CHAPTER –IV
MONEY LAUNDERING IN INDIA: AN OFFSHOOT OF DRUG TRAFFICKING

Introduction

In India, the annual income generated from illicit drug trade, one of the biggest criminal enterprises, is very high. Transportation and distribution of drugs to affluent European and North American markets using the border States as transit point facilitate black money generation, which is not only an economic phenomenon; but having political, social and historical dimensions too. The unholy nexus between politicians and bureaucrats on the one hand and the business men on the other, fuels black economy in India\(^1\). The main source of black money is the illicit drug trade which has spawned large money laundering networks as a drain on the nation’s economy\(^2\).

The expression “money laundering”, which is closely aligned with other crimes such as fraud, theft, financing of terrorism\(^3\), trafficking in human beings, tax evasion, illegal diamond trade etc\(^4\). has been known to the general public throughout the world since 1989, when the media exposed the scandal
involving enormous money derived from drug trafficking and kept out of reach of investigators\(^5\).

The literal meaning of ‘laundering’ is ‘washing’; and “money laundering” can, therefore be termed as washing of the money which is tainted or earned from illegal activities and subsequently mixing up with legitimate funds in such a way that the original source is concealed and it appears to be money earned from a legitimate source. Huge sums generated by illegal drug trafficking forms the lion share of money laundered in India on account of the fact that India is a major illegal drug-transit country. The annual global turnover of laundered money in India is estimated to be around $ 500 million and the major share is generated by the illicit trade in narcotics\(^6\).

In 1972, the Wanchoo Committee cautioned: “black money is a cancerous growth in the countries’ economy which if not checked in time, will surely lead to its ruination; and the situation has been worsened by years”\(^7\). Moreover, in 1985, the National Institute of Public Finance and Planning (NIPFP) estimated the size of the black economy at 20% of the legitimate economy for 1980-81. Later, economist G.B Gupta reckoned the black economy to be worth 42% of GDP for 1980-81, and 51% for 1987-88\(^8\).
Economist Arunkumar estimated the black economy in 1995 at 40% of GDP. However, KPMG estimated it to be nearly 30 per cent of the GDP and stated that a part of that money could be getting laundered. At the economic summit in 2000, the then Central Vigilance Commissioner (CVC) estimated that black money accounted for 40% of GDP.

Money laundering is a process which involves cleansing of “dirty” money earned through criminal/illegal activities to disguise their illegal origin. The tainted money is projected as clean money through intricate processes of placement, layering and laundering. The process of money laundering is of critical importance as it enables the criminals to enjoy the profits generated by criminal acts without jeopardizing their source. When criminal activity generates substantial profits, the individual or the group involved tries to disguise the sources of ill-gotten funds or change the form of such funds, or move the funds to a place where they are less likely to attract attention. Consequently, the links between the politicians and businessmen, money laundering of foreign accounts and insider-trading remain a mystery to the public.
The Problem of Money Laundering

By its very nature, money laundering occurs outside the normal range of economic statistics. Nevertheless, with other aspects of underground economic activities, rough estimates have been put forward to highlight the magnitude of the problem: KPMG and International Monetary Fund has estimated that funds worth a whopping US $590 billion to $1.5 trillion are laundered annually through the global economy which amounts to two to five per cent of the global GDP\textsuperscript{16}. India and Pakistan figure in a list of 77 countries which are of “primary concern” in terms of “major money laundering” activities. In 2000, the Central Vigilance Commission estimated black money to be around 40% of GDP which was Rs.70,000-80,000 crore\textsuperscript{17}, while the size of America’s black economy was around 5% of GDP, about $500 billion, almost double the size of India’s black economy\textsuperscript{18}.

Factors Facilitating Money Laundering in India

India’s historically strict foreign-exchange laws and transaction reporting requirements, together with the banking industry’s “know-your-customer” policy\textsuperscript{19}, make it difficult for illegal drug traffickers to use banks or
other financial institutions to launder money. Large portions of illegal proceeds are accordingly laundered through the alternative remittance system called ‘hawala’ or “hundi”. The hawala market is estimated at anywhere between 30 % and 40 % of the formal market. Remittances to India reported through legal, formal channels in 2004-2005 amounted to $ 20.5 billion.

Any commodity can be the subject matter of hawala transfer; but gold remains the most popular one. Hawala system ensures anonymity and security to transacting individuals. Lengthy formalities are required to complete a money transfer through a financial institution like a bank; on the contrary, hawala dealers provide the same remittance service as a bank with little or no documentation and at rates less than those charged by banks. Consequently, many Indians opt for the service of the latter. Moreover, Government of India seems to offer little resistance to hawala dealers. The Reserve Bank of India, the country’s Central Bank, itself admits that widespread hawala dealers operate illegally and therefore they cannot be registered and are beyond the reach of regulation. Reportedly, the RBI does intend to increase its regulation of non-bank money transfer operations by entities such as currency exchange kiosks and wire transfer services.
The Modus Operandi

Hawala system originated in South Asia as an alternative or parallel remittance system. “Hawala” is an Arabic word which means the transfer of money or information between two persons using a third person. Hawala bankers themselves are often members of old established families or clans of moneychangers, spread throughout similar communities in many other countries. They may also be shopkeepers, traders, travel agents, gold dealers or indeed members of any trade or profession, which is ostensibly respectable, and in connection with large number of visitors, and where substantial sums of cash are not unusual. Thus, it exists and operates outside of, or parallel to ‘traditional’ banking or financial channels used by businessmen.

Hawala system was developed in India before the introduction of western banking practices, and is currently a major remittance system used around the world to conduct legitimate remittances. It is but one of several such systems; another well known example is the ‘chop; ‘chit’ or ‘flying money’ system indigenous to China. These systems are often referred to as ‘underground banking’. However, this term is not always correct, as they often operate in the open with complete legitimacy, and these services are often heavily and effectively advertised. Under the hawala system, individuals
transfer value from one location to another, often without the actual movement of currency. Key features of the hawala system are that it transfers value without actually moving funds. When accounts need to be balanced between hawala, a number of techniques are used including cash and bank transfers. But historically and culturally, trade is the most common vehicle to provide “counter valuation” This is often accomplished through invoice manipulation such as over and under valuation.

Money laundering transactions fall into three stages: Placement, Layering and Integration\textsuperscript{30}. In the initial or placement stage, the launderer introduces his illegal profits into the financial system. This might be done by breaking up large amounts of cash into less conspicuous smaller sums that are then deposited directly into a bank account, or by purchasing a series of monetary instruments like cheques, money orders etc. that are then collected and deposited into the account at another location. There is a case of a bank whose branches in Coimbatore, Thrissur, Ernakulam and Palakkad received cash deposits aggregating Rs. 76 crore between October 1999 and April 2000, only to be en-cashed almost immediately which is a suspected case of hawala\textsuperscript{31}.

After the funds have entered the financial system, the second stage called layering takes place. In this stage, the launderer engages in a series of
conversions or movements of the funds to distance them from their source. The funds might be channelled through the purchase and sale of investment instruments, or the launderer might simply wire the funds through a series of accounts for laundering. In some instances, the launderer might disguise the transfers as payments for goods or services, thus giving them a legitimate appearance.

Having successfully processed his criminal profits through the first two stages of the money laundering process, the launderer then moves them to the third stage called integration, in which the funds re-enter the legitimate economy. The launderer might choose to invest the funds into real estate, luxury assets or business ventures.

**Money Laundering Methods**

Various methods are resorted to for moving the money around keeping it out of the Authorities’ reach. The most primitive method, which is the one most popularized by the media consists of actual physical transportation of money: couriers transport suitcase full of notes, mainly US dollars to a foreign country where that currency is particularly in demand on the black market.
Large amount of cash have been transported by sea or air in containers too, which are rarely checked\textsuperscript{32}.

*Smurfing* is another method. A network of traffickers sends a multitude of carriers to banks to deposit cash or buy cashiers cheques for amounts just below the regulation ceiling determined by the national law, above which all transactions must be declared to the authorities. These cheques are then collected and either physically transported abroad or deposited in foreign accounts as if they were income from legitimate operations\textsuperscript{33}.

Investments in real estate, the gambling industry, the stock exchange or research offices are also much appreciated by dubious financiers. As a result, when the narco-dollars come back into the banking system, they are already clean\textsuperscript{34}.

In early 1989, the fourth method, *La Nina* was carried out: Cash derived directly from the sale of cocaine in the major United States cities was paid to gold merchants or jewellers working for the cartel. False gold bars were imported for the jewellers to give the impression that major legal operations were being carried out. Crates supposed to be containing gold were filled with
bank notes and sent to an accomplice jeweller. This money will be deposited in banks as if taking from the sale (imaginary) of gold or jewels.\footnote{35}

However, the kind of investigation to reveal such complex financial structures obviously requires the use of sophisticated police techniques.

**The Fertile Soil for Money Laundering**

As money laundering is a necessary consequence of almost all profit generating crimes, it can occur practically anywhere in the world. Generally, money launderers tend to seek out areas in which there is a low risk of detection due to weak or ineffective anti-money laundering programmes. Since the objective of money laundering is to get the illegal funds back to the individuals who generated them, the launderers usually prefer to move funds through areas with stable financial systems.\footnote{36}

Money laundering activity may also be concentrated geographically according to the stage the laundered funds have reached: At the *placement phase*, for example, the funds are usually processed relatively close to the underlying activity; often, but not in every case, in the country where the funds originate. With the *layering phase*, the launderers might choose an offshore
financial centre, a large regional business centre, or a world banking centre—any location that provides an adequate financial or business infrastructure. Finally, at the integration phase, launderers might choose to invest laundered funds in still other locations if they were generated in unstable economies offering limited investment opportunities.37

India is fast becoming a conduit for the South East, Far East and Latin American countries. The Indian hawala system is used extensively for drug trafficking and remittances of money by both non-resident Indians and resident Indians.38 In India, about 8% of the black money has its roots in crime, including bribery, drug trafficking and terrorist activities. The other 92% is from legal activities on which taxes have not been paid.39

**Effects of Money Laundering**

- **Effects on Business:**

  The integrity of the banking and financial services in market place depends heavily on the perception that it functions within a framework of high legal, professional and ethical standards. A reputation for integrity is one of the most valuable assets of a financial institution. If funds from criminal activity can be easily processed through a particular institution – either because its
employees or directors have been bribed or because the institution turns a blind eye to the criminal nature of such funds – the institution could be drawn into active complicity with criminals and become part of the criminal network itself. Evidence of such complicity will have a damaging effect on the attitudes of other financial intermediaries and of regulatory authorities, as well as ordinary customers.\textsuperscript{40}

- **Effects on Economic Development**: 

Launderers are continuously looking for new routes for laundering their funds. Economies with growing or developing financial centres but inadequate controls for want of comprehensive anti-money laundering regimes are particularly vulnerable. Difference between national anti-money laundering systems is exploited by the launderers, who tend to move their networks to countries and financial systems with weak or ineffective counter measures\textsuperscript{41}.

Thus, if left unchecked, money laundering can erode a nation’s economy by changing the demand for cash, making interest and exchange rates more volatile, and by causing high inflation in countries where criminal elements are doing business. The siphoning away of billions of dollars a year from normal economic growth poses a real danger for the financial health of every country;
which in turn adversely affects the stability of the global market; and hence laundering is bad for the economy. 42

- **Social Impact:**

The possible social and political costs of money laundering, if left unchecked, are serious. Organized criminals can infiltrate financial institutions, acquire control of large sectors of the economy through investment or offer bribes to public officials and indeed the government. The economic and political influence of criminal organizations can weaken the social fabric, collective ethical standards; and ultimately the democratic institutions of the society. Moreover, in countries which are in transition to democracy, this criminal influence undermines the transition itself. Most disturbing of all, money laundering empowers corruption and organized crime. Corrupt public officials need to manage launder bribes, kick-backs, public funds and, on occasion, even development loans from international financial institutions. Most fundamentally, money laundering is inextricably linked to the underlying criminal activity that generated it and, therefore, enables criminal activity to continue. Moreover, terrorist groups use money laundering channels to get cash to buy arms. Thus social consequences of allowing these groups, access to launder money, can be disastrous.
Role of the Government in Combating Money Laundering

A great deal can be done by the government to combat money laundering. The measures usually aim to increase awareness of the phenomenon—both within the government and in the private business sector—and then to provide the necessary legal or regulatory tools to the authorities charged with combating the problem. Some of these tools include: making the act of money laundering a crime; giving investigative agencies the authority to trace, seize and ultimately confiscate criminally derived assets; and building the necessary framework for permitting the agencies involved to exchange information among themselves and with counterparts in other countries.43

Money launderers have shown themselves to be extremely imaginative in creating new schemes to circumvent Government counter-measures. A national system must, therefore, be flexible enough to detect and respond to new money laundering schemes.

Anti-money laundering measures often force the launderers to move to parts of the economy where tackling measures are weak or ineffective. The national system to combat money laundering must, therefore, be flexible
enough to be able to extend counter-measures to new areas of its own economy. Finally, national governments need to work with other jurisdictions to ensure that launderers are not able to continue to operate merely by moving to another location in which money laundering is tolerated.

**Efforts of the International Community to Combat Money Laundering**

The serious threat posed by money laundering to the financial systems and the sovereignty was being progressively realized by various countries of the world. As a consequence of this realization, the international community took the following initiatives to curb the menace of money laundering:-

1. The 1988 United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (Vienna Convention of 1988) provided a comprehensive legal definition of “money laundering”. This definition formed the basis of subsequent legislation on money laundering of various countries.\(^\text{44}\)

2. The Basle Statement of Principles enunciated in 1989 outlined basic policies and procedures that banks should follow in order to assist the
law enforcement agencies in tackling the problem of money laundering.\footnote{45}

3. The Financial Action Task Force (FATF) on Money Laundering which was established at G-7 summit held in Paris in 1989 to address the global problem of money laundering made forty recommendations which provide the foundation for comprehensive legislation to combat the problem of money laundering. In short, the recommendations urged all countries to adopt practical measures to apply the United Nations Convention signed in Vienna in December 1988 so that new legislation in bank secrecy could be drafted in harmony with those recommendations.\footnote{46}

4. Political Declaration and Global Programme of Action adopted by UN General Assembly \textit{inter alia} called upon the member States to develop a mechanism to prevent financial institutions from being used for laundering of drug related money and enactment of legislation to prevent such laundering.\footnote{47}

5. The United Nations in its Special Session on ‘Countering World Drug Problem Together’ which was concluded on 10\textsuperscript{th} June 1998, stressed the need to deal firmly with money laundering.\footnote{48}
6. The Global Programme Against Money Laundering (GPML), 2000 is the key instrument of the United Nations Office on Drugs and Crime 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 co-ordinates joint anti-money laundering initiatives of the United Nations with other international organizations.\textsuperscript{49}

**Indian Scenario**

India is not a member of Financial Action Task Force (FATF) on Money Laundering.\textsuperscript{50} However, India is a signatory to the United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances 1988. Besides, the United Nations Conference on ‘Money Laundering Awareness-Raising for South and South-West Asia’ was held in New Delhi from 3 to 5 March 1998. The Conference was attended by the representatives from India, Bangladesh, Iran, Maldives, Myanmar, Nepal,
Pakistan, Sri Lanka and Thailand. The Recommendations made by the Conference were as follows:

1. States should ratify the United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances, 1988 and take steps to implement its provisions. In drafting their legislations, States should have regard to the standards set out in:
   (i) the 40 recommendations of the Financial Action Task Force
   (ii) the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds of Crime, 1990; (iii) the Council of European Communities Directive of 10 June, 1991 on Prevention of the Use of the Financial System for the Purpose of Money Laundering and (iv) other relevant international instruments.

2. In order to give maximum effect to anti-money laundering measures, States should endeavour to extend the range of predicate offences (being those which are to be regarded in law as giving rise to the proceeds of crime for the purposes of money laundering legislation) beyond those connected with drug trafficking, to include in their legislation as wide a range as possible. In this connection, regard may be had to the language of
the interpretative note to FATF recommendation 4, which speaks of “all offences that generate a significant amount of proceeds”.

3. In order to secure the co-operation of the financial sector and the confidence of the public in anti-money laundering measures, States should be in a position to ensure that information provided by financial institutions to law enforcement or other bodies designated by legislation should remain confidential except insofar as it is needed for the pursuit of bona fide investigations and prosecutions, or other lawful purposes.

4. In addition to the traditional banking institutions, anti-money-laundering measures should apply as far as is practicable to non-bank financial institutions and other professions or enterprises which may be used for money-laundering.

5. Professional associations should be urged to exclude from their membership those who are involved in money laundering.

6. There is a need for more information; relevant and of high quality, to be made available on anti-money-laundering training and technical assistance which is available to States, as well as better co-ordination of such training among providers at both the bilateral and multilateral level.
7. Since many States in the region are now in the process of drafting relevant legislation they should consider authorizing their draftsmen to work together to promote to the greatest extent possible, the harmonization of their legislative provisions in order to maximize the level of co-operation between them in investigations and prosecutions of relevant offences. One way to accomplish this, which States should consider, would be for States to meet together in any appropriate forum to compare their draft legislations with a view to ensuring uniformity wherever possible, having due regard to the circumstances and sovereignty of each State. Such a forum might involve expert advisers from relevant international organizations or from other States with experience in such legislation.

8. States should consider measures which would make alternative remittance systems, where they are not prohibited (hawala, etc.) subject to the same anti-money laundering rules as other financial institutions, for the purpose of preventing their abuse by money launderers. In formulating such measures, States should seek to harmonise them with those of others in the region, and having regard to the language of FATF recommendation. States outside the region should be urged to examine the feasibility of
discouraging or restricting the promotion of *hawala-type* remittance systems, including such promotion in their advertising media.

9. States should consider setting aside a portion of the value of the criminal assets they confiscate to support anti-money laundering training and technical assistance programmes.

10. Wherever possible subsequent to initial training and experience, such further training should be based upon a ‘train the trainers’ approach to ensure a greater and more cost-effective spread of knowledge and experience throughout the region; and such training should extend beyond law enforcement and encompass other relevant sectors such as financial and legal/judicial.

11. Money laundering should be included as a topic in training programme in all relevant public and private sector institutions.

12. Government and international organizations should take measures to sensitize the public, legislators, policy makers and the media with regard to the dangers posed by money laundering.

13. States should work towards establishing a mechanism in the region to promote co-ordination of and contact between their existing and future money laundering control agencies, with a view to maximizing co-operation and the timely exchange of
information. Existing groups aimed at enhancing co-operation in the efforts to fight money laundering such as the Asia Pacific Group and the Egmont Group, should be encouraged to meet on a regular basis in the region.

14. Where staff of financial institutions are found to be negligent in failing to report suspicious transactions to the appropriate authority, stringent actions shall be taken against them.

15. States should consider the use of special investigative techniques such as the controlled delivery of proceeds of crime.

16. States should consider the sharing of confiscated assets with other co-operating States.

17. The United Nations, through its appropriate agencies or bodies, is invited to consider the formulation of a specific convention relating to money laundering and the proceeds of crime, covering all offences that generate a significant amount of proceeds.

**Laws to Check Money Laundering in India**

The major statutes that incorporate certain measures which attempt to address the problem are given below:

• The Customs Act, 1962\textsuperscript{51}.

• The Code of Criminal Procedure, 1973\textsuperscript{52}.

• The Indian Penal Code, 1860.

• The Conservation of Foreign Exchange and Prevention of Smuggling Activities Act, 1974 (COFEPOSA).

• The Smugglers and Foreign Exchange Manipulators (Forfeiture of Property) Act, 1976.

• The Narcotic Drugs and Psychotropic Substances Act, 1985 (NDPSA)


• The Prevention of Illicit Traffic in Narcotic Drugs and Psychotropic Substances Act, 1988.

• The Smugglers and Foreign Exchange Manipulators Act, 1976 (SAFEMA).

• The Foreign Exchange Management Act, 2000, (FEMA).

• Prevention of Money Laundering Act, 2002 (PMLA).

• Prevention of Terrorism Act, 2002 (POTA).

The Criminal Law Amendment Ordinance, 1944 permitted the attachment and forfeiture of money or property obtained through bribery,
criminal breach of trust, corruption, or theft, and of assets that are disproportionately large in comparison to an individual’s known sources of income. The Code of Criminal Procedure, 1973 establishes India’s basic framework for confiscating illegal proceeds. The Narcotic Drugs and Psychotropic Substances Act, 1985, as amended in 2000, empowers the government for the tracing and forfeiture of assets that have been acquired through narcotics trafficking, and prohibits attempts to transfer and conceal those assets. The Smugglers and Foreign Exchange Manipulators Act (SAFEMA) also allows the seizure and forfeiture of assets linked to Customs Act violations. The competent authority (CA) located in the Ministry of Finance (MOF) administers both the NDPSA and SAFEMA. Amendments to the NDPSA dating from 2001 allow the CA to seize any asset owned or used by a narcotics trafficker immediately upon arrest. Before these amendments, assets could be seized only after conviction.

However, Indian law enforcement officers lack training in the procedures for identifying individuals who might be subject to asset seizure/forfeiture, and in tracing assets to be seized. They also appear to lack sufficient training in drafting and expeditiously implementing asset freezing orders. During 2005, the CA organized nine asset seizure and forfeiture workshops in New Delhi, Himachal Pradesh, Uttar Pradesh, Rajasthan and
Andhra Pradesh to train law enforcement officers in asset seizure and forfeiture procedures and regulations, with a hope that the training will lead to increased seizures and forfeitures from illicit narcotics proceeds.

The Foreign Exchange Management Act (FEMA) which was enacted in 2000, is one of the primary tools for fighting money laundering. The FEMA’s objectives include the establishment of controls over foreign exchange, the prevention of capital flight and the maintenance of external solvency. FEMA also imposes fines on unlicensed foreign exchange dealers. A closely related piece of legislation is the Conservation of Foreign Exchange and Prevention of Smuggling Act (COFEPOSA) which provides for preventive detention in smuggling and other matters relating to foreign exchange violations. The MOF’s Directorate of Enforcement (DOE) enforces FEMA and COFEPOSA. The RBI also plays an active role in the regulation and supervision of foreign exchange transactions.

In the absence of a comprehensive policy and law, the Government of India, in accordance with its international obligations, felt the urgent need for enactment of a comprehensive legislation to prevent money laundering and, therefore, appointed Inter-Ministerial Committee to look into all aspects of money laundering and to suggest a suitable legislation, if necessary. The
Committee, in its report submitted to the Ministry of Finance in July 1997, underscored the point that the drug traffickers, smugglers and other undesirable elements had amassed huge wealth which was being used to undermine the stability of the financial institutions and social order. The Committee felt that the remedy lies in the enactment of a comprehensive legislation to deal with the problem. Following this report and based on the discussions on the recommendations made therein, The Prevention of Money Laundering Bill was introduced in the Lok Sabha on 4 August, 1998. The Bill was amended by the upper house to include ‘terrorist financing’ provisions.

On 27th November 2002, the lower house of Parliament finally passed the Prevention of Money Laundering Act (PMLA) and the President of India signed the law in January, 2003. The Act came into force from 1st July 2005. This legislation criminalises money laundering, provides fines and sentences for money laundering offences, imposes reporting and record keeping requirements on financial institutions, provides for the seizure and confiscation of criminal proceeds, and provides for the creation of a Financial Intelligence Unit (FIU). Penalties for offences under the PMLA are severe and may include imprisonment for three to seven years and fines as high as 5 lakhs rupees. If the money laundering offence is related to a drug offence under the NDPSA, imprisonment can be extended to a maximum of ten years. The PMLA
mandates that banks, financial institutions and intermediaries (including stock market intermediaries such as brokers) maintain records of all cash transactions exceeding $21,740.

In pursuance of the provisions of the Act, a Central Financial Intelligence Unit, India (FIU-IND) has been set up as a multi-disciplinary unit to centralize and co-ordinate anti-money laundering and to counter terrorist financing strategies, both national and international\textsuperscript{55}.

The FIU-IND is responsible for receiving, processing, analyzing and disseminating information on STRs, and for referring suspicious cases to the appropriate enforcement agency. The MOF’s Enforcement Directorate handles the investigations and prosecution of money laundering cases. An Economic Intelligence Council (EIC) has also been established to enhance co-operation among the various enforcement agencies and directorates in the MOF. The EIC provides a forum for enforcement agencies to strengthen intelligence and operational co-ordination, to formulate common strategies to combat economic offences, and to discuss cases requiring inter-agency co-operation\textsuperscript{56}. The Central Bureau of Investigation, the Directorate of Revenue Intelligence, Customs, and Excise, the RBI, the Competent Authority, and the MOF are all active in anti-money laundering efforts\textsuperscript{57}.
Besides, many banking institutions prompted by the RBI, have taken steps on their own to combat money laundering. Many banks have compliance officers to ensure that anti-money laundering regulations are observed. As per RBI guidelines commercial banks have to adopt the “know-your customer” policy. As a supportive measure, the Indian Bankers Association established a working group to develop self-regulatory anti-money laundering procedures. Foreign customers applying for accounts in India must show positive proof of identity when opening a bank account. Banks also require that the source of funds must be declared if the deposit is more than the equivalent of $10,000. Finally, banks must report suspicious transactions. The Central Government has the power to order banks to freeze assets.

In November 2004, the RBI issued a circular updating its know-your-customer guidelines drafted to ensure that they comply with Financial Action Task Force (FATF) recommendations. The guidelines include the requirement that banks identify politically connected account holders residing outside India and identify the source of funds before accepting deposits from these individuals. The RBI has placed politically exposed persons (those entrusted with prominent public functions in other countries) in the highest risk category for the commission of financial crimes. The RBI also asked all commercial
banks to become FATF-compliant regarding customer identification for existing as well as new accounts by December 2005.59

India does not have an offshore financial centre; but does license Offshore Banking Units (OBUs) subject to the condition that they are predominantly owned by individuals of Indian nationality or origin resident outside India, or firms or corporate bodies; and that the ownership by a non-resident India is not less than 60 percent. However, these entities seem to be susceptible to money laundering activities, in part because of a lack of stringent monitoring of transaction in which they are involved.

India is a party to the 1988 UN Drug Convention, the UN International Convention for the Suppression of the Financing of Terrorism; and moreover, India is a member of the Asia/Pacific Group on Money Laundering; and a signatory to the UN International Convention against Transnational Organised Crime. In October 2001, the Central government and the United States signed a mutual legal assistance treaty, which entered into force in October 2005. India has also signed a police and security co-operation protocol with Turkey, which *inter-alia* provides for joint efforts to combat money laundering60.
In addition, the Palermo Convention was signed in December 2002. India is a member of INTERPOL; and the CBI is the official INTERPOL unit in India. All State police forces and other law enforcement agencies have a link through INTERPOL to their counterparts in other countries for the purpose of criminal investigations. Indian Customs wing is a member of the World Customs Organization and shares enforcement information with countries in the Asia Pacific region. In 2002, the Indian Parliament passed the Prevention of Terrorism Act (POTA), which criminalizes terrorist financing. In November 2004, the Parliament repealed the POTA; and amended the Unlawful Activities (Prevention) Act, 1967 to incorporate the salient features of repealed POTA including the criminalization of terrorist financing and the legal definitions for “terrorism” and “terrorist acts”.

**Prevention of Money Laundering Act, 2002: A Specific Legislation Against Money Laundering.**

The Prevention of Money Laundering Act, 2002 specifies punishment for money laundering thus: Whoever commits the offence of money-laundering shall be punishable with rigorous imprisonment for a term which shall not be less than three years but which may extend to seven years and shall also be liable to fine which may extend to five lakh rupees: Provided
that where the proceeds of crime involved in money-laundering relates to any
offence specified under paragraph 2 of Part A of the Schedule, this provision
shall have effect as if for the words “which may extend to seven years”, the
words “which may extend to ten years” had been substituted. Where the money
laundering offence relates to a drug offence under the NDPS Act, the penalty
can extend to a maximum of 10 years.63

PMLA 2002: Objections from Various Quarters

The Indian industry has expressed series of apprehensions over the
Prevention of Money-Laundering Act. The apex chambers of trade and
industry, namely, Associated Chamber of Commerce (ASSOCHAM),
Confederation of Indian Industry (CII) and the Federation of Indian Chambers
of Commerce and Industry (FICCI) have expressed their views against the law.

According to the business chambers, there are three major dangers in the
legislation: First, the Act includes certain offences listed under the Indian Penal
Code, Immoral Traffic (Prevention) Act, Arms Act, NDPS Act and the
Prevention of Corruption Act, 1988. A person can be picked up on “suspicion”
of indulging in money laundering and acquiring property with that money and
the offence is non-bailable until the appellate authority decides the case.
Besides, the onus of proving his innocence is on the suspect. This could well mean that people would remain behind bars till the appellate authority decides the case, as an appeal to the High Court was possible only after the appellate authority delivered its judgment.

The second major objection according to the chambers of trade and industry relates to the provision on the “falsification of accounts”: The definition of falsification of accounts under the Indian Penal Code, 1860 is ambiguous and hence would empower the officials with discretionary authority.

The third objection relates to offences under the Prevention of Corruption Act, 1988: Section, 8 and 9 of the Prevention of Corruption Act had been included as offences under the Prevention of Monet-Laundering Act thereby providing discretionary powers to the enforcement authorities to arrest people on suspicion. Consequently, officials could fix their opponents by invoking these two sections. Even an invitation to dinner could be described as exercising personal influence on public servants and hence violation of the money laundering prevention legislation.

The Federation of Indian Chambers of Commerce and Industry (FICCI) demanded wide ranging changes in the Act; and recommended that
‘falsification of accounts’ should be taken out from the ambit of the Act and should be dealt with under other Acts such as the Indian Penal Code, Companies Act, Income Tax Act and Chartered Accountants Act. The FICCI argued that it might not be proper to put falsification of accounts in the same category as offences such as murder and drug peddling, because it is generally difficult to find out whether there is any falsification of accounts and if so, who is liable for the falsification.

FICCI further argued that the provision of the Act which requires financial institutions and intermediaries to furnish information about all the transactions, will unnecessarily add to the cost and will give a big setback to the already sluggish capital market. It has been, therefore, suggested that the Enforcement Directorate should instead call for such information from the institutions and intermediaries. Other suggestions include: Director alone shall be empowered to arrest a person, the Director should send a prior report to a magistrate; or a police report or complaint should be filed with a Special Court, arrests should be made only on specific authorization from the Central Government; and the arrested person should be produced before the magistrate within 24 hours.
Conclusion

Terrorist financing in India, as well as in much of the subcontinent, is linked to the hawala system. Therefore, Government of India should extend whole hearted support to the international initiatives to provide increased transparency in hawala; and if necessary, should initiate regulations; and enhance law enforcement actions in this area. The involvement of the Indian citizens in the underworld of the international diamond trade should also be pondered. Further, the government should ensure that the new FIU is fully operational in order to disseminate suspicious transaction reports to domestic law enforcement and enhance information sharing with other FIU globally. Meaningful tax reform will also assists in negating the popularity of hawala and may lessen money laundering. Stringent and keen enforcement actions should also be taken to combat trade-based money laundering.

Suggestions to Combat Money Laundering

One of the most common ways of tapping black money has been amnesty schemes. There have been 12 such schemes between 1946 and 1997. Many of them helped to convert huge sums of money into white without the payment of any tax. During 1997 itself Rs. 33,000/- crore worth of assets
were declared under the scheme. Some suggestions to combat money laundering have been added below:

1) Identification of the various important sectors of the economy that generate black money.
2) Constant updating of causes and circumstances that lead to the generation of such money and wealth.
3) Identification of ways and means that are currently followed to convert black money into white.
4) Introduction of methods to reduce the existing vast accumulation of unaccounted income and wealth be best tapped without demoralizing honest taxpayers.
5) Effective and expeditious punishments for tax evaders.
6) Ensuring honest compliance with tax laws.

Moreover, any effective system to combat money laundering must be obviously based on the following three principles:

- Increased international co-operation;
- Strengthened mutual assistance in criminal proceedings; and
- A guarantee that criminals laundering funds derived from illicit activities will be brought to book and that they will be extradited, where necessary.
References

1. Prabhakar Sinha, “Funny Money is Serious Biz”, The Times of India, New Delhi (13.3.2005)
3. “Agencies To Share Inputs on Narco-Terrorism”, The Times of India, New Delhi, (16.6.01)
10. KPMG is a global network of professional firms providing Audit, Tax and Advisory services, operating in 148 countries, www.kpmg.com.
18. The size of world black money as on 2005 is given in Table 9, Appendix.
20. Supra.n.17.
22. Ibid.
23. Ibid.

Supra.n.14.


Supra.n.26.


Supra.n.5 at p.2.


Supra. n.5 at p.3.

Supra.n.33.


Supra.n.27.


Supra.n.33.


Ibid.

Basle Statement of Principles, (Bankers Online), www.bankersonline.com

“Move Against Terrorism Funding”, The Hindu, (22.6.2007).


The FIU-IND is an independent unit located within the Central Economic Intelligence Bureau (CEIB), under the administrative control of the MOF’s Department of Revenue. It consists of a director (joint secretary), seven additional directors, one technical director, ten technical officers and clerical personnel. This multi-disciplinary team of officers is appointed for a two-year rotation. The directors are from various government agencies—Police, Revenue Department, Income Tax, Customs, RBI, Intelligence Bureau, Securities and Exchange Board of India and the Legal Affairs, Department of the Ministry of Law.

In addition to the EIC, there are 18 regional economic committees in India. The CEIB functions as the secretariat for the EIC. The CEIB interacts with the National Security Council, the Intelligence Bureau, and the Ministry of Home Affairs on matters concerning national security and terrorism. The FIU and the MOF are making all efforts to become compliant with Egmont standards with the ultimate goal of becoming a member of the Egmont Group.

In 2004, the Directorate of Revenue Intelligence (DRI) referred four hawala-based money laundering cases with a U.S nexus to the U.S. Department of Homeland Security/Immigration and Customs Enforcement (DHA/ICE). It carried out successful investigations on these cases and forwarded tangible results to the MOF’s DOE.

To implement these, The Unlawful Activities (Prevention) Act 1967 was passed.

In March 2003, the Central Government announced that it had charged 32 terrorist groups under the POTA and had notified three others that they were involved in what were considered illegal activities. In July 2003, 702 persons were arrested under the POTA.

Section 4.

Taking gratification in order, by corrupt or illegal means, to influence public servants.

Taking gratification for exercise of personal influence with public servants.


Arun Kumar, The Black Economy in India, p.198.