Prevention of Money Laundering Act, 2002

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Anti-Money Laundering Legislation in India

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

Anti-Money Laundering Legislation in India

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

Subordinate legislations: Rules under PMLA

	Rules Description
1	The Prevention of ML (the manner of forwarding a copy of the Order of Provisional Attachment of property along with the material and copy of the reason along with the material in respect of survey of the adjudicating authority and it period of Retention Rules, 2005
2	The Prevention of ML (Receipt and Management of confiscated Property) Rules, 2005
3	**The Prevention of Money Laundering Maintenance of Records Rules , 2005**
4	The Prevention of Money Laundering (Forms, search and seizure and forwarding to AA, impounding of custody record and the period of retention) Rules
5	The Prevention of Money Laundering (Forms, search and seizure and forwarding a copy of Order Arrest along with material to AA and its period of retention)
6	The Prevention of Money Laundering (the manner of the Order of retention of seized property along with material to AA and its period of retention)
7	The Prevention of Money Laundering (manner of receiving the records authenticated outside India) Rules, 2005
8	**The Adjudicating Authority (Procedure) Regulations, 2013**
9	The Prevention of Money Laundering (issuance of provisional attachment order) Rules, 2013
10	The Prevention of Money Laundering (Taking possession of attached or frozen properties confirmed by AA) Rules, 2013

Legal Obligation under PMLA

Chapter V – Obligations of Banking Companies, Financial Institutions and Intermediaries

Sec 12: Reporting Entity to maintain records
Sec 12: A: Access to Information
Sec 12: AA: Enhanced Due Diligence
Sec 13: Power of Director to impose fine
Sec 14 No civil or criminal proceedings against reporting entities, directors, employees
15. Procedure and Manner furnishing information by Reporting entities

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

Legal Obligation under PMLA

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

❖ Regional Rural Banks

Reporting entities under PMLA

"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.

Reporting entities under PMLA

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

Reporting entities under PMLA

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 entities under PMLA

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

Reporting entities under PMLA

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.

Suspicious Transaction means:

- ✓ An attempted transaction
- ✓ Gives rise to reasonable ground involve offences under the Act, regardless of the value involved
- ✓ Unreasonable & unjustified complexity of the transaction
- ✓ No economic rationale or *bona fide* purposes
- ✓ Gives rise to suspicion that it may involve financing of activities relating to terrorism.

Related obligations

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)

Client identity

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)

The Four Pillars of KYC

Customer Acceptance Policy

Customer Identification Procedure

Risk Management

Monitoring of Transactions

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

Pillar-I: Customer Acceptance Policy:

This Policy should encompass what types of customers would be accepted by the banks / FIs, what types of accounts would be opened, basic and additional information to be sought from customers, application of Customer Due Diligence (CDD) procedures, verification of customers with sanctions list, etc.

***Pillar-II: Customer Identification Procedure*:**

This relates to verification of identity of customers through any of the Officially Valid Documents (OVD) stipulated by the Regulator. Such verification of the identity of the account holder should be done "within a reasonable time." Procedures for identity verification include documents, non-documentary methods (these may include comparing the information provided by the customer with consumer reporting agencies, public databases, other due diligence measures), or a combination of both. **With the introduction of OVD, the concept of "Introducer" has been done away with.**

Pillar-III: Risk Management:

After taking the customers on board, the banks / FIs have to do their risk profiling based on their identity, social/financial status, nature of business activity, location of client,

Low Risk: Individuals, Salary Employees

Medium Risk: Private Limited Companies, Partnership Firms/ Proprietorship Firms/ Unincorporated bodies

High Risk: Listed Companies, Stock Broking Companies, Politically Exposed Persons and their relatives, Gold and Bullion Merchant

Periodical updation: OVDs obtained should also be updated at regular intervals based on the risk profile of the customers as stipulated by the Regulator.

Pillar-IV: Monitoring of Transactions

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This is the most important pillar, which if done prudently can help in identification of money laundering, fraud, etc. at the incipient stage itself.

After the accounts are opened, banks can **fix certain threshold limits** based on the risk profile of the customers and monitor transactions beyond the threshold limits.

An alert system in-built into the systems of banks/FIs help in monitoring of transactions on a continuous basis and would also aid in submitting certain suspicious transaction reports to the designated agencies within the timelines stipulated.

Legal obligations & guidelines imply

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

Legal obligations & guidelines imply

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

“Reasons for Suspicion” for banking companies

The Prevention of Money laundering Act, 2002 defined and the Rules thereunder require every banking company to furnish details of suspicious transactions whether or not made in cash. **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 or crime; or
- Appears to be made in circumstances of unusual or unjustified complexity; or
- Appears to have no economic rationale or bonafide purpose.

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.

International standards – FATF

Legal System and Related Institutional Measures

Preventive Measures – Financial Institutions Preventive Measures – Non Financial Businesses and Profession

Legal Person and arrangements & Non-profit Organizations

National and International Cooperation

Extension of KYC, CDD & AML/CFT measures to other sectors in case of India, such as:

- Non-Designated Financial Businesses & Professions (NDFBPs) : 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
- Alternative remittances, Wire transfers, Non-Profit Organizations, Cash Couriers