ANTI MONEY LAUNDERING

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Anti Money Laundering (AML)

Money Laundering (ML)

Disguising or concealing of illicit income to make it appear legitimate

ML thrives in transactions, In established economic, financial landscape

Financing of Criminal activities, Trafficking, Terrorism, (TF)

ML practices finance criminal activities, deals in drugs/arms, terrorism

TF thrives on deposits below thresholds that trigger automatic reports

Data collected by agencies remains inconspicuous, Difficult to detect

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Definition, Money Laundering

Article 1 of EC Directive on Prevention of the use of Financial System for the Purpose of Money Laundering, 1991

"the conversion of property, knowing that such property is derived from serious crime, for the purpose of concealing or disguising the illicit origin of the property or of assisting any person who is involved in committing such an offence(s) to evade the legal consequences of his action, and the concealment or disguise of the true nature, source, location, disposition, movements, rights with respect to, or ownership of property, knowing that such property is derived from serious crime"

INTERPOL

"any act or attempted act to conceal or disguise the identity of illegally obtained proceeds so that they appear to have originated from legitimate sources"

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Money Laundering – 3 Stage Process

PLACEMENT

Criminal derived funds acquired.

Launderer inserts "dirty" money in legitimate FI, often as cash/ bank deposit.

Currency comes into financial system, converts illicit funds from cash into bank account/ financial instrument.

LAYERING

Movement of funds from FI to FI to hide the source, ownership of funds, obscure audit trail, sever link with original crime.

Launderer Justifies

INTEGRATION

Reinvestment of funds in an ostensibly legitimate business to cover suspicion of its origins, give legitimate character.

Launderer's plan met:

- ***Investment***
- ***Consumption***
- ***Expenditure***
- ***Pay-outs***

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Money Laundering, Multiple Techniques

Structuring Deposits

'Smurfing'

Cash is broken into smaller deposits of money to defeat suspicion of ML, reporting requirements.

Shell Companies

Fake companies to launder money.

They accept "dirty" money as payment designed to appear real and legitimate, not to fulfill contract.

Bulk Cash Smuggling

Physical smuggling of cash to another jurisdiction and depositing in FI's in jurisdiction with greater bank secrecy or less rigorous ML enforcement.

3rd Party Cheques

Counter cheques or Bankers drafts drawn on different FI's are cleared via various 3rd party accounts.

Since these are negotiable instruments in many countries, the source money is difficult to establish.

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Impacts of Money Laundering

SOCIO-POLITICAL IMPACTS	*ECONOMIC IMPACTS*
Bribery	*Tax evasion*
Infiltration of organised crime	*Activities not in State's interest*
FI's, Banks suffer	*Destabilisation of economy*
Weakening of social fabric	*Upsetting financial markets*
Collective standards of ethics deplete	*Distrubances in supply chain*
Democratic institutions ill-function	*Reputational risk to FI's*

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International Initiatives (1)

International Agreements to Combat Money Laundering

The Vienna Convention, 1988
The Council of Europe Convention
Basle Committee Statement of Principles
United Nations Global Programme Against Money Laundering
The Financial Action Task Force

India Additionally Signatory

International Convention for Supression of Financing of Terrorism, 1999
UN Convention against Transnational Crime, 2000
UN Convention against Corruption, 2003

International Initiatives (2)

The Vienna Convention, December 1988

- First major initiative to prevent ML, Groundwork to combat ML
- Member States to criminalize offence of ML from drug trafficking
- Promote International cooperation between member States on ML
- Makes extraditon between member States applicable to ML
- Domestic bank secrecy laws not interfere criminal investigations

Basle Committee on Banking Regulations and Supervisory Practices – Statement of Principles, December 1988

- Encourage banking sector to adopt common position
- Prevent banking sector from dealing in funds related to ML
- Deny banking to deposits, transfers, concelament to funds from ML
- ML may be arising from drugs, robbery, frauds, terrorism
- Identify customer, Legal compliance, Cooperation, Adherence

International Initiatives (3)

The Council of Europe Convention, 1990

- Defined, established common policy, measures on ML
- May include members outside Europe
- Facilitate international cooperation for investigative assistance
- Carry out search, seizure, confiscation of proceeds from criminality
- Focus should be serious crimes generating large profits
- Drugs, arms dealing, terrorism

United Nations Global Programme Against ML, 1997

- Increase effectiveness of international action against ML
- Offers technical services for awareness, building institutions, training
- Research & Analysis to offer key information to better understand ML
- Assist devise countermeasure strategies
- Support establishment of financial investigation services
- Raise effectiveness of law enforcement agencies

International Initiatives (4)

Financial Action Task Force (FATF)

- An Inter-governmental policy making body of over 30 countries
- Mandate to establish international standards to combat ML, TF
- 180 jurisdictions join to implement FATF standards
- Asesses AML/ Combatting Financing Terrorism (CFT) systems

What does the FATF do?

- Sets international standards to combat ML, Terrorist Financing (TF)
- Assesses, monitors compliance with FATF standards
- Conducts typologies studies of ML, TF methods, trends techniques
- Responds to new, emerging threats, such as Proliferation Financing

International Initiatives (5)

FATF recommendations are

- Standards to implement AML/CFT measures are internationally endorsed
- Increase transparency of financial system to ease detection of criminal activity
- Enable countries to successfully take action against money launderers and terrorist financiers

See www.fatf-gafi.org for the FATF Recommendations

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FATF Recommendations

- Successfully investigate and prosecute ML, TF
- Deprive criminals of gains, resources financing illicit activities
- Requires FI's to comply with:
  - Customer Due Diligence
  - Record Keeping
  - Suspicious Transaction Reporting
- Avoid becoming a haven for criminals
- Meet binding international obligations
- Enhance transparency of legal persons, arrangements
- Build capacity to fight terrorism, trace terrorist money
- Transparent, stable financial system; Attractive to foreign investors
- Ensure FI's are not vulnerable to infiltration, abuse by crime groups
- Prevent risk of sanctions, other actions by internatnional community
- Ensure FI's, businesses, professions comply AML/CFT requirements
- Adopt mechanism for cooperation, co-ordination of AML/CFT efforts

OECD Work On Tax Crime and ML

Designed to complement FATF, and involves:

- *Typologies Exercises*
- *Developing Practical Guidance on Detection of ML for Tax Auditors*
- *Examining Key Risk Areas*
- *Reviewing current country practices for sharing information between Tax and AML authorities*

Issues resources, publications, awareness tools as guidance manuals

- Recommendations for co-operation between Tax & other Agencies
- Law Enforcement Authorities enabled to combat serious crimes
- ML awareness handbook
- Portal on tax & crime

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Indian Position

Pre Prevention of Money Laundering Act, 2002 (PMLA)

- The Conservation of Foreign Exchange and Prevention of Smuggling Activities Act, 1974
- The Income tax Act, 1961
- The Benami Transactions (Prohibition) Act, 1988
- The Indian Penal Code and Code of Criminal Procedure, 1973
- The Prevention of Illicit Traffic in Narcotic Drugs and Psychotropic Substances Act, 1988

PMLA notified with effect from July 1, 2005

Imposes obligations on banking companies, FI's, intermediaries to:

- Research & Analyse key information to better understand ML
- Commits support for establishment of financial investigation services

Indian Law, PMLA

Scheduled offence – Part A, B, C

Part A: Specified provisions of 28 statutes

IPC, Narcotics, Explosives, Unlawful Activities, Arms, Wildlife, Immoral Traffic, PCA, Antiques, SEBI, Customs, Bonded Labour, Child Labour, Human Organs, Juvenile, Emigration, Passports, Foreigners, Copyright, Trademarks, IT, Biological, Plant Varieties, Environment, Water, Air, Maritime

Part B

Customs: False declaration, documents, Effect > Rs. 1 cr.

Part C

Cross border implications of offence in Part A

Offence against property, Chapter XVII of IPC

Offence of willful attempt to evade tax under Black Money Act

Authorities in India

The Securities Exchange Board of India (SEBI)	**The Reserve Bank of India (RBI)**	**Insurance Regulatory & Development Authority of India (IRDA)**
Directorate of Enforcement, **CBI-Economic Offences Wing, Banking Frauds**	**Income tax Department**	**Financial Intelligence Unit – India (FIU – IND)**

Centralised Unit for AML, Combating TF

Bank's intiative to monitor alerts by Indian Banks' Association/FIU-IND

Purpose: To act as a deterrent for ML, TF

Capacity: Process 25,000 alerts a day

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Financial Intelligence Unit - India

Set-up by Government of India vide O.M. dated November 18, 2004

Independent Body for suspect financial transactions

Central national nodal agency to manage AML ecosystem

Receive, processe, analyse, disseminate information from FI's and banks

Reports to Economic Intelligence Council, headed by Finance Minister

Co-ordinate, strengthen global efforts against ML, related crimes, by

National and international intelligence

Investigation and enforcement agencies

Interfacing between financial sector and law enforcement agencies

Functions of FIU-IND as Specialized Agency – Examine Reports

Cash Transaction Reports *Suspicious Transaction Reports*

Cross Border Wire Transfer Reports *Immovable Property Reports*

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Sovereigns Collaborate

Independent systems now exist for monitoring of suspicious transactions

Sovereigns to adopt uniform guidelines for monitoring

Collaborate to build global platforms to aid swift and decisive actions

Recommendations of 2012 FATF Guidelines

KYC Principles	*Cash Transactions*
Awareness of law for jurisdictions	***Automation to trigger reporting***
Risk assessment of accounts	***Awareness on co-operating States***
Identify "red flags" situations	***Identify linked transactions***
Procedure to identify beneficiaries	***Linked transactions are one***

Recent Instances, India (1)

Bank loans, Publically visible borrower

- Eligibility of borrowings and utilisation is suspect (ML)
- Employees, tax authorities, creditors take precipitative action to recover
- Banks declare guarantors as wilfull defaulters, non-co-operative
- Guarantor forced to give-up public offices, seat on Boards of companies Investigative Agencies restrain assets
- ED's 1st multi-city seizure of assets

Recent Instances, India (2)

Banking transactions, Kept below radar, Information leaks

- Forex business increases: Rs. 44 cr./ 2013-14 to 21,528 cr./ 2014-15
- Remittances of Rs. 6,172.92 cr. not matched by imports

Method Adopted

- All transactions kept below $100,000
- Apparent lapses of bank on account of Due Diligence in terms of:
  - KYC Norms
  - Exceptional Transaction Reports
  - Suspicious Transaction Reports
- Transactions made at a conversion rate as low as 0.00001
  - Bank's loss unless low debits were to escape attention
  - If Trading books balanced by debits in suspicious accounts, ML

Recent Instances (1), Malaysia

Development Project, 1Malaysia Development BHD (1MDB)

- Strategic State Fund to turn Kuala Lumpur into a financial hub
- ~$700 mn transferred during 2011-13 by BSI
- Transfer from 1MDB within BSI linked accounts
- Singapore Police informs Malaysian authorities
- Suspected involvement of close confidant of Political Head
- WSJ: Paper-trail traces funds - complex web to personal accounts
- Debt of 1MDB of about $11 bn is rated junk

Actions in Singapore

- Monetary Authority of Singapore orders shutdown of BSI (Singapore)
- Increased supervision implemented for stronger regulatory framework

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Recent Instances (2), France

Terrorism, Satirical Magazine

- Most likely funded by a small amount obtained through:
  - A Consumer Loan
  - Proceeds from Sale of Used Car
  - Sale of Counterfeit Goods
  - Some credit in an overseas account
- Small sums remained below radar
- Were difficult to detect fund raising, utilisation
- Human intelligence is the best way to combat these crimes

TF does not usually follow techniques of ML

Preservation of Financial Centres

Offshore financial centres, Banking secrecy jurisdictions

Increasing adoption of regulations to minimize influx of dirty money

All jurisdictions are not equally regulated

Gap in regulated jurisdictions between legal framework, implementation

External pressure for more transparency

Need to co-operate with foreign law enforcement agencies

Dubious money has been migrating to softer jurisdictions

Financial centres strike balance – Customers, Dirty Banking

Imposing Safeguards against and obstacles to illegal activities

Not constraining or obstructing legal transactions

KYC requirements balanced between Stringent v/s Lenient

Intelligence to monitor, report, regulate suspicious transactions

Online Attacks on Banking Systems

Computer systems of Central Banks / SWIFT payment systems hacked

High-profile digital heists, infiltrated 4 major banks since 2015

Expose shocking weaknesses in security of global financial systems

Hackers known as “Lazarus Group” are sneaking into banks worldwide
Have moved around more than $100 Million so far

SWIFT was not hacked, Has increased security to keep money safe

Where the money is going? Search not complete, FBI states

Similarity, characteristics in computer codes same as those in:

- Attack on South Korea media companies, 2013
- Attach on SONY, 2014
- Work of a Nation State by transitive logic

Tough to determine origin as hackers share code, mask their IP addresses

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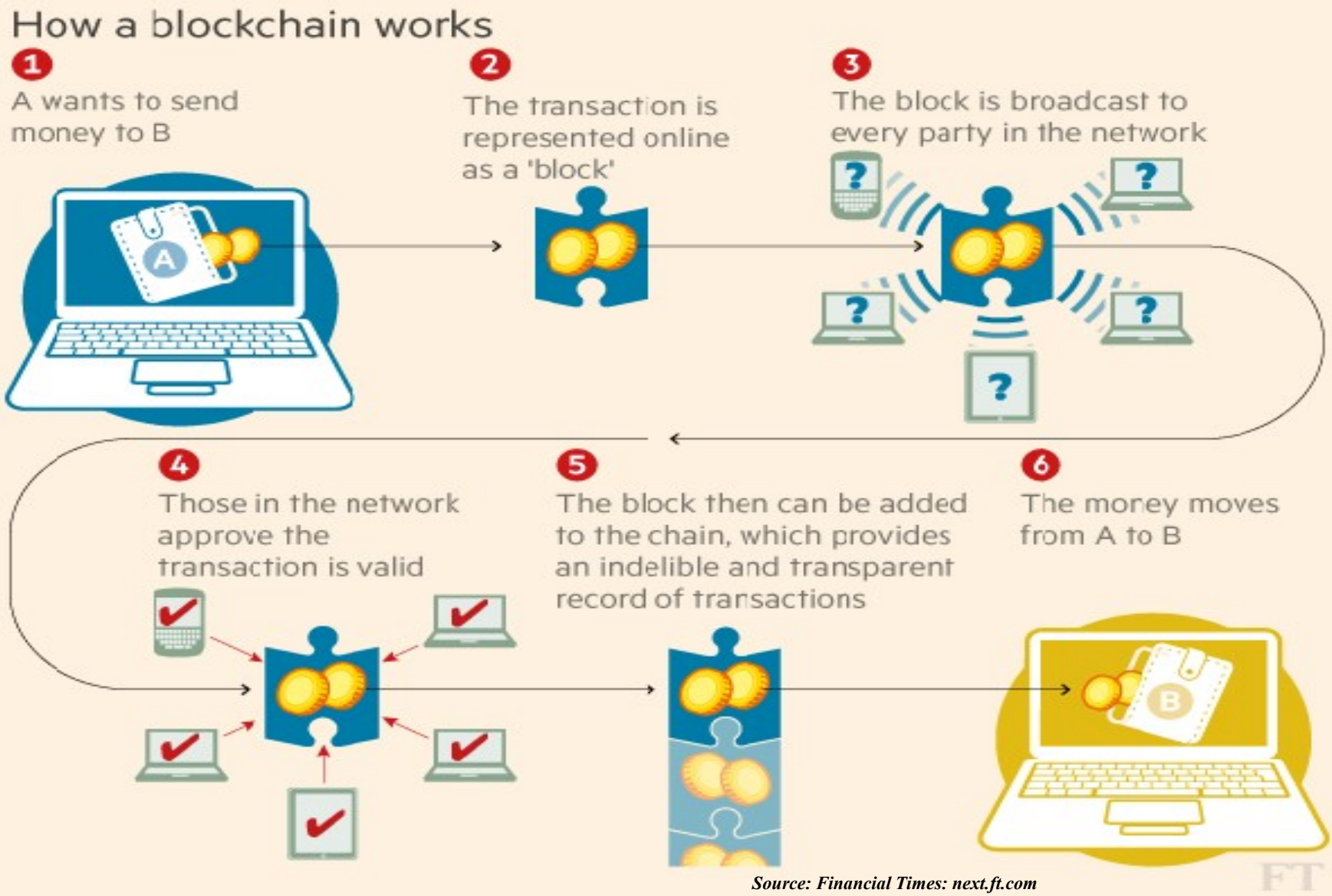
Blockchain



Source: Financial Times: next.ft.com

Features of Blockchain, 2nd Era of Internet

Key Features, Running on millions of devices

- Lower barriers to business creation
- Global distributed ledger / Vast database
- Forms online networks – removing middlemen
- Uses network of computers to approve transactions
- Anyone can move, store, manage anything of value
- Allows consumers and suppliers to connect directly
- Trust derives from clever code and mass collaboration
- Unprecedent level of security, privacy, inclusion exists
- All networks in a chain have to approve the transaction
- Internet of value to transform socio-economic power grid
- Manage money, deeds, patents, clinical trials, degrees, votes
- Reduces server costs, increases speed, efficiency of transactions
- Will rewire the economy for innovation, Anyone can build value
- Governments will have to follow greater transparency, accountability

Banks Seek Remedy in Blockchain

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Source: Financial Times: next.ft.com

Banks Seek Remedy in Blockchain

Banks are looking to crypto-technological advances

This will secure the transactions undertaken by them

Bitcoin Technology uses Blockchain pattern

A powerful tool to cut costs, secure transactions of Banks, FI's

Study by Santander Bank, Oliver Wyman and Anthemis suggests:
Blockchain Technology to cut bank's costs on:

- Infrastructure for Cross-border payments
- Securities trading and regulatory compliance

By An Estimated $15-$20 b / year

Source: Financial Times: next.ft.com

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Bitcoin, Litecoin, Bbqcoin, Dogecoin

- US Fed Reserve, Bank of Canada, BOE, experimenting
- Killing cash would reduce crime and regulation, bring traceability
- Harder to forge; Commerce with less fraud, leakage, friction
- Virtual Currencies, like Bitcoin, are basis of transactions on Internet
- Cryptographic digital currencies, utilise peer/peer electronic payments
- Blockchain technology, shared public ledger authenticates validity
- Regulated in some countries, Bitcoin listed on BTC, Mt. Gox
- Unregulated in India
- RBI: Trade/Usage unauthorized by Central Bank, Monetary Authority

Virtual Currencies under the Sale of Goods Act?
Tax aspect in the usage of Virtual Currency?
Safety of transactions in Virtual Currency?
Losses: Hacking, password, compromised credentials, malware attack?

Vitrual Currency, Sovereign Backing

- Bank of Tokyo-Mitsubishi: Launching “MUFG Coin”, 2017
- Users can withdraw money from account into App on smartphones
- Money converted into MUFG coins at ‘1’ MUFG Coin to ‘1’ Yen
- Advanced, Recognised versions will enable information
- Government will know who has how much cash, its spending
- Accountability will be intrinsically built into MUFG Coin/ Blockchain

Salient Features, MUFG Coin

Users can remit money to others using Internet/ Blockchain Technology
Users share bills, such as those generated on a night out
Users can exchange MUFG Coins with foreign currencies at lower costs
ATM machine loads MUFG Coins onto smartphones

Vitrual Currency – Benefit v/s Risk

Benefit	Risk
Reduction in Infrastructure costs Shared platform Lower customer costs	Associated with illegal activities Prevent ML, trade in illegal goods
Blockchain can be regulated Increased transparency, tracability	Securing Blockchain for wider use Vulnerable to cyber attack /hacks Identity thefts
Solves: ‘who watches the watcher’	Hacker the ‘new watcher’

Trade Based Money Laundering, TBML

- Attractive vehicle for moving around a legitimizing illicit funds
- Trade data analysis, International sharing of trade data, Useful Tools
- Tools can identify trade anomalies; help investigation, prosecution
- Authorities appear less capable of identifying, combating TBML
- Authorities keen for training to staff in TBML
- Methods of TBML:
  1. Over-Invoicing, Under-Invoicing
  2. Over-Shipping, Short-Shipping
  3. Fictitious Trades
  4. Use of Shell, Fictitious Companies
  5. Multiple Invoicing of Goods and Services
  6. Black Market Trades

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Typical TBML Typologies (1)

Typology, Indicative Description	Relevant Information
Over-Invoicing Invoice goods, services, > fair market price Seller receives higher value than open market	• Product Taxonomy • Product Categorisation • Category of Goods • Goods Description • Unit Price of Goods • Quantity of Goods • Market Price of Goods
Under-Invoicing Invoice goods, services < fair market price Seller receives lower value than open market	

Typical TBML Typologies (2)

Typology, Indicative Description	Relevant Information
Over Shipping, Short Shipping Mismatch in quantity invoiced, shipped Buyer / Seller gains excess value on payment	• Product Category • Product Description • Unit Price • Units
Fictitious Trades 'Ghost Shipping' / 'Phantom Shipping' Seller colludes with Buyer Shipping, custom documents appear in order	• Transaction Date • Quantity • Unit Price of goods • Transport Documents • Validity of Documents

Typical TBML Typologies (3)

Typology, Indicative Description	Relevant Information
Use of Shell, Fictitious Companies Insignificant assets, operations Useage, opaque transaction structures Camouflage flow of funds Hide transfer values from Investigative Authorities	• Company Name, Details • Beneficial Owners, Details • Name of Counterparty, Details • Transport Documents contain: ➢ Details of Shipper ➢ Details of Consignee ➢ Details of Notifying Party

Typical TBML Typologies (4)

Typology, Indicative Description	Relevant Information
Multiple Invoices of Goods, Services One Trade, Multiple invoice Multiple invoice, Same Goods/ Service Money Launderer pays all invoices Justifies payments	• Transaction Date • Transaction Amount • Product Description • Invoice Number • Information of Bank Account • Bank's Chops

Typical TBML Typologies (5)

Typology, Indicative Description	Relevant Information
Black Market Trades "Black Market Peso Exchange Arrangements Laundering domestic funds to be transferred Funds used for payment by foreign importer Typical trade involves: Launderer sells funds to foreign money broker Broker integrates funds in financial system Broker effects small transactions, 'Smurfing' Broker pays for goods on behalf of importer Fraudulent documents may not be involved	• Product Description • Product Category • High-value Goods • Counterparty Location • Situs of dealing Banks • Parties Information • Banking Transactions

Panama Papers

- Anonymous source obtaines access to internal database
- World's biggest offshore law firms looses secrecy of its records
- Information: 11.5 million documents and 2.6 TB, 'Panama Papers'
- ~400 journalists at 107 media entities in 76 countries investigate
- Information, results 1st published in a report in April 2016
- Details of account holders, beneficaries made public
- Information can be used in matters pertaining to:
  1. Falsity about assets in previous claims, legal proceedings
  2. Recovery from assets of persons with outstanding judgements
  3. Tracing the proceeds of fraud, diversion of assets
  4. Lack of disclosure
  5. Breach of contract

Ponzi's, Existed Before Charles Ponzi:20/C

- Scam investment designed to separate investors from their money
- Convinces few investors to place money into an investment
- Promise return of investment and income after specified time
- Pointing to historical success to convince more investors
- Typically targets vast majority of earlier investors to return
- Break pattern in cycle; Do not return, escape with money, New life

Salient Features of Ponzi Scheme

Benefits Offered

Credibility Established

Setup Attractive for Gulible Investor

Effective Communications with Investors

Early Stage Investors Returned Investment, Income

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Precious Metal, Counterfeit, Personal Effects

Precious Metals, Gold, etc.

Extremely attractive vehicle for ML

Used to convert illicit cash to stable, anonymous, transformable assets

Safe, fungible asset to reinvest funds, profits of criminal activities

Target for funds of criminal activity, readily monetisable, lucarative

Counterfeits

Attract aspirational buyers, Look alike / 2nd hand repaired products

Short stay outlets at each site, Absence of customer service, warranty

Personal Effects

Carriage, movement of Personal Effects for ML

Stored value higher than decalred value

Work around with cavities in regulations, laws in a jurisdiction

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Recovery

Key requirement, United Nations Convention against Corruption
Highlights importance for countries to ratify, implement Convention

Stolen assets are difficult to trace

Where found, difficult to establish sufficient capacity in both countries

Recovery remains far and distant

Prosecutors need to think creatively

Discover the sort of information to support asset recovery actions

- Economic analysis by international financial institutions are useful
- Need to develop good working relationships with foreign counterparts
- How legal systems can be enhanced to facilitate information exchange

FATF – *Best Practices Paper on Confiscation*, February 2010

Highlights challenges faced by international community in this area

Traceability

Important to trace flow of funds, people behind transactions

Determine real beneficiaries, Affix liability and action claw-back

Recovery is dependent on co-operation across jurisdictions

FATF guidelines on Information Sharing, Structured to trace transactions

Tracing to source of transaction above threshold, ultimate beneficiaries

- Name of originator
- Originator account number, if used to process the transaction
- Originator's address, national identity number
- Name of beneficiary
- Beneficiary account number
- Purpose of transaction

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Traceability, No Defence to Restitution

Defence is not open to one who has changed his position in bad faith, as the Defendant paid the money with knowledge of the facts entitling the Plaintiff to restitution.

It is commonly accepted that Defence shou.d not be open to the wrongdoer.

These matter may differ from case to case.

Traceability, Defence to Restitution

Defence is available to a person whose position has so changed that it would be inequitable in all the circumstances to require him to make restitution, or alternatively to make restitution in full.

The mere fact that the Defendant has spent the money, in whole or in part, does not of itself render it inequitable that he should be called upon to repay, because the expenditure might in any event have been incurred by him in the ordinary course of things.

The mistaken assumption that mere expenditure of money may be regarded as amounting to a change of position for present purposes has led in the past to opposition by some to recognition of a Defence which in fact is likely to be avialable only on comparitvely rare occasions.

Traceability, Jurisprudence

Position Summarised

Tracing benefits acquired by fraud, breach of confidence, breach of fiduciary relationships or by other wring doings do not get the benefit of change of position.

Change of position as a defence has to be causally linked to the receipt that makes it inequitable for the recipient to make restitution.

Mere fact that the recipient has spent the money, whole or in part, does not make it inequitable because expenditure might have been incurred by him in any event in ordinary course of things.

But a bona-fide recipient is entitled to establish the defence that he had increased his outgoings as a result of the receipt.

(Para 168, Halsbury Law of England, Vol. 40(1), 4th Edition)

Amnesty Schemes, Premium to Dishonesty?

New method/s of ML gains monstrous proportions every few decades

Methods become acceptable, Adopted as everyone is doing so

Assumes size that poses systemic risk if processes are disturbed

Sovereigns expected to carry out developmental agenda

Cannot spend resources to pull-up, penalise every offender

Legislation carves amnesty for applicants coming clean

Amnesty not for gains of crime, socially unacceptable activities

Compounding, Settlement payments by Banks, FI's

Business continuity provided to Banks, FI's offering co-operation

Penalty for Honest?

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THANK YOU

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