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Anti Money Laundering - Strategy and Way Forward

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Abstract- Money Laundering is an International issue since from the beginning of its evolution. This is a threat to the world economy, because of the fact that the black money is being used for the Terrorist financing and several other illegal activities by various sources of money laundering activities. Such activities are not only impairing the world financial health, but also a threat to the human kind. In order to curb the money laundering the steps taken by India and the principles adopted by United States; should be acknowledged by the world to combat money laundering and terrorist financing.

Index Terms- Financial intelligence & regulation, Money Laundering, Terrorist Financing

I. KEY FINDINGS

The world now acknowledged that the organized crime groups extended their umbrella of anti-social activities by expanding their portfolio through the help of drug cartels, human trafficking, counterfeit goods, supplying armed weapons, illegal migration and so on.

It is estimated that the transnational organized crime groups in the world, contributed the illicit proceeds around 0.2% and 0.33% of profits from the drug trafficking.

Technology is playing a pivotal role in drug trafficking an easier job than before. The cellular market has provided an extra weapon for the drug traffickers by creating an opportunity that they no more needed to travel to longer distances or through personal reach. The work is simply getting done through a simple instant message. The street vendors go to the users and collect the cash and drug supplier's text the customers on the location of drug supply, making the process a simple and easy than ever before. It is also come into limelight that customers can also purchase drugs using cryptocurrency, example: bitcoin.

Around 30 per cent of drug proceeds are set to contribute towards the illicit financial flows. A study with specific interviews with drug cartels in Italy in 2016 had a same answer and the drug proceeds are used towards money laundering across international borders.

It is also important to note that the illicit money makes the economy weak. It makes the country poor and forces the citizens to turn towards anti-social activities. The drug money used in the real estate business artificially increases the prices of the properties. It destroys the exports of the country, encourages unequal competition among the companies, and encourages corruption. In this process, genuine businesses get it difficult to survive in the market and no further investments will be seen in the country. The increase in the illicit money in the country's economy will increase the corruption and collapse the regulatory system. Thus making the country failure and develops unrest.

II. INTRODUCTION

Money Laundering is one of the key elements which contribute its best in collapsing the world economy. Money Laundering has become an art and science in the modern world, which draws off billions of dollars from the world financial system each and every year and then contributing the illegal money to reach the terror organizations globally. This becomes a serious challenge for the developed and developing countries. The money that is routed through illegal activities is even used for the political gains of the countries that are economically in backward status. It is also important to note that counterfeit currency is a major substance to money laundering activity. The money is used for the drug dealings, human trafficking, exploitation, buying and building weapons, Terrorism and so on.

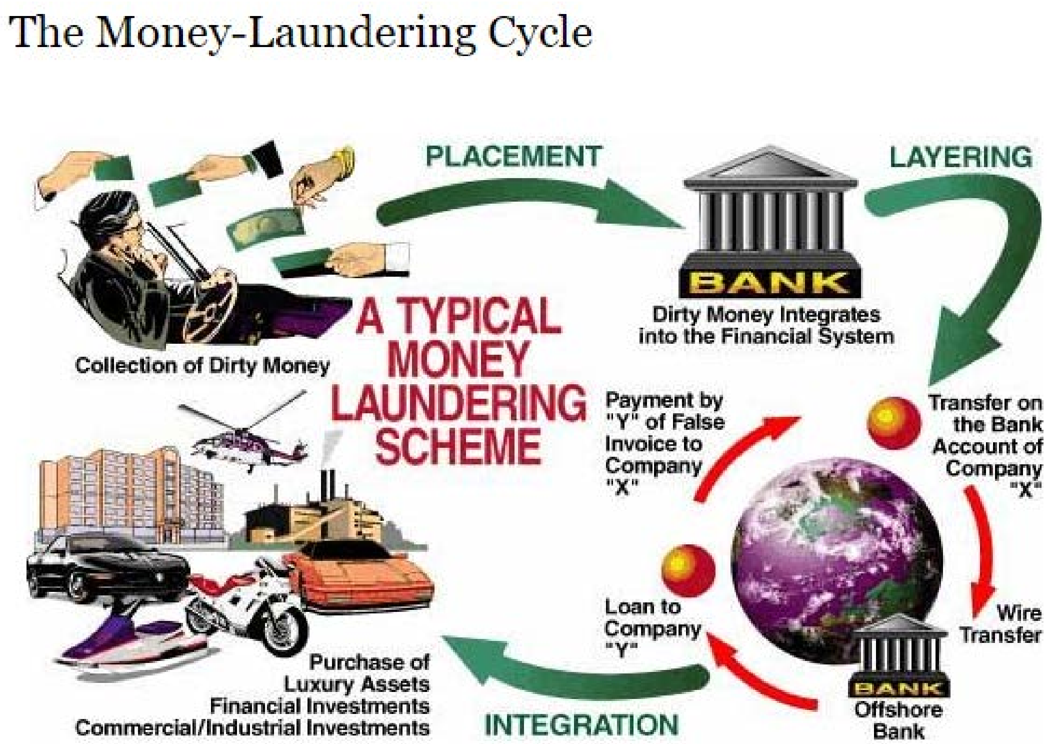
Developed countries are already cautious about the money laundering and the impacts of it and formed an international joint operation to control and cease the money laundering activities. The detailed steps and procedures adopted by India and United states are two examples for the world to recognize and adopt for the eradication of money laundering. It is not fair to conclude that other countries are not in cognizant with the impact of money laundering and they have not developed the tools and techniques to address it. The focus in the current topic is India and United States and how they both are working on eradicating money laundering.

III. RESEARCH ELABORATIONS

Money Laundering Stages:

Money Laundering is done in several varieties of transactions that are almost become impossible identify and track down the illegitimate transactions, compared to the legitimate one.

1. **Step One: Placement** — getting the cash into the Physical system.
2. **Step Two: Layering** — Spin the money around the world, in and out of fake companies that can never be traced back to the originality. This step is followed by sending phony invoices between those companies where all kinds of goods and services that never existed. Their banks pay those invoices wiring money back and forth across the borders. It's although often impossible to follow the money trail due to digitalization of the global markets. It is easier to Layer with the countries that are disconnected from the rest of the world in the banking services.



(**Source:** http://www.unodc.org/unodc/en/money-laundering/laundrycycle.html)

3. **Step Three: Integration** — bringing the illicit money into the real estate, investments, buying luxury assets etc. are the done in the final stage of Integration. It is highly impossible to determine the difference between legal and illegal assets due to the fact that the money once invested in these activities, transfers the hands, banks and finally into the financial systems across the globe.

How big is the problem:-

The world of transnational crime- The first official estimate was in 1998 by the International Monitory Fund, which estimate about 2% to 5% of global GDP, or $900 billion US dollars of black money is flowing across the world economy. The latest report that was updating it was the United Nations Office on Drugs and Crime Report in 2011, which is consistent with the IMF numbers. 3.6% of the global GDP is illicit proceeds.

The ratios of socio economic costs to the economy from $1 of illicit drug proceeds, it's a 2 to 1 ratio globally and the United States is 3 to 1. That means for every $1 of illicit drug money costs $3 for the society to address all the issues associated with it.

Demonetization in India- A lesson for the rest of the world

On November 8, 2016; India announced the demonetization of Rs 500 and Rs 1000 currency notes and introduced new Rs 500 and Rs 2000 currency notes to curb the contraband currency notes. The impact of demonetization automatically helps in eradicating terrorism financing, funding to infrastructure projects through illegal money, financing to antisocial elements to create political unrest. Demonetization helped India at large with the immediate effect by making billions of contraband currency into just a piece of paper, which stopped funding to the antisocial elements that used to create political unrest in some of the world renowned tourist parts of the country like Jammu and Kashmir. However the immediate effect of demonetization to the general public was felt heavily during the first two months of the implementation and banks, ATM's ran out of the currency notes, creating panic among general public. In support to the anxiety of the general public, media played a key role in relatively negative propaganda on the demonetization, supporting the opposition political parties. The negative publicity slowly vanished and a confidence was developed in the public due to the RBI interference during the end of 2016 and introduced the new Rs 500 and Rs 2000 currency notes in the early 2017 helped the banks and post offices gain the public trust about the timely support of central govt. Public slowly understood the importance of demonetization through the banks, post offices and subsequently media's support to the government's move is a big plus point.

The impact of demonetization is seen on several sectors of the economy. The major impacted sector is the financial sector, which is highlighted below.

(a) **Retail Sector:** The retail sector has seen a major decline in the growth due to lack of availability of currency notes in the general market, which set the general public to limit their spending on retail sector.

(b) **Increase in retail savings:** The impact of demonetization helped the banks in getting more retail savings, thus increased the balance sheet of the banks.

(c) **Increase in the bank accounts:** Demonetization helped generating five crore new bank accounts under various government schemes within 1 year from the date of implementation**.**

(d) **An eye on unusual financial transactions:** An amount of < Rs Two trillion is estimated of depositing into the various savings and govt scheme accounts into the banks by various fraudulent modes of financial disposition.
(e) **Decrease in lending rates:** The increase in savings and current account balances with the deposits of general public, banks received costless monies into their books, which helped in reducing the lending rates.
(f) **Increase in investments:** A great amount of household savings are diluted towards mutual funds and Insurance sector due to the demonetization
(g) **More retail digital payments:** Demonetization helped the economy in alternate payments mechanism. General public started using various means of card payment services and thus increase digital payments.
(h) **Increase in contraband currency circulation:** Antisocial activists started circulating/ disposing off the contraband currency into the general public to get rid of the currency before Dec 31, 2016.

Before the implementation of demonetization on Nov 8th, 2016; Indian Govt has introduced a new act to curb black money **"THE BLACK MONEY (UNDISCLOSED FOREIGN INCOME AND ASSETS) AND IMPOSITION OF TAX ACT, 2015" and** reviewed the Older "Benami Transactions (Prohibition) Act, 1988" and made various changes to it, keeping in mind the upcoming demonetization and released it as "Benami Transactions Act, 2016".

The govt has given an opportunity to the general public to disclose the undisclosed income, voluntarily through "Income Declaration Scheme (IDS) between June 2016 to Sep 2016; without exempting the tax deduction. Govt started tracking on all large scale investments on various precious metal purchases and made it compulsory to provide Permanent Account Number (PAN) for all money dealings in excess of Rs 200,000.

The plan for demonetization on November 8th, 2016 is a perfect step with a lot of back ground work done by the Govt of India to curb the illegal and illicit money in the country.

The after effects of Demonetization:

Within the 12 months from the date of demonetization, nearly 99% of the demonetized currency was back into the banks through various sources of currency exchange options provided by Govt of India. With that said, the value of notes in circulation was reduced by 20.2% and the volume of currency in circulation has increased by 11.1%.

It is also visible that the digital transactions increased with the decrease of money in circulation.

Monthly digital transactions (Rs in Million)

October, 2016	870
November, 16	1020
December, 16	1490
January, 2017	1460
Febraury,17	1310
March,17	1560
April,17	1560
May,17	1430
June,17	1360
July,17	1380
August,17	1380
Total	**14820**

With the increase in digital transactions, it is also observed that an increase in the electronic frauds during the same period of demonetization in India.

Cyber Frauds:

There were 13,083 cases of electronic wallets and electronic payment reported for the FY 14-15 and the cases increased to 16,468 for the FY 15-16. In order to curb the electronic crimes, Govt of India is also created cyber forensic labs.

The issue so far:

By the end of Nov 2017, approximately ≤ 85% of the debarred money has been deposited into the banks and started re circulation into the market. That means the general public re invented a safe mechanism to deal with the cash even though the limit for cash transactions are Rs 200,000 only.

Drawbacks:

It was understood that the demonetization was announced without printing the sufficient new currency. The banks, ATM's were empty within a period of 2 weeks from the date of demonetization due in sufficient supply of smaller denominations in the place of Rs 500 and Rs 1000 notes.

Prior issuance of ATM cards to all the customers of the banks would have helped in reducing the chaos of cash withdrawals inside the bank premises. It was also noted that there were enormous amount of que's outside the banks for the withdrawal and deposit of currencies causing several incidents of death to general public.

General public started approaching money launders to get their existing Rs 500 and Rs 1000 notes exchanged, in lieu of the abnormal Que outside the banks for the exchange of demonetized currency. Money launders started using the fictitious accounts to deposit the illicit money they collected through the chain and started exchanging the currency by bribing the bank officials. It was also noted that Gold and other related investments are increased right after the demonetization; due to the fact that Gold merchants started accepting illicit money in exchange of gold and bringing back the debarred money into the system for recirculation through illegal processes.

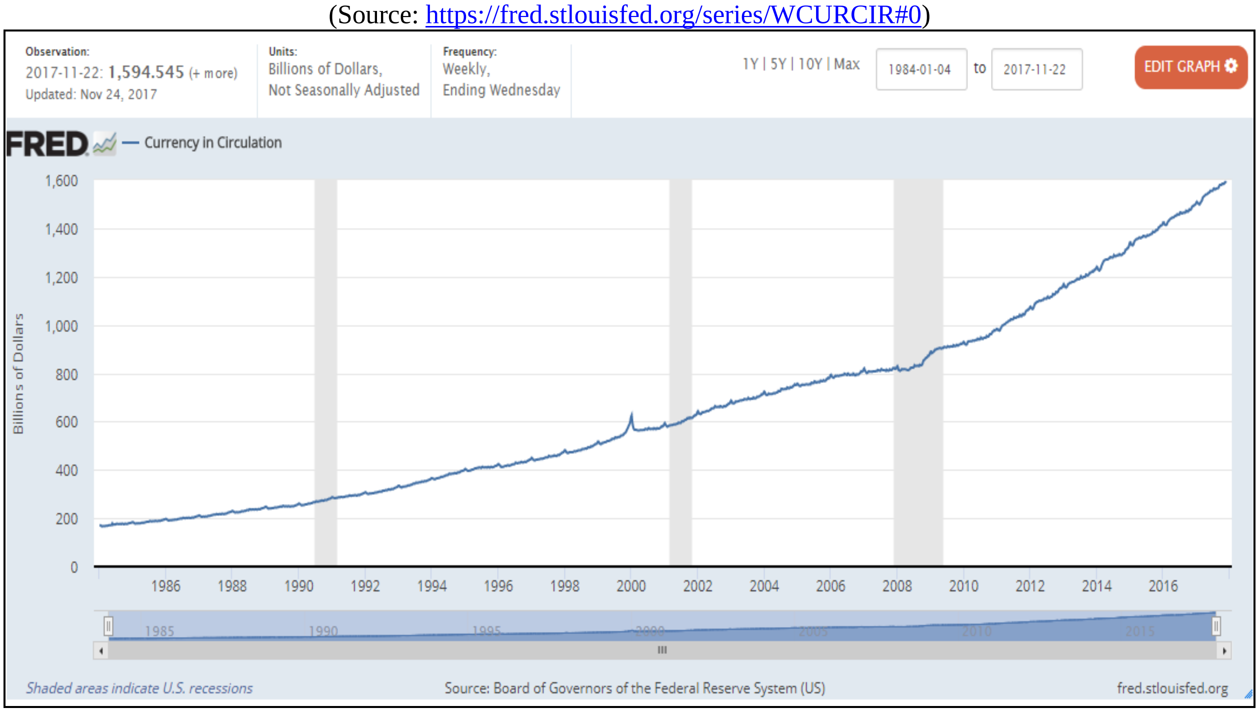
<u>Result of demonetization in India:</u>

- Banks kept on monitoring on all the bank accounts and was observed that $\leq$ 0.2 million illegal bank accounts are frozen during the period of demonetization. There are also 0.30 million directors are barred from the companies for having financial maneuvers.
- The IT department of India served warning letters and investigated on the persons who exceeded in depositing the demonetized currencies into their bank accounts.
- It is also observed that demonetization has halted the political unrest and militancy in Jammu & Kashmir, due to the fact that there is no enough currency in circulation to be supplied to the political miscreants in the area. However this is a temporary phenomenon in the area of Kashmir.
- Demonetization helped the Govt to identify those individuals with a huge amount of debarred cash in their personal lockers and not able to get away with their illegal money.
- It is also noted that debarring Rs 500 and Rs 1000 notes helped the country fight against the terrorist activities within the country and also temporarily halted the activities from the neighboring countries who supply counterfeit currency into India.
- Businessmen started paying advance income tax and declare the demonetized currency by surrendering the excess money and converting it to white money.
- There will be only positive outcomes over a period of 3-4 years from the date of demonetization and the result will be much a welcome approach for the Govt of India.

<u>United States</u>:

As of Nov 2017, currency in circulation—that is, U.S. coins and paper currency in the hands of the public—totaled about $1.6 trillion dollars. The amount of cash in circulation has risen rapidly in recent decades and much of the increase has been caused by demand from abroad. The Federal Reserve estimates that the majority of the cash in circulation today is outside the United States. The below chart depicts the actual Billions of Dollars in circulation from 04/01/1984 to 22/11/2017.

(Source: https://fred.stlouisfed.org/series/WCURCIR#0)



This includes both notes and coins held in the hands of the public and in the safe rooms of the depository institutions. About 0.33% of the unfit for circulation currency notes are destroyed by Fed every year. For example, a $1 bill is the most circulated currency, stays in the market for a period of approx. 5.9 yrs ; $ 100 note for approx. 15 years.

Denomination of Bill	Life Expectancy (Years)
$1	5.9
$5	4.9
$10	4.2
$20	7.7
$50	3.7
$100	15

(Source : https://www.newyorkfed.org)

The Fed requests for new currency from the (BEP) Bureau of Engraving and Printing, which manufactures the required currency and sends it directly to the Reserve Banks. Unlike the other countries, United States maintains only 6 small Denomination bills in circulation which helped the country to prevent hoarding of physical cash. However it continuously striving to prevent money laundering.

The United States received failing scores for its efforts to prevent the laundering of criminal proceeds by shell companies, accountants and real estate agents, the Financial Action Task Force (FATF) said in a report (Source: Reuters)

There are many loopholes in the law enforcement; which led the illicit, counterfeit and contraband money flow into US economy. However Financial Action Task Force "FATF's" relentless efforts in curbing the Anti money laundering, Anti-terrorist financing etc. are highly effective and FATF has implemented innovative tools and techniques to monitor and control the anti-money laundering .

FATF gave non-complaint to Washington due to the lack of monitoring of non-financial institutions involvement in the money laundering activities. Mostly the non-financial institutions are named as realtors and law firms.

In the United States real estate agents are excluded from the scrutiny and disclosure of suspected money laundering activities by their customers into the purchase of properties through illicit money. FATF noticed and brought these activities into lime light, which raised concerns on Washington and its lake of monitoring.

New York states banking regulation body accused Standard Charted Bank of assisting around $250 bn through money laundering activities between 2001-2007. Regulators charged the bank with numerous counts of charges of knowingly engaging in different fraudulent activities to assist around and into the financial systems with its dollar denomination currencies around the world. This depicts an example of why US banks are more attractive towards money launderers. It is also unclear about how much money went towards financing nuclear program and terrorist financing. The bank altered the reports of the source for wire transfers. The bank used series of codes to wire transfer money into Iran, showing various sources of money.

More recently HSBC, Bank of America and Wachovia are also been investigated and accused of helping Mexican drug traffickers, laundered their illicit funds through the American banking system.

The United States has some of the strictest Anti-money laundering laws in the world plus a regulatory environment capable of investigating the reported cases. However it is very common to have some prominent contacts among the bankers and drug traffickers in money laundering activities by paying huge incentives. US has become a safest path to the money launderers through passing the money through US banking systems and once the money moves out of US, is declared as genuine money in most of the cases.

Regulators are more concerned on the most non regulated financial systems in the world, from where the money laundering is done through a series of transactions showing it as a legitimate transaction. However it is very difficult for the regulators to monitor on each and every financial transaction about their legitimacy. Regulators are dependent on banks to notify on any suspicious activities. It depends on the banks to notify regulators on which is a suspicious transaction or comingle with lawyers in justifying the transactions as legitimate. The process of close monitoring is not eradicating the money laundering, however it is making the money laundering expensive with the involvement of more number of players to it. Tax evasion is added as an offence to the money laundering prosecution in 2012 as a global standard.

With this stated, US is expanding its Real Estate Data targeting Los Angeles, San Diego, SFO, Brexar county-Texas, New York City, Miami. There are triggers which are associated with each of these counties, so that regulators start investigating more into the real estate transactions.

In order to further strengthen the regulatory in the United States, FinCEN (**Financial Crimes Enforcement Network)** was introduced by order of the Secretary of the Treasury on April 25, 1990 to include regulatory responsibilities. FinCEN's developed an information technology portal called FinCEN Portal and Query System, which migrated with 11 years of data into FinCEN Query. It is a search engine like Google and it is a "one stop shop" accessible via the FinCEN Portal allowing wide range of searches across more fields than before and resulting in more outputs. Since September 2012 FinCEN generates 4 new reports: Suspicious Activity Report (FinCEN SAR), Currency Transaction Report (FinCEN CTR), the Designation of Exempt Person (DOEP) and Registered Money Service Business (RMSB). These reports are used to track, identify and take further actions to curb money laundering and terrorist financing. (Source: https://en.wikipedia.org/wiki/Financial_Crimes_Enforcement_Network)

IV. CONCLUSION

The threat to the world economy through money laundering is immense and it is 2 to 3 times expensive to prevent the society from the impact of these illicit activities through money laundering. Not only it is expensive, but also it is a major challenge to the regulatory authorities to identify the money laundering agencies and take a criminal action against them due to the political, local and international boundaries and restrictions. Bilateral and Multilateral agreements with the countries which are more active towards the prevention and control of anti-money laundering should come forward and work closely for the global cause. It is also pertinent to state that money laundering is a global threat due to the fact that there are several countries who mainly survive with the money laundering, drug trafficking etc. The laws in those countries are weak and that attracts the rest of the world to route the illicit money through these countries into rest of the developing and developed countries causing world unrest. A strict legal action towards these countries and standard law will make the money launderers from gaining advantage of using different laws and jurisdictions. The financial institutions, law enforcement agencies, administrators and regulators come close and need to work together as a joint task force to combat the issue of money laundering and terrorist financing, so that there would not be another 09/11 in any other country.

Strategies that countries and territories can follow to combat money laundering:

- Maintain Coins, Small denominations currency bills, adopt proper security measures which reduce printing of duplicate bills, demonetization of older bills in circulation and reissuing new currency bills with the same denomination with more security features.
- Vigilant on all the bank accounts with international money transfers on frequent basis and those accounts that pool the money from different sources.
- Make a due diligence on the customer, follow KYC norms and raise red alerts when a banker finds any suspicious activity in their customer accounts.
- There should be more coordination between the regulatory, FI's and enforcement dept in addressing the issue of money laundering.
- Strict punishment to those individuals or groups who are caught in Money laundering. Instead of 1 yr , 2yr of 5 yrs imprisonment and a small amount of financial penalty would not be sufficient. There should be more than what the culprit's imagination level.
- Create a Financial Intelligence Unit (FIU) in every country and it should contain bankers, investigators, financial crime analysts, who can help and analyze the information from banking portal and red flag the money laundering activities to the regulatory for further investigation or criminalization.
- Take strict actions on those countries which encourage money laundering activities and terrorist financing. Monitor the banks and take stringent action against the banks which loosen the wire transfer regulations.
- Bank secrecy laws should be reconsidered and any restriction on information sharing between the banks and regulatory should be reconsidered and protection should be provided to the banks / bankers who provide support to the regulatory in providing the appropriate information on criminal activities of their customers.
- Keep the records of the customers and their transactions for a period of at-least 5 years in case of physical documents and electronic documents should be stored in the data base for at-least 10- 20 years. In this process regulatory authorities can go back and reference the physical and electronic documents of those suspected customers over a period of time to identify the criminal activities.
- Banks and the staff should be given adequate training on modern techniques on identification of money laundering activities and periodically, the training should become a mandatory tool for all the employees of the bank.
- International coordination between countries should be implemented to monitor the agencies which are working closely on money laundering activities and their reach is global.
- Countries should implement stringent laws on money launderers and anti-social elements, whose properties should be seized and forfeited into Government books.

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