



IBA Seminar on preventing abuse of banking system for money laundering

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What is Money Laundering?

- Money laundering is the process by which the proceeds of the crime, and the true ownership of those proceeds, are concealed or made opaque so that the proceeds appear to come from a legitimate source.
- Generally money laundering is the process by which one conceals the existence, illegal source, or illegal application of income to make it appear legitimate. In other words, it is the process used by criminals through which they make “dirty” money appear “clean” or the profits of criminal activities are made to appear legitimate.



Money Laundering

- Money laundering generally refers to ‘washing’ of the proceeds or profits generated from:
 - (i) Drug trafficking
 - (ii) People smuggling
 - (iii) Arms, antique, gold smuggling
 - (iv) Prostitution rings
 - (v) Financial frauds
 - (vi) Corruption, or
 - (vii) Illegal sale of wild life products and other specified predicate offences



Money Laundering

- Money launderers are big time criminals who operate through international networks without disclosing their identity.
- The money laundered every year could be in the range of \$600 bio to \$2 trio. This gives money launderers enormous financial power to engage or coerce or bribe people to work for them
- Generally, money launderers use professionals to create legal structure/ entities which act as ‘front’ and use them for laundering of funds



Money Laundering Process

- Money Laundering consists of three stages:
 1. The first stage involves the **Placement** of proceeds derived from illegal activities – the movement of proceeds, frequently currency, from the scene of the crime to a place, or into a form, less suspicious and more convenient for the criminal.
 2. The second stage is called **Layering**. It involves the separation of proceeds from illegal source through the use of complex transactions designed to obscure the audit trail and hide the proceeds. The criminals frequently use shell corporations, offshore banks or countries with loose regulation and secrecy laws for this purpose.



Money Laundering Process

3. The third stage is called **Integration**. It represents the conversion of illegal proceeds into apparently legitimate business earnings through normal financial or commercial operations. Integration creates the illusion of a legitimate source for criminally derived funds and involves techniques as numerous and creative as those used by legitimate businesses. For e.g false invoices for goods exported, domestic loan against a foreign deposit, purchasing of property and co-mingling of money in bank accounts.



Typologies/ Techniques employed

- Deposit structuring or smurfing
- Connected Accounts
- Payable Through Accounts
- Loan back arrangements
- Forex Money Changers
- Credit/ Debit cards
- Investment Banking and the Securities Sector
- Insurance and Personal Investment Products
- Companies Trading and Business Activity
- Correspondent Banking
- Lawyers, Accountants & other Intermediaries
- Misuse of Non-Profit Organisations



Financing of terrorism

- Money to fund terrorist activities moves through the global financial system via wire transfers and in and out of personal and business accounts. It can sit in the accounts of illegitimate charities and be laundered through buying and selling securities and other commodities, or purchasing and cashing out insurance policies.
- Although terrorist financing is a form of money laundering, it doesn't work the way conventional money laundering works. The money frequently starts out clean i.e. as a 'charitable donation' before moving to terrorist accounts. It is highly time sensitive requiring quick response.



Combating financing of terrorism

- (i) State Sponsored
- (ii) Other Activities- legal or non-legal
- Legal Sources of terrorist financing
 - Collection of membership dues
 - Sale of publications
 - Cultural of social events
 - Door to door solicitation within community
 - Appeal to wealthy members of the community
 - Donation of a portion of personal savings



Combating financing of terrorism

○ Illegal Sources

- Kidnap and extortion;
- Smuggling;
- Fraud including credit card fraud;
- Misuse of non-profit organisations and charities fraud;
- Thefts and robbery; and
- Drug trafficking



Macroeconomic impact

- Money laundering can have a range of severe macroeconomic consequences on countries.
- IMF has cited unpredictable changes in money demand, prudential risks to the soundness of banking systems, contamination of legal financial transactions, and increased volatility of international capital flows and exchange rates due to unanticipated cross-border asset transfers.



Macroeconomic impact

- The economic and political influence of criminal organizations can weaken the social fabric; collective ethical standards and ultimately the democratic institutions of the society. Organized crime can infiltrate financial institutions, acquire control of large sectors of the economy through investment, or other bribes to public officials and indeed governments
- Money Laundering can also have a dampening effect on FDI if a country's financial sectors are perceived to be under control and influence of organized crime.



Money Laundering Risks

What are the risks to banks?

(i) Reputational risk

(ii) Legal risk

(iii) Operational risk (failed internal processes, people and systems & technology)

(iv) Concentration risk (either side of balance sheet)

All risks are inter-related and together have the potential of causing serious threat to the survival of the bank



Penalties imposed on banks

- Jan. 2006 ABM AMRO US\$ 80 mio
- Aug. 2005 Arab Bank US\$ 24 mio
- Feb. 2005 City National Bank US\$750,000
- Jan. 2005 Riggs Bank US\$ 41 mio
- Oct. 2004 AmSouth Bank US\$ 50 mio
- Sep. 2004 City Bank Japan Licence cancelled
- May. 2004 Riggs Bank US\$ 25 mio



Advantages of KYC norms

- Sound KYC procedures have particular relevance to the safety and soundness of banks, in that:
 1. They help to protect banks' reputation and the integrity of banking systems by reducing the likelihood of banks becoming a vehicle for or a victim of financial crime and suffering consequential reputational damage;
 2. They provide an essential part of sound risk management system (basis for identifying, limiting and controlling risk exposures in assets & liabilities)



What KYC means?

- **Customer?**
- One who maintains an account, establishes business relationship, on who's behalf account is maintained, beneficiary of accounts maintained by intermediaries, and one who carries potential risk through one off transaction
- **Your?** Who should know?
- Branch manager, audit officer, monitoring officials, PO
- **Know?** What you should know?
- True identity and beneficial ownership of the accounts
- Permanent address, registered & administrative address



What KYC means?

- Making reasonable efforts to determine the true identity and beneficial ownership of accounts;
- Sources of funds
- Nature of customers' business
- What constitutes reasonable account activity?
- Who your customer's customer are?



Core elements of KYC

- Customer Acceptance Policy
- Customer Identification Procedure- Customer Profile
- Risk classification of accounts- risk based approach
- Risk Management
- Ongoing monitoring of account activity
- Reporting of cash and suspicious transactions



Risk based approach

- The potential risk that a customer carries depends on:
 - (a) Identity of the customer including beneficial ownership
 - (b) The nature of customer's business and his product profile-jewels, precious metals, arms, antiques
 - (c) Location of business
 - (d) Products and services offered
 - (e) Customer's customer or clients; their location & business



High risk countries

- Geography
 - Drug producing nations
 - Drug transshipment countries
 - Drug using countries
 - Secrecy jurisdictions and tax havens, particularly those that grant offshore banking licenses.
 - Countries with high degree of public corruption
 - Countries linked to terrorist financing
 - Non Cooperative Countries and Territories



High risk customers

- Non-bank financial institutions (money transmitters, cheque cashiers, full fledged money changers, sellers of stored value cards, security brokers & dealers etc.)
- Travel agencies / Property dealers/ builders
- Professional and consulting firms
- Exporters or importers of goods and services
- Cash intensive business e.g. retail stores, restaurants, gambling casinos, second hand car dealerships etc.
- Off-shore corporations, banks in secrecy heavens
- Non-profit organisations e.g charities



High risk products & services

- Wire transfers
- Electronic banking services which includes services offered through internet, credit cards, stored value cards
- Private banking relationships
- Correspondent banking relationships



Cross border accounts-deposits

- All KYC procedures to be observed
- Third party verification of documents through Correspondent bank which is committed to KYC regime and is willing to share KYC information on demand
- Verification of document during visit to India
- Remittance through banking channels



Payment gateways/ wire transfers

- Both domestic and cross border wire transfers carry potential risk of money laundering
- Payment gateways facilitate wire transfers for customers of banks located anywhere in the world
- Whether AML/ KYC compliance level
- Ascertain whether it is regulated at the place of incorporation
- Insist on complete originator information with wire
- Make payment to beneficiary through account or DD
- Keep record of transactions



Measures to deter money laundering

- Board and management oversight of AML risks
- Appointment a senior executive as principal officer with adequate authority and resources at his command
- Systems and controls to identify, assess & manage the money laundering risks
- Make a report to the Board on the operation and effectiveness of systems and control
- Appropriate documentation of risk management policies, their application and risk profiles



Measures to deter money laundering

- Appropriate measures to ensure that ML risks are taken into account in daily operations, development of new financial products, establishing new business relationships and changes in the customer profile
- Screening of employees before hiring and of those who have access to sensitive information
- Appropriate quality training to staff
- Quick and timely reporting of suspicious transactions



Salient features of IPO scam

Modus operandi

- Current account opened in the name of multiple companies on the same date in the same branch of a bank
- Sole person authorised to operate all these accounts who was also a Director in all the companies
- Identity disguised by using different spelling for the same name in different companies
- Multiple accounts opened in different banks by the same group of joint account holders



Salient features of IPO scam

- Huge funds transferred from companies accounts to the individual's account which was invested in IPO's
- Loans/ overdrafts got sanctioned in multiple names to bypass limit imposed by RBI
- Loans sanctioned to brokers violating guidelines
- Multiple DP accounts opened to facilitate investment in IPO
- Large number of cheques for the same value issued from a single account on the same day



Salient features of IPO scam

- Multiple large value credits received by way of transfer from other banks
- Several accounts opened for funding the IPO on the request of brokers, some were in fictitious names
- Refunds received got credited in brokers a/cs
- Margin money provided by brokers through single cheque
- Nexus between merchant banker, brokers and banks suspected



Operational deficiencies

Factors that facilitated the scam

- Photographs not obtained
- Proper introductions not obtained
- Signatures not taken in the presence of bank official
- Failure to independently verify the identity and address of all joint account holders
- Directors identity/ address not verified
- Customer Due Diligence done by a subsidiary



Operational Deficiencies

- Objective of large number of jt. account holders opening account not ascertained
- Purpose of relationship not clearly established
- Customer profiling based on risk classification not done
- Poor monitoring and reporting system due to inadequate appreciation of ML issues
- Absence of investigation about use and sources of funds



Operational Deficiencies

- Unsatisfactory training of personnel
- No system of fixing accountability of bank officials responsible for opening of accounts and complying with KYC procedures
- Ineffective monitoring and control



Money Laundering

○ Thank You