

STRATEGIES THAT HELP BANKS COMBAT AND PREVENT MONEY-LAUNDERING EFFECTIVELY AND COMPREHENSIVELY

By: *Prapanna Lahiri

**Retd Banking Professional, 27, Dr Asutosh Sastri Road, Kolkata, West Bengal, India.*

Laundering literally means washing or cleaning dirty clothes. In financial parlance money obtained unlawfully or immorally from crimes like extortion, insider trading, drugs/ arms/ human trafficking, smuggling, illegal gambling and terrorism is often called “Dirty Money”. Criminals worldwide indulging in the above crimes and terrorism often use the banking system to channel the proceeds of their illegal transactions (dirty money) into the economy in a manner that makes them appear honestly acquired. This criminal practice involves filtering ill-gotten profits (dirty money) through a series of transactions aimed at “cleaning” the funds to make it finally look like proceeds from legal activities. The basic feature of money laundering, therefore, is that it is driven by criminal activities and conceals the true source, ownership or use of funds.

The United States Treasury Department defines Money laundering as the process of making illegally-gained proceeds (i.e. "dirty money") to appear legal (i.e. "clean"). Traditionally, the process of money laundering occurs in three independent stages.

Placement is the stage at which criminally derived funds are introduced in the legitimate financial system through deposits or other means.

Layering is the substantive stage of the process in which the property is ‘washed’ so as to disguise its ownership and source. This is accomplished by moving the money around through numerous accounts to create confusion in the minds of observers.

Integration is the final stage wherein the ‘laundered’ money is integrated into the legitimate financial system through additional transactions involving purchase of assets.

But this three staged definition of money laundering is highly simplistic. In reality these stages often overlap and in some cases, for example in cases of financial crimes, there is no requirement for the proceeds of crime to be ‘placed’. The enormity of this menace of money laundering is evident from the fact that the International Monetary Fund (IMF) estimates the aggregate size of money laundering in the world could be somewhere between 2 and 5 percent of the world’s gross domestic product. Hence, the international community has sought to make the fight against money laundering and the financing of terrorism a priority. This effort aims at protecting the integrity and stability of the international financial system, cutting off the resources available to terrorists, and making it more difficult for those engaged in crime to profit from their criminal activities. The IMF with its universal membership, surveillance functions, and financial sector expertise has sought to play a unique role towards this goal by directing international efforts to combat money-laundering and the financing of terrorism. The IMF is especially concerned about the possible consequences of money laundering and financing of terrorism on its members' economies. The consequences include vulnerability and instability of financial institutions and financial systems and also the dampening effect on foreign direct investment. At the national level the nations are required to enact national counter-terrorism and anti-money-laundering legislations and regulations in line with international standards and norms and train the relevant government authorities, judiciary, investigators, prosecutors

and banks in the application of these legislations. Money launderers and terrorist financiers exploit loopholes in the Anti Money Laundering systems of a nation and try to move their funds to or through jurisdictions with weak or ineffective legal and institutional frameworks.

That the process of money laundering essentially utilises the banking system is borne out by the fact that it is a diverse and often complex process that need not always comprise cash transactions. The process involves separating proceeds of criminal activity from their origin through the use of layers of complex financial transactions using the banking system. Money Laundering is a global menace that cannot be contained by any nation alone. Nations employ a kind of standard international norms to counter money laundering with some variations depending on peculiarities obtaining in each nation. All financial intermediaries that include banks have a critical role to play in countering money laundering. Role of the financial intermediaries are discussed below:

1. **Customer Identification:** Banks and financial institutions (FIs) are advised to follow certain customer identification procedure for opening of accounts and monitor transactions of suspicious nature for the purpose of reporting the same to appropriate authority. Before a business relationship can be established **due diligence** must always be carried out on customers in order to prevent identity theft, identity fraud, money laundering, terrorist financing, etc.,. The cardinal step in this regard is the '**Know Your Customer (KYC)**' procedures which have become critical elements in the effective management of banking risks. KYC safeguards go beyond simple account opening and recordkeeping and require banks to formulate a customer acceptance policy and a tiered customer identification programme that involves more extensive due diligence for higher risk accounts, and includes proactive account monitoring for suspicious activities. Due diligence encompasses gathering comprehensive information about customers such as:

- a) Customer's name
- b) Identity Number
- c) Legal domicile
- d) Contact number (Telephone)
- e) Place of birth
- f) Nationality
- g) Employment status
- h) Name of employer
- i) Customer's residence (if it differs from legal domicile)

Besides collecting customer information the KYC framework also includes verifying customers' identity and address by asking them to submit documents like proof of identity and proof of address that are mandatory under KYC norms. Banks have been advised to keep information collected from the customer for the purpose of opening of account as confidential and not divulge any details thereof for cross selling or any other purposes. It has to be ensured by banks that information sought from the customer is relevant to the perceived risk and is not intrusive nor is too strict, resulting in denial of banking service to the general public. The objective of KYC guidelines is to prevent banks from being used, intentionally or unintentionally, by criminal elements for money laundering or terrorist financing activities.

2. **Monitoring of transactions:** Ongoing monitoring is an essential element of effective KYC procedures. Banks can effectively control and reduce their risk only if they have an understanding of the normal and reasonable activity of the customer so that they have the means of identifying transactions that fall outside the regular pattern of activity.
3. **Maintenance of Records:** Rule 3 of Prevention of Money Laundering Act, 2002, the anti money laundering legislation in India, stipulates that every banking company, financial institution and intermediary shall maintain a record of:
 - a) All cash transactions of the value of more than Rupees ten lakhs (10,00,000) or its equivalent in foreign currency;
 - b) All series of cash transactions integrally connected to each other, valued below Rupees ten lakhs (10,00,000) or its equivalent in foreign currency that have taken place within a month;
 - c) All cash transactions wherein forged or counterfeit currency or bank notes have been used as genuine or where any forgery of a valuable security or a document has taken place facilitating the transactions;
 - d) All suspicious transactions whether or not made in cash.

A suspicious transaction means a transaction whether or not made in cash which, to a person acting in good faith –

 - (i) Gives rise to a reasonable ground of suspicion that it may involve the proceeds of crime, or
 - (ii) Appears to be made in circumstances of unusual or unjustified complexity, or
 - (iii) Appears to have no economic rationale or bonafide purpose
 - (iv) Gives rise to a reasonable ground of suspicion that it may involve financing of the terrorist activities
4. **Preservation of Records:** The records of all transactions are required to be maintained by every banking company, financial institution and intermediary for a period of ten years (in India) from the date of cessation of the transactions with their clients.
5. **Training of employees:** Bank employees dealing with customers' accounts have to be trained in anti-money laundering and be instructed to report activities that they deem suspicious. Responsibility should be explicitly allocated within the bank for ensuring that the bank's policies and procedures are implemented effectively by various levels of its personnel.
6. **Anti-money laundering software:** Software equipped to filter customer data, classify it according to level of suspicion and inspect it for anomalies that shall include any sudden and substantial increase in funds, a large withdrawal, or moving money to a bank secrecy jurisdiction, shall be used. The software should flag names on government "blacklists" and transactions that involve countries hostile to the host nation
7. **Reporting to government:** Once the software has mined data and flagged suspect transactions, it will alert bank management which will take a call whether or not to file a report with the government.

The anti money laundering measures listed above are not exhaustive and banks employ many other tools to fight the menace depending on the type of account and type of its customers. Criminals are very creative in developing typologies (techniques) to launder money and finance terrorism. Money laundering and terrorism financing typologies vary from place to place and over time, based on the location, economy,

financial markets, and anti money laundering/ anti financing of terrorism regimes. There should be constant international and national efforts to outwit these innovators in money laundering.