Technical Report on Market Integrity - Issues and Status

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Foreword

Introduction

The international community has emphasized the need for strengthening the architecture of the international financial system in the wake of the recent financial crises. The initiatives have been directed towards preventing the recurrence of such crises and safeguarding global financial stability. In this context of achieving a sound basis for domestic and international financial stability, the on-going efforts in development, adoption and implementation of international standards for the financial system are considered crucial. In view of the importance of the subject, and the far reaching initiatives that have been taken by the international community in the adoption and implementation of financial standards and codes, this report puts forth a general overview of this enterprise, particularly focusing on key concepts and the developments that have taken place in this area in recent years. We also highlight the ongoing efforts in India in this direction, expecting them to contribute in their own significant way in the overall task of promoting a sound and stable global financial system.

We have great pleasure in placing in the public domain, the expert Reports on various subject areas pertaining to our financial system. The Reports have made critical assessment of India's status and compliance with prescribed international financial standards and codes and suggest means for achieving the best international practices.

We would, however, like to emphasize that the recommendations contained in these reports are the product of independent evaluation and assessment of standards and codes, and do not reflect the views of the Reserve Bank or the Government of India or other concerned regulatory agencies.

What are Standards?

Standards set out by international financial institutions and other standard setting bodies are generally accepted as good principles, practices and guidelines for

relevant areas in the financial system. Standards have developed mostly as a result of the recognition and understanding of the weaknesses that precipitated financial crises. Standards are classified by their degree of specificity and reckoned on the basis of their sectoral or functional attributes. They cover a broad range of areas in the financial system and are, therefore, interdependent or sometimes functionally overlapping.

Why are Standards Important?

Standards help to promote sound financial systems domestically and financial stability internationally. They play an important role in strengthening financial regulation and supervision, enhancing transparency, facilitating institutional development and reducing vulnerabilities. Standards also facilitate informed decision making in lending and investment and improve market integrity and, thereby, minimize the risks of financial distress and contagion. Standards are not ends in themselves but a means for promoting sound financial fundamentals and sustained economic growth. The adoption of standards in itself, however, is not sufficient to ensure financial stability. The implementation of standards must fit into a country's overall strategy for economic and financial sector development taking into account the stage of development, level of institutional capacity and other domestic factors.

What is New about Standards?

The standards devised by standard setting bodies are widely accepted as promising benefits in strengthening financial systems and helping in achieving sustained economic growth. Standards also promote convergence of practices among countries in various areas of the financial system, thereby, allowing clear assessment methodologies for comparability across jurisdictions. For ease of implementation, standards are distinguished by their degree of specificity covering (i) principles or general fundamental rules that offer flexibility in implementation to suit country priorities and circumstances, (ii) practices that are more specific and demonstrate practical applications, and (iii) specific methodologies/guidelines which provide detailed guidance on steps required for relative objective assessment of the degree of compliance. In providing this choice of prioritization and methodological guidance,

countries can have effective implementation plans under different economic circumstances.

For Whom are Standards Relevant?

Standards serve many purposes and are of special interest to market participants. They can serve as a means of providing some kind of benchmark for market participants to operate efficiently. They are important to the regulators concerned with the financial system, central bank and Government as they are key components of efforts to strengthen domestic economic and financial systems and preserve financial stability.

What are the Key Standards?

The Financial Stability Forum (FSF) was initiated by members of G-7 in February, 1999 with the mandate to promote international financial stability by improving the functioning of markets and reducing systemic risk through information exchange and international cooperation in supervision and surveillance of financial markets. The FSF has drawn together various standard-setting bodies constituted by means of cooperation among central banks, international financial institutions, national authorities and international supervisory and regulatory bodies. The FSF has posted The Compendium of Standards, which serves as a common reference for various standards. This is basically an initiative of the Financial Stability Forum and is a joint product of the various standard setting bodies represented on the Forum. Currently there are 69 standards cited in the Compendium, which are organised under three broad headings and fifteen subject areas, viz., macroeconomic policy and data transparency (covering monetary and financial policy transparency, fiscal policy transparency, data dissemination and data compilation), institutional and market infrastructure (covering insolvency, corporate governance, accounting, auditing, payment and settlement, market integrity and market functioning) and financial regulation and supervision (covering banking supervision, securities regulation, insurance supervision and financial conglomerate supervision).

Who are the International Standard Setting Bodies?

International standard setting bodies had existed for a long time, but in the light of the growing degree of global interdependence and linkages, the world economy can be exposed to potential threat of contagion from problems in financial markets. It has, therefore, become imperative to strengthen financial systems through intensified coordination and cooperation among regulatory bodies, international regulatory bodies and international financial institutions charged with fostering standards and codes. There are various international organizations which have made significant contribution to raising standards of soundness and risk-awareness in financial systems.

The International Monetary Fund (IMF) has developed international standards for data dissemination and transparency practices in fiscal, monetary, and financial policies, and has contributed to the development of international standards for banking supervision.

Basel Committee on Banking Supervision (BCBS) has formulated the 'Core Principles of Effective Banking Supervision' which ensure best supervisory practices in the area of banking supervision.

Committee on Payment and Settlement System (CPSS) has advocated 'Core Principles for Systemically Important Payments Systems' that are aimed at enhancing the efficiency and stability of payment, clearing, settlement and related arrangements.

International Accounting Standards Committee (IASC), an independent private sector body, is charged with the responsibility of developing and approving International Accounting Standards (IAS).

International Association of Insurance Supervisors (IAIS) is responsible for setting standards that are fundamental to developing effective insurance regulation and supervisory practices.

International Organisation of Securities Commissions (IOSCO) has established core standards for effective surveillance of international securities transactions and promotes integrity of markets through rigorous application of standards and effective enforcement against offences.

The Organisation for Economic Cooperation and Development (OECD) promotes policies for efficient functioning of markets and encourages convergence of policies, laws and regulations covering financial markets and enterprises.

The Financial Action Task Force (FATF) and the G-7 have recommended adoption of standards in the area of market integrity and functioning. The FATF, in particular, has made 40 specific recommendations for combating money laundering.

Standard Setting Bodies in India

In India, we have standard setting bodies which are, in practice, the national regulators, who have the legal authority to set and implement regulatory rules and procedures in the financial sector. For example, the Reserve Bank of India (RBI) is responsible for regulation and supervision of banks and other financial institutions and money, foreign exchange and Government securities markets. The Securities and Exchange Board in India (SEBI) is charged with the duty to protect the interests of investors in securities and to promote the development of, and to regulate the securities market by measures as it deems fit. The Insurance Regulatory and Development Authority (IRDA) is entrusted with the task of protecting the interests of the policy holders, to regulate, promote and ensure orderly growth of the insurance industry and for matters therewith or incidental thereto. The Department of Company Affairs (DCA) of the Ministry of Law, Justice and Company Affairs, *inter alia*, provides legal framework for incorporation and proper functioning of companies, surveillance over the working of corporate sector to ensure financial health and compliance with statutory provisions, prescribing cost audit rules and appointment of cost auditors, investigation of complaints, coordination with other regulatory bodies such as other Government departments and autonomous institutions like SEBI, RBI and stock exchanges and monitoring the development of professional bodies i.e.,

Institute of Chartered Accountants of India (ICAI), Institute of Company Secretaries (ICS) and Institute of Cost and Work Accountants of India (ICWAI).

Further, we have self regulatory organizations such as the Indian Banks Association (IBA), Fixed Income Money Market and Derivatives Association of India (FIMMDA), Association of Merchant Bankers of India (AMBI), Association of Mutual Funds of India (AMFI), Foreign Exchange Dealers Association of India (FEDAI), Primary Dealers Association of India (PDAI), clearing house associations and stock exchanges, among others, which play a critical role in developing codes of conduct and setting and maintaining standards for different segments of the financial system with a view to promoting and protecting interests of institutions, investors and depositors in India.

As banking channels are seriously susceptible to money laundering activities, the IBA has taken a lead role in evolving a self regulatory code aimed at combating money laundering activities in the banking system. The self regulatory code, among other prudential procedures, are expected to be put in place, although at present there is no nodal agency entrusted with oversight in this context.

India's Standing Committee on International Financial Standards and Codes

With a view to promote and assist in the task of adoption and implementation of international financial standards in India, a Standing Committee on International Financial Standards and Codes was set up on December 8, 1999. The Committee has been entrusted with the task of monitoring developments in global standards and codes being evolved by standard setting bodies as part of the effort to create a sound international financial architecture and to consider all aspects of applicability of these standards to Indian financial system. The Committee is also assigned with the task of periodically reviewing the progress in regard to the codes and practices and making available its reports to all concerned organizations in public and private sectors with the aim of sensitizing public opinion and creating awareness of the concerned subject areas.

Advisory Groups in India

To assist the Standing Committee, Advisory Groups were constituted in different areas of the financial system under the Chairmanship of eminent experts, generally not holding official positions in government or other regulatory bodies in ten major areas - accounting and auditing, banking supervision, bankruptcy, corporate governance, data dissemination, fiscal transparency, insurance regulation, transparency of monetary and financial policies, payments and settlement system and securities market regulation. The Advisory Groups had, in general, the following terms of reference :

(i) to study present status of applicability and relevance and compliance of relevant standards and codes,

(ii) to review the feasibility of compliance and the time frame over which this could be achieved given the prevailing legal and institutional practices,

(iii) to compare the levels of adherence in India, vis-à-vis in industrialized and also emerging economies particularly to understand India's position and prioritize actions on some of the more important codes and standards, and

(iv) to chalk out a course of action for achieving the best practices.

Of the twelve core subjects highlighted by the FSF, Advisory Groups constituted by the Standing Committee have covered eleven subject areas. At the time of the constitution of Advisory Groups, no formal Group was formed in the area of market integrity. However, in the light of recent developments it was felt that a Technical Paper would be prepared. Accordingly, a Technical Group comprising of Shri C.R Muralidharan and Smt Indrani Banerjee from Department of Banking Operations and Development (DBOD) and Dr. Himanshu Joshi from Department of Economic Analysis and Policy (DEAP) was constituted to study the status and compliance of India's position with respect to the key principles of market integrity prescribed by the G-7 in general and the Recommendations of the Financial Action Task Force (FATF) on anti money laundering and terrorist financing in particular, and to make appropriate recommendations for further enhancing the quality of market integrity.

About this Technical Report

This Technical Report makes a detailed assessment of India's position with respect to G-7 principles on market integrity, 40 recommendations of the FATF on anti money laundering, and its 8 Special Recommendations on Terrorist Financing. In doing so, the Report takes stock of the wide spectrum of existing legal provisions, policies and regulations against money laundering activities in the domestic and cross border contexts. It highlights the gaps in the existing provisions and the international standards set in this regard. The Report also describes the current status in terms of the ongoing efforts being made in the direction of full compliance, especially, the provisions of the proposed anti money laundering and anti terrorism Bills, and examines the need for residual actions to be taken in legal, policy and procedural domains to fulfill the requirements of the G-7 principles and FATF recommendations.

The Report can be accessed on the Reserve Bank web site <www.rbi.org.in>.

Purpose of this Technical Report

The Report will be circulated among the members of the Standing Committee and Chairmen and members of other Advisory Groups for their considered views. As in the previous cases, we are also publishing the report with the similar objective of inviting comments from the widest section of market participants and other interested observers on the issues addressed by the Technical Group.

We shall be grateful to receive views and comments on the Report which may be addressed to the Secretariat, Standing Committee on International Financial Standards and Codes, 24th Floor, Central Office, Reserve Bank of India, Fort, Mumbai- 400001 (cpc@bom2.vsnl.net.in). It is requested that the responses on the Report may kindly be sent as early as possible for suitable consideration by the Standing Committee.

What Next ?

Although not taking any particular view on the recommendations of the Technical Group, the Standing Committee would prepare a summary and highlight key aspects of the recommendations of the Report as also identify action points requiring attention by regulatory authorities/agencies concerned so that the follow up could be undertaken.

Sd/-	**Sd/-**
(C.M. Vasudev)	**(Y.V. Reddy)**
Co-Chairman	**Chairman**
Standing Committee on International Finance Standards and Codes	**Standing Committee on International Finance Standards and Codes**

Chapter 1
Introduction

1.1 There is unanimity in opinion that a sound financial system is a necessary condition for sustainable growth. In recent times, the need for developing a new international financial architecture has been strongly felt by the international community to preserve the stability and soundness of the global financial system. Towards this end the Financial Stability Forum (FSF), promoted by members of G-7, took the lead in constituting various standard setting bodies with cooperation among central banks, international financial institutions, national authorities and international supervisory and regulatory bodies. The mandate of the FSF is to foster international financial stability by improving the functioning of markets and reducing systemic risk through information exchange and international cooperation in supervision and surveillance of markets. It has, in the process, brought out a Compendium of Standards highlighting 12 core standards for sound financial systems deserving priority implementation, depending on country circumstances. These key standards are also broadly accepted as representing minimum requirements for good practices in areas of macroeconomic policy and data transparency, institutional and market infrastructure, and financial regulation and supervision.

1.2 In due recognition of this international effort and to implement these standards and codes in areas of the financial system, the Reserve Bank, in consultation with the Government, constituted a Standing Committee on International Standards and Codes in December 1999. The Committee was entrusted with the task of monitoring developments in global standards and codes and assessing aspects of their applicability to the Indian financial system. The Committee would, *inter alia*, disseminate its Reports to a wide audience including relevant public and private sector organizations and institutions, to sensitize public opinion and create awareness in different subject areas. The Standing Committee constituted ten Advisory Groups comprising of eminent non-official experts in ten different subject areas in the financial system. The Advisory Groups were required to study the present status of applicability, and compliance of the relevant standards and codes, review the feasibility of compliance and the time frame over which this could be achieved given the prevailing legal and institutional practices.

The study reviewed the extent of adherence in India to international norms vis-à-vis industrial countries and also emerging economies, particularly to understand India's position and prioritize actions on some of the more important codes and standards, and to chalk out a course of action for conforming to the best practices.

1.3 The Standing Committee identified ten subject areas for referral to the Advisory Groups, which largely corresponded to the list of key standards highlighted by the FSF for implementation. These were Transparency in Monetary and Financial Policies, Data Dissemination, Payments and Settlement Systems, Banking Supervision, Securities Market Regulation, Accounting and Auditing, Fiscal Transparency, Insurance Regulation, Bankruptcy Laws and Corporate Governance.[i] The Committee, however, did not then consider the set of codes on market integrity and anti money laundering (AML) as incorporated in the 40 recommendations of the FATF.

1.4 In the aftermath of the September 11 attacks, issues in market integrity have received increasing attention by the international financial community. Market integrity is becoming an important adjunct in the quest for ensuring financial stability. The important link between financial market integrity and financial stability is underscored in the Basel Core Principles for Effective Supervision (BCP) and in the Code of Good Practices on Transparency in Monetary and Financial Policies, and in particular those on the prevention, uncovering and reporting of financial system abuse, including financial crime, and money laundering.

1.5 Effective anti-money laundering measures are important for the integrity of the financial system as well as for fighting financial crime, and form part of the core supervisory principles covering all financial sectors. The recommendations of the Financial Action Task Force (FATF), which leads the international efforts in dealing with money laundering, provide a comprehensive blueprint of the action required to prevent the use of the financial system for laundering proceeds of criminal activities. Many of the recommendations are similar to some of the principles contained in the Basle Core Principles for Banking Supervision, and underline the importance of adhering to the "Know Your Customer" (KYC) principle.

1.6 In view of the increasing urgency of adopting anti money laundering (AML) measures, there is need to take cognizance of the recommendations of the FATF and to carry out an assessment of the level of compliance and action required for implementation. This Technical Report lays out the current status of India's compliance with the FATF recommendations on money laundering while briefly reviewing the existing laws, provisions and regulations established for the purposes of detection and law enforcement against criminal financial activity. The Report is in the nature of a self-assessment and seeks to provide an overview of the existing legal framework and contemplated course of action to curb money laundering.

1.7 The Report sets out the key principles that synthesize 'market integrity' and provides an overview of the initiatives of international organizations and other-country experience in countering money laundering. It then examines the present Indian position with regard to compliance with international standards in combating money laundering and ensuring market integrity. In the light of the above, it chalks out the future course of action required for effective compliance with international norms in this regard.

Chapter 2

Market Integrity – Dealing With Financial Crime

2.1 Conceptually, enforcing market integrity implies taking steps to improve international cooperation between law enforcement authorities and financial regulators on cases involving serious financial crimes and regulatory abuse. Towards this end, the Group of Seven countries (G-7) set out ten key principles of market integrity and it was decided that while remaining consistent with fundamental national and international legal principles and essential national interests, countries should :

(1) ensure that their laws and systems provide for maximum cooperation domestically between financial regulators and law enforcement authorities in both directions. In particular, when financial regulators identify suspected financial crime activity in supervised institutions or financial markets, they should share this information with law enforcement authorities or, if applicable, the national Financial Intelligence Unit;

(2) ensure that there are clear definitions of the role, duty, and obligations of all the national authorities involved in tackling illicit financial activity;

(3) provide accessible and transparent channels for co-operation and exchange of information on financial crime and regulatory abuse at the international level, including effective and efficient gateways for the provision of information. Instruments such as Memoranda of Understanding and Mutual Legal Assistant Treaties can be very valuable in setting out the framework for co-operation but their absence [the absence of MoU or MLAT] should not preclude the exchange of information;

(4) at the international level, either introduce or expand direct exchange of information between law enforcement authorities and financial regulators or ensure that the quality of national co-operation between law enforcement authorities and financial regulators permits fast and efficient indirect exchange of information;

(5) ensure that law enforcement authorities and financial regulators are able to supply information at the international level spontaneously as well as in response to

requests and actively encourage this where it would support further action against financial crime and regulatory abuse;

(6) provide that their laws and systems enable foreign financial regulators and law enforcement authorities with whom information on financial crimes or regulatory abuse is shared to use the information for the full range of their responsibilities subject to any necessary limitations established at the outset;

(7) provide that foreign financial regulators and law enforcement authorities with whom information on financial crimes or regulatory abuse is shared are permitted, with prior consent, to pass the information on for regulatory or law enforcement purposes to other such authorities in that jurisdiction. Proper account should be taken of established channels of co-operation, such as mutual legal assistance statutes and treaties, judicial co-operation, Memoranda of Understanding, or informal arrangements;

(8) provide that their law enforcement authorities and financial regulators maintain the confidentiality of information received from a foreign authority within the framework of key principles 6 and 7, using the information only for the purposes stated in the original request, or as otherwise agreed, and observing any limitations imposed on its supply. Where an authority wishes to use the information for purposes other than those originally stated or as otherwise previously agreed, it will seek the prior consent of the foreign authority;

(9) ensure that the arrangements for supplying information within regulatory and law enforcement co-operation framework are as fast, effective and transparent as possible. Where information cannot be shared, parties should as appropriate discuss the reasons with one another;

(10) keep their laws and procedures relating to international cooperation on financial crimes and regulatory abuse under review to ensure that, where circumstances change and improvements can be made, an appropriate response can be implemented as quickly as possible.

Chapter III

Initiatives of International Organizations

3.1 The Financial Action Task Force (FATF)

One of the important facets of market integrity is developing and promoting policies to combat money laundering and financing of terrorism. As mentioned, the inter governmental Financial Action Task Force (FATF) consisting of 29 countries with major financial centers in Europe, North and South America and Asia and two international organizations have proposed a set of 40 recommendations to combat money laundering. The FATF has defined money laundering as " the processing of criminal proceeds in order to disguise their true origin". It encompasses involvement in any transaction or series of transactions that seeks to conceal or disguise the nature or source of proceeds derived from illegal activities, such as drug trafficking, terrorism, and fraud. The money laundering process involves three stages - *placement*, ie physically disposing of cash derived from illegal activity, *layering* or separating proceeds of criminal activity from their source through layers of financial transactions designed to hamper the audit trail, disguise origin of funds, and provide anonymity, and *integration*, ie placing the laundered proceeds back into the economy such that they enter the system as apparently legitimate funds. Money laundering can be done with or without the knowledge of the financial institution or counter-party to the financial transaction, although to be guilty of the crime of money laundering, actual or implied knowledge is required.

3.2 Recognising the nexus between organised crime, money laundering and terrorism, the FATF, in its meeting held on 30th October 2001 expanded its mission to combat the financing of terrorism. It formulated a set of eight Special Recommendations on Terrorist Financing to make the international legal framework more operational and effective in dealing with the threat of terrorism.

3.3 These relate to (1) implementation of UN Security Council Resolution 1373, (2) criminalizing the financing of terrorism and (3) freezing and confiscating terrorist assets. (4) the reporting of suspicious transactions related to terrorism, (5) international co-operation on investigations, inquiries and proceedings relating to financing of terrorism, terrorist acts and terrorist organizations, (6) regulation of alternative remittance networks (hawala channels), (7) scrutiny of wire transfers to

validate the remitters particulars and (8) review of the adequacy of laws which relate to entities which can be abused for the financing of terrorism such as non-profit organisations. FATF members agreed to carry out a self-assessment exercise against these recommendations before 31 December, 2001. Though India is not a member of FATF, it is a member of the Asia Pacific Group on Anti Money laundering activities, which has accepted the FATF 40 recommendations as its operational standard.

3.4 The recommendations made by the FATF on combating money laundering are recognized as universal principles of policy and cover criminal justice system and law enforcement, the financial system and its regulation, and international cooperation. The recommendations are consistent with the Vienna Convention and have acted as a guidepost for money laundering rules and regulations adopted by the Caribbean Financial Action Task Force (CFTF) and the Organization of American States (OAS). Countries are encouraged to adopt these recommendations flexibly according to particular circumstances and constitutional and legal frameworks.

3.5 **Methodology Document of International Monetary Fund (IMF)**

In a separate but complementary effort to the FATF and following the Board's decisions of April, 2001, an anti money laundering (AML) Methodology Document was prepared by the members of the International Monetary Fund and World Bank based on financial sector supervisory standards relating to preventing abuse of the financial system. The Document is intended to ensure both comprehensiveness and uniformity in the assessments of the AML elements in financial sector supervisory standards. It incorporates the existing principles of prudential supervision in the three main financial sectors - banking, insurance and securities, enunciated by the Basel Committee, the International Association of Insurance Supervisors (IAIS), and the International Organisation of Securities Commissions (IOSCO) respectively.

3.6 The Document emphasizes the necessity of controls and procedures within the financial sector supervisory and regulatory frameworks to prevent the abuse of financial system by criminals. Enunciating four basic principles for adherence by all financial institutions, the Document requires (i) compliance with anti money laundering laws, including suspicious transactions reporting to a administrative body or Financial Intelligence Unit, (ii) customer identification (KYC) and suspicious

transaction monitoring, (iii) cooperation with supervisors and law enforcement agencies and, (iv) putting in place anti money laundering policies, procedures and training.

3.7 Later on November 5, 2001 the Fund brought out a discussion paper on intensified Fund surveillance in anti money laundering work and combating the financing of terrorism. The paper notes the pernicious effects of money laundering and financing of terrorism stating that it has ‘far reaching negative consequences for global economic growth and financial stability’.

3.8 In the meeting of the Executive Board on November 12, 2001, the Directors supported the Fund’s involvement beyond AML to efforts aimed at curbing terrorism financing and considered an expansion of the Methodology Document to cover the original 40 recommendations of the FATF and additional 8 on terrorism financing. The Directors also agreed that while the responsibility for enforcement of AML and anti terrorism financing measures rested with the national authorities, the package of ‘further actions taken by the Fund would constitute a substantive and measured response to global challenges with regard to AML and terrorist financing’.

3.9 Basel Core Principles and Guidelines on Customer Due Diligence for banks

Basel Core Principle 15 addresses issues relating to banks' management, organization and internal control procedures. It requires banking supervisors to determine that banks have adequate policies, practices and procedures in place, including strict "know-your-customer" rules, that promote high ethical and professional standards in the financial sector and prevent financial crimes through exchange of information and greater knowledge of bank customers. The Basel Committee's KYC guidelines serve as a benchmark for supervisors to assess the adequacy of their controls and procedures. Though KYC is most closely associated with the fight against money laundering, the Basel Committee's approach is from a wider prudential perspective and its interest in sound KYC standards originates from its concerns for market integrity and sound risk management practices.

3.10 United Nations Global Program against Money Laundering

The 1988 U.N. Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (Vienna Convention) called upon countries to criminalize money laundering, to ensure that bank secrecy provisions do not impede the process of criminal investigations and to facilitate legislative amendments for investigation, prosecution, and international cooperation. By working to combat money laundering, the United Nations makes a crucial contribution to the fight against organized crime. The Global Programme against Money Laundering (GPML) is the key instrument of the United Nations Office of Drug Control and Crime Prevention in this task. Through GPML, the United Nations helps Member States to introduce legislation against money laundering and to develop and maintain the mechanisms that combat this crime. The programme encourages anti-money laundering policy development, monitors and analyses the problems and responses, raises public awareness about money laundering, and acts as a co-ordinator of joint anti-money laundering initiatives by the United Nations with other international organisations.

3.11 **The Egmont Group**

Many countries have set up specialised government agencies as part of their systems for dealing with the problem of money laundering. These entities, which are commonly referred to as financial intelligence units or " FIUs ", facilitate rapid exchange of information between financial institutions and law enforcement authorities as well as between jurisdictions. Since 1995 a number of FIUs have been working together in an informal organization called the Egmont Group, located in Netherlands. The Egmont Group's agreement on information sharing among jurisdictions is the most important standard on this topic and is consistent with the FATF 40. The Group has 58 countries at present. India is still not a member of the Egmont group. G-7 has called on other countries to join the Egmont Group and to establish a terrorist asset tracking centre or similar mechanism and to share all information on a cross-border basis.

3.12 Since the adoption of the Basel Supervisors' Committee Statement of Principles on Money Laundering in 1988, many international organizations and regional groupings have adopted new rules and regulations to counter money laundering activities. In regional context, the Asia Pacific Group on Money

Laundering, and the Commonwealth Secretariat are also engaged in supervisory and enforcement actions to counter the threat of money laundering.

Chapter IV

International Anti Money Laundering Efforts

4.1 Many countries have enacted legislation and adopted measures to counter money laundering in line with the FATF recommendations and the United Nations Global Program against Money Laundering. The 1989 Economic Summit of major industrialised countries deliberated upon the FATF 40 recommendations and called upon member countries to implement and coordinate money laundering laws in the world's major financial centers, including the United States, Canada, the European Community, Japan, Australia, and Singapore.

4.2 European Community (EC)

In 1991 the EC issued a directive on money laundering that is compatible with and, in some cases, even exceeds the recommendations of FATF, mandating reporting of suspicious transactions and identification of beneficial owners and customers. EC members are in the process of translating the directive into national laws. EC members include Belgium, Denmark, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, and the United Kingdom.

4.3 The United States

Among industrialised countries, the U.S has established one of the most comprehensive frameworks to combat money laundering. The United States has put the following laws into operation:

- ? The Bank Secrecy Act of 1970
- ? The Money Laundering Control Act of 1986
- ? The Anti Drug Abuse Act of 1988
- ? Section 2532 of the Crime Control Act of 1990
- ? Section 206 of the Federal Deposit Insurance Corporation Improvement Act of 1991
- ? Title XV of the Housing and Community Development Act of 1992
- ? USA Patriots Act, 2001

4.4 The statute makes it illegal for a financial institution or employee to disclose, to the subject of a referral or a grand jury subpoena, that a criminal referral has been

filed or a grand jury investigation has been initiated in connection with a possible crime involving a violation of money laundering and BSA laws. Officers who improperly disclose information concerning a grand jury subpoena for bank records are subject to prosecution.

4.5 The Bank Secrecy Act of 1970 is designed to :

- ? Deter laundering and the use of secret foreign bank accounts.
- ? Create an investigative "paper trail" for large currency transactions by establishing regulatory reporting standards and requirements (e.g. the Currency Transaction Report requirement).
- ? Impose civil and criminal penalties for non-compliance with its reporting requirements.
- ? Improve detection and investigation of criminal, tax, and regulatory violations.

4.6 The Money Laundering Control Act of 1986, part of the Anti-Drug Abuse Act of 1986, made money laundering a federal crime. It created three new criminal offences for money laundering activities by, through, or to a financial institution. These offences are:

- ? Knowingly helping launder money from criminal activity.
- ? Knowingly engaging (including by being wilfully blind) in a transaction of more than $10,000 that involves property from criminal activity.
- ? Structuring transactions to avoid Bank Secrecy Act (BSA) reporting.

The penalties for those offences include imprisonment for a maximum of 20 years, fines up to $500,000 or two times the amount laundered, and forfeiture of assets.

4.7 The Anti-Drug Abuse Act of 1988 reinforced anti-money laundering efforts in many ways, including by:

- ? Significantly increasing civil, criminal, and forfeiture sanctions for laundering crimes and BSA violations including forfeiture of "any property, real or personal, involved in a transaction or attempted transaction in violation of

laws" relating to the filing of Currency Transaction Reports, money laundering, or structuring transaction.

- ? Requiring strict identification and recording of cash purchases of certain monetary instruments.
- ? Permitting the Treasury Department to require financial institutions to file additional, geographically targeted reports.
- ? Directing the Treasury Department to negotiate bilateral international agreements covering the recording of large U. S. currency transactions and the sharing of such information. A number of such agreements have been signed with other countries since 1988.
- ? Increasing the criminal sanction for tax evasion when money from criminal activity is involved.

4.8 Section 2532 of the Crime Control Act of 1990 enhanced the enforcement authority of the Office of the Comptroller of Currency (OCC) by giving it (and other federal banking agencies such as the Federal Reserve Board, Federal Deposit Insurance Corporation, and Office of Thrift Supervision) the authority to request the assistance of a foreign banking authority in conducting any investigation, examination, or enforcement action. It also permits the OCC to consider and accommodate requests for assistance from foreign banking authorities conducting investigations to determine whether any person has violated, is violating, or is about to violate any law or regulation relating to banking matters or currency transactions administered or enforced by the requesting authority.

4.9 Section 206 of The Federal Deposit Insurance Corporation Improvement Act (FDICIA) of 1991 allows the OCC (and other bank supervisory authorities) some latitude to disclose information obtained in the course of exercising its supervisory or examination authority to foreign bank regulatory or supervisory authorities. Such disclosure must be appropriate, must not prejudice the interests of the United States, and must be subject to appropriate assurances of confidentiality.

4.10 The Housing and Community Development Act of 1992 (P.L. 102-550 referred to as the Annunzio-Wylie Anti-Money Laundering Act) strengthens penalties

for depository institutions found guilty of money laundering. It allows regulators to close or provide for seizure of institutions by:

- ? Appointing a conservator or receiver. The FDIC or the OCC may appoint a receiver or conservator for an insured depository institution that is found guilty of a money laundering offence or a criminal Bank Secrecy Act violation.
- ? Terminating the institution's charter. The Comptroller, upon receipt of written notification from the Attorney General that a national bank or federal branch or agency of a foreign bank has been found guilty of money laundering, must issue a notice of intention to terminate the charter of the institution and schedule a pre determination hearing. For criminal convictions involving BSA violations the Comptroller has discretion to issue a notice of a hearing to determine whether or not to revoke a bank's charter. In either case, at the hearing which follows, the Comptroller determines whether the charter will be terminated by considering whether:
- ? Directors or senior executive officers had knowledge of or were involved in the activity;
- ? The bank had policies and procedures to prevent money laundering;
- ? The bank cooperated with law enforcement authorities, and the extent of its cooperation;
- ? The bank implemented additional controls to prevent the recurrence of the offence;
- ? The interest of the local community requires the bank to continue operating to ensure that adequate deposit and credit services are available;
- ? Suspend or remove institution-affiliated parties who have violated the BSA or been indicted for money laundering or criminal activity under the BSA;
- ? Prohibit any individual convicted of money laundering from unauthorized participation in any federally insured institutions.

4.11 The Act requires the Secretary of the Treasury to :

- ? Issue regulations requiring national banks and other depository institutions to identify which of their account holders (other than other depository institutions

or regulated broker dealers) are non-bank financial institutions, such as check cashing services.

- ? With the Board of Governors of the Federal Reserve System, adopt a rule requiring financial institutions and other entities that cash checks, transmit money, or perform similar services to maintain records of domestic and international wire transfers that are useful in law enforcement investigations.
- ? Establish a BSA Advisory Group that includes representatives from the departments of Treasury and Justice and the Office of National Drug Control Policy and other interested persons and financial institutions. The group is a means of informing the private sector representatives about how reported information is being used.

4.12 The Act permits the Secretary of Treasury to :

- ? Require any financial institution, or any financial institution employee, to report suspicious transactions relevant to possible violation of law or regulation. This would also protect those parties from civil suit arising from such reports and provide a so-called "safe harbor."
- ? Require financial institutions to adopt anti-money laundering programs that, at a minimum, include: 1) internal policies, procedures, and controls; 2) designation of a compliance officer; 3) maintenance of an ongoing employee training program; and 4) an independent audit function to test the adequacy of the program.

4.13 More recently, on 24th October 2001, the United States enacted the USA Patriot Act in the aftermath of 11 September attacks requiring banks operating in the US to establish enhanced due diligence policies, procedures and controls designed to detect and report instances of money laundering. The Act, inter alia, makes modifications in several Chapters of the U.S Code and gives enhanced powers to authorities for disclosure with power to make further regulations, all geared towards countering money laundering and terrorism. The Act is aimed at preventing the misuse of legitimate financial mechanism including correspondent bank facilities and promoting bilateral and multilateral action, particularly in cases of money laundering by foreign persons and foreign countries.

4.14 **The United Kingdom**

Following the findings of the Hodgson Committee charged with the brief of inquiring into ways of filling the gaps in laws, and the deliberations of the Home Affairs Select Committee, Drug Trafficking Offences Act (DTOA) was passed in 1986. This was the first statute to categorise money laundering as a criminal offence. Subsequently, the Act has been amended to cover laundering of the proceeds of all crimes while various other related provisions have been added. The legal framework for combating money laundering activities have the following salient attributes:

i. To encourage and in some cases compel the reporting of suspicious activities, especially in relation to drug trafficking. This is ensured by making failure to report suspicious activity a substantive offence, but also in the provision of exceptions relating to acquisition and the like of tainted property where a disclosure has been made.
ii. The prohibition of any dealing with suspect funds, at least until a disclosure has been made and the consent of the law enforcement authorities obtained to proceed in the matter. This follows from the objective of denying the money launderer access to the market.
iii. The prohibition of doing anything that might alert the launderer to the existence of an investigation or prejudice such an investigation, to protect investigation and the person who made the disclosure.

4.15 The Money Laundering Regulations of 1993 made under section 2(2) of the European Communities Act, 1972 have made further modifications and additions to existing laws requiring financial institutions to put in place systems to deter money laundering, and to assist the relevant authorities to detect money laundering activities. These regulations were meant to comply with the 1991 EC Directive on Money Laundering. Other provisions to implement the Directive in full were included in the Criminal Justice Act 1993.

4.16 Given the serious dimension of the problem, even financial secrecy havens esp., Switzerland and Luxembourg, as also other countries in the developing world as the Philippines, Chile etc are also ensuring enactment of money laundering legislation

to ensure that banks and other non-bank financial institutions are responsible for knowing their customers.

Annexure I presents an extract from the FATF IX Report on Money Laundering Typologies which surveys the scale and scope of money laundering activities in various regions of the world.

4.17 **Factors Impeding Efforts to Curb Money Laundering**

There are several factors that impede effective cooperation and coordination at the international level to combat money laundering effectively.

Institutional limitations in many countries, including judicial and police systems, extradition arrangements, immigration, asset seizure, anti-money laundering, and anti-corruption laws are some of the issues that may have to be addressed. Jurisdictional overlaps and less than adequate international co-ordination hamper actions against money launderers. As of now more than ninety jurisdictions offer the protection of bank secrecy laws which impose criminal sanctions on those who release information regarding clients' transactions.

4.18 The increasing volume and complexity of international transfers makes it easy for criminals to frequently move money abroad and recycle through international payment systems to obscure the audit trail. Internet based banking and new banking technologies make it difficult for banks to monitor account activity. Though, some of the tax haven jurisdictions may co-operate with foreign law enforcement authorities, investigations in matters of criminal activity may involve considerable delays.[ii] There is need also to trail many offshore corporations with large assets but anonymous owners, directors and officers. The requirement of law in many jurisdictions having to prove fraudulent transfers and the statute of limitation inhibits timely and effective action against money launderers.

4.19 In the financial system, problems arise because of shortfalls in reporting requirements that make cash deposit reports of no use for detection. The difficulties in exercising uniform regulation and oversight over a multitude of non-bank financial institutions such as exchange houses, check cashing services, insurers, mortgagors,

brokers, importers, exporters and other trading companies, gold and precious metal dealers, casinos and express delivery services, makes it extremely difficult to detect money laundering.

Chapter V

The Present Indian Position

5.1 The existing Indian position in regard to the structure of controls and procedures for combating money laundering or regulatory abuse is contained in different Acts, regulations, policies and guidelines pertinent to both cross border and domestic financial transactions.

5.2 **The Legal and Policy Framework for Cross Border Transactions -**

The enforcement of checks and balances for external or foreign exchange transactions enshrined in the erstwhile Foreign Exchange Regulation Act (FERA), 1973 encompassed statutory provisions, policy measures, administrative schemes, circulars, and instructions. The FERA came in to being following the recommendations of the Public Accounts Committee, 1968 and report of the Law Commission, 1972 which dealt with the question of leakage of foreign exchange through invoice manipulation and trial and punishment of social and economic offences, respectively. The FERA sought to control and regulate foreign exchange transactions with the express intent of conserving foreign exchange. It executed prohibition and regulation by 'grant of permission', and hence was considered too harsh and restrictive. Under FERA, all transactions which were permitted were based on prescriptive regulations leaving less scope for law and adjudication. Notably, even minor violations were subject to severe penal action including imprisonment. Although the Amendment Act 29 of 1993 sought to remove certain unwarranted restrictions and brought about simplification of procedures to improve the climate for increased flow of foreign investment for growth and promotion of trade, the penalties for violation and subsequent searches, detention or arrests were also increased.

5.3 Following the liberalization of the Indian economy and increased inflows of foreign exchange, the FERA was replaced by the Foreign Exchange Management Act (FEMA) in 1999. FEMA, 1999 ushered in a change in the substance of the Act and sought to consolidate and amend the laws relating to foreign exchange with the objective of facilitating external trade and payments and promoting the orderly development and maintenance of foreign exchange market in India. As compared with FERA, FEMA does not require seeking general or specific permission for all transactions, though the Reserve Bank (in consultation with the Government) has

retained the right to regulate/prohibit certain payments by issuing notifications/circulars. Under FEMA, the enforcement provisions have been considerably systematized to stop arbitrary use of powers. The adjudication and investigation functions have been bifurcated and powers of arrest and custodial investigation vested with the Enforcement Directorate (ED) withdrawn. Investigation procedures were dovetailed with like powers conferred under Chapter XIII of the Income Tax Act, 1961 such as calling for information, inspection of registers etc and offences under the law made civil rather than criminal in nature. The Enforcement Directorate nevertheless is charged with responsibility of detection and enforcement of the provisions of the Act and to check mal-practices such as illegal acquisition or transfer of foreign exchange including hawala, non repatriation of export proceeds, unauthorized maintenance of accounts in foreign countries, under or over invoicing of exports and imports, siphoning off of foreign exchange through fictitious imports, etc.

5.4 The transition from FERA to FEMA reflects an evolutionary process, from strict control and regulation to facilitation of economic activity in keeping with the dynamic changes in the Indian economy. Whereas the provisions of FEMA especially regarding procedures for punishment appear to have been diluted, the Reserve Bank in consultation with the Government continues to reserve the right to regulate, restrict or prohibit any foreign exchange transactions it deems fit in public interest. Both the Acts, in common, continue to place detailed restrictions on hawala market to prevent its use as a conduit for money laundering activities and terrorism financing. The transition from FERA to FEMA reflects the view that it is more relevant to improve surveillance and preemptive measures rather than rely solely on harsh rules and regulations for prevention of financial crimes.

5.5 Besides FEMA, the Indian Customs Act, 1962 plays a vital role in curbing money laundering by imposing stiff penalties including imprisonment for offences under Customs Act such as smuggling, improper imports and exports and wrong declaration of exports. Offenders of Customs Act are liable for both civil and criminal liabilities depending on the seriousness of the offence. While civil liability could result in monetary penalties and confiscation of goods, criminal liability could lead to penalty and imprisonment of the offender. Further, the offender of the Act is subject both to departmental and court adjudication and could be penalized independently by

both these entities. Offences under the Customs Act are not restrained by the Limitation Act that sets the time limit for launching a prosecution.

5.6 The Smugglers and Foreign Exchange Manipulators Forfeiture of Property Act, 1975 is another legislation that provides for forfeiture of illegally acquired properties of smugglers and foreign exchange manipulators and for matters connected therewith and incidental thereto. The application of this law is restricted to the persons convicted under the Customs Act, 1962 or Sea Customs Act, 1878 or other foreign exchange laws. Under this Act, no person shall hold any illegally acquired property either by himself or through any other person on his behalf.

5.7 The Foreign Contribution (Regulation) Act, 1976 empowers the Central Government to regulate flow of funds to various organizations. If the Central Government is of the view that any organization is acting against national interest, it can block its funds. It casts an obligation on banks to ensure that no foreign donation is received by an organization unless it is registered with the Home Ministry.

5.8 The United Nations (Security Council) Act, 1947 enables the Central Government to give effect to certain provisions of the Charter of the United Nations. If under article 41 of the Charter of the United Nations, the Security Council of the United Nations calls upon the Central Government to take measures not involving the use of armed force to give effect to any decision of the Council, the Central Government may, by order published in the Official Gazette, make such provisions (including provisions having extra-territorial operation) as appear to it necessary or expedient for enabling those measures to be effectively applied. Under the Act, provision may be made for the punishment of persons offending against the order.

5.9 **The Legal and Policy Framework for Domestic Domain -**

In the domestic domain, the Income Tax Act, 1961 provides a framework for combating money laundering by penalizing acts of tax evasion. Unlike the Customs Act, income tax offences only have civil liabilities that allows the offender a reasonable opportunity to be heard. The Income Tax Act is empowered to prosecute offences such as concealment, fraudulent removal, transfer or delivery of any property with the intention to evade taxes, willful failure to produce accounts and documents,

making false statements in verification or delivery of an account or statement, willful failure to furnish the return on income etc. Tax evasion from manufacturing activity is also countered by provisions of Excise and Sales Tax Acts which in turn circumscribe the scope of money laundering activities.

5.10 Although in the strict sense of the term, either FEMA or Customs or Income Tax Acts are not true analogues of laws designed for prosecuting offences pertaining to money laundering, they do play an important role by capping conduits of transfer for and detecting possible movements of funds obtained from unlawful and criminal means. Besides, there are several other Acts such as the Arms Act, Narcotics and Psychotropic Substances Act, Ancient Monument Prevention Act having strict provisions that help in checking money laundering through these means.

5.11 In the domestic corporate sector the regulatory body namely, the Department of Company Affairs administers the Companies Act, 1956 [Amendment Act, 2000 now] and the Monopolies and Restrictive Practices Act, 1969. The Companies Act focuses on promoting good corporate governance practices and stresses on investor protection. It, *inter alia*, deals with issues such as promotion and formation of companies, membership, capital, charge on assets, meetings, manner of keeping accounts and conducting audit and winding up proceedings. Apart from other reasons listed in the Act, companies could also be wound up if the business of the company is being conducted to defraud its creditors or members or for a fraudulent or unlawful purpose. The Companies (Amendment) Act, 2000 has since increased the penalties for violation of the provisions of the Act by almost ten times. The new Act also makes it mandatory to obtain permission of the Regional Director for shifting of registered office of the company within the same state. This would allow better tracking of the location and activities of any company in question.

5.12 Under the Criminal Law Amendment Ordinance XXXVIII of 1944, prosecution agencies can get the proceeds of crime relating to bribe, breach of trust and cheating confiscated by an order of attachment and on completion of the criminal prosecution can get an order from court forfeiting the proceeds. The Ordinance covers only certain offences such as corruption, breach of trust and cheating and not all crimes under the Indian Penal Code (IPC). This Ordinance was amended in 1946 and

the onus of proving that the money was not proceeds of crime was shifted to the accused. The law is implemented by state police and by the Central Bureau of Investigation (CBI), an apex investigating agency, in cases of corruption under the Prevention of Corruption Act.

5.13 **Money Laundering Bill**

India is a signatory to the United Nation Resolution of 1998 which calls upon the member States to take legal steps to prevent money laundering. The Government of India initiated a specific Prevention of Money Laundering Bill, 1999 (PMLB), in line with this Resolution. The PMLB defines money laundering as an act of acquiring, owning, possessing, concealing or transferring any proceeds of crime and knowingly entering into any transaction pertaining to a crime listed in the Indian Penal Code (IPC). The Bill seeks, *inter alia*, to declare money laundering a criminal and extraditable offence, provides for confiscation of the proceeds of crime, makes it obligatory for financial institutions to maintain record of transactions above a certain value and disclose reportable transactions. The provisions of PMLB also seek to promote international cooperation in investigation of money laundering, in line with the FATF recommendations. In practice, the PMLB seeks to prevent and control criminal financial activity relating to offences under the IPC, drugs and narcotics and corruption by initiating summons, searches and seizures of perpetrators of such crimes. The bill which has been approved by the Union Cabinet will provide the requisite legal and institutional framework for Anti Money Laundering.

5.14 The relationship between Prevention of Money Laundering Bill (PMLB) and FEMA has been critically discussed at various fora. It is argued that since offences of FEMA are not listed in the PMLB schedule, this could result in an anachronistic situation as far as the main problem is concerned. At the same time, the differences between the PMLB and FEMA may be more logically reconciled in the light of their very objectives. In this respect, whereas the PLMB seeks to prosecute more serious crimes mentioned in the IPC, FEMA is designed to facilitate external trade and payments and to ensure orderliness in the foreign exchange market. The apparent dichotomy between these two sets of legislations is sought to be redressed by a host of other legal, procedural and policy-related changes initiated by regulatory authorities to curb cross border money laundering activities. For example, the Reserve Bank has

underscored the need for banks to keep track of the origin, the beneficiary and the destination of foreign currency non-resident accounts. Banks are advised to keep a watchful eye on banking transactions of organizations to prevent violation of regulatory provisos and procedures.

5.15 **Other recent initiatives**

With a view to further intensifying efforts to combat money laundering in the Indian banking system, the Reserve Bank of India constituted a Committee on Bank Frauds in 1999 (Chairman: Shri B.D. Narang). The Committee advised putting in place procedures, systems and controls to help identify money laundering, for customer identification, and scrutiny and monitoring of transactions including a careful examination of the purpose and nature of business carried out by customers. The banks have been given suitable instructions based on the recommendations.

5.16 Last year, a Working Group comprising of representatives from the Reserve Bank, Indian Banks Association (IBA), and the banking industry was set up by the IBA to develop procedures to study global practices in checking money laundering and to draft norms on anti money laundering procedures. The recommendations of the Working Group are expected to serve as a ‘ self regulatory code’ for the banking system. The fundamental principle of anti money laundering policy continues to rest on the concept of ‘ know your customer’, requiring banks to conduct a thorough scrutiny for customer identification at the time of opening of account and to take precautionary steps to prevent doubtful transactions. The Group has suggested that the background details of customers such as salary structure and amount deposited should be scrutinized and inconsistencies reported to relevant authorities. Towards this purpose, the Group has prepared a format for collating a ‘customer profile’ to help banks to classify the account into different risk categories for the purpose of activity monitoring. A major recommendation of the Group is the need for appointment of a Money Laundering Reporting Officer by every bank to whom the branches would report suspicious activities. To facilitate this, the Group has prepared an indicative list of transactions requiring due diligence to assist banks in detecting suspicious activities. Banks are also to develop and implement reporting structures within the present legal structure and institute checks and balances to ensure close scrutiny on cash transactions. The Recommendations of the IBA on Anti Money Laundering are

being taken into account in the issue of guidelines for adoption by all banks in India in a uniform manner.

5.17 The Reserve Bank set up an expert committee on Bank Frauds in 2001 (Chairman: Professor N.L Mitra) to suggest measures for countering the problem of bank frauds. In its Report, the Committee has suggested setting up of a separate investigation bureau and a special court, converting the CBI special cell on economic offences into a full fledged body and constitution of a committee of representatives from all financial regulators in banking, capital market and insurance for preliminary investigation for the determination of the exact nature of the crime. In order to activate the proposed framework, the Committee has proposed that whereas the investigation bureau should be staffed with experts drawn from various areas and entities such as from banks, insurance, capital market regulator, financial experts and persons with knowledge in information technology, it recommended that appeals against the ruling of special courts lie only with the Supreme Court so as to have expeditions settlement of cases. Further, investigators, under permission of the special courts, should be empowered to search, seize and attach funds and properties obtained by frauds. The courts should also be empowered to confiscate such property and restore these to the rightful owner (s). To deal with cases of major financial frauds the Committee proposed appointment of special prosecutors by the Government. The recommendations have important implications in carrying forward the concept of market integrity in dealing with financial crimes.

5.18 In order to oversee and guide these arrangements, the Committee proposed setting up of a Statutory Fraud Committee under the Chairmanship of a nominee of the Reserve Bank and which should include one nominee each from SEBI and IRDA. Nominees to the Committee should have varied expertise and experience in banking, insurance, capital market operation and management of financial systems. Further to improve co-ordination, all regulators of the financial system must meet the bureau periodically under the Chairmanship of the RBI Governor to exchange information and review actions taken in cases of banking and financial fraud.

5.19 The Report contended that there was a need to define ‘financial fraud’ as a crime and to undertake serious measures to deal with it. This suggestion of the

Committee purports to bring bank/financial frauds under the ambit of the meaning of money laundering. In this context, the Committee also proposed that banks, financial institutions and financial intermediaries should consider evolving a 'Best Practice Code' and submit it to the regulator as per the recommendations made by the expert committee constituted by the RBI to study the legal aspects of bank frauds. Finally, the Committee suggested a two pronged approach to handle bank and financial frauds focusing on preventive measures to minimize the number of instances of fraud and prohibitive measures to deal firmly with incidents of financial fraud.

5.20 **Prevention of Terrorism Act -**

The promulgation of the Prevention of Terrorism Act (POTA), 2002 by the President of India is the first comprehensive legal effort for the prevention of, and for dealing with, terrorist activities and for matters connected therewith. Chapter II of the Act proposes specific punishments for, and measures for dealing with terrorist activities. It fulfils India's obligations in complying with the UN Security Council Resolution No. 1373 requiring member nations to undertake comprehensive measures to tackle the problem of terrorism. Section 3(6) of the Act provides for life imprisonment or/with fine extending to Rupees ten lakhs for any person knowingly holding property derived or obtained from commission of any terrorist act or through terrorist funds. Section 8 of the Act also allows forfeiture by the central government of proceeds of terrorism, whether or not the person from whose possession it is seized or attached, is prosecuted under this Act. The Act provides for safeguards in providing an opportunity to the person whose property has been seized. The Act attempts to deter terrorist activities in general and enforce seizure and blocking of money for financing of terrorism.

Chapter VI

Status of Indian Compliance With the Recommendations of Fatf on Money Laundering and Terrorist Financing

6.1 To counter the growing menace of money laundering and financing of terrorism, a number of legal and other measures are contemplated. The ongoing work in the area is also being expedited in areas where existing gaps with regard to international standards are noted. This Section provides a review of the status of compliance with the 40 recommendations of the FATF. A detailed assessment in respect of compliance with the FATF 40 and related Basel principles and criteria in the Methodology Document of the Fund is provided in Annexure II. It also highlights the efforts undertaken by relevant authorities to improve compliance. Most of these recommendations as well as the eight Special Recommendations concerning the financing of terrorism will be complied with following the enactment of The Prevention of Money Laundering Bill, 1999 and Prevention of Terrorism Act, 2002. The focus on FATF recommendations for assessment is relevant because compliance with these recommendations will automatically ensure compliance with relevant Basel principles and criteria laid down in the Fund Bank Methodology Document which overlap each other in several aspects.

Sr. No.	FATF 40 Recommendations	Present position
1	Each country should take immediate steps to ratify and to implement fully, the 1988 United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances **(the Vienna Convention)**	India is a signatory to the 1988 United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (the Vienna Convention).
2	Financial institution **secrecy laws** should be conceived so as not to inhibit implementation of these recommendations.	Disclosure in public interest or as per law by financial institutions is not considered a violation of secrecy even now. This position stands clearly articulated in the instructions issued by regulatory authorities.
3	An effective money laundering enforcement program should include **increased multilateral co-**	India has bilateral agreements and also fully abides by the international conventions in this

Sr. No.	FATF 40 Recommendations	Present position
	operation and mutual legal assistance in money laundering investigations and prosecutions and extradition in money laundering cases, where possible.	regard and no difficulty is anticipated in acceding to the requests for assistance in money laundering investigations both at the regulatory or Government levels. Besides, further specific provisions of reciprocal arrangement for assistance to a "Contracting State" i.e. any country or place outside India in respect of which arrangements have been made by the Central Government with the Government of such country through a treaty or otherwise" are included in the proposed enactment.
4	Each country should take such measures as may be necessary, including legislative ones, to enable it to **criminalise money laundering** as set forth in the Vienna Convention. Each country should extend the offence of drug money laundering to one based on serious offences. Each country would determine which serious crimes would be designated as money laundering predicate offences.	Money laundering has been declared a criminal offence in the Prevention of Money Laundering Bill, 1999 and has been defined as "acquisition, possession, ownership or transfer of any proceeds of crime or entering knowingly into transactions related to the proceeds of crime or concealing or aiding in the concealment of proceeds of crime".
5	As provided in the Vienna Convention, the offence of money laundering should apply at least to **knowing money laundering activity**, including the concept that knowledge may be inferred from objective factual circumstances.	In existing circulars, the focus is more on prevention and dealing with fraud and tax evasion rather than on the problems of money laundering. However, in terms of the Criminal Procedure Code, information about any criminal activity which is known but not passed on to enforcement authorities is construed as abetment of an offence punishable under law.
6	Where possible, **corporations** themselves - not only their employees - should be **subject to criminal liability**.	Under the Prevention of Money Laundering Bill, 1999, various categories including companies are subject to criminal liability.

Sr. No.	FATF 40 Recommendations	Present position
7	Countries should adopt measures similar to those set forth in the Vienna Convention, as may be necessary, including legislative ones, to enable their competent authorities to **confiscate property laundered**, proceeds from, instrumentalities used in or intended for use in the commission of any money laundering offence, or property of corresponding value, without prejudicing the rights of bona fide third parties.	The Prevention of Money Laundering Bill, 1999, provides for attachment, adjudication and confiscation of property involved in Money-laundering.
8	**Recommendations 10 to 29 should apply** not only to banks, but also **to non-bank financial institutions**. Even for those non-bank financial institutions which are not subject to a formal prudential supervisory regime in all countries, for example bureaux de change, governments should ensure that these institutions are subject to the same anti-money laundering laws or regulations as all other financial institutions and that these laws or regulations are implemented effectively.	At present most of the activities listed in the annex and carried out by banks, financial institutions, non banking entities and other corporates are supervised by the respective regulatory authority, viz, RBI, SEBI, IRDA, Forward Market Commission. Entity-wise regulators are listed separately in the Annexure. Formal arrangements for information sharing between SEBI and the RBI (as a supervisor of non-banking entities and other foreign exchange bureaus) exist even now and a nominee of RBI is placed on the Board of SEBI. IRDA is framing rules for insurance authorities and regulatory exchange of information is taking place. The concept of "know your customer" is well entrenched in the Insurance Sector as "Insurance is sold rather than bought". Interaction of the insurance agent, development officers with the policyholders works well in preventing and deterring money-laundering practices in the Indian insurance system. The Securities and Exchange

Sr. No.	FATF 40 Recommendations	Present position
		Board of India (SEBI), the regulator for the capital markets, has issued regulations prohibiting fraudulent and unfair trade practices relating to securities markets under the SEBI Act, 1992.
9	The appropriate national authorities should consider applying Recommendations 10 to 21 and 23 to the conduct of financial activities as a commercial undertaking by businesses or professions which are not financial institutions, where such conduct is allowed or not prohibited. Financial activities include, but are not limited to, those listed in the attached annex.	Entities other than financial institutions engaged in financial activities listed in the recommendation also come under the purview of certain other regulators.
10	Financial institutions should **not keep anonymous accounts** or accounts in obviously fictitious names: they should be required (by law, by regulations, by agreements between supervisory authorities and financial institutions or by self-regulatory agreements among financial institutions) to identify, on the basis of an official or other reliable identifying document, and record the identity of their clients, either occasional or usual, when establishing business relations or conducting transactions (in particular opening of accounts or passbooks, entering into fiduciary transactions, renting of safe deposit boxes, performing large cash transactions).	As part of 'know your customer' principle RBI has been advising banks to adhere to prescribed guidelines relating to identification of depositors. The banks have been advised to safeguard against unscrupulous persons opening "benami" (fictitious) accounts mainly to use them as conduit for fradulently encashing third party cheques, etc. Opening of accounts only after proper verification of the identity of the customer has also been made applicable in case of requests for account opening over the Internet. When the insurance proposals are submitted by the policyholders, the agents in the area, where the proposers are residing, verify all the details mentioned in the proposal forms and certify the correctness of the same. Furthermore, the regulations do not allow payment of commission or any other considerations to be

Sr. No.	FATF 40 Recommendations	Present position
		paid to persons other than designated/registered insurance agents.
11	Financial institutions should take reasonable **measures to obtain information about the true identity** of the persons on whose behalf an account is opened or a transaction conducted if there are any doubts as to whether these clients or customers are acting on their own behalf, for example, in the case of domiciliary companies (i.e. institutions, corporations, foundations, trusts, etc. that do not conduct any commercial or manufacturing business or any other form of commercial operation in the country where their registered office is located).	Detailed instructions have been issued by RBI to banks from time to time on Customer identification, Unusual transactions that arouse suspicion, Reporting mechanism to facilitate further probe, Maintenance of records, etc. However, considering the genuine difficulties in establishing the source of funds in respect of certain deposit accounts designated in foreign currency, accepted by banks in India, there is a need for rationalizing the schemes available for non-resident Indians at present.
12	Financial institutions should maintain, for at least five years, all necessary records on transactions, both domestic or international, to enable them to comply swiftly with information requests from the competent authorities. Such records must be sufficient to permit reconstruction of individual transactions (including the amounts and types of currency involved if any) so as to provide, if necessary, evidence for prosecution of criminal behaviour. Financial institutions should keep records on customer identification (e.g. copies or records of official identification documents like passports, identity cards, driving licenses or similar documents), account files and business correspondence for at least five years after the account is closed.	Records on transactions are preserved as per provisions of the Banking Companies (Period of Preservation of Records) Rules, 1985, Bankers' Book Evidence Act, 1891. In terms of this, records are to be kept for at least eight years after closure of the account in certain cases. Documents are available to competent authorities. The proposal form is the property of insurance companies and the company maintains the records till the policy matures and even for a period of seven years after the policy matures. The insurance agents cannot keep the proposal forms with them and they have to submit to the insurance company for further processing. Once the proposal is accepted, the company does not part with these forms under any circumstances to the agents.

Sr. No.	FATF 40 Recommendations	Present position
		The SEBI requires every stock broker to keep and maintain books of accounts, records and documents. Every stock broker is also required to intimate to the Board the place where the books of accounts, records and documents are maintained. FIIs have to ensure that the domestic custodian takes steps for reporting to SEBI information, including daily transactions entered into by the Foreign Institutional Investor and preservation for five years of records relating to his activities as a Foreign Institutional Investor.
13	Countries should pay special attention to **money laundering threats** inherent **in new** or developing **technologies** that might favour anonymity, and take measures, if needed, to prevent their use in money laundering schemes.	To address money laundering concerns associated with Internet banking, banks are permitted to offer banking facilities on Internet subject to the existing regulatory framework only. Thus a bank having physical presence in India only is allowed to offer banking services over Internet and cross border transactions are subject to existing exchange control regulations. The relevant extract from the Report of the Working Group on Internet Banking is enclosed as Annexure III.
14	Financial institutions should pay **special attention** to all complex, **unusual large transactions**, and all unusual patterns of transactions, which have no apparent economic or visible lawful purpose. The background and purpose of such transactions should, as far as possible, be examined, the findings established in writing, and be available to help supervisors, auditors and law enforcement agencies.	Several instructions have been issued in this regard. For eg, banks have been advised not to issue drafts, M.T. etc. for over Rs.50,000/- against deposit of cash. Banks have also been advised to monitor flow of funds and keep a proper vigil over requests for cash withdrawal of large amounts. Maintenance of record by branches in respect of cash transactions for Rs.10 lakh and above and reporting the same to the controlling offices every fortnight. Banks authorized to

Sr. No.	FATF 40 Recommendations	Present position
		import gold are required to ensure that payments towards gold/silver/platinum of value of Rs.50,000 and above is received only by debit to customers account or against cheque or other instruments tendered by purchasers and not in cash. Banks are required to pay special attention to all complex, unusual large transactions and all unusual pattern of transactions, which have no apparent underlying economic or business purpose. Whenever a proposal is received the insurance companies undertake not only medical underwriting but also the financial underwriting and ensure that the transaction is not unusual. Any kind of abnormality is reported to higher authorities and they check the consistency of the same in accordance to the policy holders income position etc. No intermediary is entertained other than the registered insurance agents/advisors. Even the payment of commission to the agents is well documented and transparent.
15	If financial institutions suspect that funds stem from a criminal activity, they should be required to **report** promptly their **suspicions to the competent authorities**.	While existing laws do not prescribe suspicious activity reporting by banks, records of banks are open to inspection for the authorities who have access to records under search and seizure powers vested in them.
16	**Financial institutions**, their directors, officers and employees should be **protected by legal provisions** from criminal or civil liability for breach of any restriction on disclosure of information imposed by contract	Though banks in India are obliged to maintain secrecy arising out of contractual relationship with their constituents, the obligation is subject to exceptions such as disclosure under compulsion of law, if there is a duty to the public

Sr. No.	FATF 40 Recommendations	Present position
	or by any legislative, regulatory or administrative provision, if they report their suspicions in good faith to the competent authorities, even if they did not know precisely what the underlying criminal activity was, and regardless of whether illegal activity actually occurred.	to disclose, if the interest of the bank requires it, and where disclosure is with the express or implied consent of the customer. There are extensive guidelines and internal service rules which provides necessary protection to legitimate reporting. Various statutes relating to Government revenue collection, Criminal Procedure Code and related laws also enable such reporting to the competent authority in confidence by a member of public. The Prevention of Money Laundering Bill, 1999 stipulates that financial institutions, banking companies, etc will not be liable to civil proceedings against them for furnishing information as required under the Act.
17	**Financial institutions**, their directors, officers and employees, should not, or, where appropriate, should **not** be allowed **to**, **warn their customers** when information relating to them is being reported to the competent authorities.	The responsibility for monitoring and reporting of suspicious or unusual cash transactions is currently enjoined upon banks. A number of instructions have been issued by RBI from time to time specifying follow up of such transactions and revision by higher authorities. Maintenance of confidentiality is implicit in this exercise and banks are obliged to keep the exercise outside the knowledge of the customer concerned.
18	Financial institutions reporting their suspicions should **comply with instructions from the competent authorities**.	The Prevention of Money Laundering Bill lists out the competent authorities for the purposes of the Act and the obligation to comply with further directions thereafter.
19	Financial institutions should **develop programs against money**	Though instructions exist on the general purport of the

Sr. No.	FATF 40 Recommendations	Present position
	laundering. These programs should include, as a minimum : (i) the development of internal policies, procedures and controls, including the designation of compliance officers at management level, and adequate screening procedures to ensure high standards when hiring employees; (ii) an ongoing employee training programme ; (ii) an audit function to test the system.	recommendation, the emphasis is more on frauds and other related risks. Reporting of frauds, case by case, for more than Rs.100,000 is in place. Such frauds are reported to banks' top management as well as to RBI under the reporting system prescribed by RBI. This vigilance function in banks co-ordinates with RBI as well as the Central Vigilance Commission (for Government owned banks). RBI has advised banks to report frauds immediately to the concerned investigative agency particularly in respect of large value frauds. However, an orientation of the guidelines to anti-money laundering measures is required, including institution of ongoing employee training programme and audit function to test the system. As per the IRDA regulations, insurance agents have to undergo a minimum specified period of training and in this training they are taught interalia about the vigilance policy and the need for verification of all details given by the proposers. Since the insurance agents act as an intermediary between the Company and the policyholders, they have to certify the correctness of information given by the policy holders/proposals and these insurance agents are under supervision of other middle/senior management of the insurance company.
20	Financial institutions should ensure that the **principles** mentioned above are also **applied to branches and majority owned**	Branches located abroad have been advised to comply with host country regulations. They are required to provide Report on

Sr. No.	FATF 40 Recommendations	Present position
	subsidiaries located abroad, especially in countries which do not or insufficiently apply these Recommendations, to the extent that local applicable laws and regulations permit. When local applicable laws and regulations prohibit this implementation, competent authorities in the country of the mother institution should be informed by the financial institutions that they cannot apply these Recommendations.	Frauds as part of Returns prescribed by RBI under Offsite Monitoring System.
21	Financial institutions should give special attention to business relations and transactions with persons, including companies and financial institutions, from countries which do not or insufficiently apply these Recommendations. Whenever these transactions have no apparent economic or visible lawful purpose, their background and purpose should, as far as possible, be examined, the findings established in writing, and be available to help supervisors, auditors and law enforcement agencies.	Institutionalized arrangements to keep record of transactions through the financial system of entities in non-cooperative countries falls in the domain of Government's law enforcement machinery and needs to be coordinated with Ministry of External Affairs.
22	Countries should consider implementing feasible measures to detect or monitor the physical cross-border transportation of cash and bearer negotiable instruments, subject to strict safeguards to ensure proper use of information and without impeding in any way the freedom of capital movements.	Restrictions have been imposed on export out of India and import into India of Indian currency as well as foreign currency. Given the prevailing restrictions on capital account convertibility, scope for money laundering through movement of capital is limited. Customs authorities monitor the cross-border movement of funds.
23	Countries should consider the feasibility and utility of a system where banks and other financial institutions and intermediaries	All transactions in foreign exchange are reported to the Reserve Bank through a prescribed Return which in turn forms the

Sr. No.	FATF 40 Recommendations	Present position
	would report all domestic and international currency transactions above a fixed amount, to a national central agency with a computerised data base.	basis of data collection by the Bank.
24	Countries should further encourage in general the development of modern and secure techniques of money management, including increased use of checks, payment cards, direct deposit of salary checks, and book entry recording of securities, as a means to encourage the replacement of cash transfers.	To encourage non-cash transactions, licensing policy for offsite and onsite Automated Teller Machines (ATMs) has been liberalised. In addition to credit cards, banks have extended the facility of smart/debit cards to their customers. Transactions in Government securities by institutions are done through the delivery vs payment system and settled through book entries.
25	Countries should take **notice of the potential for abuse of shell corporations** by money launderers and should consider whether additional measures are required to prevent unlawful use of such entities.	Shell banks (ie banks without a physical presence) are not allowed to be set up under the extant regulations.
26	The competent authorities supervising banks or other financial institutions or intermediaries, or other competent authorities, should ensure that the supervised institutions have adequate programs to guard against money laundering. These authorities should co-operate and lend expertise spontaneously or on request with other domestic judicial or law enforcement authorities in money laundering investigations and prosecutions.	As observed in the Financial Sector Assessment Programme of India by the Fund, existing RBI guidelines against money laundering and fraud are generally adequate although the FATF norms have not been adopted. There is scope to adapt the present rules and procedures which relate to the prevention and dealing with fraud, more specifically to the problem of money laundering.
27	Competent authorities should be designated to ensure an effective implementation of all these Recommendations, through	Designation of Competent authorities in the PMLB will facilitate effective implementation of this recommendation.

Sr. No.	FATF 40 Recommendations	Present position
	administrative supervision and regulation, in other professions dealing with cash as defined by each country.	
28	The competent authorities should establish guidelines which will assist financial institutions in detecting suspicious patterns of behaviour by their customers. It is understood that such guidelines must develop over time, and will never be exhaustive. It is further understood that such guidelines will primarily serve as an educational tool for financial institutions' personnel.	RBI has been circulating to banks details of frauds of ingenious nature which come to its notice so that individual banks could introduce the necessary safeguards to prevent and detect such frauds. To assist banks in detecting suspicious patterns of behaviour by their customers, an indicative list of transactions requiring due diligence has been prepared by the Bank and by the IBA Working Group.
29	The competent authorities regulating or supervising financial institutions should take the necessary legal or regulatory measures to guard against control or acquisition of a significant participation in financial institutions by criminals or their confederates.	Sufficient safeguards exist in the Banking Regulation Act for due diligence to ensure that a person not 'fit and proper' can neither set up nor acquire a controlling stake in a bank. Moreover transfer of shares in a bank in excess of the ceiling of 5% requires the consent of the RBI and the transfer is invalid in the absence of the central bank's acknowledgement. A significant provision in B.R. Act relates to restriction of voting rights to 10% regardless of the actual extent of shareholding.
30	National administrations should consider recording, at least in the aggregate, international flows of cash in whatever currency, so that estimates can be made of cash flows and reflows from various sources abroad, when this is combined with central bank information. Such information should be made available to the International Monetary Fund and the Bank for International Settlements to facilitate	Inflow into the country and outflow out of the country of foreign exchange are compiled by the Bank and made available to the IMF, etc. Incidentally, arrangement exists under the Special Data Dissemination Standards (SDDS) of the IMF for international exchange of information, especially on macro-economic issues.

Sr. No.	FATF 40 Recommendations	Present position
	international studies.	
31	International competent authorities, perhaps Interpol and the World Customs Organisation, should be given responsibility for gathering and disseminating information to competent authorities about the latest developments in money laundering and money laundering techniques. Central banks and bank regulators could do the same on their network. National authorities in various spheres, in consultation with trade associations, could then disseminate this to financial institutions in individual countries.	Considerable promotional and educational work needs to be done by RBI to inculcate the discipline needed to prevent use of banking channels for money laundering purposes.
32	Each country should make efforts to improve a spontaneous or "upon request" international information exchange relating to suspicious transactions, persons and corporations involved in those transactions between competent authorities. Strict safeguards should be established to ensure that this exchange of information is consistent with national and international provisions on privacy and data protection.	Mechanism exists for provision of information under certain forums such as through the Interpol network. The system of cooperation and sharing of information with foreign supervisory agencies is well set.
33	Countries should try to ensure, on a bilateral or multilateral basis, that different knowledge standards in national definitions - i.e. different standards concerning the intentional element of the infraction - do not affect the ability or willingness of countries to provide each other with mutual legal assistance.	India has a good pool of accounting and legal professionals and no difficulty is anticipated in complying with this Recommendation. The country is also moving towards adoption of international standards in accounting and other prudential norms. This facilitates a common knowledge base and easier understanding of the operations of the Indian financial system.
34	International co-operation should be supported by a network of	Due importance is attached by the Government of India to enhancing

Sr. No.	FATF 40 Recommendations	Present position
	bilateral and multilateral agreements and arrangements based on generally shared legal concepts with the aim of providing practical measures to affect the widest possible range of mutual assistance.	bilateral and multilateral cooperation through agreements and other arrangements for exchange of information. The legal system in India has developed over centuries and legislative changes have been made in tune with international legislative requirements.
35	Countries should be encouraged to ratify and implement relevant international conventions on money laundering such as the 1990 Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime.	India as a member of the G-20 and Asia-Pacific Group on Anti Money Laundering has been actively involved in international efforts to counter money laundering.
36	Co-operative investigations among countries' appropriate competent authorities should be encouraged. One valid and effective investigative technique in this respect is controlled delivery related to assets known or suspected to be the proceeds of crime. Countries are encouraged to support this technique, where possible	India has requisite arrangements with international major law enforcement authorities.
37	There should be procedures for mutual assistance in criminal matters regarding the use of compulsory measures including the production of records by financial institutions and other persons, the search of persons and premises, seizure and obtaining of evidence for use in money laundering investigations and prosecutions and in related actions in foreign jurisdictions.	Contemplated in the Prevention of Money Laundering Bill, 1999.
38	There should be authority to take expeditious action in response to requests by foreign countries to identify, freeze, seize and	Contemplated in the Prevention of Money Laundering Bill, 1999.

Sr. No.	FATF 40 Recommendations	Present position
	confiscate proceeds or other property of corresponding value to such proceeds, based on money laundering or the crimes underlying the laundering activity. There should also be arrangements for coordinating seizure and confiscation proceedings which may include the sharing of confiscated assets.	
39	To avoid conflicts of jurisdiction, consideration should be given to devising and applying mechanisms for determining the best venue for prosecution of defendants in the interests of justice in cases that are subject to prosecution in more than one country. Similarly, there should be arrangements for coordinating seizure and confiscation proceedings which may include the sharing of confiscated assets.	Contemplated in the Prevention of Money Laundering Bill, 1999.
40	Countries should have procedures in place to extradite, where possible, individuals charged with a money laundering offence or related offences. With respect to its national legal system, each country should recognise money laundering as an extraditable offence. Subject to their legal frameworks, countries may consider simplifying extradition by allowing direct transmission of extradition requests between appropriate ministries, extraditing persons based only on warrants of arrests or judgements, extraditing their nationals, and/or introducing a simplified extradition of consenting persons who waive formal extradition proceedings.	Contemplated in the Prevention of Money Laundering Bill, 1999.

Sr. No.	FATF 8 Recommendations	Present position
1	**Ratification and implementation of UN instruments** Each country should take immediate steps to ratify and to implement fully the 1999 United Nations International Convention for the Suppression of the Financing of Terrorism. Countries should also immediately implement the United Nations resolutions relating to the prevention and suppression of the financing of terrorist acts, particularly United Nations Security Council Resolution 1373.	The United Nations (Security Council) Act, 1947 enables the Central Government to give effect to any decision of the Council by making provisions for effective application of those measures including punishment of persons offending against the order. Following the promulgation of the Prevention of Terrorism Ordinance, 2001 for the prevention of terrorist activities, in October 2001, it was decided in consultation with the Government of India, that banks should keep a watchful eye on the transactions of the terrorist organizations identified and listed in the Schedule to the Ordinance. If something is found violative of the extant Acts or normal banking operations, the matter is to be reported by the concerned bank to the appropriate authorities under the Ordinance, under advice to RBI.
2	**Criminalising the financing of terrorism and associated money laundering** Each country should criminalise the financing of terrorism, terrorist acts and terrorist organisations. Countries should ensure that such offences are designated as money laundering predicate offences.	Money laundering has been declared a criminal offence in the Prevention of Money Laundering Bill, 1999 and has been defined as "acquisition, possession, ownership or transfer of any proceeds of crime".
3	**Freezing and confiscating terrorist assets**	

Sr. No.	FATF 8 Recommendations	Present position
	Each country should implement measures to freeze without delay funds or other assets of terrorists, those who finance terrorism and terrorist organisations in accordance with the United Nations resolutions relating to the prevention and suppression of the financing of terrorist acts. Each country should also adopt and implement measures, including legislative ones, whichwould enable the competent authorities to seize and confiscate property that is the proceeds of, or used in, or intended or allocated for use in, the financing of terrorism, terrorist acts or terrorist organizations.	Action to freeze bank accounts of listed entities is taken at the instance of Government of India. RBI is empowered under Section 11 of FEMA to give directions to authorised persons in regard to making of payment or doing or desist from doing any act relating to foreign exchange or foreign security.
4	**Reporting suspicious transactions related to terrorism** If financial institutions, or other businesses or entities subject to anti-money laundering obligations, suspect or have reasonable grounds to suspect that funds are linked or related to, or are to be used for terrorism, terrorist acts or by terrorist organisations, they should be required to report promptly their suspicions to the competent authorities.	While existing laws do not prescribe suspicious activity reporting by banks, records of banks are open to inspection for the authorities who have access to records under search and seizure powers vested in them.
5	**International Co-operation** Each country should afford another country, on the basis of a treaty, arrangement or other mechanism for mutual legal assistance or information exchange, the greatest possible	The Prevention of Money Laundering Bill, 1999, provides for reciprocal arrangement for assistance to a "Contracting State" i.e. any country or place outside India in respect of which

Sr. No.	FATF 8 Recommendations	Present position
	measure of assistance in connection with criminal, civil enforcement, and administrative investigations, inquiries and proceedings relating to the financing of terrorism, terrorist acts and terrorist organisations. Countries should also take all possible measures to ensure that they do not provide safe havens for individuals charged with the financing of terrorism, terrorist acts or terrorist organisations, and should have procedures in place to extradite, where possible, such individuals.	arrangements have been made by the Central Government with the Government of such country through a treaty or otherwise".
6	**Alternative Remittance** Each country should take measures to ensure that persons or legal entities, including agents, that provide a service for the transmission of money or value, including transmission through an informal money or value transfer system or network, should be licensed or registered and subject to all the FATF Recommendations that apply to banks and non-bank financial institutions. Each country should ensure that persons or legal entities that carry out this service illegally are subject to administrative, civil or criminal sanctions.	Services for the transmission of money or value are provided by banks, financial institutions, non-banking entities and corporates who are supervised by the respective regulatory authorities viz. RBI, SEBI, IRDA, Forward Market Commission.
7	**Wire transfers** Countries should take measures to require financial institutions, including money remitters, to include accurate and meaningful originator information (name, address and account number) on	Money remittance can currently be done in India through Authorised Dealers (banks) and through Postal Department. The remittance through post offices is restricted and cannot be misused. The

Sr. No.	FATF 8 Recommendations	Present position
	funds transfers and related messages that are sent and the information should remain with the transfer or related message through the payment chain. Countries should take measures to ensure that financial institutions, including money remitters, conduct enhanced scrutiny of and monitor for suspicious activity funds transfers which do not contain complete originator information (name, address and account number).	regulatory requirements and oversight over banks together with further action proposed in the light of FATF recommendations should facilitate compliance with this requirement.
8	**Non-profit organizations** Countries should review the adequacy of laws and regulations that relate to entities that can be abused for the financing of terrorism. Non-profit organisations are particularly vulnerable, and countries should ensure that they cannot be misused ✍ by terrorist organizations posing as legitimate entities; ✍ to exploit legitimate entities as conduits for terrorist financing, including for the purpose of escaping asset freezing measures; and ✍ to conceal or obscure the clandestine diversion of funds intended for legitimate purposes to terrorist organizations.	The banks are prohibited under the Foreign Contribution (Regulation) Act to open deposit accounts of non-profit organizations and for receipt of donations from foreign countries unless the organization has a valid registration issued by Government of India. This restriction would keep in check attempts of terrorist organizations to obtain resources by registering as legitimate Non-government organisations.

Chapter VII

Status of Compliance with G-7 principles of Market Integrity

7.1 Ten Principles of G-7

To improve international co-operation regarding financial crimes and regulatory abuse, the Group of Seven countries (G-7) set out ten key principles for improving international cooperation between law enforcement authorities and financial regulators on cases involving financial crime and regulatory abuse. The ten key principles that synthesize 'market integrity' issued by the G-7 require, essentially :

(i) maximum cooperation domestically among regulators and law enforcement authorities in matters of financial crimes,

(ii) clear definitions of the role, duty and obligations of all national authorities involved in combating illicit financial activity,

(iii) accessible transparent channels for cooperation and exchange of information on financial crime and regulatory abuse at the international level,

(iv) improving the quality of national cooperation between law enforcement authorities and financial regulators to secure fast and efficient indirect exchange of information,

(v) ensuring spontaneous provision of information by law enforcement authorities and regulators in response to requests at the international level,

(vi) providing for laws and systems to enable foreign financial regulators to share information for the full range of their responsibilities subject to limitations enunciated at the outset,

(vii) providing for passing on the shared information on financial crimes or regulatory abuse, with prior consent to other such authorities in that jurisdiction,

(viii) providing for confidentiality on shared information and its use only for the purposes stated in the original request including observance of the limitations imposed on its supply,

(ix) ensuring that arrangements for supplying information within regulatory and law enforcement cooperation framework are fast, effective and transparent and reasons for not sharing information with one another are clearly laid down

(x) ensuring review of laws and procedures relating to international cooperation so as to allow improvements in response to changing circumstances.

7.2 Current regulatory framework in India

In India, there are several agencies entrusted with the task of regulation and supervision of different institutions and market participants in the financial sector. While the specific objective may vary from depositor protection and investor protection to market regulation, their common concern is maintaining financial stability. The Reserve Bank of India (RBI) regulates and supervises the major part of the financial system through its various departments. The supervisory role covers Commercial Banks, Non-Banking Financial Companies (NBFCs), Urban Cooperative Banks (UCBs) and some All-India Financial Institutions (AIFIs). Some of these AIFIs in turn regulate and/or supervise other institutions in the financial sector, viz., Regional Rural Banks (RRBs), and Central and State Cooperative Banks are supervised by the RBI through National Bank for Agriculture and Rural Development (NABARD); State Financial Corporations (SFCs) by Industrial Development Bank of India (IDBI) (to be transferred to SIDBI) and Housing Finance Companies by National Housing Bank (NHB).

7.3 The Securities and Exchange Board of India (SEBI) regulates the capital markets and supervises several institutions such as the Stock Exchanges, Mutual Funds and other Asset Management Companies, securities dealers and brokers, Merchant Bankers and Credit Rating Agencies. SEBI regulates venture capital funds also. Companies in the insurance sector are regulated by Insurance Regulatory Development Authority (IRDA). Banks are permitted to be involved in insurance activity through joint ventures / equity participation/selling agency type arrangements. The Department of Company Affairs (DCA) regulates the deposit taking activities of non-banking non-financial companies and also some activities of NBFCs.

7.4 Several mechanisms exist to ensure coordination among the various regulators in the financial system. There is exchange of information on a routine basis and on occasions through special request. A nominee of RBI is on the Board of SEBI. While

nominees of Ministry of Finance and Department of Company Affairs are on the Board of SEBI along with a Deputy Governor of RBI, the Finance Secretary is a member (without voting rights) of the Board of Directors of RBI.

7.5 A High Level Committee on Capital Markets is presided over by the Governor RBI in which the Finance Secretary/Secretary Economic Affairs, Chairman SEBI, and Chairman IRDA are associated as members. The High Level Committee has constituted a Standing Working Group to enable coordination between Ministry of Finance, RBI and SEBI at the operating level and assist the Committee in its deliberations. Conferring legal status to this Committee to set up an apex regulatory authority was suggested by an Advisory Group to address regulatory gaps and overlaps in the functioning of RBI, SEBI and the government departments of company and economic affairs. Similarly, the setting up of a system to allow designated functionaries to share specified market information on a routine and automatic basis was suggested. Following the preparation of a Technical Paper on Regulation of Debt Market, 1999, the Government by issuing notification under Section 29 A of the Securities and Contracts Regulation Act has clearly demarcated the regulatory jurisdiction over money, and government securities market.

7.6 It is expected that information sharing arrangements between regulators and enforcement agencies will be put in place after the agency to administer the proposed Money Laundering Legislation is identified.

7.7 The current status of India's compliance vis-a-vis the G-7 principles of market integrity are as under :

Recommendation	Present Status
(i) Maximum cooperation domestically among regulators and law enforcement authorities in matters of financial crimes	Informal mechanisms exist for cooperation domestically among regulators and law enforcement authorities in matters of financial crimes.
(ii) Clear definitions of the role, duty and obligations of all national authorities involved in combating illicit financial	The role, duty and obligations of authorities are formalized in Acts enacted by the legislature. The

Recommendation	Present Status
activity	Economic Offences wing of the Enforcement Directorate, the Reserve Bank, SEBI, Income Tax and Customs etc are statutory bodies with clear definition of roles and responsibilities. The vigilance function in banks co-ordinates with RBI as well as the Central Vigilance Commission (for Government owned banks). For example, RBI has advised banks to report frauds immediately to the concerned investigative agency particularly in respect of large value frauds.
(iii) Accessible transparent channels for cooperation and exchange of information on financial crime and regulatory abuse at the international level	The Prevention of Money Laundering Bill, 1999, provides for reciprocal arrangement for assistance to a "Contracting State" i.e. "any country or place outside India in respect of which arrangements have been made by the Central Government with the Government of such country through a treaty or otherwise".
(iv) Improvement in the quality of national cooperation between law enforcement authorities and financial regulators to secure fast and efficient indirect exchange of information	There is a well functioning system of cooperation and information sharing between the relevant domestic agencies responsible for the soundness of the financial system. This includes supervisors for banks and other institutions, as well as tax authorities and law enforcement authorities, for example. The coordination mechanism among regulatory authorities is formalised in some cases such as in state-level coordination committees and task forces which are need-based and issue-based. Coordination mechanisms among agencies would be strengthened once the PMLB is passed.
(v) Spontaneous provision of information by law enforcement authorities and regulators in response to requests at the international level	Mechanism exists for provision of information under certain forums such as through the Interpol network. The system of cooperation and sharing of information with foreign supervisory agencies is well set.

Recommendation	Present Status
(vi) Laws and systems to enable foreign financial regulators to share information for the full range of their responsibilities subject to limitations enunciated at the outset	Sharing of information takes place through India's participation as a member of various international organizations such as the Interpol and in forums such as Fund-Bank meetings which provides an opportunity for information sharing. Information sharing on mutual basis with other regulators such as FSA, Federal Reserve, and MAS, in countries where Indian banks have operations, is orderly and systematic.
(vii) Passing on the shared information on financial crimes or regulatory abuse, with prior consent to other such authorities in that jurisdiction	Information, wherever necessary, is shared in public interest and in accordance with the laws of the land between regulators under due process of law and to facilitate law enforcement in consonance with statutory provisions. Centralised arrangements in this regard are being contemplated.
(viii) Confidentiality on shared information and its use only for the purposes stated in the original request including observance of the limitations imposed on its supply	The statutes governing regulators provide for obligation of confidentiality on the part of the regulator and sharing of information is subjected to such obligation. This ensures that information is used only for the purpose for which it is intended. Thus, information released to another supervisor may only be used for supervisory purposes.
(ix) Arrangements for supplying information within regulatory and law enforcement cooperation framework are as fast, effective and transparent. Discuss reasons as appropriate with one another where information cannot be shared	Efforts are on by the government to bring together various regulatory and law enforcement agencies which are regulating economic entities and where scope exists for financial crimes to take place. Improved coordination and central data base are also being planned.
(x) Review of laws and procedures relating to international cooperation so as to allow improvements and appropriate response in changing circumstances.	There is need to compare and assess laws of various countries to arrive at a common understanding of various crimes. Differences exist, for example, on what is "excessive" in "excessive bank secrecy. Differences exist among jurisdictions as to what acts constitute

Recommendation	Present Status
	crimes, which raise questions as to which domestic laws one country may help another in enforcing. For instance, some countries maintain a broad range of exchange controls (e.g. capital controls), violations of which are financial crimes. These financial crimes may not, however, be crimes in other countries.

Chapter VIII
Conclusions

8.1 Findings of the Assessment

Going by the assessment carried out above vis-à-vis FATF 40, India has complied with 15 recommendations, is deemed to have complied with 15 recommendations, and is compliant with scope for improvement with regard to 5 recommendations. Further review is required to establish compliance in respect of 5 recommendations pertaining to governmental issues. Regarding FATF 8, India has complied with 1 recommendation, is deemed to have complied with 4 recommendations, and is compliant with scope for improvement in respect of 3 recommendations. It is pertinent to record that the Financial Sector Assessment of IMF (with specific reference to compliance with Basle Core Principles) has also confirmed that the existing guidelines in India against money laundering and fraud are generally adequate, even though the FATF norms had not been adopted. However, in view of the potential scope for misuse of financial institutions for money laundering, levels of supervisory oversight, both intra organization and outside it, for the identification and reporting of unusual transactions needs to be further specified. Specific orientation of the existing KYC guidelines to prevent and detect money laundering is required.

The existing framework against money laundering activities in India would need further strengthening by improving procedures and policies for preparing appropriate customer profiles and coordination and cooperation with regulatory and other authorities (other than those that have search and seizure powers vested by law) for sharing of information and reporting of suspicious activities.

8.2 Future course of action

Further initiatives by the Government, by RBI, and other regulators in terms of legal changes, policy decisions, and adoption of procedures will be useful for more effective and coordinated implementation of the Recommendations. Significant among these are the enactment of the Prevention of Money Laundering Bill and the Prevention of Terrorism Act, and renewed emphasis by RBI on KYC guidelines with anti money laundering focus, for immediate implementation by banks.

The respective roles of the financial supervisory authorities and the enforcement and criminal/terrorist detection agencies has to be delineated and regulatory gaps and overlaps removed. At the same time, policy for individual banks will have to take into account the size and nature of operations of the bank and extent of computerization, keeping in view the specificities of the Indian context in which banks operate.

8.3 The specific areas where further action would be needed are the following :

? Creation of greater awareness of the threat of money laundering and terrorist financing through specific guidelines and other awareness programmes through training and media publicity.

? Adoption by banks of policy, procedures, and controls required to prevent potential misuse of the banking system by money launderers. This will include:

- Renewed emphasis on the need for concerned bank staff to familiarise themselves with "Know Your Customer" (KYC) policies and procedures in day-to-day business and with applicable laws and international norms recommended by FATF on Money Laundering.

- Account opening forms to capture additional information on the customer than being done at present and creation of a 'customer profile' on individual customers.

- Appointment of AML compliance officer for coordinating and monitoring day to day compliance with the bank's anti-money laundering policy.

? A re-look at the existing deposit schemes available for non-residents with particular emphasis on establishing source of funds.

? Creation of a data bank for suspicious transactions and circulation of indicative list of suspicious activities to assist banks in detecting suspicious patterns of behaviour by their customers.

? Suspicious Activity Reporting by banks in formats prescribed by the regulator

? Observance of safeguards by banks to ensure protection of customer's rights to privacy.

? Close scrutiny is required of business transactions with countries that do not conform with international anti money laundering standards.

? Effective coordination between regulatory and enforcement authorities and various agencies which are regulating economic entities and where scope exists for money laundering and frauds to take place. Establishing a nodal agency such as the Serious Frauds Office (SRO) may have to be examined to deal with suspicious activities and for coordinating investigation and follow up.

? More formal inter-regulatory arrangements also need to be considered to ensure the applicability of FATF recommendations across banks, non banks, other financial institutions and such businesses or professions which are not financial institutions but conduct financial activities as a commercial undertaking.

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[i] The ten subject areas considered by the Standing Committee, in fact, cover 11 subjects of the FSF list with Accounting and Auditing combined into one rather than considered separately.

[ii] Major characteristics of tax haven are:

(i) No arrangements for sharing tax information with other countries,(ii) availability of instant corporations,(iii) corporate secrecy laws,(iv) excellent electronic communications,(v) tight bank secrecy laws,(vi) a large tourist trade that can explains major inflows of cash,. (vii) use of major world currency, preferably the United States dollar, as the local money,(viii) relatively invulnerable government to outside pressure,(ix) high degree of economic dependence on the financial services sector, (x) geographic location that facilitates business travel to and from rich neighbors, (xi) time zone location,(xii) free-trade zone, and (xiii) availability of a flag-of-convenience shipping registry.