

**TRADE BASED MONEY LAUNDERING –**  
**A COMPREHENSIVE STUDY**

**A Dissertation submitted to the National University of Advanced Legal  
Studies, Kochi in partial fulfillment of the requirements for the award**

**of**

**Master of Law (LL.M Degree) in International Trade Law**



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This is to certify that Mr.M A AZEEZ MUSHTAQUE REG NO: 10599 has submitted his dissertation titled “**TRADE BASED MONEY LAUNDERING- A COMPREHENSIVE STUDY**”, in partial fulfillment of the requirement for the award Degree of master of laws in international trade law to the national university of advanced legal studies, Kochi under my guidance and supervision. it is also affirmed that the dissertation submitted by her is original, bona -fide and genuine.

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## **DECLARATION**

I, M A AZEEZ MUSHTAQUE, do hereby declare that this dissertation work titled “Trade Based Money Laundering” researched and submitted by me to the national university of advanced legal studies in partial fulfillment of the requirement for the award of degree of master of laws in international trade law under the guidance and supervision of Dr.Balakrishnan K ,Professor , National University of Advanced Legal studies is an original, bonafide and legitimate work. It has been pursued for an academic interest .This work or any type thereof has not been submitted by me or anyone else for the award of another degree of either this university or any other university.

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Lastly and most importantly my family, without whose unfailing love and the support none of this would have been possible. My heartfelt love and gratitude to all my friends for their overwhelming support at every point.

M A AZEEZ MUSHTAQUE

## **CERTIFICATE ON PLAGIARISM CHECK**

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## **LIST OF ABBREVIATIONS**

1. **AML** - Anti-Money Laundering
2. **TBML** - Trade-Based Money Laundering
3. **PMLA** - Prevention of Money Laundering Act
4. **WTO** - World Trade Organization
5. **WIPO** - World Intellectual Property Organization
6. **AMC** - Asset Management Company
7. **UN** - United Nations
8. **RBI** - Reserve Bank of India
9. **NIA** - National Investigation Agency
10. **TRIPS** - Trade-Related Aspects of Intellectual Property Rights
11. **HC** - High Court
12. **SC** - Supreme Court
13. **C.S.** - Civil Suit
14. **AIR** - All India Reporter
15. **SCC** - Supreme Court Cases
16. **CDD** – Customer Due Dilligence
17. **FBI**- Federal Bureau of Investigation
18. **OECD**-Organization for Economic Cooperation and Development
19. **BCCI** – Bank of Credit and Commerce
20. **AI**- Artificial Intelligence
21. **FATF**- Financail Action Task Force
22. **BSA**- Banking Secrecy Act
23. **IMF**- International Monetary Fund
24. **CFT**- Counter Financing Terrorism
25. **KYC** – Know Your Customer
26. **CDD**- Customer Due Diligence
27. **EU**- European Union
28. **AMLD**- Anti Money Laundering Directive

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## **TRADE BASED MONEY LAUNDERING –A COMPREHENSIVE STUDY**

Money laundering is giving oxygen to organised crime.”

*Enrique Peña Nieto, President of Mexico, in June 2012*

“The only way to stop the flow of this dirty money is to get tough on the bankers who help mask and transfer it around the world. Banks themselves don’t launder money, after all: people do.”

*Robert Mazur, former federal agent who worked as an undercover money launderer, speaking in January 2013 after the HSBC fine*

“Money laundering is a very sophisticated crime and we must be equally sophisticated.”

*Janet Reno, while serving as Attorney General of the United States from 1993 to 2001*

Transnational crime is a trillion dollar business activity, which is valued at as much as \$2.2 trillion or more each year. These criminal networks need to disguise their illicit profits in order to benefit from the proceeds within the legitimate financial system. Trade-based money laundering (TBML), in its simplest form, refers to the movement and concealment of illicit monies using trade methods. However, the definition can extend to large scale fraud as well as the cross-border movement of illegal or controlled goods.

## CHAPTER-1

### INTRODUCTION TO MONEY LAUNDERING

Money laundering is a criminal activity where vast amounts of money generated from illegal deeds such as the drug trade and human trafficking are made to look as though they've come from legitimate sources. The funds, deemed 'dirty' due to their criminal origins, undergo a cleansing process to appear 'clean'. To combat this, financial institutions implement Anti-Money Laundering (AML) strategies to identify and halt such activities. The aim is to transform money obtained from illicit activities into money that appears legally earned, thereby eluding detection by law enforcement. Furthermore, money laundering plays a crucial role in financing terrorism and holds significant implications for compliance.

Money laundering is a practice almost as old time itself. From as early as 2000 BCE, wealthy Chinese merchants would move their profits outside of China, as the government did not support commercial trading. They would then reinvest their smuggled funds into other enterprises, a technique still used today. In the US, money laundering took off in the 1920s during the prohibition era. As alcohol was made illegal in the US, a profitable black market soon arose to fill the boozy gap. Organized crime boomed as the demand for alcohol rose.<sup>1</sup>

You may have heard of Al Capone, who was a major mob boss in Chicago. It is rumoured that the term “money laundering” originated from Capone, as he set up Laundromats across the city in order to disguise the origin of the money earned from alcohol sales. Any illicit profits would simply be added to the revenue generated by the Laundromats and thus re-introduced into the financial system<sup>2</sup>

#### **The Need to Launder Money**

A significant challenge faced by large, organized criminal groups, such as those involved in drug trafficking, is managing the vast sums of cash generated without drawing the attention of law enforcement. These entities and their cash recipients prefer not to report this income, avoiding substantial tax liabilities. To tackle the issue of possessing millions in cash from illicit dealings,

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<sup>1</sup> <https://medium.com/kyc-io-scalable-kyc-management-solutions/the-history-of-money-laundering-be56bc65d6ae>

<sup>2</sup> <https://financialcrimeacademy.org/the-history-of-money-laundering-2/>

these organizations engage in "money laundering." This process is designed to mask the illicit origins of their funds, integrating them into the legitimate financial system, like banks or businesses, making it appear legal.

## **KEY FEATURES**

- a. Money laundering is the process of disguising the origins of money obtained illegally to make it appear legitimate.
- b. The rise of online banking and cryptocurrencies has facilitated easier and undetectable transfer and withdrawal of funds by criminals.
- c. Efforts to prevent money laundering have become global, targeting not only criminal proceeds but also the financing of terrorism.
- d. The financial industry enforces stringent anti-money laundering (AML) measures to combat this issue.

## **Objectives:**

- a. To understand money laundering process and how it is executed through trade mechanisms
- b. To focus on the need to have a comprehensive law for the effective curbing of money laundering
- c. How international trade acts as a means of fostering money laundering techniques

## **Statement of the problem:**

Legally, Trade based Money laundering (TBML) presents significant challenges for regulatory and enforcement agencies due to its complexity and transnational nature. Criminals use techniques such as over-invoicing, under-invoicing, multiple invoicing, falsifying trade documents, and phantom shipping to exploit regulatory gaps and discrepancies in trade laws across different jurisdictions. Despite the implementation of Anti-Money Laundering (AML) and Counter Financing of Terrorism (CFT) regulations based on international standards set by the Financial Action Task Force (FATF), the effectiveness of these legal measures is often compromised. Inconsistent enforcement, limited resources, and varying legal standards across countries hinder the fight against TBML. <sup>3</sup>Additionally, the involvement of numerous stakeholders in trade transactions complicates legal oversight and accountability. This problem demands enhanced legal frameworks, stricter compliance requirements, greater transparency in trade practices, and

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<sup>3</sup> <https://financialcrimeacademy.org/trade-based-money-laundering/>

improved international legal cooperation to ensure consistent enforcement and effective prosecution of TBML activities. Addressing these legal challenges is crucial to protect the integrity of global trade and financial systems.<sup>4</sup>

The Prevention of Money Laundering Act (PMLA) of 2002 in India, designed to combat financial crimes like money laundering, faces several formidable legal challenges. Central among these is the complexity and ambiguity within its provisions, leading to inconsistent interpretations and enforcement by various agencies and the judiciary. Another critical hurdle is the stringent burden of proof required to establish money laundering offenses, often compounded by the sophisticated methods used by perpetrators to conceal their illicit activities. Procedural delays further hinder effective enforcement, causing prolonged investigations and legal proceedings. Moreover, the Act's provisions for property attachment and confiscation can be legally contested, raising questions about due process and property rights protection. Internationally, challenges include differing legal frameworks and varying commitments to combat money laundering, which complicates cross-border investigations and asset recovery efforts. Balancing the rights of the accused with stringent anti-money laundering measures also presents a persistent challenge. Addressing these legal complexities demands comprehensive reforms, enhanced coordination among regulatory bodies, and strengthened international cooperation to ensure the PMLA's efficacy in combating financial crimes effectively.<sup>5</sup>

### **Research questions**

- 1. what are some of the most common methods used in TBML?**
- 2. what are the ways in which international trade facilitates money laundering**
- 3. what role can technologies play in supporting the identification and prevention of TBML?**
- 4. what are some of the main challenges in identifying and preventing TBML?**
- 5. what legal reforms can be implemented so that money laundering can be curbed**

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<sup>5</sup> <https://www.fatf-gafi.org/content/dam/fatf-gafi/fsrb-fur/UAE-Follow-Up-Report-2023.pdf.coredownload.pdf>

## **Significance of study**

Around the world International Trade and cross border trades have been expanding. The laws and rules are different among various countries. This makes it easy to launder money by cross boarder trading. Criminals around the world use different techniques to convert their illicit funds to legitimate funds. **Also with advent of technology and crypto currency** new techniques to launder money have also arisen. New laws, legislations and international cooperation among countries are necessary to combat this. So how and what techniques international trade organizations and how new legislation within India can be enacted to curb the money laundering process is what is focused in this thesis

## **ResearchMethodology**

This research work deals with non-empirical research. The methodology used is purely doctrinal in nature. The research includes primary and secondary materials. Primary materials consist of text of laws, declaration etc. and Secondary material consists of books, articles, research paper and magazine reports etc. This research is also explanatory and comparative nature. Available and proposed laws are analysed and explained.

## **Hypothesis:**

The existing legal frameworks of countries around the world and in India are not adequate to cover all aspects and curb the money laundering process. Moreover it is silent on some of the important main areas of trade based money laundering

## **Review of literature**

Dr. J.D. Aggarwal and Prof. Aman Aggarwal (2004) in their publication "International Money Laundering in Banking Sector" discuss: - The definition of money laundering. - Various scandals within the banking sector regarding money laundering. - Measures implemented by banks to prevent money laundering.

T.S. Masani (2007) in the article titled "Money Laundering – A Big Crime" elaborates: - That money laundering involves the conversion or disguising of illegally obtained money. - Discusses the role of the Financial Intelligence Unit-India (FIU-IND). - Provides an overview of the Prevention of Money Laundering Act, 2002.



Kishore Jagirdar (2008) in the article "Money Laundering in India-an Overview" observes: - The primary objectives behind money laundering. - Explains the significance of the Prevention of Money Laundering Act 2002 in addressing money laundering issues.

Vandana Ajay, in her paper "Money Laundering: Concept, Significance, and its Impact," argues that money laundering is a worldwide issue that requires global attention. The only way to effectively combat this problem is through international collaboration. Criminals often stay one step ahead of law enforcement by hiring professional teams, including chartered accountants, lawyers, and those connected to the banking sector, to make their illegal funds appear legitimate, usually charging a fee of 10 to 15% for their services. The potential collusion between such professionals, politicians, law enforcement, and criminal organizations is a concerning possibility. Bankers are identified as key players in this scheme, with their involvement being crucial for its execution. The advancement of technology, especially in the realm of digital fund transfers, has made tracing these illicit funds even more challenging. Addressing money laundering effectively necessitates international legal and law enforcement collaboration. The fight against money laundering should predominantly be through legal penalties and should leverage international frameworks of cooperation between judicial and law enforcement bodies. It's also critical to underline that merely enacting Anti-Money Laundering Laws is insufficient; law enforcement agencies must continuously adapt to the evolving tactics of money launderers who are always finding new ways to evade detection.

Vijay Kumar Singh, in his paper "Controlling Money Laundering in India: Problems and Perspectives," discusses that tackling money laundering is an ever-evolving challenge. Criminals are perpetually devising new methods to launder money, staying ahead of regulatory measures. He highlights that the Financial Action Task Force (FATF) has observed, through its analysis of criminal trends, that as member countries strengthen their anti-money laundering regulations, offenders seek out and exploit vulnerabilities in less regulated jurisdictions to continue their illegal activities.

## **CHAPTERIZATIONS:**

The present work is divided into mainly **Nine** chapters:

### **Chapter 1:** Introduction to Money laundering

This chapter deals with introduction to Money laundering and its objectives, hypothesis along with the review of literature.

### **Chapter 2:** History and evolution of money laundering

In this chapter the history, evolution and significance of money laundering are discussed

### **Chapter3:** Techniques, methods and trades associated with money laundering

This chapter deals with study of trade based money laundering techniques, what trade and businesses are commonly used to launder money

### **Chapter4:** International Trade and money laundering

This chapter deals with how international trade acts as a means to launder money. It also looks into how various International Trade organizations and other agencies have devised methods and strategies to curb the money laundering process

### **Chapter5:** Money Laundering in India (PMLA Act 2002)

In this chapter we look into the evolution and enforcement of the PMLA Act and a few major Money Laundering scams based in India

### **Chapter6:** Money Laundering and its ill Effects

In this chapter we see how money laundering creates a negative effect on the economic and political scenario of a state

### **Chapter7:** Anti-Money Laundering Techniques

In this chapter we look into what methods and techniques can be followed to curb the money laundering process. This chapter also explores various international organizations that aim to curb money laundering.

### **Chapter8:** Crypto Currency, Technology and Money Laundering

This chapter deals with the rise of crypto currency and money laundering techniques associated with it

**Chapter9:** Conclusion and Suggestions

The ending chapter includes certain conclusions and suggestions regarding measures to counter money laundering in India and around the world

## CHAPTER 2

### HISTORY AND EVOLUTION OF MONEY LAUNDERING

The origins of money laundering can be traced back to over two thousand years ago, according to historian Sterling Seagrave, when rich merchants in China began to "clean" their profits to bypass regional trade restrictions<sup>6</sup>. Over the years, this illicit practice evolved, particularly noticeable during the Prohibition era in the United States, when criminal organizations funneled profits from illegal alcohol sales through ostensibly legitimate enterprises. This era was marked by notorious figures such as Al Capone, who utilized this method, helping to shape the contemporary definition of 'money laundering.' Money laundering has long been intertwined with the evolution of commerce and banking, serving as a method to shield assets and money from government seizure and taxes. The origins of money itself are obscure, but the act of laundering money dates back thousands of years. Sterling Seagrave, in his book "Lords of the Rim," details how Chinese merchants would conceal their riches from authoritarian rulers to avoid confiscation and exile over 4,000 years ago. <sup>7</sup>They would also relocate and invest their wealth in distant provinces or even outside of China. Over time, this led to the development of the offshore industry and tax havens, which are key components in the current landscape of money laundering, involving the international transfer of funds from criminal activities to evade government oversight. This includes oppressive governments and tyrannical leaders. Various minorities, such as the Jews, have historically undertaken measures to safeguard their wealth from both autocratic and democratic leaders who targeted them due to their beliefs or ethnicity. <sup>8</sup>

The term "money laundering" is often believed to originate from the era of notorious American gangster activity that began during Prohibition—the prohibition of alcoholic beverages. Several methods were employed to mask the origins of substantial sums of money made from the importation and sale of alcohol and other illicit activities like gambling. "Money Laundering" is thought to have derived from Mafia-operated Laundromats in the United States, where gangsters needed to legitimize large amounts of cash made from various criminal activities, including extortion, prostitution, gambling, and bootlegging.<sup>9</sup>

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<sup>6</sup> <https://www.publishersweekly.com/9780399140112>

<sup>7</sup> <https://www.publishersweekly.com/9780399140112>

<sup>8</sup> Vaithilingam & Nair (2007)

<sup>9</sup> <https://financialcrimeacademy.org/the-history-of-money-laundering-2/>

One method they utilized was the acquisition of seemingly reputable businesses, blending their illegal profits with the legitimate income these businesses generated. Entrepreneurs like Al Capone were drawn to Laundromats due to their cash-only operations, providing a significant advantage for integrating illicit earnings. Alphonse Gabriel "Al" Capone (January 17, 1899 – January 25, 1947) was a notorious American mobster who ruled over a crime syndicate during the Prohibition era. His group, the Chicago Outfit, also known as the "Caponese," engaged in illegal liquor trafficking and bootlegging, alongside other criminal activities such as prostitution in Chicago throughout the early 1920s up to 1931. Despite his vast empire of crime, Capone's downfall came in October 1931 when he was found guilty of tax evasion, leading to his imprisonment, rather than for the criminal enterprises that built his wealth. The process known as "money laundering" directly refers to the method of transforming illegal earnings into seemingly legitimate funds through multiple transactions, effectively concealing the illicit origins.<sup>10</sup> One ironic twist was that legal gambling became a technique for hiding these origins. The primary challenge for these criminals was dealing with cash, particularly in small denominations, as depositing such amounts would raise suspicion. Managing a significant volume of money, especially in low-value coins, posed a considerable challenge. Hence, they ventured into businesses such as slot machines and laundry services, giving rise to the term "money laundry." The abuse of merchants and others by rulers led them to find ways to hide their wealth, including ways of moving it around without it being identified and confiscated.<sup>11</sup>

Interestingly, one strategy for masking the source of funds was through legitimate gambling. The challenge criminals encountered was dealing with large quantities of cash, primarily in the form of small denomination coins. Placing these coins in a bank would prompt inquiries. Managing the storage of substantial sums in such minor currencies proved to be a logistical nightmare. Therefore, they ventured into setting up certain businesses, notably slot machines and laundry services. It is from this practice that the term "money laundering" emerged.<sup>12</sup>

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<sup>10</sup> <http://law2.umkc.edu/faculty/projects/ftrials/capone/caponeaccount.html>

<sup>11</sup> Gupta, Dr. Anuradha. "Money Laundering and Financing of Terrorism-A Study on Methods to Fight Money laundering in India and USA". Journal of the Institute of Chartered Accountants of India, volume 58, No.10, APRIL 2010

<sup>12</sup> <https://financialcrimeacademy.org/the-history-of-money-laundering-2/>

The origins of money laundering are thought to be as ancient as the commission of crimes themselves. Historian Sterling Seagrave has pointed out that over 2000 years ago, affluent merchants in China were forced to launder their earnings due to the regional government's restrictions on numerous commercial practices. According to Seagrave, these restrictions stemmed from a view of merchants as being unscrupulously greedy and operating under a different set of rules, often gaining their wealth from illicit activities such as black market dealings, extortion, and bribes. Consequently, to protect their wealth from the persistent demands of corrupt officials, these merchants resorted to converting their money into easily transportable assets and relocating their wealth outside of the government's reach to reinvest in their businesses, a strategy still employed by money launderers today<sup>13</sup>. Money laundering involves the process of disguising the origins of money obtained from illegal activities to make it appear legally earned. This process typically unfolds in three stages: placement, where illicit funds are initially introduced into the legitimate financial system; layering, which involves complex transactions to obscure the illegal origins; and integration, where the laundered money is mixed into the economy, making it appear legitimate.<sup>14</sup>

**Stages of money laundering typically consist of three steps:**

1. Introducing cash into the financial system through some means (“Placement”).
2. Carrying out complex financial transactions to conceal the illegal source of the cash (“Layering”).
3. Acquiring wealth generated from the illicit funds’ transactions (“Integration”).

Depending on the circumstances, some of these steps may be skipped. Non-cash proceeds, for example, already in the financial system would not need to be placed. All of these causes of money laundering.

**Money Laundering in the 1930s**

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<sup>13</sup> <https://www.lawteacher.net/free-law-essays/commercial-law/the-early-history-of-money-laundering-commercial-law-essay.php>

<sup>14</sup> Arora, Rajni (2012) “ Black money in India: present status and future challenges”. International journal of Science, Engineering and technology research, Volume 1, issue 5.

<https://financialcrimeacademy.org/the-history-of-money-laundering-2/>

In the 1930s, the United States' Prohibition era significantly furthered the issue of money laundering, primarily to counteract the rise of organized crime. The Prohibition era, lasting from 1920 to 1933, was a time when the making, selling, and transportation of alcoholic beverages were banned across the country. This period inadvertently fueled the growth of organized crime through the lucrative illegal alcohol trade. The landmark prosecution of notorious mobster Al Capone on tax evasion charges marked a pivotal shift in how law enforcement and the state tackled the financial operations of criminal organizations. Although initially focusing on tax evasion, authorities had to adapt their strategies as criminals began to comply with tax laws to cover their tracks.

The notion that money laundering as we understand it today originated in this era is widely held. As organized crime syndicates amassed vast sums from bootlegging, they sought methods to legitimize their ill-gotten wealth. By acquiring legitimate businesses and blending their criminal proceeds with the legitimate income these businesses generated, they effectively disguised the origins of their money. This era paved the way for the development of laws specifically targeting money laundering, aiming to dismantle the financial power of organized crime

### **Money Laundering in the 1980s**

In the 1980s, the battle against drugs led governments to implement stricter money laundering laws. These laws were designed to help track down and confiscate the earnings from drug-related crimes, as well as to capture the leaders and members of drug trafficking rings. For law enforcement, this strategy also flipped the usual requirement for evidence on its head. Typically, authorities are required to prove someone's guilt before they can confiscate their assets. This approach greatly simplifies the work of law enforcement agencies and significantly reduces the burden of proof required of them. However, there have been instances where law enforcement has misused these powers by seizing and retaining money without substantial proof of criminal activity, using it to boost their own budgets.<sup>15</sup>

### **Watergate Scandal**

The Watergate scandal was a significant American political controversy involving the administration of President Richard Nixon from 1972 to 1974, leading to Nixon's resignation. It

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<sup>15</sup> <https://kyc-chain.com/the-history-of-money-laundering/>

stemmed from the administration's attempts to hide its involvement in the break-in at the Democratic National Committee's office in the Watergate complex on June 17, 1972. The connection of the burglars' cash to Nixon's re-election campaign fund prompted further probes. These investigations, along with disclosures in the burglars' trials, resulted in the House of Representatives empowering its judiciary committee with expanded investigative capacities to explore specific subjects under its domain, and the formation of a special investigation committee by the Senate. It turns out that the actual term money laundering was first used in 1973 relating to the Watergate scandal.<sup>16</sup>

### **Global history of money laundering and Indian legislation**

July 14 to July 16, 1989- Financial Action Task Force (FATF) established at the summit of seven major industrial nations, held in Paris to examine the problem of money laundering made 40 recommendations.<sup>17</sup>

February 23, 1990—Political Declaration and Global Programme of Action, annexed to the resolution S-17/2 was adopted by the General Assembly of the United Nations at its 17th special session.<sup>18</sup>

June 8 to June 10, 1998—Political Declaration adopted by the special session of the United Nations General Assembly calls upon the member states to adopt national money laundering legislation and programme.<sup>19</sup>

August 4, 1998—To achieve objective of preventing money laundering, the Bill was introduced in the Parliament on August 4, 1998.

March 4, 1999—The Bill was referred to the Standing Committee on Finance, which presented its report on March 4, 1999 to Lok Sabha.

January 17, 2003—The Prevention of Money-Laundering Bill having been passed by both the Houses of Parliament received the assent of the President of India on January 17, 2003.

July 1, 2005—It came on the Statute Book as The Prevention of Money Laundering Act, 2002, that came into force from July 1, 2005.<sup>20</sup>

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<sup>16</sup> <https://financialcrimeacademy.org/the-history-of-money-laundering-2/>

<sup>17</sup> <https://odishapolicecidcb.gov.in/sites/default/files/PMLA%20Act%20as%20amended%20in%202013.pdf>

<sup>18</sup>

[https://www.unodc.org/documents/commissions/CND/Political\\_Declaration/Political\\_Declaration\\_1990/1990\\_Political\\_Declaration\\_and\\_Programme\\_of\\_Action.pdf](https://www.unodc.org/documents/commissions/CND/Political_Declaration/Political_Declaration_1990/1990_Political_Declaration_and_Programme_of_Action.pdf)

<sup>19</sup> <https://www.icsi.edu/media/webmodules/CSJ/December/13.pdf>

<sup>20</sup> <https://risingkashmir.com/history-and-genesis-of-money-laundering-act-in-india/>



## **Conclusion**

Tracing the history of money laundering uncovers its ancient roots in our financial past, going back to merchants in China more than two millennia ago. This criminal practice, which involves making money gained from illicit activities appear legal, has evolved over time to outsmart legal and financial regulations across the globe. In the United States, it found fertile ground during the 1930s Prohibition era, with organized crime syndicates, like those led by Al Capone, using legitimate businesses such as laundries to disguise their illegal earnings.

Contrary to widespread belief, the association of money laundering with Laundromats is now often debunked as a myth.

The phrase "money laundering" became popular during the 1970s Watergate Scandal, where it was used to describe the process of hiding the origins of illegally obtained money to make it seem legal.

During the 1980s, the introduction of anti-money laundering laws became a key strategy in fighting organized crime, especially in the drug trade. These laws made it easier to prosecute criminals and seize assets, but they also raised concerns about potential misuse by law enforcement. The intricate and evolving history of money laundering highlights its ongoing threat to the world's economies and the ever-present challenge of developing effective measures to counter it.

## **CHAPTER- 3**

### **TECHNIQUES, METHODS AND TRADES OF MONEY**

#### **LAUNDERING**

Money laundering is a term that conjures images of shadowy figures and underground criminal networks. Understanding the money laundering stages is crucial not only for businesses and financial institutions but for every individual who wants to protect their hard-earned money and maintain the integrity of the global financial system.

#### **Key Features**

- a. Money laundering is a crime that conceals the origins of illegally obtained funds, making them appear legitimate.
- b. It involves three distinct stages: placement, layering, and integration. Common techniques include cash smuggling, shell companies, and real estate investments.
- c. Anti Money Laundering (AML) regulations are essential for effective prevention with Know Your Customer checks being critical to comply with these rules.

#### **Understanding Money Laundering**

Money laundering is a financial crime that affects individuals, businesses, and entire economies. At its core, it is the process of concealing the origins of illicitly obtained funds, making them appear legitimate and obscuring their connection to criminal activities. The money laundering process enables criminals to integrate illegal funds into the legitimate financial system, making it difficult for law enforcement and financial regulators to trace and seize these funds.

The global nature of modern finance has only made money laundering more challenging to combat. Criminals exploit the interconnectedness of financial systems, frequently moving cash abroad and utilizing multiple foreign bank accounts and complex transactions to evade detection by tax authorities and financial regulators.

A clear understanding of the three stages of money laundering – placement, layering and integration – is crucial for comprehending how this crime operates and how to prevent it.

## **What is Money Laundering?**

Money laundering is the process of transforming illegally obtained funds (or “dirty money”) into seemingly legitimate assets, making it difficult to trace the true source of the funds and use them for criminal activities. In this article, we will have “money laundering explained” in a simple way.

It typically involves three stages:

- a. Placement: where the illicit funds enter the legitimate financial system
- b. Layering: where the funds are moved around to create confusion and distance them from their criminal origin
- c. Integration: where the money is reintroduced into the economy in a way that makes it appear to have come from legitimate sources.

Criminals can effectively conceal their ill-gotten wealth, finance more illegal activities, and evade taxes when they successfully maneuver through these stages.

## **Money Laundering Process**

A thorough comprehension of the three stages – placement, layering, and integration – that illicit funds typically traverse is fundamental to effectively tackling money laundering. These stages serve to conceal the origin of the funds, make them difficult to trace, and ultimately enable criminals to use the money for illegal purposes without detection.

The subsequent sections provide a detailed examination of each of these stages, illuminating the strategies and techniques used by money launderers to elude authorities and obscure their funds’ true origins. A common and relatively straightforward method to launder money involves channelling it through a business with frequent cash transactions, like a restaurant. The laundering process typically unfolds as follows:

### **a. Placement**

The placement stage marks the beginning of the money laundering process (a.k.a. the money laundering stages), where dirty money is introduced into the financial system. This stage is considered the most vulnerable for criminals, as they must find ways to deposit large amounts of cash without raising suspicion.

Common methods used during placement include:

- a. Depositing cash in smaller amounts to avoid detection (a technique known as “structuring”)
- b. Purchasing monetary instruments like checks or money orders

- c. Funneling money through cash businesses such as casinos or car washes.

Once criminals successfully inject illicit funds into the financial system, they initiate the process of concealing their origins and laundering the money.

It is basically false or fake earnings from a legitimate business.

Example, A legitimate restaurant owned by a criminal or a criminal organization is used as a front. Money from illicit activities is slowly deposited into the restaurant's bank account. The establishment reports daily cash sales far higher than its actual earnings. For instance, if the restaurant legitimately earns \$2,000 in cash on a particular day, an additional \$2,000 from illegal sources will be added to this figure. The restaurant then falsely claims it made \$4,000 in daily sales, making the illicit funds appear as legitimate business revenue.

### **b. Layering the Money**

To address potential tax complications from declaring higher revenue than what's actually earned and to further obscure the illicit origin of the funds, the laundered money might be invested in other legitimate businesses, like real estate. This stage often involves using shell or holding companies that manage various enterprises to further complicate tracing the money's origins. The laundered funds might circulate through casinos, foreign currency exchanges, the financial market, and eventually move to offshore accounts in countries with lax banking laws, making it harder to track the money back to its criminal source.

Layering is the second stage of the money laundering stages in which criminals engage in a series of transactions to create confusion and distance the funds from their criminal origin. This can involve:

- a. Transferring money between multiple bank accounts, often in different jurisdictions
- b. Using shell companies
- c. Using digital currencies to further obscure the money trail

The objective of layering is to create a complex web of financial transactions that makes it extremely difficult for law enforcement to trace the source of the illicit funds. Criminals can further shield themselves from detection and prepare to reinfuse their laundered funds into the legitimate economy after successfully traversing the layering stage.

### **c. Integration**

The final step involves introducing the laundered money back into the economy through legitimate channels, such as investments in businesses, real estate, or luxury items like jewelry and

cars, or even establishing new businesses for future laundering operations. By this point, the money has been "cleaned" so that the criminal or organization can use it openly without relying on illegal methods. The money is now openly invested or used to purchase assets. Successful integration allows criminals to use their laundered money for further criminal activities or to fund their personal lifestyles with minimal risk of detection. This stage underscores the importance of robust anti-money laundering controls and vigilance in monitoring transactions for signs of potential money laundering.<sup>21</sup>

Different Strategies for Transactions Include: -

a. **Structuring or Smurfing**:- Splitting large cash sums into smaller deposits across many accounts to avoid detection.

b. **"Mules" or Cash Smugglers**:- Physically smuggling cash across borders to deposit in foreign banks.

c. **Investing in Commodities**:- Purchasing easily transportable assets like gems and gold.

d. **Buying and Selling**:- Engaging in quick investments like real estate, vehicles, and boats using cash.

e. **Gambling**:- Laundering money through casinos.

f. **Shell Companies**:- Creating companies that exist only on paper to facilitate laundering.

## **The Impact of Money Laundering**

The consequences of money laundering extend far beyond the criminals who profit from it. Money laundering allows criminal organizations to finance their operations and grow their influence, posing a threat to public safety and national security.

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<sup>21</sup> <https://financialcrimeacademy.org/the-three-stages-of-money-laundering/#:~:text=Money%20laundering%20is%20a%20crime,companies%2C%20and%20real>

Additionally, money laundering undermines the integrity of financial systems, as it allows criminals to exploit loopholes and weaknesses in regulations, ultimately eroding trust in financial institutions. On an economic level, money laundering can deter investment and hinder economic growth by reducing the availability of capital and fostering instability in the financial system.<sup>22</sup>

## **Common Money Laundering Techniques and Trades**

Money launderers employ a variety of money laundering schemes to achieve their goals, often adapting and refining their methods in response to changes in regulations and law enforcement practices. Some of the most common techniques include cash smuggling, shell companies, and real estate investments. Each of these techniques exploits vulnerabilities in the financial system and enables criminals to conceal the origins of their illicit funds.

Subsequent sections provide an in-depth exploration of these techniques and examine their role in facilitating global money laundering.

### **Cash Smuggling**

Cash smuggling involves physically transporting large amounts of cash across international borders, often with the aim of depositing the money in foreign banks or investing in assets that are less likely to be scrutinized by authorities. By moving cash abroad, criminals can evade detection by law enforcement and financial regulators in their home countries, making it more difficult for authorities to trace the source of the funds and prosecute those involved in money laundering.

To combat cash smuggling, businesses can:

- a. Implement robust AML policies
- b. Monitor transactions for signs of suspicious activity
- c. Educate employees on the risks and warning signs associated with this technique.

### **Shell Companies**

Shell companies are non-operational entities created to hide the true ownership of assets and facilitate money laundering transactions. These companies often have no physical presence or employees and are used to obscure the identity of the individuals or organizations behind the company, making it difficult for authorities to trace the source of the funds and hold the criminals accountable.

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<sup>22</sup> <https://financialcrimeacademy.org/the-three-stages-of-money-laundering/>

To deter money laundering through shell companies, businesses can implement comprehensive AML policies, monitor transactions, and provide employee training and awareness.

### **Real Estate Investments**

Real estate investments offer an attractive avenue for money laundering, as they provide a means of obscuring the origin of funds and converting illicit cash into seemingly legitimate assets. By purchasing properties with illegal funds and later selling them for a profit, criminals can effectively launder their money and reintegrate it into the legitimate financial system.

The large sums of money involved in real estate transactions and the potential for property values to appreciate over time make this an appealing option for money launderers seeking to hide their illicit gains and generate further profits.

### **Mispricing**

Mispricing involves the practice of declaring goods at incorrect values, known either as under-invoicing or over-invoicing. This tactic is a prevalent method in Trade-Based Money Laundering (TBML), where companies can move large sums of money by trading goods of minimal value. Often, this involves falsifying the quality of goods to adjust the invoice pricing<sup>23</sup>.

### **Multiple-Invoicing**

Multiple-Invoicing happens when duplicate invoices are issued for the same shipment of goods, artificially increasing the value transferred through the financial system. It can also be part of fraudulent schemes where companies receive inflated credit based on the overvalued collateral goods.

### **Over or Under-Shipment**

In the context of TBML, over or under-shipment occurs when a seller ships more or less than the agreed quantity of goods to the importer, altering the value of the transaction. Variations might also include declaring a different quality of goods, which can cause further discrepancies in value<sup>24</sup>.

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<sup>23</sup> <https://www.tookitaki.com/compliance-hub/trade-based-money-laundering-explained#>:

<sup>24</sup> <https://complyadvantage.com/insights/trade-based-money-laundering/>

## **Phantom Shipments**

Phantom Shipments are instances where Organized Crime Groups (OCGs) bill for the transportation of goods that either haven't been shipped or don't exist at all. Leveraging the industry's reliance on paper documentation, these groups can forge shipping documents to make it appear as though legitimate transactions have occurred, facilitating the illicit transfer of funds.

## **Casino and Gambling Laundering**

Casinos and gambling establishments present an alluring opportunity for money laundering, providing a colourful landscape for camouflaging illicit funds. The thrill of games of chance often masks the motives of criminals, who exploit the fluidity and excitement of wagering to transform their ill-gotten gains into seemingly legitimate earnings.

As a favoured money laundering technique, the bettors wager large sums of money on games with relatively low risk, such as blackjack or roulette. These savvy gamblers may intentionally lose a portion of their bets, creating the impression of genuine gambling activities. Subsequently, they exchange their chips for crisp banknotes, absolving them of any dubious associations.

## **Cyber Laundering**

Cyber laundering, a burgeoning method of money laundering, takes advantage of the digital world to hide the origin of illegal funds. As technology progresses at breakneck speed, criminals discover new ways to cover their tracks, making it harder for traditional detection methods to catch them. The dark web adds another layer of anonymity for criminals, allowing them to make transactions without being easily detected.

Digital currencies and crypto currencies are key tools in cyber laundering. Criminals use mixing services, or "tumblers," to blend their illegal money with legal funds. This makes it challenging for authorities to trace where the money initially came from.

Online gaming platforms have also become popular for cyber laundering. Virtual assets, in-game currencies, and items are frequently traded across countries, resulting in a complicated network of transactions that is difficult for investigators to understand.

## **Round Tripping**

Round-tripping, a cunning method employed by money launderers, involves moving funds across borders to obscure their illicit origins. Typically, funds are sent out of a country, then brought back in the guise of legitimate investments or business transactions.



Example, a UK-based company "A" with ill-gotten gains, eager to clean their dirty money. They establish an offshore entity "B" in a tax haven, transferring their funds there. Company B then invests these funds back into Company A as a loan, purchase of shares, or other legitimate-seeming transactions. The money, now disguised as legitimate capital, re-enters the UK economy, successfully completing the round-trip.

This circular flow of funds effectively distances the money from its unlawful source, making it difficult for authorities to trace. Round-tripping is particularly attractive to money launderers due to its ability to exploit tax havens, which often have lax regulations and provide anonymity<sup>25</sup>

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<sup>25</sup> <https://www.lexisnexis.com/blogs/gb/b/compliance-risk-due-diligence/posts/examples-money-laundering>

## **Conclusion**

Money laundering is a dynamic and evolving threat to global financial systems, employing a range of sophisticated techniques to obscure the origins of illicit funds. Key methods include placement, layering, and integration, each leveraging various strategies to move and disguise money. Placement introduces illicit funds into the financial system through means such as cash smuggling and structuring deposits. Layering obscures the money's origin through complex transactions, including the use of shell companies, offshore accounts, and cryptocurrency exchanges. Finally, integration assimilates the laundered money into the legitimate economy through investments in real estate, luxury goods, and businesses.

Understanding these techniques is crucial for developing effective countermeasures. Regulatory frameworks like the Financial Action Task Force (FATF) standards and national Anti-Money Laundering (AML) laws provide essential guidelines, but enforcement remains challenging due to the ingenuity of money launderers. Technological advancements in data analytics, artificial intelligence, and blockchain offer promising tools to enhance detection and prevention efforts. However, continued innovation, robust international cooperation, and comprehensive legal reforms are vital to counteract the sophisticated and transnational nature of money laundering effectively. Addressing these challenges is imperative to protect the integrity of global financial systems and maintain economic stability.

## **CHAPTER – 4**

### **INTERNATIONAL TRADE AND MONEY LAUNDERING**

#### **What is Trade based Money Laundering?**

The Financial Action Task Force (FATF) defines TBML as “the process of disguising the proceeds of crime and moving value using cross-border trade transactions in an attempt to legitimize their illicit origins.” TBML is typically affected through the mis-invoicing of international trade transactions. By fraudulently misreporting the price, quantity, or quality of goods, criminals can quickly move substantial amounts of money or value from one jurisdiction to another.<sup>26</sup>

#### **Why is Trade based money laundering done?**

Crimes and the act of money laundering have a symbiotic relationship, serving to balance each other out. Money laundering serves the purpose of concealing the origins of illicitly obtained money, effectively "cleaning" it. Individuals engage in this practice to protect their unlawfully gained profits by placing them in jurisdictions with lower taxes, thereby disguising the illicit funds. A crime is only recognized as such when proven, which is precisely the methodology behind money laundering: making illicit earnings appear as legitimately acquired wealth. To execute this, money launderers exploit various methods and networks to consolidate their illicit funds in locations where tracing the money's origins and tracking the transactions becomes challenging. These methods are chosen to ensure personal safety, minimal or zero tax obligations, and political stability. The exposure of the Panama Papers shed light on the ways in which the affluent and influential conceal their fortunes. The papers also revealed how corporations have facilitated their clients in avoiding sanctions, laundering money, and sidestepping taxes. A significant amount of illegal funds is generated through intricate trade-based money laundering operations<sup>27</sup>. Recent data indicates a rise in illegal financial outflows from Bangladeshi citizens, attributed largely to the gains from RMG (Ready-Made Garments) exports. To fulfill orders for RMG exports, Back-to-back Letters of Credit (BBLC) worth millions are issued daily against export contracts and letters of credit, highlighting a potential avenue for financial

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<sup>26</sup> <https://www.worldbank.org/en/olc/course/35619>

<sup>27</sup> <https://www.investopedia.com/terms/p/panama-papers.asp>



Furthermore, the complex nature of TBML schemes makes them difficult to detect and investigate, allowing criminal organizations to exploit loopholes in regulatory systems. This not only weakens the integrity of financial institutions but also erodes public trust in the global financial system.

Moreover, the interconnected nature of international trade means that the repercussions of TBML extend beyond individual economies, affecting global supply chains and market dynamics. The increased use of TBML techniques poses a systemic risk to the international financial system, requiring coordinated efforts from governments, financial institutions, and regulatory bodies to combat effectively.<sup>32</sup>

## **The Role of Financial Institutions in Preventing Trade Based Money Laundering**

Financial institutions play a crucial role in identifying and preventing TBML. They are responsible for conducting enhanced due diligence on their customers, monitoring trade transactions, and reporting suspicious activities to the appropriate authorities.

To effectively combat TBML, financial institutions should establish robust Know Your Customer (KYC) procedures to ensure the legitimacy of their clients' trade activities. They should also implement transaction monitoring systems to detect unusual patterns, conduct periodic risk assessments, and provide comprehensive training to their employees.

Furthermore, financial institutions need to stay abreast of the latest trends and techniques used by money launderers to exploit trade transactions. This includes understanding the complexities of international trade finance, such as the use of shell companies, trade mispricing, and the manipulation of invoices to disguise illicit funds.

Collaboration between financial institutions, regulatory bodies, and law enforcement agencies is essential in the fight against TBML. Information sharing and coordination can help in identifying and disrupting money laundering activities effectively. Financial institutions should actively participate in public-private partnerships and industry forums to exchange best practices and strengthen their anti-money laundering efforts.

## **How to Prevent Trade Based Money Laundering?**

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<sup>32</sup> <https://www.tookitaki.com/compliance-hub/trade-based-money-laundering-explained>

Preventing TBML requires a comprehensive approach involving collaboration between governments, financial institutions, and other stakeholders. Some key measures to prevent TBML include:

1. **Enhanced Regulatory Frameworks:** Governments should enact and enforce stringent legislation targeting TBML, imposing penalties for non-compliance and providing adequate resources for law enforcement agencies.
2. **International Cooperation:** Countries must collaborate by sharing information and intelligence to track illicit flows and disrupt TBML networks that operate across borders.
3. **Technological Solutions:** Utilizing advanced analytics, artificial intelligence, and machine learning can enhance the detection and prevention capabilities of financial institutions in identifying TBML.
4. **Public Awareness:** Creating awareness campaigns and educating businesses about the risks and indicators of TBML can empower them to identify and report suspicious activities.

Moreover, it is essential for financial institutions to conduct thorough due diligence on their customers and counterparties to ensure they are not unwittingly facilitating TBML. This includes verifying the legitimacy of transactions, understanding the underlying economic substance of trade deals, and monitoring for any unusual patterns or red flags that may indicate potential money laundering activities.<sup>33</sup>

Additionally, regulatory authorities can play a crucial role in combating TBML by conducting regular audits and assessments of financial institutions to evaluate their compliance with anti-money laundering regulations. By imposing strict reporting requirements and conducting on-site inspections, regulators can deter illicit activities and hold institutions accountable for any lapses in their anti-money laundering controls.<sup>34</sup>

### **Non-documentary trades – The biggest challenge**

Identifying trade-based money laundering (TBML) presents significant challenges due to its complex nature. A major hurdle for compliance personnel in spotting TBML is the occurrence of non-documentary trades. In such transactions, the amount of information available to banks is

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<sup>33</sup> <https://www.tookitaki.com/compliance-hub/trade-based-money-laundering-explained>

<sup>34</sup> <https://insights.namescan.io/money-laundering-explained/>

limited and varies based on the transaction's structure and the bank's policies<sup>35</sup>. For example, a bank might only receive basic details like the name, address, and account number of the seller, along with the name and account number of the buyer. During these transactions, the trade happens automatically, similar to how a wire transfer operates, with no need for manual handling. This limitation makes it difficult for banks to trace the actual trade movements in international deals when dealing with non-documentary trades. Even when processing a wire transfer, the accessible information is often inadequate for the bank's verification processes. Banks typically only step in if there is an issue with the transaction instructions or if a transaction is halted for further examination due to sanctions. To effectively manage these risks, banks are tasked with gaining a thorough understanding of their customers and their businesses. This requires conducting detailed due diligence assessments, which should examine the volume and types of goods or services involved. Customer profiles can help banks to validate the flow of transactions and ensure their authenticity.

## **Technology and Innovation in Detecting Trade Based Money Laundering**

Technological advancements play a pivotal role in enhancing the detection and prevention of TBML. Anti-money laundering (AML) software and data analysis tools can help financial institutions identify suspicious trade activities, analyze vast amounts of data, and detect patterns that would be difficult to identify manually.

Moreover, the use of blockchain technology, with its transparent and tamper-proof nature, holds potential in making trade transactions more secure and traceable, reducing the opportunities for TBML. Adopting these innovative solutions can significantly strengthen the efforts against TBML.<sup>36</sup>

One of the key challenges in combating TBML is the constantly evolving nature of money laundering techniques. Criminals are adept at finding new ways to exploit vulnerabilities in the financial system, making it crucial for authorities to stay ahead of these tactics. This is where cutting-edge technologies such as artificial intelligence (AI) and machine learning come into play. By leveraging these tools,

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<sup>35</sup> <https://shuftipro.com/blog/trade-based-money-laundering-challenges-detection-and-prevention/>

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[https://www.researchgate.net/publication/376132205\\_Exploring\\_the\\_Application\\_of\\_Blockchain\\_Technology\\_in\\_Financial\\_Services](https://www.researchgate.net/publication/376132205_Exploring_the_Application_of_Blockchain_Technology_in_Financial_Services)

financial institutions can continuously adapt their detection methods to keep up with the changing landscape of financial crime.<sup>37</sup>

Furthermore, collaboration between public and private sectors is essential in the fight against TBML. Information sharing and cooperation between financial institutions, regulatory bodies, and law enforcement agencies can lead to more effective detection and prosecution of money laundering activities. Technology serves as a catalyst for this collaboration, providing the necessary infrastructure for secure data exchange and communication.

## **Future Trends and Challenges in Trade Based Money Laundering**

The fight against Trade Based Money Laundering (TBML) continues to evolve as criminals adapt their techniques to exploit vulnerabilities in the global trade system. Addressing the challenges associated with TBML requires constant vigilance and ongoing collaboration.

Future trends in combating TBML are likely to focus on the development of advanced technologies and data-sharing platforms that facilitate real-time information exchange among governments, financial institutions, and other stakeholders. These technologies will enable more efficient and effective detection of suspicious trade transactions, allowing authorities to take swift action to prevent money laundering.

One such technology that holds promise in the fight against TBML is artificial intelligence (AI). AI algorithms can analyze large volumes of trade data, including invoices, shipping documents, and financial records, to identify patterns and anomalies that may indicate illicit activity. By automating the analysis process, AI can significantly enhance the speed and accuracy of TBML detection, freeing up investigators to focus on more complex cases.

Another emerging technology that is expected to shape the future landscape of TBML prevention is blockchain. Blockchain is a decentralized and transparent ledger that records transactions in a secure and immutable manner. By leveraging blockchain technology, trade transactions can be recorded and

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<sup>37</sup> <https://www.tookitaki.com/compliance-hub/trade-based-money-laundering-explained>



verified in real-time, making it more difficult for criminals to manipulate trade documents and disguise illicit funds.<sup>38</sup>

Moreover, regulatory bodies are expected to place a greater emphasis on enforcing strict compliance measures and holding financial institutions accountable for their anti-money laundering efforts. This includes conducting thorough due diligence on customers, implementing robust transaction monitoring systems, and reporting suspicious activities to the relevant authorities. By imposing stronger regulatory frameworks, governments can create a deterrent effect and ensure that financial institutions prioritize their anti-money laundering obligations.

Furthermore, international cooperation will play a crucial role in combating TBML. As money laundering knows no borders, sharing information and intelligence among countries is essential to identify and disrupt global money laundering networks. Inter-governmental organizations, such as the Financial Action Task Force (FATF), are working to enhance international cooperation and coordination in the fight against TBML.<sup>39</sup>

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<sup>38</sup> <https://www.tookitaki.com/compliance-hub/trade-based-money-laundering-explained>

<sup>39</sup> <https://www.tookitaki.com/compliance-hub/trade-based-money-laundering-explained>

## **Conclusion**

In conclusion, TBML presents a significant challenge to the global financial system, posing threats to economic stability, fair trade, and the integrity of the financial sector. Understanding the basics, techniques, red flags, and prevention measures associated with TBML is vital in combating this complex form of money laundering. By leveraging technology, fostering international cooperation, and implementing robust regulatory frameworks, governments and financial institutions can make significant strides in preventing TBML and safeguarding the global economy.

## CHAPTER- 5

### MONEY LAUNDERING IN INDIA (PMLA ACT 2002)

Money laundering has been an issue since ancient times but became particularly prominent with the emergence of organized criminal activities in Western countries during the 20th century. Criminals often integrated their illegal earnings with those from lawful businesses such as laundromats to disguise the origin of their money. The Reserve Bank of India has taken steps to prevent Money Laundering activities, particularly within **Asset Management Companies (AMCs)**, by implementing policies and procedures. To safeguard AMCs from being exploited for money laundering through currency exchange operations, the Reserve Bank has issued comprehensive **Anti-Money Laundering (AML) guidelines**. The aim of these guidelines is to ensure that the network of **Authorized Money Changers (AMCs)** involved in buying and selling foreign currency and travelers' cheques does not become a conduit for laundering money. In India, the fight against money laundering is legislatively supported by the Prevention of Money-laundering Act, which was initially proposed as a bill in 1998 and, after scrutiny by the Standing Committee on Finance, was passed by both houses of Parliament. It was sanctioned by the President on January 17, 2003, and became known as **THE PREVENTION OF MONEY-LAUNDERING ACT, 2002 (Act No. 15 of 2003)**.

#### **Need of the Act and Background of the Act**

- a. The humongous volume of black money generated through international drug trafficking posed a grave threat to the economy of many countries
- b. There was widespread realisation that the black money generated through the flourishing drug trade and integrated into the legitimate economy was likely to destabilise the world economy and endanger the integrity and sovereignty of nations.<sup>40</sup>
- c. Therefore in 1988, the United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances was held. a. Seven major industrial nations held a summit in Paris (July 1989) and established the Financial Action Task Force (FATF) to examine the problem of money laundering and recommend measures to tackle this menace.
- d. In 1990, the United Nations General Assembly adopted a resolution, namely, the Political Declaration and Global Programme of Action which called upon all member-countries to

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<sup>40</sup> <https://www.thehindu.com/opinion/lead/the-pmla-a-law-that-has-lost-its-way/article68017135.ece>

enact suitable pieces of legislation to effectively prevent the laundering of drug money

## **Prevention of Money laundering Act (2002)**

The Prevention of Money Laundering Act of 2002 (PMLA) was established to combat the crime of legitimizing income or profits derived from illegal activities. This act allows the government or authorized bodies to seize assets obtained through illegal earnings. Essentially, money laundering refers to the process of transforming money earned unlawfully into funds that appear legal.

## **Objectives of Prevention of Money Laundering act**

The Prevention of Money Laundering Act, 2002 was introduced to combat the issue of Money Laundering . Some of its objectives are as follows:

- a. Prevent Money Laundering
- b. Combat/ channelizing of money into illegal activities and economic crimes
- c. . Provide for confiscating property derived from, or involved/used in, money laundering.
- d. Penalize the offenders of money laundering offences
- e. Appointing an adjudicating authority and appellate tribunal for taking charge of money laundering matters
- f. Provide for matters connected and incidental to the acts of money laundering

## **Common Forms of Money Laundering**

Below are some of the common methods of money laundering in India<sup>41</sup>

- a. Bulk cash smuggling
- b. Fictional loans
- c. Cash-intensive businesses
- d. Round-tripping
- e. Trade-based laundering
- f. Shell companies and trusts
- g. Real estate
- h. Gambling

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<sup>41</sup> <https://www.identfy.com/blog/examples-of-money-laundering/>

i. Fake invoicing

Hawala is an alternative money transfer mechanism that operates underground, described as quicker, more cost-effective, and more dependable than traditional banks like Citibank for many in the world's remote regions. Utilizing a system of informal agreements and IOUs, **hawala can transfer significant sums without any money physically crossing borders** or official transaction records, aside from private notes. Banks primarily serve to hold savings, lend money, and facilitate the settlement of transactions among clients, with advisory services essentially expanding on these fundamental roles. Parallel or underground banking, often referred to as such, focuses on conducting one or several of these core banking functions using highly efficient and unauthorized methods for global money movement. Renowned examples include the **Chop, Hundi**, and Hawala systems within certain ethnic communities, which allow for financial transactions to occur without traditional paper trails. Central to hawala's operation are trust and network connections, which enable hawala "bankers" or hawaladars to move money worldwide discreetly, often without any substantial documentation, and if records exist, they're typically encrypted<sup>42</sup>. Originating as South Asia's primary money transfer method before Western banking was introduced, hawala still sees use for legitimate purposes due to cultural and financial reasons, sometimes even complementing Western banking methods. However, it also facilitates illicit financial transactions in places like India and Pakistan, operating based on familial or criminal networks and leaving no paper evidence<sup>43</sup>. Hawala transactions involve no written receipts or formal payment orders, but rather a verbal agreement and a coded message to deliver the equivalent amount in local currency, sometimes with **fees up to 15%**. Despite high commission rates, the system manages vast sums of money. Termed an 'alternative remittance system', hawala predates modern banking and, while it serves legitimate needs in India and Pakistan, is susceptible to misuse for illegal activities, including '**Black Hawala**' for unauthorized transactions. It contributes notably to issues like corruption and smuggling in India, and in Pakistan, it plays a role in corruption and drug trafficking, as well as being implicated in financial crimes such as money laundering and tax evasion worldwide<sup>44</sup>

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<sup>42</sup> <https://documents1.worldbank.org/curated/en/410351468765856277/pdf/multi0page.pdf>

<sup>43</sup> <https://cleartax.in/s/hawala-money>

<sup>44</sup> [https://www.raijmr.com/ijrhs/wp-content/uploads/2017/11/IJRHS\\_2015\\_vol03\\_issue\\_07\\_11.pdf](https://www.raijmr.com/ijrhs/wp-content/uploads/2017/11/IJRHS_2015_vol03_issue_07_11.pdf)

## **Money Laundering Offence:**

A person shall be guilty of the offence of money laundering when, he/she has directly or indirectly attempted to indulge, knowingly assisted, knowingly is a party, or is actually involved in one or more of the following processes or activities connected with proceeds of crime: <sup>45</sup>

- a. Concealment
- b. Possession
- c. Acquisition
- d. Use
- e. Projecting as untainted property
- f. Claiming as untainted property

‘Proceeds of Crime’, means and includes, any property obtained or is derived directly or indirectly as a result of criminal activity relating to a Scheduled Offence (as provided below).

## **Key Provisions of PMLA**

### **a. Reporting Requirements:**

Banks, financial institutions, and intermediaries must keep transaction records, report any suspicious activities to the Financial Intelligence Unit (FIU), and follow Know Your Customer (KYC) rules.

### **b. Penalties for Money Laundering:**

Those found guilty of money laundering can face three to seven years in prison and fines, with the term increasing up to ten years for crimes involving proceeds over one crore rupees.

### **c. Seizure and Forfeiture of Assets:**

The legislation permits the preemptive seizure and forfeiture of assets tied to money laundering, allowing their sale by the government.

### **d. Global Cooperation:**

The PMLA encourages international collaboration for investigating and prosecuting money laundering, including agreements for mutual legal assistance and information sharing.

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<sup>45</sup> <https://dea.gov.in/sites/default/files/moneylaunderingact.pdf>

## **List of Offences Under PMLA**

Under PMLA, The commission of any offence, as mentioned in Part A and Part C of the Schedule of PMLA will attract the provisions of PMLA. Some of the Acts and offences, which may attract PMLA, are enumerated below:

- a. Part A enlists offences under various acts such as: Indian Penal Code, Narcotics Drugs and Psychotropic Substances Act, Prevention of Corruption Act, Antiquities and Art Treasures Act, Copyright Act, Trademark Act, Wildlife Protection Act, and Information Technology Act.
- b. Part B specifies offences that are Part A offences, but the value involved in such offences is Rs 1 crore or more.
- c. Part C deals with trans-border crimes and reflects the dedication to tackle money laundering across global boundaries.

## **Distinction Between Money Laundering and Fund Syphoning**

Simply earning or acquiring property through criminal activities does not constitute money laundering, but it can be considered as fund syphoning. Money laundering involves acquiring property through a crime categorized as a Scheduled offence, and then treating or claiming that property as legitimate.<sup>46</sup>

## **Investigation Authorities under PMLA**

The Enforcement Directorate within the Department of Revenue, Ministry of Finance, Government of India, is tasked with probing money laundering offences under the Prevention of Money Laundering Act (PMLA). The Financial Intelligence Unit – India (FIU-IND), also under the Department of Revenue, serves as an autonomous entity reporting to the Economic Intelligence Council (EIC), led by the Finance Minister. FIU-IND is charged with collecting, assessing, and disseminating data on suspicious financial activities. Its responsibilities include:

- a. Enhancing coordination and fortifying the initiatives of national and international intelligence.
- b. Advancing global efforts to combat money laundering and associated crimes.

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<sup>46</sup> <https://cleartax.in/s/prevention-of-money-laundering-act-2002>

The investigation of scheduled offences falls to specific agencies as indicated in their respective statutes, such as local police, the Central Bureau of Investigation (CBI), customs departments, the Securities and Exchange Board of India (SEBI), or other investigative bodies as required.

## **Legal Consequences for Money Laundering**

Actions that may be taken include<sup>47</sup>:

- a. Seizure/freezing of property and records and attachment of property obtained with the proceeds of crime.
- b. Any person who commits the offence of money laundering shall be punishable with
  - i. Rigorous imprisonment for a minimum term of three years and this may extend up to seven years.
  - ii. Fine (without any limit).

## **Adjudicating Authority under the PMLA,**

The Central Government has the power to appoint an adjudicating authority to exercise powers and authority conferred under this Act. An adjudicating authority must consist of a bench of<sup>48</sup>:

- a. A chairperson
- b. Two other members, out of which one individual must have experience in law, administration, finance or accountancy field.

An individual in the field of law can be a member of the adjudicating authority if he/she:

- i. Has qualifications to be appointed as a judge of any district, or
- ii. Has been a representative member of the Indian Legal Service and has held a post in Grade I of that service.

The bench of the adjudicating authority will operate in New Delhi and other locations as specified by the Central Government and the chairperson.

## **Powers of the Adjudicating Authority**

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<sup>47</sup> <https://dea.gov.in/sites/default/files/moneylaunderingact.pdf>

<sup>48</sup> <https://dea.gov.in/sites/default/files/moneylaunderingact.pdf>



The Adjudicating authority is authorized to send a notice to individuals accused of a money laundering offence under the PMLA, demanding them to explain the origins of their income, earnings, or assets that were used to acquire property that has been attached, seized, or frozen by the Director under this Act. Moreover, they are required to justify why these properties should not be considered as involved in money-laundering and be confiscated by the Central Government. After receiving a response from the accused, as well as hearing from both the aggrieved individual and the Director, and examining all the available evidence, the Adjudicating Authority will determine whether any of the properties mentioned in the complaint are linked to money laundering. If the Adjudicating Authority concludes that certain properties are involved in money laundering, the accused must formally acknowledge the attachment, seizure, or freezing of the property. Such properties will then be handed over to those legally entitled to them.

### **Obligation of the Banks, Financial Institutions and Intermediaries to Maintain Records**

The financial institutions, banks and intermediaries have the following obligations under the PMLA: <sup>49</sup>

- a. To maintain records of every transaction and amount, irrespective of whether such transactions were carried on in one go or there were series of transactions having an internal connection with each other when such series occurred within thirty days.
- b. To inform the Director appointed under the PMLA about such transactions within the allotted time.
- c. To verify the identity of the clients.
- d. To keep a record of all the documents relating to the identity of the clients and the beneficial owners, account files and business transactions relating to the clients.

These records must be kept for 5 years from the time the transaction took place. The Director appointed under the PMLA has the power to look into the records from the bank, financial institutions, and intermediaries.

If the Director finds out that the bank, financial institutions, or intermediaries have not kept the records, he/she can levy a fine ranging from Rs.10,000 to Rs.1,00,000. However, no civil or criminal case can be filed against any bank, financial institution, or intermediary.

Over the past decades, several anti-money laundering policies have been adopted to overcome laundering. Financial institutions and governments are constantly looking for new approaches to

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<sup>49</sup> <https://cleartax.in/s/prevention-of-money-laundering-act-2002>

fight against the money launderers. The banks and financial institutions play a pivotal role in the world of financial crime. It is important that they are properly trained on how to identify and handle money laundering. Almost every bank employee receives training in anti-money laundering, and all financial institutions and banks are legally required to report any suspicious activities<sup>50</sup>

## **Emerging Issues**

**a. Crime Proceeds:** The focus of PMLA is on the money derived from crimes that undergo laundering processes.

i. Even those indirectly involved in the crime, who partake in the laundering process at a later stage, are held accountable under this legislation.

ii. The PMLA operates on the presumption that an accused person is guilty until they prove their innocence, which is a departure from the classical Anglo-Saxon legal principle that assumes a person's innocence until proven guilty.

**b. Comprehensive List of Offenses:** The PMLA has broadened its scope to include an extensive array of offenses far beyond its initially intended targets.<sup>51</sup>

- It has been expanded to encompass crimes that are not directly related to narcotics trafficking, organized crime, and other grave offenses.

**c. Issue of Transparency during Investigations:** The process involving the Enforcement Case Information Report (ECIR) is marked by a lack of clear procedural guidelines for starting investigations and issuing summons, with the accused often remaining uninformed about the ECIR's specifics

**d. Bail Conditions under Scrutiny:** The stipulations for bail within the PMLA (Section 45) have garnered significant political attention in India today.

i. The Supreme Court of India, through a two-judge bench decision in the case of Nimesh Tarachand Shah vs Union of India (2018), found these conditions unconstitutional, citing a breach of Articles 14 and 21.<sup>52</sup>

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<sup>50</sup> Harvey, Jackie. "Just How Effective Is Money Laundering Legislation?" *Security Journal*, vol. 21, no. 3, July 2008, pp. 189–211.

*DOI.org (Crossref)*, <https://doi.org/10.1057/palgrave.sj.8350054>.

<sup>51</sup> <https://cleartax.in/s/prevention-of-money-laundering-act-2002>

ii. But in 2022, in **VIJAY MADANLAL CHOUDHARY & ORS. versus UNION OF INDIA & ORS** the Supreme Court upheld the validity of various provisions of the Prevention of Money Laundering Act (PMLA) which empowers ED to make arrests, conduct search and seizures and attach proceeds of crime<sup>53</sup>.

## **Challenges in implementing the PMLA 2002**

It has been quite challenging to implement the PMLA 2002 due to various obstacles:

Laundering Act (PMLA) 2002 has faced several challenges:

- a. **Insufficient resources:** The enforcement bodies struggle with limited resources, making it difficult to thoroughly investigate and prosecute offenses related to money laundering. The need for coordination between various departments like police, customs, and taxation agencies under the PMLA often leads to procedural delays and inefficiencies.
- b. **Intricate legal structure:** The legal system surrounding the investigation and prosecution of money laundering crimes is complex, requiring navigation through numerous laws and regulations. This complexity can lead to confusion and slow down the process of investigating and prosecuting money laundering crimes.
- c. **Low rate of convictions:** The rate of convictions for money laundering crimes in India is notably low. This is due to several reasons, including insufficient evidence, procedural delays in the judicial system, and the capacity of the defendants to employ costly legal representation.
- d. **Challenge of proof:** The challenge in money laundering cases is proving the crime beyond reasonable doubt, as the responsibility of proof is on the prosecution, making it difficult to secure convictions.
- e. **Political influence:** There have been instances where political interference has hindered the investigation and prosecution process of money laundering crimes. This can manifest as pressure on investigators or prosecutors to abandon cases or slow down proceedings.<sup>54</sup>

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<https://indiankanoon.org/docfragment/117859307/?formInput=money%20laundering%20%20doctypes%3A%20judgments>

<sup>53</sup> [https://www.livelaw.in/pdf\\_upload/633-vijay-madanlal-choudhary-v-union-of-india-27-july-2022-428134.pdf](https://www.livelaw.in/pdf_upload/633-vijay-madanlal-choudhary-v-union-of-india-27-july-2022-428134.pdf)

<sup>54</sup> [https://www.nja.gov.in/Concluded\\_Programmes/2019-20/P-](https://www.nja.gov.in/Concluded_Programmes/2019-20/P-)

## Conclusion

India as a signatory to the treaties and an important participant in the international process and the fight against money laundering is bound legally and morally, to adopt the global best practices and respond to the changing needs of the times.

But legal and constitutional safeguards must be kept in mind in this context.

The Supreme Court's decision in Pankaj Bansal vs Union of India <sup>55</sup> is a significant step towards enhancing transparency, accountability, and fairness in the arrest procedures under PMLA. It delved into an important point of law — how is the enforcement directorate (ED) required to “inform” persons arrested under the Prevention of Money Laundering Act, 2002, (PMLA) of the grounds of their arrest.<sup>56</sup>

In addition to increased transparency, the decision will foster better corporate governance. There must be a global consensus on the need to have a law to deal effectively.

In summary, the Prevention of Money Laundering Act (PMLA) 2002 plays a crucial role in the fight against money laundering within India. Despite facing certain obstacles, this legislation has been key in identifying and taking legal action against money laundering activities. It's vital for all organizations governed by this act to adhere to the required reporting standards and collaborate with law enforcement bodies to successfully tackle money laundering.

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1204\_PPTs/2.Contemporary%20Adjudicatory%20Challenges%20in%20PMLA%20cases.pdf

<sup>55</sup> [https://main.sci.gov.in/supremecourt/2023/30275/30275\\_2023\\_16\\_1501\\_47281\\_Judgement\\_03-Oct-2023.pdf](https://main.sci.gov.in/supremecourt/2023/30275/30275_2023_16_1501_47281_Judgement_03-Oct-2023.pdf)

<sup>56</sup> [https://www.livelaw.in/pdf\\_upload/633-vijay-madanlal-choudhary-v-union-of-india-27-july-2022-428134.pdf](https://www.livelaw.in/pdf_upload/633-vijay-madanlal-choudhary-v-union-of-india-27-july-2022-428134.pdf)

## **CHAPTER -6**

### **MONEY LAUNDERING AND ITS ILL EFFECTS**

#### **Corruption and Money Laundering**

Money laundering and corruption are closely linked, as individuals engaging in bribe-taking must find secure locations to store their illicit gains. Those offering bribes often act as intermediaries, funneling these funds into banks across the globe, which play a significant part in the laundering process. This necessitates international cooperation to tackle the issue, as corruption enables criminals to evade punishment for a range of harmful activities including money laundering, environmental degradation, drug trafficking, and terrorism. In many cases, state power is exploited by high-ranking officials, including Heads of State and Ministers, for personal financial gain, leading to widespread corruption. The scale and sophistication of such corruption have led to significant scandals in various countries, undermining governance and leading to national crises, as seen in Russia, Asia, Italy, Venezuela, and Brazil. "Grand corruption" detrimentally impacts the quality of projects, with bribe-payers often sacrificing project quality<sup>57</sup> to recoup their expenses, posing grave risks to the public. This undermines the integrity of administrative demands for quality. It's observed that project approvals are frequently based on the potential for bribery rather than actual need, resulting in the selection of economically and functionally unsound projects. Such corruption erodes public confidence in governance, distorts decision-making, and tarnishes a country's reputation, thereby deterring foreign investment and prompting international financial institutions to steer clear. This avoidance can lead to higher interest rates and exacerbate economic issues. Countries across Africa, Asia, and South America, including Nigeria and Pakistan, particularly suffer under corrupt regimes, with military governments in these nations often being beyond the reach of investigation. Legislative action against money laundering and the bribery of foreign officials is crucial, with a comprehensive approach needed to close loopholes leading to these practices<sup>58</sup>. The role of banks and financial institutions must be thoroughly examined to prevent the laundering of the proceeds of corruption, including scrutinizing tax havens, shell companies, and other disguises used to hide illicit wealth. The scrutiny should include tax havens, shell companies and other cover organizations<sup>59</sup>.

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<sup>57</sup> [https://www.unodc.org/documents/NGO/Grand\\_Corruption\\_definition\\_with\\_explanation\\_19\\_August\\_2016](https://www.unodc.org/documents/NGO/Grand_Corruption_definition_with_explanation_19_August_2016)

<sup>58</sup> <https://www.imf.org/external/pubs/ft/wp/wp9863.pdf>

<sup>59</sup> Vandana Ajay Kumar. "Money laundering: concept, significance and its impact". European journal of business management, Volume 4, No.2 , 2012

## Money Laundering and Terrorism

Terrorism Funding: According to the Monitoring Committee of the Security Council which observes the implementation of the UNSC Resolution Number 1373, terrorists' assets and funds worth \$ 112 million have been seized/frozen in the aftermath of September 11, 2001. It is estimated that the AlQueda and its allies in the International Islamic Front (IIF) has about \$ 300 million at their disposal.<sup>60</sup>

Funds continue to flow and the organization is engaged in the acts of terror in different parts of the world. Similarly, funds continue to flow from Pakistan's ISI to the operatives of Harkat-ul-Mujahideen (HUM), the Harkat-ul-Jehad-al- Islamic (HUJI), the Lashkar-e-Toiba (LET) and the Jaish-eMohammad (JEM) to carry out terrorist acts against India.<sup>61</sup>

Transaction history of money laundering for funding terrorism is of little predictive use as the accounts are opened for very short duration. Transaction analysis is retrospective and therefore will give little information about the purpose of a transaction. This impedes efforts to provision early warning that an account is likely to be used for funding the activities of terrorists. Moreover the amount involved is small which does not fall within the ambit of cash transaction reporting nor suspicious transaction reporting system. Even the enforcing agencies will not be geared into action as they would hardly have any time before terrorist act to respond to a withdrawal of money for terrorist purposes.<sup>62</sup>

Terrorists transfer millions of dollars into untraceable accounts. They also finance and smuggle commodities like diamond and gold to avoid seizure abroad. Diamonds can be smuggled across borders without detection.

The major terrorist operations financed through money laundering and hawala are<sup>63</sup>:

- a. The Bombay bomb blasts of 1993 killing a large number of innocent persons.
- b. The September 11, 2001 attack on the World Trade Center killing a large number of innocent persons.
- c. The October 1, 2001 attack on J&K Assembly in Srinagar.
- d. The attack on Indian Parliament on December 13, 2001.

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<sup>60</sup> <https://www.un.org/securitycouncil/ctc/content/our-mandate>

<sup>61</sup> . Sukanta Sarkar (2010). "The parallel economy in India: Causes, impacts & government initiatives". Economic Journal of Development Issues, Volume 11-12 no.(1-2) p.124-134

<sup>62</sup> <https://doksi.net/ku/get.php?lid=40174>

<sup>63</sup> <https://www.fatf-gafi.org/en/publications/Methodsandtrends/Role-hawalas-in-ml-tf.html>

e. The October 12, 2002 attack on nightclubs in the resort island of Bali that killed 192 people, mostly foreign tourists.

f. Terrorist attack on Taj hotel in 2008

These terrorist groups use most of the money in creating infrastructure and imparting training. Infrastructure includes bribing officials, forging documents, collecting intelligence and maintaining computer and telecommunications capabilities. Arms and explosives have to be paid for, and it takes an ongoing flow of funds to deploy trained individuals for months or years as “sleepers” in cells located in the United States, Europe, and elsewhere. Terrorist groups also spend money on operations, which can mean paying for anything from flight-school tuition to car rentals to airplane tickets to bomb-making ingredients and payments to terrorists and their families

The perception of terrorism must be the same all over the world. It must not change with place and people. Regarding an attack on World Trade Center as terrorist act and not the same while the Indian Parliament was attacked will create confusion and also affect the will to fight terrorism adversely. Strong bonds of international cooperation and global intelligence sharing are the prerequisite to curb this menace otherwise its hydra-head cannot be crushed.<sup>64</sup>

### **Effects of money laundering**

Mr. Stanley Morris, who leads the OECD's FATF Working Group focused on Statistics and Methods, highlighted the long-standing concern of the FATF to assess the extent of money laundering and break down its elements since its inaugural report. He pointed out the essential need for quantitative data on money laundering in at least four domains:<sup>65</sup>

a. To grasp the scale of the criminal activity, enabling law enforcement and lawmakers to unify on the importance of anti-money laundering initiatives, thereby crafting effective enforcement strategies that align with both national and international regulatory frameworks.

b. To evaluate the success of anti-money laundering measures and assess their impact.

c. To comprehend the broader economic implications of money laundering, especially its negative impact on financial institutions and national economies.

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<sup>64</sup> [https://www.raijmr.com/ijrhs/wp-content/uploads/2017/11/IJRHS\\_2015\\_vol03\\_issue\\_07\\_11.pdf](https://www.raijmr.com/ijrhs/wp-content/uploads/2017/11/IJRHS_2015_vol03_issue_07_11.pdf)

<sup>65</sup> <https://www.fatf-gafi.org/en/publications/Mutualevaluations/Fatf-methodology.html>

d. To categorize and thoroughly understand the various aspects of money laundering, which is crucial for effective mitigation efforts. However, he noted the current absence of an economic silver bullet that could precisely measure the scale of money laundering either globally or within major nations due to the lack of adequate estimation foundations.

He also mentioned that what constitutes a crime in one nation might not be considered so in another, leading to varying profitability of crimes and, consequently, differences in the propensity to launder money across different territories. Morris argued that due to these variations, it's unlikely that a unified model of money laundering exists. Addressing the impacts of financial crime, Morris stressed its wide-reaching consequences, including higher taxes for law-abiding citizens, increased insurance premiums, elevated business costs leading to a mix of reduced profits and higher consumer prices, and the diversion of funds to corrupt individuals and those involved in illicit trades. Making money laundering unrewarding or as dangerous as handling stolen goods would significantly deter financial crime, affecting everyone by inadvertently supporting a fairer economic environment<sup>66</sup>

### **Financial Effects of money laundering**

- a. The principles guiding the financial system, including its professional and ethical standards, are undermined.
- b. The organization gets involved in active collaboration with criminals, effectively becoming a part of the criminal network, similar to the case with the Bank of Credit and Commerce International (BCCI), which earned the notorious nickname "Bank of Criminals and Crooks International." <sup>67</sup>
- c. The IMF has issued warnings regarding sudden, unexplained shifts in demand for money, potential threats to the stability of banks, and the risk of legal financial activities becoming tainted.
- d. There will be an increase in the unpredictability of both international capital flows and exchange rates as a result of unforeseen cross-border financial movements

### **Economic Effect of Money Laundering**

- a. Financial systems in emerging or developing economies are especially at risk due to their

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<sup>66</sup> <https://www.fincen.gov/news/news-releases/fatf-report-highlights-money-laundering-trends-0>

<sup>67</sup> <https://www.washingtonpost.com/archive/politics/1991/07/28/bcci-scandal-behind-the-bank-of-crooks-and-criminals/563f2216-1180-4094-a13d-fd4955d59435/>



inadequate safeguards, compared to those in developed markets which have stringent measures against money laundering.

b. Countries and financial institutions that lack strong preventive measures against money laundering are more likely to be targeted by launderers.

c. It is a misconception to believe that emerging economies can afford to be indiscriminate about the origins of their capital inflows. Delaying measures against such practices poses a significant risk, as it allows organized crime to gain a stronger foothold.

d. The perception that organized crime has significant influence over a nation's commercial and financial sectors can negatively impact the level of foreign direct investment it receives.

### **Social and Political effect of Money Laundering**

The Social and Political effects of unchecked money laundering are serious

a. Criminal organizations can penetrate financial institutions, take over large parts of the economy through investment, or offer bribes to public officials and even governments.

b. The moral and social structure of the community will be endangered, putting the democratic institutions of society at risk. The criminal influence will be particularly dangerous in transitioning countries, rendering the government ineffective. Money laundering facilitates the perpetuation of criminal activities.

c. Unchecked money laundering has the potential to undermine a nation's financial institutions. Because of the high level of integration in capital markets, money laundering could also have negative effects on currencies and interest rates, as launderers reinvest funds in locations where their activities are less likely to be detected, rather than where returns on investment are higher.

## **Conclusion**

In the end, this cleaned money integrates into international financial networks, potentially destabilizing the economies and currencies of countries. Therefore, money laundering represents both a challenge for law enforcement and a significant threat to national and global security. It leads to a decrease in tax income due to shadow economies, unfair competition against lawful businesses, harm to financial institutions, and hindrance of economic growth. By combating money laundering, not only is financial crime diminished, but criminals and terrorists are also stripped of resources needed to perpetrate further grave offenses.

## **CHAPTER- 7**

### **ANTI- MONEY LAUNDERING TECHNIQUES**

The United States led the charge against money laundering by implementing the Bank Secrecy Act (BSA) in 1970, marking one of the earliest moves to curb this financial crime.<sup>68</sup> Over the years, the BSA was fortified with further anti-money laundering measures. The Financial Crimes Enforcement Network now oversees the BSA, aiming to protect the financial system against financial crimes such as money laundering, terrorist financing, and other illegal activities. In 1989, in a collective effort to clamp down on money laundering, various countries and organizations established the Financial Action Task Force (FATF). Its goal is to create and promote global standards to combat money laundering. Following the terrorist attacks on September 11, the FATF also took on the responsibility of addressing AML and counter-terrorism financing. The International Monetary Fund (IMF), with its 189 member nations, focuses on maintaining the integrity of the international monetary system. The IMF is concerned about the consequences money laundering and related crimes can have on the integrity and stability of the financial sector and the broader economy.<sup>69</sup>

#### **Why is anti-money laundering important?**

The estimated amount of money laundered globally in one year is 2% to 5% of global GDP, or US\$800 billion to US\$2 trillion – and that’s a low estimate.<sup>70</sup> Money laundering often accompanies activities like smuggling, illegal arms sales, embezzlement, insider trading, bribery and computer fraud schemes. It’s also common with organised crime including human, arms or drug trafficking, and prostitution rings.

Anti-money laundering (AML) efforts are intricately linked with efforts to prevent the funding of terrorism, known as Counter-Financing of Terrorism (CFT). These measures are utilized by financial entities to hinder the flow of money to terrorist organizations. AML guidelines address both the origin of the laundered money and its intended use, including terrorist activities. Beyond the ethical obligation to combat these illegal activities, financial institutions also engage in AML practices to:

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<sup>68</sup> <https://www.fincen.gov/history-anti-money-laundering-laws>

<sup>69</sup> [https://www.sas.com/en\\_gb/insights/fraud/anti-money-laundering.html](https://www.sas.com/en_gb/insights/fraud/anti-money-laundering.html)

<sup>70</sup> <https://www.cleardil.com/blog/why-are-anti-money-laundering-checks>

a . Adhere to legal standards that mandate the monitoring of customer interactions and transactions and the reporting of any suspicious behavior.

b.Safeguard their brand's reputation and the value for their shareholders.

c.Prevent regulatory sanctions and avoid the financial and legal repercussions stemming from failure to comply or from oversight.

d. Reduction of costs related to fines, employee and IT costs, and capital reserved for risk exposure.<sup>71</sup>

## **Know Your Customer (KYC)**

At the core of regulatory adherence for financial entities is a procedure widely known as Know Your Customer (KYC). This protocol involves verifying the identity of new clientele and certifying that their funds are derived from legitimate sources. The primary goal of the KYC process is to thwart money laundering right at its inception, typically when a customer seeks to make a deposit. Financial organizations assess new clients against directories of entities with a heightened risk of engaging in money laundering activities. This includes criminals and those convicted, individuals and businesses facing economic sanctions, and politically exposed persons, which includes overseas government officials and their relatives and close associates. What Does KYC Verification Entail? KYC Verification refers to the collection of guidelines and criteria within the investment and financial sectors that ensure brokers gather adequate information regarding their clients, including their risk tolerance and financial status.<sup>72</sup>

### **KYC in the Banking Industry**

Within the banking industry, KYC mandates that bank employees and advisors accurately identify their clients, the true owners of corporate entities, and the essence and objectives of customer relationships. Furthermore, banks are required to monitor customer accounts for any suspicious or illegal transactions and to uphold and verify the precision of client account information.

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<sup>71</sup> [https://www.sas.com/en\\_gb/insights/fraud/anti-money-laundering.html](https://www.sas.com/en_gb/insights/fraud/anti-money-laundering.html)

<sup>72</sup> <https://www.investopedia.com/terms/k/knowyourclient.asp>

## What Are KYC Documents?

Account owners generally must provide a government-issued ID as proof of identity. Some institutions require two forms of ID, such as a driver's license, birth certificate, social security card, or passport. In addition to confirming identity, the address must be confirmed. This can be done with proof of ID or with an accompanying document confirming the address of the client

## **Customer Due Diligence (CDD)**<sup>73</sup>

Throughout their relationship with clients, financial institutions are required to perform continuous customer due diligence (CDD). This involves keeping transactional data and client records current and accurate to meet regulatory standards and assist in any necessary inquiries. As time passes, new sanctions and Anti-Money Laundering (AML) watchlists might necessitate regular reviews of customers to ensure ongoing compliance and manage regulatory risks.

As set forth by the Financial Crimes Enforcement Network (FinCEN) of the U.S. Treasury, the fundamental elements of CDD in the United States consist of:

- a. Identifying and verifying the personal information of customers
  - b. Determining and confirming the identities of beneficial owners holding a 25% or greater interest in a company when an account is opened
  - c. Comprehending the intent and assessing the risk profiles of customer relationships
  - d. Observing for and acting on peculiar transactions and maintaining current customer data
- CDD aims to identify and prevent money laundering activities such as layering and structuring. This includes “smurfing”.the practice of dividing large transactions into smaller ones to avoid detection by regulatory reporting thresholds.

If patterns and anomalies indicate money laundering activities, suspicious transactions in U.S. jurisdictions must be reported in Suspicious Activity Reports (SARs) to relevant financial agencies for further investigation.<sup>74</sup>

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<sup>73</sup> <https://www.signicat.com/blog/customer-due-diligence-cdd-and-its-role-in-banking>

<sup>74</sup> [https://www.sas.com/en\\_gb/insights/fraud/anti-money-laundering.html](https://www.sas.com/en_gb/insights/fraud/anti-money-laundering.html).

<https://www.investopedia.com/terms/a/aml.asp#:~:text=Anti%2DMoney%20Laundering%20in%20the%20U.S.&text=Additional%20legislation%20was%20passed%20in,off%20funding%20for%20terrorist%20organizations.>

## **What's the Difference Between AML, CDD, and KYC?**

Anti-money laundering (AML) refers to legally recognized rules, national and international, that are designed to thwart hiding criminal profits inside the financial system.

Customer due diligence (CDD) refers to practices that financial institutions implement to detect and report AML violations.

Know Your Customer (KYC), also known as Know Your Client, is a component of CDD that involves screening and verifying prospective banking clients.

### **Anti-Money Laundering in the U.S.**

AML regulations in the U.S. expanded after the Bank Secrecy Act (BSA) was passed in 1970. For the first time, financial institutions were required to report cash deposits of more than \$10,000, collect identifiable information of financial account owners, and maintain records of transactions.

Additional legislation was passed in the 1980s amid increased efforts to fight drug trafficking, in the 1990s to enhance financial surveillance, and in the 2000s to cut off funding for terrorist organizations.<sup>75</sup>

Banks, brokers, and dealers now follow a complex regulatory framework of conducting due diligence on customers and tracking and reporting suspicious transactions. A written AML compliance policy must be implemented and approved in writing by a member of senior management and overseen by an AML compliance officer.<sup>76</sup>

### **Anti-Money Laundering in Europe**

The European Union (EU), along with other regions, has aligned its anti-money laundering efforts with those of the United States. The significance of international enforcement against money laundering escalated in 1989 with the formation of the Financial Action Task Force (FATF) by a coalition of countries and non-governmental organizations (NGOs). The FATF, an intergovernmental organization, aims to establish and encourage the implementation of global standards to curb money laundering. These efforts took on increased urgency in October 2001, in the wake of the terrorist attacks on September 11, prompting the FATF to also focus on hindering

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<sup>76</sup> <https://www.investopedia.com/terms/a/aml.asp>

terrorist funding.<sup>77</sup>The set of guidelines known as the FATF's 40 Recommendations serves as a comprehensive framework for Anti-Money Laundering (AML) and Counter-Terrorist Financing (CTF) measures, influencing over 190 jurisdictions<sup>78</sup> globally. This framework encompasses Customer Due Diligence (CDD), monitoring of transactions, the reporting of suspicious activities, and reinforcing international cooperation.

The Council of the European Union's AMLD, a directive that sets out AML/CFT requirements for all EU member states, has been amended several times to reflect the changing risks of money laundering and terrorist financing. The Basel Committee on Banking Supervision's CDD for Banks provides detailed recommendations for banks on how to identify and verify the identity of their customers.<sup>79</sup>

## **Can Money Laundering Be Stopped?**

At its most effective, enforcing Anti-Money Laundering (AML) measures can hope to limit the extent of money laundering, not entirely eliminate it. Despite stringent AML regulations, those involved in money laundering always manage to find sufficient resources, collaborators, new technologies, and inventive strategies to circumvent the barriers, even if such measures do indeed complicate their operations.

## **Organisations that tackle money laundering**

### **a. International Monetary fund**

The IMF is raising alarms regarding the impactful repercussions of money laundering, financing terrorism, and the financing of proliferation (the act of providing financial support or services for the development of nuclear, chemical, or biological weapons), along with analogous offenses that jeopardize both the financial industry and the wider economy. Such illicit activities can destabilize nations, leading to diminished law enforcement, governance, regulatory efficiency, foreign investment, and the flow of international capital.

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<sup>77</sup> <https://www.investopedia.com/terms/a/aml.asp#:~:text=Anti-Money%20Laundering>

<sup>78</sup> <https://www.investopedia.com/terms/a/aml.asp#:~:text=Anti-Money%20Laundering>

<sup>79</sup> [https://home-affairs.ec.europa.eu/policies/internal-security/organised-crime-and-human-trafficking/money-laundering\\_en](https://home-affairs.ec.europa.eu/policies/internal-security/organised-crime-and-human-trafficking/money-laundering_en)

Activities related to money laundering and financing terrorism within one nation can trigger significant negative impacts beyond its borders and on a global scale. Nations with lax or ineffective regulatory measures become prime targets for these criminals, who aim to hide their illicit deeds by taking advantage of the global financial system's complexity, the variances in national legislations, and the rapid movement of funds internationally.

### Role of IMF to combat money laundering and terror financing

The International Monetary Fund (IMF) boasts an extensive history in advancing policies related to anti-money laundering (AML), combating the financing of terrorism (CFT), and disrupting financing that supports proliferation, both internationally and within the frameworks of its member countries. Following an enhancement of its AML programs in 2000, the IMF broadened its scope to include CFT initiatives in the aftermath of the September 11, 2001 terrorist attacks. By 2004, the IMF's Executive Board had decided to incorporate AML/CFT assessments and capacity-building activities as a standard component of the IMF's responsibilities.<sup>80</sup>

In 2018, as part of its five-year review cycle of policy, the IMF Executive Board reviewed the IMF's AML/CFT strategy and gave strategic directions for the work ahead.<sup>81</sup>

The IMF's bilateral surveillance initiative assesses the adherence of countries to global anti-money laundering and counter-financing of terrorism (AML/CFT) norms and aids them in crafting strategies to rectify deficiencies. Consideration of AML/CFT is integrated into other IMF activities, including the Financial Sector Assessment Program (FSAP), its inclusion in the Fund's lending protocols where applicable, and the execution of AML/CFT evaluations and capacity-building efforts with member countries.

Additionally, the IMF examines the effects of significant trends such as digital currencies, financial innovation (fintech), Islamic banking, the cost of corruption and ways to counteract it, illegal financial movements, and the decline in correspondent banking connections, all from the standpoint of financial integrity.<sup>82</sup>

### **b. Financial Action Task Force**

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<sup>80</sup> <https://www.imf.org/en/About/Factsheets/Sheets/2023/Fight-against-money-laundering-and-terrorism-financing>

<sup>81</sup> <https://www.investopedia.com/terms/f/financial-action-task-force-fatf.asp>

<sup>82</sup> <https://www.imf.org/en/About/Factsheets/Sheets/2023/Fight-against-money-laundering-and-terrorism-financing>



The Financial Action Task Force (FATF) is an intergovernmental body formed to devise and advance policies aimed at combating financial crimes. Established by the G7 in 1989 and headquartered in Paris, the FATF issues guidelines targeting money laundering, terrorist financing, and additional risks threatening the international financial system. Originally focusing on money laundering, its scope has since been widened to address financing for weapons of mass destruction, corruption, and terrorist funding. Known initially as the Groupe d'action Financière, <sup>83</sup>this task force has garnered backing from the majority of developed nations.

### Understanding the Financial Action Task Force (FATF)

Exploring the Role of the Financial Action Task Force (FATF) With the globalization of the economy and the expansion of international trade, financial crimes like money laundering have surged, necessitating a body like the FATF. This organization not only formulates strategies to fight financial crime but also reviews its members' policies and promotes the global adoption of anti-money laundering standards. Given the ever-evolving tactics of money launderers and criminals, the FATF periodically updates its recommendations. For instance, recommendations to counteract terrorist financing were introduced in 2001, and in 2012, these were expanded to address new challenges, including the financing of weapons of mass destruction proliferation, and added emphasis on transparency and fighting corruption.

### Members of the Financial Action Task Force

By 2021, the Financial Action Task Force boasted 39 members, among them the United Nations and the World Bank. For a country to join, it must possess strategic significance, evidenced by factors such as a substantial population, significant GDP, and a well-developed finance and insurance sector, in addition to aligning with internationally recognized financial norms and playing active roles in vital global bodies.

Membership mandates the endorsement and implementation of the latest FATF guidelines, a commitment to both undergo and conduct evaluations with fellow members, and collaboration in shaping new guidelines.

Furthermore, a vast array of international bodies, engaged in fighting money laundering, are associated with the FATF as observer organizations. This group includes prominent entities like

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<sup>83</sup> <https://www.fatf-gafi.org/en/home.html>

Interpol, the International Monetary Fund (IMF), the Organization for Economic Cooperation and Development (OECD), and the World Bank.

To help national governments set up effective AML/CFT regimes, the FATF issued recommendations covering the criminal justice system, the financial sector, certain non-financial businesses and professions, transparency, and mechanisms of international cooperation. Together with the FSRBs, the IMF and World Bank, the FATF monitors countries' compliance with these recommendation.<sup>84</sup>

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<sup>84</sup> <https://www.investopedia.com/terms/f/financial-action-task-force-fatf.asp>

## **Conclusion**

Authorities have advanced their strategies in preventing money laundering by creating and updating regulatory measures that encourage active engagement from banks and other financial entities. It's essential to have anti-money laundering measures in place to protect the financial system against criminal activities.

## **CHAPTER- 8**

### **CRYPTO CURRENCY, TECHNOLOGY AND MONEY LAUNDERING**

Money laundering poses a significant risk to the integrity, proper operation, reputation, and stability of society in terms of the financial system in the current context of the unprecedented evolution of technology and the ability to conduct transactions, particularly in the electronic, virtual environment, anywhere in the world, at high speed.

The financial sector is starting to undergo a significant transformation due to technological advancements. In order to ensure that anti-money laundering (AML) and countering terrorist financing (CFT) regulations are kept current as new technologies are developed, The Financial Action Task Force (FATF), the international organization tasked with preventing money laundering and terrorist financing, has already expended a lot of effort in this area.

The compliance sector is increasingly familiar with terms like artificial intelligence (AI), fintech, machine learning, regtech, and big data, but how are these technologies being utilized to stop money laundering, and the future hold for a compliance professional as a result<sup>85</sup>

#### **Advantages of Technology: Big Data, Machine Learning, and AI**

Big data, AI, and machine learning have allowed businesses to take a more intelligent approach to fighting financial crime while also making it faster and less expensive. <sup>86</sup>Financial institutions are switching from the conventional black-and-white rules approach to a more technologically oriented, flexible, and all-encompassing program that is much more effective at spotting anomalies.

Transaction monitoring is one example of a slow, manual activity that is now automated using machine learning and artificial intelligence (AI), which can scan vast amounts of data much more quickly than humans.

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<sup>85</sup><https://www.sanctionscanner.com/knowledge-base/money-laundering-and-technology-20>

<sup>86</sup> <https://www.sanctionscanner.com/knowledge-base/money-laundering-and-technology-20>

Traditional trigger alerts, such as those based on a transaction exceeding a specific threshold or taking place outside the account holder's country of residency, sometimes result in false positives, necessitating human assessment to ease any worries.

But since AI can quickly spot patterns in behaviour, transactions, and abnormalities, compliance specialists may spend more time analyzing the data, looking into the causes, and sharing their findings with other financial institutions or authorities.

Technology's benefits go beyond transaction monitoring. Big data has made it possible for organizations to go beyond merely tracking financial crime at the transaction level and to begin "mapping out" strings of transactions, allowing for the establishment of links and the identification of patterns in the data. This makes it easier for the organization to identify the origins of illegal behavior.<sup>87</sup>

Financial institutions can establish the people, organizations, and supply chains involved in the laundering process as well as a better understanding of the trail of illicit gains from activities like drug, arms, human, and wildlife trafficking as well as slavery, corruption, fraud, and other similar crimes through the use of big data.

With the digital age revolutionizing the way we conduct financial transactions, technology has become a double-edged sword in the fight against money laundering. While it has undoubtedly brought convenience and efficiency to financial systems, it has also opened new avenues for criminals to launder money discreetly and on a global scale.

## **The Advent of Digital Money Laundering**

Digital money laundering is the process of concealing the origins of illicit funds using digital channels and sophisticated technologies. The anonymity provided by cryptocurrencies, online payment gateways, and encrypted communication platforms has made it easier for criminals to launder money across borders without detection. Digital currencies, such as Bitcoin, have gained popularity among money launderers due to their decentralized nature, making it challenging for authorities to trace transactions and identify the parties involved.<sup>88</sup>

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<sup>87</sup> <https://www.sanctionsscanner.com/knowledge-base/money-laundering-and-technology-20>

<sup>88</sup> <https://leamingtonobserver.co.uk/lifestyle/crypto-casinos-vs-traditional-gambling-uk-comparison/>

### **a. Dark Web and Cybercrime**

The dark web, a hidden corner of the internet, has become a hotbed for illegal activities, including money laundering. Criminals leverage anonymous marketplaces and encrypted communication to carry out financial transactions away from the prying eyes of law enforcement agencies. Cybercriminals, who engage in ransomware attacks, identity theft, and online fraud, often resort to digital money laundering to convert their ill-gotten gains into legitimate assets.<sup>89</sup>

### **b. Mixing Services and Tumbling**

Mixing services and tumbling techniques further complicate the tracing of digital money laundering.<sup>90</sup> These services use complex algorithms to shuffle cryptocurrencies between multiple wallets, obfuscating the trail of funds and severing the direct link between the illicit source and the legitimate destination. As a result, the laundered money appears clean and ready for use, making it difficult for investigators to connect the dots.

### **c. The Challenge for Regulators**

The rapid evolution of technology has outpaced regulatory efforts to combat digital money laundering effectively. Traditional anti-money laundering (AML) measures, designed for fiat currency transactions, struggle to keep up with the complexities of digital transactions. Regulators face the challenge of understanding emerging technologies and adapting AML regulations accordingly.

### **d. Decentralization and Pseudonymity**

The decentralized nature of cryptocurrencies and the use of pseudonyms to conduct transactions further exacerbate the challenges for regulators. Unlike traditional financial institutions, there is no centralized authority to monitor and regulate digital currencies. As a result, tracking and identifying the real-world identities behind cryptocurrency transactions becomes a daunting task.

### **e. Emerging Solutions**

To combat the escalation of digital money laundering, regulatory bodies and financial institutions are turning to technology for solutions. Blockchain analytics and machine learning algorithms are being employed to trace cryptocurrency transactions and identify patterns indicative of money laundering. These technologies enable authorities to connect seemingly unrelated transactions and detect suspicious activities more efficiently.

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<sup>89</sup> <https://www.gethow.org/tag/hidden-internet>

<sup>90</sup> <https://www.sanctionscanner.com/knowledge-base/money-laundering-and-technology-20>

## **f. Strengthening Customer Due Diligence**

Financial institutions are also enhancing their customer due diligence processes to mitigate the risk of digital money laundering. Robust know-your-customer (KYC) procedures, coupled with transaction monitoring systems, help identify potentially illicit activities and report them to the relevant authorities promptly.<sup>91</sup>

## **g. Global Cooperation and Information Sharing**

The borderless nature of digital transactions necessitates international cooperation to effectively combat digital money laundering. Countries worldwide are joining forces to share information, intelligence, and best practices in the fight against financial crime. Organizations such as the Financial Action Task Force (FATF) play a crucial role in setting international standards and promoting effective AML measures.

## **Five pillars and growing expectations**

An AML program satisfactory to supervisors involves implementation and risk-based management of a number of moving parts, beginning with addressing the traditional four pillars of AML compliance<sup>92</sup>

- a. tailored internal controls,
- b. independent testing,
- c. ongoing training,
- d. designation of a dedicated AML officer with sufficient resources.

Plus we now have a formal 5<sup>TH</sup> AML pillar that focuses on ongoing customer-based risk.

To meet these ever-growing demands and comply with industry standards, today's AML programs increasingly must rely on sophisticated automated analytical and digital processes and tools.

A prime example: The new FinCEN rule governing beneficial ownership. The new rule presents the challenge of looking through multiple, complex layers of legal ownership to understand key

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<sup>91</sup> <https://www.gethow.org/tag/hidden-internet>

<sup>92</sup> <https://www.idenfy.com/blog/five-pillars-of-aml-compliance/>

hierarchies, associations, and relationships and the risks they pose. This must be done globally, and firms must keep pace with the enormous number of changes continuously occurring.<sup>93</sup>

Satisfying beneficial ownership and other AML requirements cannot be done using outdated and inefficient manual processes. The days of having scores of humans manually googling people and institutions and relying on internet pages filled with unstructured data are past.

Banks must use advanced digital solutions to comprehensively scour worldwide public and non-public sources to ensure data quality; quickly and effectively draw out, sift through, and analyze massive amounts of structured and unstructured information to reach meaningful conclusions; and make results available in a user-friendly manner.<sup>94</sup>

## **5 tech paths to compliance<sup>95</sup>**

Let's briefly explore five innovative digital and analytical technologies that can optimize AML compliance.

### **a. Cognitive Computing**

Cognitive computing has multiple definitions. But the key concept is making computer systems understand more of what the user wants.

Digital assistants that can manage large amounts of structured and unstructured information, and reconcile ambiguous and even self-contradictory data, which are good examples of cognitive computing, are constantly improving. Such tools enable humans to perform a range of activities not possible even a few years ago, including auto-replying to emails with custom and context specific messages and more easily supporting complex queries.

Cognitive computing's key benefit is the ability to enhance assessment of AML risk portfolios.<sup>96</sup> The technology does so by presenting information, such as data used to build customer profiles, in a timely, natural, and usable way. The technology also makes determinations that are evidence-based; evaluates multiple options; assesses vast amounts of data and their connections; and continually evolves to account for new outcomes and actions.

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<sup>93</sup> <https://www.fincen.gov/news/news-releases/fincen-issues-final-rule-regarding-access-beneficial-ownership-information>

<sup>94</sup> <https://www.genpact.com/insight/five-aml-technologies-you-must-understand>

<sup>95</sup> [www.veritis.com/blog/the-role-of-technology-in-enhancing-aml-compliance-in-the-finance-sector](http://www.veritis.com/blog/the-role-of-technology-in-enhancing-aml-compliance-in-the-finance-sector)

<sup>96</sup> [www.veritis.com/blog/the-role-of-technology-in-enhancing-aml-compliance-in-the-finance-secto](http://www.veritis.com/blog/the-role-of-technology-in-enhancing-aml-compliance-in-the-finance-secto)



## **b. Graph Analytics**

Graph analytics explores relationships between individuals; e.g., they are used in such prompts such as “Do you know this person?” and “Would you like to connect?”

Graph analytics thrive on high levels of complexity and interconnectedness and in discerning significant relationship patterns among varied data types. A simple example of its understanding of shared customer attributes and, thus, extension to AML is the ability to pose the question, “Could these two supposedly different people actually be the same person?”<sup>97</sup>

In addition to considering individuals, graph analytics can determine relationships among AML documents to make connections and flag anomalies, often with low levels of false positives.

Graph analytics also can be a particularly powerful tool in meeting beneficial ownership requirements. An entire network infrastructure and all its links to third parties can be represented in graphs, thus simplifying the process of understanding and tracing complex organizational structures.

With the current advances in traversing social graphs and available computing power, it is possible to conduct such analytics at web-scale, further expanding the possibilities of understanding the ecosystem of risk actors.

## **c. Machine Learning**

Machine learning is primarily about pattern detection. In traditional computer programming the rules are specified beforehand. In machine learning, the system acquires its own rules, based on the data and patterns found. This has profound implications for AML.

The Fair Isaac Corporation recently stated that machine learning is core to its vision for FICO scores and AML compliance, and the technology continues to gain more and more acceptance across the financial services industry. Increasingly advanced forms of machine learning now are approaching sophisticated levels of artificial intelligence.<sup>98</sup>

Risk scoring presents a good example of the benefits of machine learning.<sup>99</sup> Traditionally, rules are specified in advance. In contrast, a scoring model based on machine learning “learns” from the

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<sup>97</sup> [www.veritis.com/blog/the-role-of-technology-in-enhancing-aml-compliance-in-the-finance-secto](http://www.veritis.com/blog/the-role-of-technology-in-enhancing-aml-compliance-in-the-finance-secto)

<sup>98</sup> <https://www.genpact.com/insight/five-aml-technologies-you-must-understand>

<sup>99</sup> [www.logicgate.com/blog/how-to-determine-risk-scores-internal-vs-external-risks](http://www.logicgate.com/blog/how-to-determine-risk-scores-internal-vs-external-risks)

data directly. A key requirement is that during the system's training phase, data on known high-risk customers, products, and geographies is presented as examples. The system then leverages its learning to risk-score based on patterns not initially obvious—or appearing merely random.

#### **d. Cloud Computing**

The use of a virtual private cloud can help significantly with the rationalization of disparate data sources both within and external to an institution.<sup>100</sup>

In performing know your customer, beneficial ownership, or other required AML remediation activities, it is not uncommon for an analyst to need to interact with a large number of systems. Using cloud computing facilitates accessing, bringing together, and enriching needed data.

Cloud computing also offers a number of other benefits, such as improved risk-scoring capability. This is particularly true with the advent of advanced risk systems that can learn from data over time. Moreover, the historic concerns regarding cloud-based AML solutions, particularly in relation to data security, are increasingly being allayed.

#### **e. Robotic Process Automation**

RPA can be deployed as an initial solution while efforts around cloud computing and data enrichment are underway. With RPA, software robots emulate the login, point, click, and copy-and-paste actions of a human user in a rapid but specified sequence.<sup>101</sup>

The advantage for AML systems is that the data can stay disparate, as each robot has its own credentials and is tackling the inherent multiple system inefficiencies through speed and repetitions.

Note that limitations can arise; e.g, with exceptions processing or other activities where data rationalization and pattern detection challenges are not easily addressed.

The bottom line is that state-of-the-art technology, analytics, and data management are keys to successful implementation of an AML compliance program that meets industry standards and

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<sup>100</sup> <https://www.cloudflare.com/learning/cloud/what-is-a-virtual-private-cloud/>

<sup>101</sup> <https://www.automationanywhere.com/rpa/robotic-process-automation>

regulatory expectations, and at the same time stays ahead of the curve to address future changes more easily and efficiently.<sup>102</sup>

## **Solutions That Ensure Anti-money Laundering And Know Your Customer Compliance**

AML solutions enhanced by artificial intelligence facilitate effortless adherence to legal and regulatory requirements while also reducing financial risks. Below are several solutions that enable adherence to AML and KYC protocols and strategies.

### **a. Transaction Monitoring**

Each transaction encountered by your business daily carries inherent risk levels. Therefore, employing transaction monitoring software is vital for financial entities to meet anti-money laundering mandates. Businesses can establish their custom rules for identifying suspicious and high-risk financial activities automatically, even without any background in coding.

### **b. Anti-Money Laundering Name Screening**

AML name screening tools allow for efficient compliance with essential sanctions, PEP scanning services, a risk-based approach, and adherence to both local and international AML compliance policies, safeguarding your business from potential risks and negatives that may emerge as transactional volume increases. Thus, they also prevent regulatory fines. AML name screening facilitates conducting Customer Due Diligence (CDD) and Know Your Customer (KYC) in alignment with specified obligations.

### **c. Anti-Money Laundering Transaction Screening**

AML transaction screening software enables banks or DNFBPs to promptly verify the details of both the sender and receiver. By utilizing this software, organizations can significantly reduce the likelihood of financial crimes by tracking the transaction's parties. Moreover, entities can customize their search options and utilize advanced search parameters. The software organizes data in a manner that delivers thorough results without compromising on accuracy.

### **d. Adverse Media Screening**

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<sup>102</sup> <https://www.infopro.com.my/articles/harnessing-advanced-technology-to-combat-financial-crimes/>

Adverse media software assists companies in identifying and monitoring any negative publicity regarding existing or potential clients. It's a crucial component of anti-money laundering and KYC procedures, aimed at recognizing and mitigating potential risks. Adverse media encompasses news related to terrorist financing, arms trafficking, corruption, money laundering, bribery, drug smuggling, human rights violations, and tax evasion. By incorporating adverse media screening with PEP scans during customer onboarding, financial institutions can ensure compliance with AML directives.<sup>103</sup>

## **How Does Technology Ease AML And KYC Processes?**

Anti-Money Laundering, or AML, refers to the laws and regulations designed to thwart financial crimes and manipulations. Each country implements its own specific AML rules and protocols. The process of knowing your customer, or KYC, represents a portion of the measures taken to prevent money laundering. KYC involves a range of practices aimed at identifying an individual or business entity at the start of their financial relationship with an institution, or sometimes even prior to that transaction.

Furthermore, it's essential for agents and brokers to understand the potential for real estate transactions to be used in illicit financing operations, and to know the actions required to spot and prevent such misuse. This protocol mandates that financial institutions (FIs) and Designated Non-Financial Businesses and Professions (DNFBPs) collect specific information about their potential clients, including their name, business name, residential address, age, valid identification, nationality, among other details. Businesses at risk of being implicated in money laundering must adopt compliance strategies to prevent it. The absence of defined AML compliance measures could lead to regulatory penalties.

However, adherence to these practices can initially be challenging due to the extensive documentation required and the necessity for meticulous attention to detail to grasp the underlying principles and effectively educate staff. Moreover, as these strategies are subject to periodic updates, there arises a significant need for technological interventions.

Advances in artificial intelligence, machine learning, and big data analytics play a crucial role in significantly lowering the risks associated with money laundering.

## **Crypto Currency and Money Laundering**

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<sup>103</sup> <https://amluae.com/a-guide-to-sanction-and-pep-screening-in-customer-onboarding-process/>

Money laundering frequently occurs in the realm of cryptocurrency crimes. Offenders take advantage of the blockchain's privacy features to conceal the origins of illegally obtained funds, transforming them into legitimate cash that can be integrated into the economy. They utilize this method to clean money originating from a variety of illegal activities, including traditional crimes and cybercrimes, through the use of digital currency platforms. The majority of well-known exchanges and Virtual Assets Service Providers (VASPs) fall under regulations set by the Financial Action Task Force (FATF), which aims to curb the use of virtual assets in money laundering and financing of terrorism<sup>104</sup>. FATF employs a risk-based strategy that encompasses Know Your Customer (KYC) standards. These standards compel exchanges and other VASPs to confirm the identities of their clients, making it more challenging for wrongdoers to employ sophisticated tactics to evade detection by financial investigators and launder their illicit earnings

### **How does crypto currency money laundering work?**

Criminals deploy various techniques and platforms that channel funds across multiple addresses or companies in order to mask their origin as seemingly legitimate, ultimately directing them to a receiving address or an exchange for liquidation. This strategy significantly complicates tracing the transactions. The following outlines the top five methods employed by criminals to launder money through the blockchain:<sup>105</sup>

**a. Nested services** encompass a variety of platforms operating within one or more exchanges. These platforms use addresses that are affiliated with the exchanges in order to leverage the exchanges' liquidity and engage in trading activities. Due to some exchanges having lower compliance requirements for nested services, malicious parties are able to use these to launder money. Transactions carried out via these nested services on the blockchain's ledger are recorded as if they were executed by the host exchanges themselves, not by the nested services or individual addresses involved.

The most prevalent and infamous nested service type is the Over-the-Counter (OTC) broker. OTC brokers provide a means for traders to conduct large cryptocurrency transactions in a manner that is straightforward, secure, and private. By facilitating direct cryptocurrency transactions between two parties without the need for an exchange, these brokers allow for trading between different cryptocurrencies (like Ethereum and Bitcoin) or between cryptocurrencies and fiat money (such as

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<sup>104</sup> <https://www.fatf-gafi.org/en/topics/virtual-assets.html>

<sup>105</sup> <https://www.merklescience.com/3-reasons-why-the-future-of-anti-money-laundering-rests-on-blockchain>

Bitcoin and euros).

While the OTC brokers secure transaction partners in exchange for a fee, they remain uninvolved in the negotiation process. Following agreement on terms, the assets are transferred between parties via the broker.

In August 2020, The U.S. Department of Justice (DOJ) filed a complaint to forfeit 280 cryptocurrency addresses involved in the laundering of approximately 28.7 million dollars' worth of crypto currency stolen from an exchange by the North Korea-affiliated hackers known as Lazarus Group. The complaint detailed two hacks of crypto exchanges by North Korean actors, who stole millions of dollars' worth of cryptocurrency and ultimately laundered the funds through Chineseover-the-counter (OTC) cryptocurrency traders and follows related actions pertaining to the theft of \$250 million in cryptocurrency through other exchange hacks by North Korean actors<sup>106</sup>.

The Lazarus Group has been utilizing OTC traders for fund laundering purposes. The US Department of the Treasury's Office of Foreign Assets Control (OFAC) sanctioned three individuals in April 2023, which included two crypto traders operating over the counter, for their support to the North Korean group.<sup>107</sup>

**b. Gambling platforms** have become a prevalent choice for laundering cryptocurrency funds. Payments are made to the platforms using either identifiable or anonymous accounts. These funds are then either cashed out or used for betting, often in collaboration with partners. Once withdrawn from the gambling account, the money can be regarded as having attained a legal status. The Financial Action Task Force (FATF) issued a report in September 2020 titled “Virtual Assets Red Flag of Money Laundering and Terrorist Financing,” in which it identified gambling services as potential indicators of money laundering or terrorist financing activities. Specifically, the FATF report points out two circumstances that could raise red flags:

- i. Deposits or withdrawals from a virtual asset address or wallet that have direct or indirect connections to known dubious sources, including suspect gambling websites.

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<sup>106</sup> <https://www.cognyte.com/blog/anti-money-laundering-cryptocurrency/>

<sup>107</sup> Grau, David. “Cryptocurrency Money Laundering Explained.” *Cognyte* (blog), August 8, 2023. <https://www.cognyte.com/blog/anti-money-laundering-cryptocurrency/>.

ii. VA transactions originating from or destined to online gambling services<sup>108</sup>.

**c. Mixers** are platforms that combine various digital currencies from multiple sources, distributing them at random intervals to new addresses or wallets to enhance privacy. These services are typically employed to obscure the origins of funds before they're moved to legitimate entities or major trading platforms. The controversy surrounding the utilization of mixers for crypto money laundering has been prominent, with significant cases highlighted in the media. In March 2023, the US Department of Justice, in cooperation with international partners, dismantled ChipMixer, a clandestine crypto mixer implicated in laundering over \$3 billion of cryptocurrency. This effort led to German authorities confiscating cryptocurrency valued at over \$46 million from the service's servers.

**d. Tornado Cash**, another infamous mixer, managed to launder upwards of \$7 billion from its inception in 2019 until the arrest of its developer by the Dutch government in 2022.

**e. Fiat exchanges** facilitate the conversion of cryptocurrency to cash and can be classified as mainstream, peer-to-peer (P2P), or non-compliant (those not adhering or subjected to regulatory standards). After such exchanges, conventional financial investigative techniques are necessary. In 2022, illicit entities utilized exchanges for converting approximately \$23.8 billion worth of cryptocurrency, marking a 68% rise from the previous year. Notably, nearly half of these funds were processed by mainstream exchanges, which typically implement compliance protocols. Furthermore, before conversion, over 40% of these illicit funds are channeled through intermediaries, like mixers or Decentralized Finance (DeFi) protocols, to veil the origin of the funds.

Services based in jurisdictions considered high-risk due to their insufficient Anti-Money Laundering (AML) or Counter-Financing of Terrorism (CFT) measures are identified as such.

The Financial Action Task Force (FATF) lists jurisdictions with poor AML/CFT measures, commonly referred to as the “black list” and “grey list.” Similarly, the European Commission highlights countries with significant deficiencies in their AML/CFT regimes, deemed to pose serious threats to the European Union’s financial system.<sup>109</sup>

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<sup>108</sup> <https://www.cognyte.com/blog/anti-money-laundering-cryptocurrency/>

<sup>109</sup> <https://www.infopro.com.my/articles/harnessing-advanced-technology-to-combat-financial-crimes/>

## **Conclusion**

Authorities are continually confronting fresh obstacles in their probes due to the enhancement in money laundering methods. Money laundering holds a pivotal role in all cryptocurrency-related criminal activities, as it furnishes offenders with a method to transfer ill-gotten gains. Without the capability to launder money, profits from cryptocurrency cannot be amassed or exchanged into traditional currency without attracting the attention of the police. Therefore, it's vital for law enforcement and security bodies to adopt sophisticated blockchain analytics tools to effectively combat the individuals involved in money laundering and put an end to cryptocurrency crimes

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## **CHAPTER 9**

### **CONCLUSION**

It is clear that the problem of money laundering is a global concern requiring attention from the international community. Tackling this issue effectively is unattainable without the cooperation of various countries. To remain ahead of authorities, criminals frequently enlist the assistance of professional advisors such as lawyers, chartered accountants, and connections within the banking industry. They employ these resources to disguise the illicit origins of their money, making it appear as if it were earned legally.. These specialists typically command a fee ranging from 10 to 15% of the total amount involved<sup>110</sup>. The intertwined relationships among white-collar criminals, politicians, law enforcement, and several mafia groups cannot be overlooked. Bankers are particularly significant to the operation of these schemes; their involvement is pivotal, and without their help, these operations would likely fail. The developments in technology and the simplicity of executing wire transfers have complicated the task of tracking these illegal flows of money even further. Given the international dimension of money laundering, a collective effort from law enforcement agencies across different countries is vital for effectively tackling and breaking down these intricate criminal networks. To combat money laundering effectively, a mix of legal measures and international cooperation between justice and law enforcement agencies is necessary. Furthermore, it's important to recognize that simply enacting Anti-Money Laundering laws is not enough. The law enforcement community must constantly adapt to the sophisticated techniques of money launderers who continually develop new methods to evade detection and prosecution.<sup>111</sup>

To tackle trade-based money laundering (TBML) effectively, several crucial actions and reforms are essential. Foremost is the necessity for improved global collaboration, which entails aligning and standardizing trade and financial rules across nations to close gaps exploited by launderers. Integrating advanced technologies like blockchain and AI can significantly boost the ability to spot and monitor suspicious trade activities through real-time data analysis and secure transaction records. Equipping customs and financial institutions with specialized training will ensure they are adept at identifying and combating TBML tactics. Furthermore, enhancing the transparency of trade transactions by implementing thorough reporting requirements and audit processes will help in tracking the movement of goods and finances. Establishing strict penalties for TBML violations, along with the strict enforcement of Anti-Money Laundering and Combating the

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<sup>110</sup> <https://complyadvantage.com/insights/3-stages-money-laundering/>

<sup>111</sup> <https://core.ac.uk/download/pdf/234624157.pdf>

Financing of Terrorism (AML/CFT) laws, will deter potential offenders and protect the global trade system's integrity. Advancing in the fight against money laundering requires a holistic approach that includes regulatory updates, technological progress, and international collaboration. A pivotal move is the alignment and updating of AML standards internationally to close loopholes that enable financial crimes, thereby fostering a united front against these illegal ventures. Enforcing stringent reporting obligations and enabling swift financial data exchange will improve financial dealings' transparency and accountability. The adoption of state-of-the-art technologies, such as artificial intelligence, machine learning, and blockchain, is crucial in enhancing the detection and prevention of money laundering by facilitating the analysis of huge datasets for irregular patterns and transactions. Building partnerships between the public and private sectors is vital, as financial institutions play a key role in identifying and reporting suspicious activities. Continuous educational programs and training for financial institution employees, law enforcement, and regulatory personnel will keep them abreast of the latest strategies and techniques in combating money laundering. Given money laundering's transnational nature, sharing information and cooperating internationally are imperative. Establishing legal assistance, extradition, and asset repatriation agreements through bilateral and multilateral partnerships will strengthen worldwide efforts against these offenses. Moreover, increasing public awareness about money laundering's risks and consequences, and promoting a compliance-focused, ethical culture within the financial sector, are crucial to a stronger defense against financial crimes. By employing these strategies, the global community can make significant strides in eradicating money laundering and boosting the safety of international financial systems.

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