it with their services to identify and access the extent of risk involved in the particular transaction so that it can devise the AML measures and implement them effectively. Unless the counter measures are followed vigilantly by the bank in the first instance then it is difficult for the enforcement agency alone to prevent the crime of laundering.