

## MONEY LAUNDERING- A THREAT TO NATIONAL SECURITY IN INDIA

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*There's no such thing as good money or bad money. There's just money.*

*-Charles Luciano*

### 1. INTRODUCTION

Money is neither clean nor dirty *per se*, but becomes contaminated as it moves from the legal economy across the legal-illegal limits established by the law and into the unofficial subversive economy. It is the vindication, the decisions and the measures of the individuals with which money is worn makes the money tainted. Most alarming fact is that money laundering and terrorist financing has become an international threat.<sup>i</sup>

Impact of globalization together with off-shore financial haven, bank secrecy, informal economy and high speed wire transfer and internet banking<sup>ii</sup> is making the job of money launderer quite proactive and easy. Day is not far when people will be able to transfer their crime proceeds across the planet without it being traced. Every new terrorist attack that comes up is a manifestation of ill gotten, bloody money.<sup>iii</sup>

### 2. MEANING AND DEFINITION OF MONEY LAUNDERING

Money Laundering, the metaphorical “cleaning of money” with regard to appearance in law, is the practice of engaging in specific financial transactions in order to conceal the identity, source and/or destination of money and is a main operation of underground economy. Thus money laundering is a process by which large amounts of illegally obtained money (from drug trafficking, terrorist activities or other serious crimes) is given an appearance of having originated from a legitimated source.<sup>iv</sup>

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<sup>i</sup> Birks, Peter, *Laundering and Tracing*, Clarendon Press, Oxford, 1995.

<sup>ii</sup> Retrieved from: <http://www.businessweek.com/stories/2006-11-06/policing-online-money-launderingbusinessweek-business-news-stock-market-and-financial-advice> last accessed on 30 Nov 2017.

<sup>iii</sup> Available at: [http://www.academia.edu/319875/Underground\\_Banking\\_-\\_Money\\_Laundering\\_over\\_the\\_internet](http://www.academia.edu/319875/Underground_Banking_-_Money_Laundering_over_the_internet) (accessed on 30 Nov 2017)

<sup>iv</sup> Adukia Rajkumar S. “*Encyclopedia on Prevention Of Money Laundering Act 2002*” 6<sup>th</sup> Edn, Published By K.G Maheshwari-Kolkata. Pg 2

**The Financial Action task force on Money laundering (FATF) defines** money laundering as “the processing of criminal proceeds to disguise their illegal origin” in order to “legitimize” the “ill-gotten gains of crime.”

**Article 1 of the Draft European Communities (EC) Directive of march 1990** defines it as the conversion or transfer 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 the property or of assisting any person who is involved in committing such as offence or offences to evade the legal consequences of his action, and the concealment or disguise of the true nature, source, location, disposition, movement, rights with respect to, or ownership of property, knowing that such property is derived from serious crime.<sup>v</sup>

**The United Nations** defines “Money laundering as process which disguises illegal profits without compromising the criminals who wish to benefit from the proceeds.

**Section 3 of the Prevention of Money Laundering Act, 2002** defines offences of money laundering as: “whosoever directly or indirectly attempts to indulge or knowingly assists or knowingly is a party or is actually involved in any process or activity connected with the proceeds of crime and projecting it as untainted property shall be guilty of offence of money laundering.”<sup>vi</sup>

### **3. HISTORICAL BACKGROUND AND DEVELOPMENT OF THE CONCEPT OF MONEY LAUNDERING**

The term “money laundering” is said to have originated from Mafia ownership of Laundromats, at the time of the famous American gangsterism that arose originally out of Prohibition- the banning of alcoholic drinks. Several mechanisms were used to disguise the origins of the large amounts of money generated by the import and sale of alcohol and other “rackets” such as gambling, some of which was illegal.

In ‘Money Laundering’ as an expression is one of fairly recent origin. The original sighting was in the news papers reporting the Watergate scandal in 1973. The expression first appeared in a judicial or legal context in 1982 in America.<sup>vii</sup>

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<sup>v</sup>Scott, Hal. S. and Philip. A. Wellons, *International Finance: Transaction, Policy and Regulation*, 9<sup>th</sup> Ed., Foundation Press, New York, 2002.

<sup>vi</sup>Shah, Vinod. K., *Prevention of Money Laundering*, (2002) PL Web Jour 7. also see, [http://www.ebc-India.com/lawyer/articles612\\_1.htm](http://www.ebc-India.com/lawyer/articles612_1.htm)

<sup>vii</sup>US v. \$4,255,625.39(1982)551 F Supp 314

Ironically one of the methods of concealing the source of the money was legal gambling. The major headache that the gangsters faced was that the money was in cash, often in small denomination of coins. If the coins were put into the bank questions would be asked. But the storage of large amount of money in low value coins is a storage nightmare. So they created businesses, one of which was slot machines, and another of which was laundries so it is said that the term "Money laundry" was born.

#### **4. STAGES OF MONEY LAUNDERING**

The money laundering circuit can be framed in different ways to suit particular method or circuit of money laundering. Money laundering is a compound chain of activities whereby vast amount of cash generated from illegitimate activities viz. selling of narcotic drugs, extortion, gambling, illicit liquor trade etc is put all the way through a series process so that it comes out at the other end as clean and legal money.

The process pursued in money laundering circuit are

##### **4.1 Placement**

##### **4.2 Layering**

##### **4.3 Integration:**

**4.1 Placement:** Placement involves transforming the crime proceeds into a more convenient & less suspicion form, then getting those proceeds into mainstream financial system. It requires finding a solution to the problem of how to move the masses of cash generated from the illegal activity into a more convenient form for introduction into the economic stream.

**4.2 Layering:** Layering (disguising) involves making a series of financial transactions that in their frequency, complexity, and dimensions often resemble legitimate financial activity. Money is passed through shell companies, shell banks, shell corporations, offshore trusts and offshore jurisdictions. In the layering process, electronic transfer of money is very helpful because it enables movement of money through a variety of entities and several jurisdictions in a matter of hours.

**4.3 Integration (legitimization):** It involves the amalgamation of layered crime proceeds into the mainstream financial system. Once the funds are layered, they are then integrated into the financial system by way of investments in legitimate commercial enterprises and

financial instruments, (such as letters of credit, bonds, securities, bank notes, bills of lading, cashier's cheque, and guarantees), is made to show legitimate. With these legitimate marketable enterprises, the money can be repatriated to the home country, as legitimate earnings.

At each of the three stages of money laundering various techniques can be utilized.

Following are the various measures adopted all over the world for money laundering:

1. *Structuring Deposits*: (Smurfing) This is a method of placement whereby cash is broken into smaller deposits of money, used to defeat suspicion of money laundering and avoid anti-money laundering reporting requirements.<sup>viii</sup>
2. *Shell companies*: These are fake companies that exist for no other reason than to launder money. They take in dirty money as "payment" for supposed goods or services but actually provide no goods or services; they simply create the appearance of legitimate transactions through fake invoices and balance sheets.<sup>8</sup>
3. *Third-Party Cheques*: Counter cheques or banker's drafts drawn on different institutions are utilized and cleared via various third-party accounts. Third party cheques and traveller's cheques are often purchased using proceeds of crime. Since these are negotiable in many countries, the nexus with the source money is difficult to establish.<sup>ix</sup>
4. *Bulk cash smuggling*: This involves physically smuggling cash to another jurisdiction and depositing it in a financial institution, such as an offshore bank, with greater bank secrecy or less rigorous money laundering enforcement.<sup>x</sup>

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<sup>viii</sup>Smurfs - A popular method used to launder cash in the placement stage. This technique involves the use of many individuals (the "smurfs") who exchange illicit funds (in smaller, less conspicuous amounts) for highly liquid items such as traveller cheques, bank drafts, or deposited directly into savings accounts. These instruments are then given to the launderer who then begins the layering stage. For example, ten smurfs could "place" \$1 million into financial institutions using this technique in less than two weeks. National Drug Intelligence Center (August 2011). "National Drug Threat Assessment, p40.

<sup>ix</sup>Arvind Giriraj and Prashant Kumar Mishra, Money Laundering: An Insight Into The Modus Operandi With Case Studies

[http://www.skoch.in/images/stories/security\\_paper\\_knowledge/Arvind%20Giriraj%20and%20Prashant%20Kumar%20Mishra%20-%20Money%20Laundering.pdf](http://www.skoch.in/images/stories/security_paper_knowledge/Arvind%20Giriraj%20and%20Prashant%20Kumar%20Mishra%20-%20Money%20Laundering.pdf) (accessed on 30 Nov 2017).

<sup>x</sup>"National Money Laundering Threat Assessment" (PDF). December 2005. p. 33  
<http://www.dea.gov/pubs/pressrel/011106.pdf> (30 Nov 2017).

## **5. PREVENTION OF MONEY LAUNDERING – GLOBAL INITIATIVES**

Money laundering is an international phenomenon, transnational co-operation is of critical importance in the fight against this menace. A number of initiatives have been taken to deal with the problem at the international level.

### **5.1 THE VIENNA CONVENTION**

It was the first major initiative in the prevention of money laundering held in December 1988. This convention laid down the groundwork for efforts to combat money laundering by obliging the member states to criminalize the laundering of money from drug trafficking.<sup>xi</sup>

### **5.2 THE COUNCIL OF EUROPE CONVENTION**

This convention in 1990 establishes a common policy on money laundering. One of the purpose of this convention is to facilitate international cooperation as regards investigative assistance, search, seizure and confiscation of the proceeds of all types of criminality, particularly serious crimes such as drug offences, arms dealing, terrorist offences etc. and other offences which generate large profits.

### **5.3 BASEL COMMITTEE'S STATEMENT OF PRINCIPLES**

In December 1988, the Basle Committee on Banking Regulations and Supervisory Practices issued a statement of principles which aims at encouraging the banking sector to adopt common position in order to ensure that banks are not used to hide or launder funds acquired through criminal activities.

### **5.4 THE FINANCIAL ACTION TASK FORCE (FATF)**

The FATF is an inter-governmental body established at the G7 summit at Paris in 1989 with the objective to set standards and promote effective implementation of legal, regulatory and operational measures to combat money laundering and terrorist financing and other related threats to the integrity of the international financial system. The FATF has developed a series of Recommendations that are recognised as the international standards for combating money laundering and the financing of terrorism.

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<sup>xi</sup>United Nations Convention Against Illicit Traffic In Narcotic Drugs And Psychotropic Substances, 1988 available at [http://www.unodc.org/pdf/convention\\_1988\\_en.pdf](http://www.unodc.org/pdf/convention_1988_en.pdf) (accessed on 30 Nov 2017)

## **6. PREVENTION OF MONEY LAUNDERING – INDIAN INITIATIVES**

In India, before the enactment of Prevention of Money Laundering Act, 2002 (PMLA) the major statutes that incorporated measures to address the problem of money laundering were:

- i. The Income Tax Act, 1961
- ii. The Conservation of Foreign Exchange and Prevention of Smuggling Activities Act, 1974 (COFEPOSA)
- iii. The Smugglers and Foreign Exchange Manipulators Act, 1976 (SAFEMA)
- iv. The Narcotic Drugs and Psychotropic Substances Act, 1985 (NDPSA)
- v. The Benami Transactions (Prohibition) Act, 1988
- vi. The Prevention of Illicit Traffic in Narcotic Drugs and Psychotropic Substances Act, 1988
- vii. The Foreign Exchange Management Act, 2000, (FEMA)

A consolidated and firm Law came in India in shape of **Prevention of Money Laundering Act, 2002**. The Prevention of Money Laundering Bill 1998 was introduced in Parliament on 4<sup>th</sup> August, 1998. The Bill received the assent of the President and became Prevention of Money Laundering Act, 2002 on 17<sup>th</sup> January 2003. The Act has come into force with effect from 1<sup>st</sup> July 2005. It has been amended in 2005, 2009 and recently in 2012. The objective of the Act is to prevent money-laundering and to provide for confiscation of property derived from, or involved in, money-laundering and for matters connected therewith or incidental thereto<sup>xii</sup>. RBI issued Master Circular on Know Your Customer (KYC) norms/ Anti-Money Laundering (AML) standards/ Combating of Financing of Terrorism (CFT)/ Obligation of banks under Prevention of Money Laundering Act, 2002 and Banks

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<sup>xii</sup>C. Satapathy, Money Laundering: New Moves to Combat Terrorism, Economic and Political Weekly, Vol. 38, No. 7 (Feb. 15-21, 2003), pp. 599-602.

were advised to follow certain customer identification procedure for opening of accounts and monitoring transactions of a suspicious nature for the purpose of reporting it to appropriate authority.

RBI has issued Master Circular on Know Your Customer (KYC) norms, Anti-Money Laundering (AML) standards, Combating of Financing of Terrorism (CFT), Obligation of banks under Prevention of Money Laundering Act, 2002 and Banks were advised to follow certain customer identification procedure for opening of accounts and monitoring transactions of a suspicious nature for the purpose of reporting it to appropriate authority. Under **KYC Policy** banks are to frame policies incorporating the following four key elements:

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

Also, The Financial Intelligence Unit - India (FIU-IND) is the nodal agency in India for managing the AML ecosystem and has significantly helped in coordinating and strengthening efforts of national and international intelligence, investigation and enforcement agencies in pursuing.

## **7. JUDICIAL PRONOUNCEMENTS:**

### ***THE FAKE STAMP PAPER OR TELGI SCAM***

The syndicate led by Abdul Karim Telgi used the chemically washed stamps and thus re-introduced the used stamp papers back into the system simply by washing them in the chemicals so as to remove the original contents. This was made possible because of the loophole in the system where there was no branding of new stamps and the used stamp papers were not cancelled. The trial court found the accused guilty of the offences and sentenced him to various terms of imprisonment.

The accused filed an appeal to the High Court against the order of the Trial Court. While dismissing the appeal the Court held that Appellant has caused substantial loss to the Government and corresponding gain to himself by his 'white collar' crime. It was an economic crime which has cascading effect. This is one of those exceptional

cases where the law should come down with heavy hands to deal such kind of persons who are a menace to the Society<sup>xiii</sup>.

### *GLOBAL MONEY LAUNDERING RING OF IQBAL MIRCHI*

A full-blown investigation into suspected terror funding and hawala (illegal money transaction) operations of the infamous 'D' company has been launched with the Enforcement Directorate (ED) bringing under its scanner a Rs. 3,000 crore global money laundering ring allegedly involving family members and associates of late Iqbal Mirchi— who was a right-hand man of fugitive Pakistan-based don Dawood Ibrahim. Mirchi, who died in 2013 in the UK, is suspected to have laundered and moved funds through the hawala route to purchase a host of properties in at least 10 or more countries with the help of his associates.

The agency which has registered a case under the Foreign Exchange Management Act (FEMA) recently to probe the entire range of complex real estate transactions found that at least four buildings located in Mumbai were sold off by Mirchi's family in 2010 by creating "fictitious identities" and front companies in "contravention of RBI guidelines and FEMA rules." The agency has also issued notices to Mirchi's widow, two sons, relatives, lawyers and business associates in connection with its investigation conducted under the Foreign Exchange Management Act (Fema). The agency has also contacted the Reserve Bank of India (RBI) to obtain records on Mirchi and his associates' business and banking operations in India. The ED has handed over the investigation of the case to a special investigation team as it has identified numerous assets used to run the hawala racket.

### **8. CRITICAL ANALYSIS**

With the advent of technology it has been possible for the money launderers to act on obscure the origin of proceeds of crime by cyber finance techniques. The enforcement agencies are not able to match up with the speed of growing technologies. The issue of money laundering is growing at a very high pace.

Its unawareness among the common public is an impediment for implementation of proper anti-money laundering measures. According to Interpol Intelligence sources,"

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<sup>xiii</sup>Abdul Karim Telgi and Sohail Khan vs. Union of India, through CBI, 2014(2)JLJ136



the size of the 'hawala' in India could be nearly 40% of India's Gross Domestic Product where there are fewer complexities and formalities, little or no documentation, lower rates and they also provide security and anonymity. This is mainly because such people don't know the seriousness of this crime and are not aware of its harmful after effects.

Non-fulfilment of the purpose of KYC Norms: RBI has issued the policy of KYC norms with the objective to prevent banks from being used by criminals for money laundering or terrorist financing activities. However, it does not cease or abstain from the problem of Hawala transactions as RBI cannot regulate them. Further, such norms are only a mockery as the implementing agencies are indifferent to it. Also, the increasing competition in the market is forcing the Banks to lower their guards and thus facilitating the money launderers to make illicit use of it in furtherance of their crime.

The widespread act of smuggling there are a number of black market channels in India for the purpose of selling goods offering many imported consumers goods such as food items, electronics etc. which are routinely sold. The black merchants deal in cash transactions and avoid custom duties thus offering better prices than the regular merchants. After liberalization of government, though this problem has been lessened but it has not been done away with completely and still poses a threat to a nation's economy.

Lack of comprehensive enforcement agencies the offence of money laundering is no more stuck to one area of operation but has expanded its scope include many different areas of operation. In India, there are separate wings of law enforcement agencies dealing with money laundering, cyber crimes, terrorist crimes, economic offences etc. Such agencies lack convergence among themselves. The issue of money laundering, as we have seen, is a borderless world but these agencies are still stuck with the laws and procedures of the states.

The criminals dealing with these activities do not have any particular pattern i.e. they have distinct patterns of operation. India has taken extensive measures in order to curb with the issue of money laundering. It can rightly be said that the manpower has been

tripled as there is Directorate of Enforcement which leads all the money laundering cases and investigations related to it in the country; there is also Financial Intelligence Unit which tracks down and analyses the risk of money laundering through the agencies reporting to it and there is time to time upgradation of the legislative framework through the proposed changes. However, there is still a further need to increase the enforcement and take more strict actions against the persons violating them. Also, the financial institutions are required to implement additional levels of control in areas such as transaction monitoring, annual review, periodic updation of accounts etc. Moreover, cost factor also plays a very significant role in having an effective anti-money laundering regime as high costs and low budget may lead to reduced focus and thus higher risks.

As it can be seen that money laundering involves activities that are international in nature and are also at a greater level, therefore, to make a heavy impact it is necessary that all countries should enact strict and as far as possible same laws so that the money launderers will have no place to target in order to launder their proceeds of crime by way of weakness of jurisdiction or the like. Since the States have no obligation in deciding which offences should be considered as predicate offences to money laundering there is no consensus into the international harmonizing efforts for anti-money laundering. Thus, there is a need to enlist common predicate offences to solve the problem internationally particularly keeping in mind the trans-national character of the offence of money laundering. Furthermore, the provision of financial confidentiality in other countries is an issue. The states are unwilling in compromising with this confidentiality. There is a need to draw a line between such financial confidentiality rules and these financial institutions becoming money laundering havens.

## 9. CONCLUSION

Combating the offence of money laundering is a dynamic process since the criminals involved in it are continuously looking for new ways to do it and achieve their illicit motives. Moreover, since various countries are entering into multiple agreements and conventions in order to strengthen their measures to combat money laundering, the money launderers are targeting and exploiting those jurisdictions which are weak and do not have sufficient laws to deal with such an offence.

Apart from that, many a people are of the opinion that money laundering seem to be a victimless crime. They are unaware of the harmful effects of such a crime. So there is a need to educate such people and create awareness among them and therefore infuse a sense of watchfulness towards the instances of money laundering. This would also help in better law enforcement as it would be subject to public examination. Moreover, to have effective anti-money laundering measures there need to be a proper coordination between the Centre and the State. For that the tussle between the two should be removed. The laws should not only be the responsibility of the Centre but it should be implemented at the State level also. The more decentralized the law would be the better reach it will have. Therefore, to have an effective anti-money laundering regime, one has to think regionally, nationally and globally.