



Asia/Pacific Group
on Money Laundering

APG

[India ME1]

[2004 Assessment Methodology]

CONFIDENTIAL

**ASIA/PACIFIC GROUP
ON MONEY LAUNDERING**

**APG MUTUAL EVALUATION REPORT
ON INDIA**

Against 2003 FATF 40 Recommendations and 9 Special Recommendations

March 2005

*Adopted by APG Members at the 2005 APG Annual Meeting
on 13 July 2005*

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PREFACE - INFORMATION AND METHODOLOGY USED FOR THE EVALUATION

1. The evaluation of the anti-money laundering (AML) and combating the financing of terrorism (CFT) regime of India was based on the Forty Recommendations 2003 and the Nine Special Recommendations on Terrorist Financing 2001 of the Financial Action Task Force (FATF), and was prepared using the AML/CFT Methodology 2004. The evaluation was based on the laws, regulations and other materials, including the PMLA and the draft rules as they existed at the time of the mutual evaluation as supplied by India, and information obtained by the Evaluation Team during its on-site visit to India from 14 March to 25 March 2005, and subsequently. During the on-site the Evaluation Team met with officials and representatives of all relevant Indian government agencies and the private sector. A list of the bodies met is set out in Annex 2 to the mutual evaluation report.

2. The evaluation was conducted by a team of assessors composed of APG experts in criminal law, law enforcement and regulatory issues. The Evaluation Team consisted of:

- a. *Legal Expert:* Ms Nicola Rivers, Australia;
- b. *Financial/regulatory Experts:* Mr Richard Chalmers, United Kingdom and Mr Amit Sharma, United States;
- c. *Law Enforcement Expert:* Mr Philip Tsang, Hong Kong, China; and
- d. *APG Secretariat:* Mr Rick McDonnell, Head of Secretariat and Mr Arun Kendall, Executive Officer.

3. The experts reviewed the institutional framework, the relevant AML/CFT laws, regulations, guidelines and other requirements, and the regulatory and other systems in place to deter money laundering (ML) and the financing of terrorism (FT) through financial institutions and Designated Non-Financial Businesses and Professions (DNFBP), as well as examining the capacity, the implementation and the effectiveness of all these systems.

4. This report provides a summary of the AML/CFT measures in place in India as at the date of the on-site visit or immediately thereafter. It describes and analyses those measures, and provides recommendations on how certain aspects of the system could be strengthened (see Table 2). It also sets out India's levels of compliance with the FATF 40+9 Recommendations (see Table 1).

5. It should be noted that subsequent to the on-site visit by the Mutual Evaluation Team, India has continued to augment its AML/CFT regime since the finalisation of this report. The Team understands that the measures brought into force on 1 July 2005 involved the implementation of the amended PMLA and the revised Rules. It would be expected that these significant developments would result in increased levels of compliance with the FATF Recommendations and improve the ratings. Details of these measures have been provided by India in Table 3.

EXECUTIVE SUMMARY

Background Information

1. This report provides a summary of the AML/CFT measures in place in India as at the date of the on-site visit or immediately thereafter (March 2005). It describes and analyses those measures, and provides recommendations on how certain aspects of the system could be strengthened. It also sets out India's levels of compliance with the FATF 40+9 Recommendations (see the attached table on the Ratings of Compliance with the FATF Recommendations).¹

2. India passed the *Prevention of Money Laundering Act* (PMLA) in 2002 to establish a centralised AML/CFT system, but this requires a suite of implementing Rules to come into force. The Indian authorities have advised that the implementing Rules will come into force on 1 July 2005. Given the imminent implementation of the PMLA, the MER analyses this legislation and provides comments on its effectiveness. The ratings, reflect the status of the legislation in force at the time of the mutual evaluation in March 2005; that is, they reflect the fact that the PMLA and the implementing Rules had not come into force. However, with the PMLA and the implementing Rules having come into force with effect from 1 July 2005, it would be expected that these significant developments would result in increased levels of compliance with the FATF Recommendations and improve the ratings. Details of these measures have been provided by India in Table 3.

3. India has not undertaken any comprehensive threat assessment of money laundering or terrorist financing. Its legislative efforts have been concentrated on fighting tax evasion and the large 'black money' component in its economy. There has been an implicit assumption by Indian authorities that many of the laws dedicated to identify and eradicate tax evasion would also capture money laundering activities. Prior to the introduction of the PMLA, the only legislation to explicitly provide for the seizure and forfeiture of the proceeds of crime has been the *Narcotics and Psychotropic Substances Act 1985* (NDPS Act), which criminalises the dealings in proceeds associated with drug trafficking only. Prior to the introduction of the PMLA, the only legislation that recognised money laundering as an offence was the *Narcotics and Psychotropic Substances Act 1985* (NDPS Act) which only applies to proceeds of drug offences in specific circumstances. India has developed comprehensive anti-terrorist legislation due to its first hand experience with terrorism, and has recognised the need to combat the financing of terrorism through amendments to the *Unlawful Activities (Prevention) Act 1967* (UAPA) in 2004 and amendments to the PMLA in early 2005 which made terrorist financing a predicate offence.

2 Legal System and Related Institutional Measures

4. India has criminalised money laundering under two pieces of legislation: section 8A of the NDPS and section 3 of the PMLA. The NDPS specifically criminalises the laundering of the proceeds of drug trafficking, and does not require a conviction for the predicate offence. The NDPS came into operation in 2001, and there has only been one prosecution under section 8A, which is still under way. The PMLA has not yet come into effect, but once the implementing Rules have been passed by Parliament, it will be fully operational. The PMLA requires a conviction for a predicate offence before a conviction for money laundering can be obtained. Predicate offences are listed in a schedule to the

¹ Also see the attached table on the Ratings of Compliance with the FATF Recommendations for an explanation of the compliance ratings (C, LC, PC and NC).

Act, but these do not include many of the predicate offences listed as essential by the FATF Recommendations, including organised crime, fraud, smuggling and insider trading. Furthermore, the PMLA distinguishes between two schedules of predicate offences, of which one specifies a high threshold of Rs. 3 million (\$US 68,000) in value relating to the proceeds of crime before money laundering charges under the PMLA can be prosecuted

5. Terrorist financing is an offence under the *Unlawful Activities (Prevention) Act 1967* (UAPA), which is the main anti-terrorist legislation in India. The UAPA criminalises the raising of funds for the purpose of committing terrorist acts and holding property derived from terrorist acts or acquired through terrorist funds. It is not clear that the legislation extends to those who provide funds to terrorists in the knowledge that those funds will be used for terrorism, and the position of someone who merely provides funds to terrorists without raising money specifically for that purpose is also not clear under the legislation. The UAPA does not define 'funds', which may lead to problems before the courts. There have been no prosecutions under the UAPA, although under a previous incarnation of this legislation operating between 2002 and 2004, there were 26 prosecutions with 2 convictions.

6. Powers of confiscation, freezing and forfeiture of the proceeds of crime in India stem from three different sources depending on the nature of the crime: the NDPS Act, the UAPA and the PMLA, once it comes into operation. The police and the prosecution authorities have a full range of powers to identify and trace assets.

7. The PMLA provides for the confiscation of the proceeds of crime, but not of the instrumentalities used or intended to be used in an offence. Property of corresponding value cannot be seized where there is no direct link to the crime itself. The legislation requires there to be a conviction for the predicate offence before property can be forfeited: there are no civil forfeiture procedures available. The UAPA does allow for property derived directly or indirectly from the proceeds of terrorism to be confiscated whether it is held by a terrorist or not. The UAPA also provides for the proceeds of terrorism to be attached and confiscated without a conviction. The NDPS Act is similarly constructed to the UAPA but does not allow for seizure of property with a corresponding value. There have as yet been no prosecutions or convictions under the UAPA or the PMLA since it has not come into force. In 2002, proceeds equal to approximately \$US5.63 million were forfeited under the NDPS Act.

8. United Nations Security Council Resolutions (UNSCR) S/RES/1267(1999) and S/RES/1373(2001) have been implemented through the *Prevention and Suppression of Terrorism (Implementation of Security Council Resolutions) Order 2004*. The Order provides the Indian Government with broad powers to issue such directions as are necessary to implement the Order including the powers to prevent and suppress terrorist acts falling within the UNSCR, such as the power to freeze assets. A Schedule appended to the Order lists proscribed persons and organisations. There is some confusion on the manner in which UNSCR 1267 and 1373 lists are disseminated in India, and how frequently the Schedule is updated. The RBI issues circulars to the financial institutions for which it is responsible and the circulars provide updated UNSCR lists issued by the Indian Government. However, little guidance is provided in the circulars and there are no follow up procedures to ensure the effective operation of the lists and application of the law. There has only been one documented case of a company's assets being frozen, and it is highly unusual that there have been no instances of any other account holders' names matching those on the lists.

9. India does not yet have an operational Financial Intelligence Unit (FIU). While there is no intention to introduce specific legislation establishing an FIU, the PMLA does

provide for the appointment of staff to oversee the FIU's operations and therefore to effectively function as an FIU. The FIU is intended to operate as a repository for suspicious transaction reports (STRs) which are then forwarded to a relevant body to investigate and prosecute. The main agency responsible for this will be the Directorate of Enforcement (a department within the Ministry of Finance), which currently has responsibility for investigating foreign currency violations and *hawala* operations. The Director responsible for running the FIU has been appointed and is in the process of recruiting staff and organising the administrative and operational functions of the FIU.

10. India is a federal state, and policing is for the most part undertaken at state level. State police forces have general responsibility for investigating criminal matters which can include terrorism and economic crimes (including money laundering) as delegated to them by other agencies. There are, however, a number of national agencies responsible for overseeing specific pieces of legislation governing what are termed for the most part 'economic crimes'. These include the Directorate of Enforcement responsible for foreign currency and remittance violations, the Commissioner of Customs, the Narcotics Control Bureau, and the Central Bureau of Investigation (CBI). The CBI is responsible (along with the State police forces) for the bulk of other crimes including terrorist activities, intellectual property, corruption and fraud. There are currently no suspicious transaction reporting (STR) obligations on these bodies which would enable them to report STRs to other relevant authorities, pending the implementation of the PMLA. There is no central record of statistics which would allow the monitoring of these agencies' operations and effectiveness.

3 Preventive Measures - Financial Institutions

11. Supervision of the financial services sector is divided between three main agencies, the Reserve Bank of India (RBI), the Securities and Exchange Board of India (SEBI) and the Insurance Regulatory and Development Authority (IRDA). The roles of the RBI and the SEBI are well established, with the former being responsible for the licensing and supervision of banking business and non-bank financial institutions (which include finance companies, hire purchase companies, dealers in government securities, investment companies and lottery-type schemes); while the SEBI is responsible for the licensing and supervision of stock exchanges, market intermediaries, depositories and custodians, and collective investment schemes. The IRDA was established in 2000 to regulate, promote and ensure orderly growth of insurance business, but it has been slow to develop its operations and has yet to roll out a full supervisory regime.

12. There is no unified set of customer due diligence (CDD) standards for the financial sector. Some form of customer identification requirements are applied to most of the key financial institutions, but these vary enormously in the detail of the obligations imposed, many of which, outside the banking sector, have not been introduced specifically to enforce AML/CFT controls. The RBI is the most advanced of the regulators in promulgating CDD requirements for the institutions that it supervises, having published a set of guidelines in November 2004 that very closely match the language of the Basel Committee's paper on this issue. These replace earlier, far less detailed guidelines issued in 2002. However, full implementation of the latest guidelines is not required until end-2005; they contain some ambiguities about which provisions are deemed to be mandatory; and they do not meet the criteria necessary for consideration as "law or regulation". The SEBI has, over the years, imposed some customer identification obligations on the securities sector, but these have been targeted primarily at preserving market integrity, and do not address specific AML/CFT measures. With respect to the insurance sector, the IRDA has yet to put in place a substantive regulatory regime, and has not so far imposed any requirements that equate to customer identification procedures.

13. Foreign exchange houses and money remitters are regulated by the RBI but only for the purposes of foreign exchange controls. RBI regulations require authorised businesses to obtain basic customer identification data, but the focus of this process appears primarily to be to assist the authorities to identify potential evasion of income tax. Informal remittance systems (especially *hawala*) are illegal in India (although the offence became administrative rather than criminal in 1999), but it is known that there are a large number of agents involved in this activity, and opinions differ markedly on the scale of the problem and on the implication for the overall AML regime.

14. The imminent implementation of the Rules under the PMLA will provide the first common set of minimum CDD standards, although they will continue not to apply to exchange houses and money remitters, which are subject to the provisions of the PMLA. It remains unclear what will be the detailed obligations within the Rules that will apply across all the individual types of institution, but it is to be hoped that they will be aligned with the precedent set by the RBI guidelines.

15. Since the PMLA has yet to be brought into force, there is no suspicious or cash transaction reporting regime currently in place for AML/CFT purposes. However, various obligations have been imposed over the years under tax law, foreign exchange controls and general regulatory mandate requiring institutions to notify either specified agencies or whatever agency the institution might consider appropriate, whenever there is suspicion about a particular transaction. Similarly, there are a number of automatic external reporting requirements for cash transactions above defined thresholds, but in nearly all cases the driving force for such obligations has been to counter tax evasion. Reporting of currency movements across the national borders has long been a feature of the Indian exchange control and management regimes, and current requirements involve the disclosure of currency notes in excess of US\$5,000 and all foreign monetary instruments over \$10,000. Significantly lower thresholds have been established for Indian currency.

16. The PMLA, once brought into force, will institute a structures STR regime, but it will not be comprehensive. Suspicious transactions are defined in such a way that, in most cases, there will be no obligation upon an institution to report a transaction unless it believed that the funds related directly to proceeds exceeding Rs.3 million (approximately US\$75,000) derived from one of the named predicate offences. The only exception will be in relation to those actions (specifically, violent acts against the state or drug offences) for which there is no threshold for consideration as a predicate offence. Moreover, there will be no obligation to report attempted transactions, nor does the Act create an offence of "tipping off". The cash transaction reporting system currently envisages a threshold of Rs.1million (approximately US\$ 23,000), which is high by international comparison, but is considered reasonable by the authorities given the extent to which India remains a cash economy.

17. Only those financial institutions under the supervision of the RBI have been given specific directions to implement appropriate AML systems and controls, but, under the November 2004 guidelines, the institutions have until end-2005 to comply fully with the requirements. No such similar guidelines have been issued by either the SEBI or the IRDA, although the securities sector is required to have in place related measures designed to mitigate the risk of market manipulation. The PMLA and the accompanying draft Rules do not contain a specific obligation to implement appropriate systems and controls, and they provide only limited general direction to financial institutions in this regard. However, this situation would change, were measures taken to tie the RBI guidelines fully into the Rules.

18. Prudential supervision of the banking and securities sectors (and those non-bank financial institutions within the remit of the RBI) has been in place for many years and is

relatively well developed. On the other hand, the IRDA has yet to roll out a comprehensive supervisory regime for the insurance sector, while the exchange houses and money remitters are subject to oversight only for the purposes of compliance with the foreign exchange management arrangements. Market entry is controlled in all the sectors subject to prudential supervision, but the focus, in terms of "fit and proper" criteria, is largely upon management. There are no controls, within either primary or secondary legislation, over the acquisition of shares in licensed financial institutions.

19. Both the RBI and the SEBI are well resourced in terms of staffing, and have extensive on-site inspection procedures that address, among other things, the adequacy of internal controls and systems. Each agency conducts between 100 and 150 inspections each year. However, only those institutions subject to supervision by the RBI currently have any explicit AML obligations, and even in these cases, compliance with the full range of guidelines introduced in November 2004 is not being assessed until end-2005 at the earliest. The IRDA has yet to implement an examination programme (although this is expected to commence shortly), and it not entirely clear what will be its role in AML compliance procedures, since no reference is made to the powers of this agency in the draft PMLA Rules.

20. All three regulatory agencies have similar powers to require regulated institutions to furnish information on demand, and there is no apparent restriction on the type of information that may be requested. The RBI and the SEBI have broad powers to impose penalties for failure to comply with a disclosure request or, more generally, to comply with any rules, orders or directions issued under the statutes. The IRDA has no such similar enforcement powers under its governing legislation, and it is unclear on what legal authority it would seek to ensure compliance with its regulations or instructions.

4 Preventive Measures – Designated Non-Financial Businesses and Professions

21. The following DNFBPs are subject to AML/CFT obligations: real estate agents, gem and precious metal dealers, lawyers and accountants. Land-based casinos are not permitted in India, although authorities acknowledge there is a significant gambling problem in India. Trust and company service providers do not exist as a separate entity. Lawyers are regulated by the Bar Council of India, which enrolls lawyers, represents their interests and conducts disciplinary proceedings. There, however, no on-going continuing education requirements linked to practising license renewals. Lawyers are specifically prohibited from undertaking any financial transactions for their clients and there are no AML/CFT requirements for the profession. Accountants are supervised by the Institute of Chartered Accountants of India (ICAI) but, again, there are no specific AML/CFT obligations attached to their professional obligations. Gem dealers are regulated by the RBI to the extent that their businesses engage in import/export transactions and are therefore subject to the FEMA, but there is no regulation in relation to their retail operations other than obligations under tax legislation to report certain transactions. They are obligated to operate through banking channels, and therefore must comply with banking requirements. It is recommended that the Indian authorities conduct a threat assessment of the DNFBP sector and establish uniform CDD and record keeping requirements in line with the FATF Recommendations.

22. As far as the reporting of suspicious transactions is concerned, accountants are obligated as part of the licensing provisions set by the ICAI to report illegal transactions, as are lawyers under the licensing requirements set by the Bar Council of India. Gem dealers must operate through banking channels, and therefore obligations concerning suspicious transactions rest with the banks they deal with. Otherwise, the PMLA does not impose any obligations on DNFBPs to report suspicious transactions. It is recommended

that DNFBPs be brought within the framework of the PMLA and be provided with guidance and training on their obligations.

23. The PMLA, once in force, does not include any obligations for DNFBPs to report suspicious transactions, conduct specific customer due diligence, or maintain records consistent with those applied to the formal financial sector, and it is recommended that DNFBPs be brought within the framework of the PMLA and be provided with guidance and training on their obligations.

5 Legal Persons and Arrangements & Non-Profit Organisations

24. India has a central registry, the Registrar of Companies Affairs (RCA), for legal persons, which operates 21 Registries regionally throughout India. All persons wishing to form a company must register with the RCA. Irrespective of where the company is intended to operate, it can be registered at any of the regional branches upon application by at least two subscribers. Companies fall into three categories: private companies, unlisted public companies and listed public companies.

25. For private companies, subscribers must inform the RCA of any additional shareholders and describe the make up of and changes to the board, as well as at each year's end, the changes to or relinquishing of ownership of shares. At year's end, an internal managerial and financial audit must be conducted to determine what the holding situation is, and what has transpired in terms of beneficial ownership for the year. Outside of the two initial subscribers, ownership can change, enter or divest in any way as determined. For unlisted public companies, the RCA performs the technical scrutiny of the final accounts, and full disclosure requirements are necessary, similar to that of private companies. Finally, for publicly listed companies, shares are not held in physical form, and any changes to the make up of ownership must be submitted to the registrar yearly accompanied by formal third party audit. The RCA does not intervene in a publicly listed company's affairs unless a shareholder specifically communicates to the RCA – at which time they can recommend for investigation to the Serious Frauds Investigation Office (SFIO). For these companies, there is no proactive audit mechanism on the part of the RCA itself, however all records (on ownership, directors, financial statements, etc.) are open to investors and others – changes in management of publicly listed companies are regulated by the SEBI Act.

26. Charitable organisations are required to register with the State-based Registrar of Societies. The purpose of all such organisations wishing to register must be for the promotion of a number of issues including: literature, science, sports, social welfare or any other charitable purpose, as defined by the Registrar, and can be formed by an association of seven or more persons associated with one of those objectives listed above who subscribe their names to a memorandum of association and file officially with their State's Registrar. Registration in a particular state does not obligate a Society to confine its activities to that State. There are an estimated 60,000 registered societies in Delhi alone, of which 25,000 are operational. The Registrar requires an annual list of the names of managing bodies and any change made thereof, but does not have a regulatory role with regard to auditing finances, management or any other activity of the Society. Upon registration, and if tax exemption is sought by a particular organization, all audit and supervisory capacity rests with the appropriate tax authorities.

27. If a charitable organisation seeks to have a tax exemption status, they must apply separately to the Exemptions Department of the Central Board of Direct Taxes. To receive tax exemption status, the organisation must adhere to a number of

requirements including providing a full disclosure of activities, management details and financial operations including the details of disposal of funds, and they must keep all associated funds in a bank. Annual audits are conducted on roughly 5% of exempt charitable organisations based on criteria determined by the Exemptions Department or on the basis of complaints, but there is no specific oversight or mechanism for providing guidance on AML/CFT issues. The Exemptions Department estimates that there are approximately 50,000 - 60,000 exempt organisations operating throughout India, but do not have an estimate on those operating outside formal regulation. It is recommended that the Indian authorities conduct a self-assessment of their non-profit and charitable sector more generally, to determine the size and scope of the sector, particular vulnerabilities to money laundering and terrorist financing, and work to build a more rigorous supervisory regime, which would include greater auditing powers over the management and financial operations of all non-profits, not just those that are tax exempt.

6 National and International Co-operation

28. India has established the Economic Intelligence Council (EIC) to coordinate national efforts against economic crime between the various enforcement agencies and departments in the Ministry of Finance. The secretariat of the EIC is the Central Economic Intelligence Bureau, and it is intended that the FIU will report to this body once it is operational.

29. India signed the United Nations Terrorist Financing Convention on 8 September 2000 and ratified it on 22 April 2003. India has largely implemented the Terrorist Financing Convention through the UAPA. This Convention is also implemented through the Code of Criminal Procedure 1973 and the Extradition Act 1962. India has also acceded to the Vienna Convention on 27 March 1990 and signed the Palermo Convention on 12 December 2002 but has not yet ratified it. The Vienna Convention is largely implemented through amendments to the NDPS Act in 1989 and 2001, and the PMLA, once it comes into force. Section A5(5) of the Vienna Convention has not been implemented, as all confiscated assets in India go to consolidated government revenue, and are not available for sharing with other countries.

30. Powers to provide mutual legal assistance (MLA) are found in the Criminal Procedure Code, although MLA can also be provided through other legislation. As the PMLA is not yet in force, MLA in money laundering cases can only presently be provided when related to a drug offence in the NDPS Act. The PMLA will provide specific provisions for assistance in money laundering matters. While India has signed Mutual Legal Assistance Treaties (MLATs) with 19 countries (with a further 16 being negotiated), there is no requirement for an MLAT to be in existence for assistance to be provided. The powers of assistance provided in the legislation are wide. The efficacy of the system in place to deal with MLA requests, however, is unclear. The Ministry of External Affairs receives requests and passes them to the Central Bureau of Investigation (CBI) which is then responsible for coordinating processing of MLA requests, but there were no details available on targets for responding to MLA requests or statistics on the time taken to deal with individual requests. It is recommended that India maintain accurate records on MLA requests in order to monitor and coordinate responses to such requests and that the authorities introduce measures to ensure that MLA requests are met in a timely and efficient manner.

31. Terrorist financing is an extraditable offence in India pursuant to the *Extradition Act 1962*; however money laundering will not be an extraditable offence until the PMLA comes into force. In order to carry out an extradition request, there must be a bilateral treaty or extradition agreement with the requesting country. India has signed extradition

treaties with 29 countries, with agreements pending with a further 33 countries. India applies a dual criminality test in which the offence must be punishable in both India and the requesting country and the offence must be punishable by a minimum one year.

32. There are no explicit legal gateways allowing for regulatory co-operation with foreign counterparts in any of the Acts governing the operations of the RBI, the SEBI or the IRDA, and all employees of these agencies, as public servants, are covered by the Official Secrets Act. However, all three agencies indicated that, in practice, they were able to co-operate, on request, with foreign counterparts and did so on a regular basis. The PMLA does not have any explicit provisions relating to international cooperation. Other law enforcement agencies state that they have regular contact with international agencies such as INTERPOL.

MUTUAL EVALUATION REPORT

1 GENERAL

1.1 GENERAL INFORMATION ON INDIA ²

1. India covers an area of 3.29 million square kilometres with a population of 1,027 million (in 2001), making it the second most populous country in the world. It is a multilingual society with 18 principal languages. Hindi is the language of a large percentage of people (38 percent), while English is the preferred business language. The majority of Indians are Hindus (81.3%), though a significant number are Muslims (12%), Christians (2.3%), Sikhs (1.9%) and others (2.5% including Buddhists).

2. Formerly a British colony, India achieved independence in 1947. It has a federal system consisting of the Union or Central Government, and the State Governments. The 1950 Constitution provides for a parliamentary system of Government with a bicameral parliament and three branches: the executive, legislative, and judiciary. There are also elected Governments in States and in Union Territories (UTs). India's parliamentary democracy is the largest in the world.

3. The division of powers between the States and the Union are listed in a schedule to the Indian Constitution. The Constitution contains three lists – Union powers, State powers and concurrent powers. If a power is listed as concurrent, the States are prevented from enacting laws relating to that power that are inconsistent with Union laws. Residual powers rest with the Union. Currency, banking and external affairs are Union powers. In India, money laundering and terrorist financing are linked to these heads of power and therefore rest with the Union Government.

4. The government exercises its broad administrative powers in the name of the president, whose duties are largely ceremonial. A special electoral college elects the President and Vice President indirectly for 5-year terms. Their terms are staggered, and the Vice President does not automatically become president following the death or removal from office of the president.

5. Real national executive power is centred in the Council of Ministers (Cabinet), led by the Prime Minister. The President appoints the Prime Minister, who is designated by legislators of the political party or coalition commanding a parliamentary majority in the Lok Sabha (i.e. the lower house of the parliament of India). The President then appoints subordinate ministers on the advice of the Prime Minister.

6. India has 28 states and 7 UTs. At the state level, some of the legislatures are bicameral, patterned after the two houses of the national parliament. The states' chief ministers are responsible to the legislatures in the same way the Prime Minister is responsible to parliament.

7. Each state also has a governor appointed by the President, who may assume certain broad powers when directed by the Central Government. The Central Government exerts greater control over the UTs than over the states, although some territories have gained more power to administer their own affairs. Some states are trying to revitalize the traditional village councils, or panchayats, to promote popular democratic participation at the village level, where much of the population still lives.

² Sources: Indian Government Website: <http://indiainimage.nic.in/> and US Department of State Background Notes: <http://www.state.gov/r/pa/ei/bgn/3454.htm>

8. India's independent judicial system began under the British, and its concepts and procedures resemble those of Anglo-Saxon countries. The Supreme Court consists of a chief justice and 25 other justices, all appointed by the President on the advice of the Prime Minister.

9. India has the world's 12th largest economy and the third largest in Asia behind Japan and China, with total GDP of around US\$570 billion. Real GDP growth for the fiscal year ending 31 March 2004 was 8.17%, up from the drought-depressed 4.0% growth in the previous year. Growth for the year ending 31 March 2005 is expected to be between 6.5% and 7.0%. Services, industry and agriculture account for 50.7%, 26.6% and 22.7% of GDP respectively. Nearly two-thirds of the population depends on agriculture for their livelihood. About 25% of the population lives below the poverty line, but a large and growing middle class of 320-340 million has disposable income for consumer goods.

10. India is continuing to move forward with market-oriented economic reforms that began in 1991. Recent reforms include liberalised foreign investment and exchange regimes, industrial decontrol, significant reductions in tariffs and other trade barriers, reform and modernisation of the financial sector, significant adjustments in government monetary and fiscal policies and safeguarding intellectual property rights. The thrust of the reform process consisted of the following measures:

- (a) a reduction in fiscal deficit with curbs on government expenditure including subsidies, privatisation of public enterprises, and tax reforms;
- (b) devaluation of the currency followed by a fairly rapid transition to a market-driven exchange rate system and encouragement of the in-flow of foreign capital through liberalisation of foreign institutional investment rules;
- (c) granting a large measure of autonomy to the Reserve Bank of India.

1.2 GENERAL SITUATION OF MONEY LAUNDERING AND FINANCING OF TERRORISM

11. There is little tangible evidence of money laundering proliferating in India, although anecdotal evidence suggests that areas of concern relate mostly to import/export transactions being used to transfer value across borders. India's AML/CFT regime is at a nascent stage and there has been no history of investigations or prosecutions under the current legislation by which the extent of the problem could be judged in any meaningful way. Indian authorities have stated that one of the most significant issues regarding financial crime has been tax evasion, and many efforts have been made by a number of authorities to combat this issue.

12. India has experienced at first hand the effects of terrorism, and in general has developed comprehensive anti-terrorist legislation over a number of years. The issue of combating the financing of terrorism and money laundering *per se* is less well established.

13. Indian authorities express concern about the financing of terrorism given the fact that India has been and continues to be a victim of terrorist attacks. In this respect, fears have been expressed by law enforcement officers that the illegal system of *hawala* (alternative remittance) has been used as a means to facilitate the financing of terrorism. Penalties for engaging in *hawala*, however, have recently been reduced to civil penalties and there is some concern by law enforcement agencies responsible for prosecuting offenders that this is ineffective deterrence and creates vulnerability in India's AML/CFT

systems. Furthermore, India does not consider domestic (within India's borders) informal transfer mechanism as *hawala* transactions.

14. Indian authorities are also concerned by the amount of what is termed 'black money' in the economy, though their efforts to combat this are based on a desire to augment taxation revenue rather any concerns about the vulnerabilities in relation to money laundering or terrorist financing. Indeed, there is a perception in some quarters within the Indian administration that money laundering is primarily associated with tax evasion.

15. India liberalised its gold market recently, allowing for more relaxed regulations relating to the importation of bullion. This has resulted in greater transparency in this market which was previously a target for smuggling and other illegal activities.

1.3 OVERVIEW OF THE FINANCIAL SECTOR AND DNFBP

16. The mainstream financial sector in India consists of the Reserve Bank of India (RBI), banks, financial institutions, finance companies, insurance companies and intermediaries, including brokers, mutual funds, and merchant bankers.

17. The banking sector is diverse and reflects the need to service a disparate urban and rural community. There are 27 publicly owned commercial banks (including the State Bank of India and its seven affiliates which are majority-owned by the RBI), 30 privately owned domestic banks and 33 foreign-owned banks, all regulated by the RBI. In addition, there is an extensive co-operative banking system, comprising 29 state and 51 urban co-operatives, and 197 regional rural banks.

18. Although India does not play host to offshore financial services in the traditional sense, it has made provision for offshore banking units (OBUs) to operate in the Special Economic Zones (SEZ) that are currently being established to promote export-oriented commercial businesses. The RBI has so far authorised seven OBUs, which are prohibited from engaging in cash transactions and are restricted to lending to the SEZ wholesale commercial sector. However, it is understood that such entities will be able to raise deposits from non-resident businesses and individuals. OBUs are regulated prudentially by the RBI on the same basis as domestic commercial banks.

19. Non-bank financial institutions are defined as development institutions which are not permitted to provide facilities for short term deposits and cannot lend funds to the retail sector. Financial institutions undertake the flotation of bonds/debentures or provide facilities for term deposits from the public. Their role is essentially to finance the capital and long term funding needs of big industries and corporations. Activities of financial institutions are regulated and supervised by the RBI.

20. There are 27 insurance companies that operate both in the public and private sectors. These include 13 life insurers (of which one is state-owned), 13 non-life (four state-owned) and one re-insurer. The sector was liberalised in 2000, since when the institutions have been regulated by the Insurance Regulatory Development Authority (IRDA). The IRDA also serves as the primary regulator concerning AML/CFT matters.

21. Stocks are traded on 24 exchanges across the country, although only about five of these have any significant volume of activity. The National Stock Exchange (NSE) is the largest exchange in India. Market turnover in 2003 was in the region of US\$284bn. The exchanges, together with mutual funds, brokers, merchant bankers and other intermediaries which operate in stock markets, are regulated by the Securities and Exchange Board of India (SEBI).

22. Although the foreign exchange markets have been liberalised in recent years, foreign currency transactions may still only be undertaken through the banks or through dealers and money changers authorised by the RBI under the Foreign Exchange Management Act. There exists a sizeable informal sector of entities operating without licenses. There seems to be disagreement on the size and scope of the informal/*hawala/hundi* sector, and, more specifically, the nature of the problem as it relates to money laundering and terrorist financing.

23. The import of gold is only permitted by nominated agencies and entities in Export Oriented Units (EOU) and SEZ. The trade in precious stones (namely rough diamonds, cut and polished diamonds and other stones) takes place under an Open General Licence, and anyone can import these items on payment of duty and deal in such goods. For such dealers, there is no regulatory provision in place from the customs and central excise side.

24. The profession of lawyers is regulated by the *Advocates Act 1961*. They cannot organise as incorporated companies. However, two or more Advocates may constitute a partnership firm whose membership cannot exceed twenty. Partnership firms among lawyers are not very common and the profession consists of mostly individual practices. The Advocates are authorised to appear in all Courts, Tribunals and other authorities unless specifically prohibited. Solicitors and Attorneys function as independent legal professionals in some of the High Courts of the country. If they are Advocates, they are regulated by the *Advocates Act 1961*. Some Acts like the *Income Tax Act*, *Excise Act*, *Customs Act* and the *States' Sales Tax Act* permit Accountants and ex-employees to represent tax payers. Neither their number nor volume of activity is significant.

25. Notaries are regulated under the *Notaries Act 1955*, both by the Central government and State governments. Notaries attest documents, affidavits and endorse notings and protests in respect of Bills of Exchange in addition to their usual activity as Advocates.

26. Accountants in India are regulated by the *Chartered Accountants Act 1949* and the Institute of Chartered Accountants of India (ICAI). Members of the profession in India are engaged in general accountancy, cost accountancy, auditing (both internal and external) and taxation and are also engaged in a range of other activities including the formation of companies and directorial and companies secretarial work. There are 118,000 accountants registered with the ICAI, of whom around 60% are in practice. Accountants can obtain their qualifications through study programmes provided by the ICAI or have overseas qualifications from approved institutions recognised.

27. Chartered Accountants fall into four main categories: sole or small firms working locally in public practice; medium or second tier firms which operate both internationally and domestically; large firms that are local branches of one of the big five international accountancy firms; and finally there are those accountants who work in the business community (CABs) which also include those working in government departments and academic institutions.

1.4 OVERVIEW OF COMMERCIAL LAWS AND MECHANISMS GOVERNING LEGAL PERSONS AND ARRANGEMENTS

28. The *General Clauses Act 1897* defines 'person' to include any company or association or body of individuals, whether incorporated or not.

29. Companies are created, registered and regulated under the *Companies Act 1956*. Private limited companies may have two to fifty members whereas public companies must have a minimum of seven members with no limit on the maximum number. The shares of public companies may be either unlisted or listed: in the latter case they are traded on one of the country's 24 stock exchanges (see Section 5.1).

30. All companies, whether private or public, have to provide a Memorandum of Association and Articles of Association which are filed with the Registrar of the State in which the Registered Office is proposed to be situated. Companies are controlled and managed by a Board of Directors, elected by the shareholders in their Annual General Meetings. Parts of the Board retire by rotation. Public companies have to furnish copies of important resolutions and annual accounts with the Registrar. Information is also provided as to charges created on the assets of the company and changes in the composition of directors and shareholders. This information is public information. A company has to maintain a Register of Members.

31. The Union and State Legislatures have also established trading and financial corporations. The capital of such corporations is usually provided by the State or by State Agencies. These entities are not required to publish any information on their accounts. However, where such State business is registered as a company, the *Companies Act* applies to disclosure, registration and maintenance of information.

32. Non-profit organisations can be created in a similar manner. They can be registered either as an unlimited company under Section 25 of the *Companies Act* or a Society under the *Societies Registration Act*. Some charities function as Trusts, in which case the Trust Deed is registered with the Registrar of Properties. They are also required to have an office. Information as to subscribers and accounts is to be furnished to the Registrar of Societies, which is public information. Societies are also required to maintain a Register of Members. Mutual Funds are also registered as Trusts but they need to be managed by an asset management company which must be registered under the *Companies Act*.

33. Hindu Personal Law recognizes the institution of a Hindu Undivided Family headed by the father or the eldest male member, consisting of brothers, sons, male lineal descendants, their spouses and unmarried daughters. The property of the family, although held in the name of any member is supposed to be common in which the members acquire right to share by birth and marriage. Being part of customary personal law, no separate document is required to be executed for its creation or continuance. However, the banks insist on disclosure of information as to membership while opening an account.

34. Any Association composed of two or more persons for any common purpose may be formed but these entities are not popular as business structures. Most operate as philanthropic organisations or social clubs.

35. Any group of persons with common economic interest or disability may constitute themselves into a cooperative society. They are regulated under the States' *Cooperative Societies Acts*. Cooperative Societies having businesses in more than one State may be governed by the *Multi-State Cooperative Societies Act*, of the Union. Farmers, artisans, landless labourers, urban and rural workers have formed cooperative societies for collective businesses on a one member, one vote structure. Basic documents for registration of a Cooperative Society are Memorandum and Articles of Association. The

disclosure of information and the regulatory mechanism is broadly similar to that required for companies.

36. There is no established Central Registry for Trusts. The *Income-tax Act* discourages discretionary Trusts by taxing them at maximum marginal rates. The law enforcement agencies have jurisdiction to obtain and have access to the information as to the settlers, the trustees and the beneficiaries. The *Benami Transactions (Prohibition) Act 1988* declares holding of property in fictitious name or in other names as void, although the status and enforcement of this legislation is not clear.

1.5 OVERVIEW OF STRATEGY TO PREVENT MONEY LAUNDERING AND TERRORIST FINANCING

a. AML/CFT Strategies and Priorities

37. The Indian Government's approach to AML/CFT had in the past been predicated on the assumption that taxation laws would capture any elements of what was deemed to be the 'black' economy. International events have caused the authorities to review this approach. India has since sought to introduce specific AML/CFT legislation, and has sought membership of the FATF.

38. Specific AML legislation was first drafted in 1998 in the form of the *Prevention of Money Laundering Bill* (PMLA). This legislation generated a deal of initial resistance in Parliament and it was not until the events of September 11 that the Indian Government passed the PMLA in 2002 (without amendment), although it has yet to be brought into force. A subsequent election and change of government in mid-2004 shifted focus away from this issue until late 2004 when renewed efforts were made to issue the enabling Rules.

39. Ongoing concerns about the scope and application of the legislation, the need to make some amendments to the substantive legislation, and the drafting of the implementing Rule and Regulations, have further delayed the final passage of the PMLA. It is therefore only expected to receive Parliamentary assent this year following some further amendments enacted in May and the issuance of implementing Rules and Regulations, which were still outstanding at the time of the mutual evaluation. Unfortunately a substantial element of the legislation still reflects 1998 AML/CFT standards.

40. In addition to the PMLA, section 8A of the *Narcotic Drugs and Psychotropic Substances Act* criminalises the laundering of proceeds derived from drug trafficking.

41. The Reserve Bank of India (RBI) has issued extensive AML guidelines for the sectors of the finance industry over which it has responsibility. The Securities and Exchange Board of India (SEBI) utilises the guidance issued by the RBI in the sense that they rely on formal banking channels with regard to the transactions that they conduct, but have, to date, not issued any specific guidance to the securities sector on combating money laundering and terrorist financing. There are significant gaps in AML/CFT in relation to all other parts of the financial sector as well as DNFBPs.

b. The institutional framework for combating money laundering and terrorist financing

42. AML provisions in India are classed generally under the umbrella of economic crimes and currently the responsibility for enforcement of relevant legislation is spread

across a number of departments, including the Ministry of Finance and the Ministry of Home Affairs.

43. Key AML regulations are promulgated by the RBI and the SEBI and to a lesser extent, the Insurance Regulatory and Development Authority (IRDA). These institutions have both a regulatory and a supervisory role in relation to the financial institutions for they are responsible and issue guidelines for these institutions.

44. Regulatory oversight of the financial sector falls to the RBI, the SEBI and the IRDA. The RBI has addressed money laundering issues for several years within its supervisory processes, but this has not been a prominent feature of the SEBI's work, and the IRDA is a relatively new agency that has yet to develop an effective regulatory regime, in general.

45. Key agencies/organisations under the Ministry of Finance which are responsible for exercising regulatory and supervisory control over economic crimes include the Directorate of Enforcement, the Department of Banking (Financial Sector), the Central Board of Direct Taxes, the Central Board of Excise and Customs, the Central Bureau of Investigations, the Serious Fraud Investigation Office and the Central Economic Intelligence Bureau.

46. The Central Economic Intelligence Bureau (CEIB) was set up as a result of the recommendations of the Group of Ministers for coordinating and strengthening the intelligence gathering activities and enforcement action by various agencies concerned with investigation into economic offences and enforcement of economic laws. Under the CEIB, the Regional Economic Intelligence Councils (which are 18 in number) have been set up throughout the country to further coordinate work amongst the various enforcement and investigation agencies dealing with economic offences. At the national level, the Economic Intelligence Council (EIC), which is headed by the Finance Minister, was set up in 1997 to improve coordination amongst various agencies and departments under the Ministry of Finance, in view of the perceived connections developing between economic offences and threats to national security.

47. India is a signatory to the United Nations Terrorist Financing Convention and laws prohibiting terrorist financing, and dealings with proceeds derived from terrorism, are specifically addressed in the *Unlawful Activities (Prevention) Act 1967*. Law enforcement agencies have the responsibility for enforcing this act, including the state police force and internal security

48. With the introduction of the *Prevention of Money Laundering Act 2002*, a central Financial Intelligence Unit (FIU) is being established which will centralise and coordinate most of India's AML/CFT strategies, although there are some significant flaws in this framework. Reports of suspicious transactions will be fed to the FIU, and the Directorate of Enforcement will be mostly responsible for prosecuting money laundering crimes.

c. Approach concerning risk

49. India has not undertaken a comprehensive risk assessment of money laundering or the financing of terrorism. Risk-based procedures are increasingly being developed by the financial sector regulatory agencies, but these relate to their general supervisory techniques to ensure market integrity, safety and soundness, and consumer protection. No specific focus on risk assessment has been applied with respect to AML/CFT issues. It is expected that the newly established FIU will undertake some form of risk assessment as part of its normal process in monitoring the quality of reports it receives.

d. Progress since the last mutual evaluation

50. Not applicable.

2 LEGAL SYSTEM AND RELATED INSTITUTIONAL MEASURES

Laws and Regulations

2.1 CRIMINALISATION OF MONEY LAUNDERING (R.1 & 2)

2.1.1 DESCRIPTION AND ANALYSIS

51. In India, the constitutional power for legislating with respect to money laundering rests with the Union Government, as it is linked to the banking and external affairs powers in the Constitution. Beyond the relevant section in the *Narcotic Drugs and Psychotropic Substances Act 1988*, the *Prevention of Money Laundering Act 2002 (PMLA)* was the first law to criminalise money laundering. There are no State-based money laundering offences.

52. The PMLA was passed by the Indian Parliament and received Presidential assent in January 2003, however it has not yet come into force. The Act will come into force once a number of implementing Rules (subordinate legislation), which are currently under development, are passed by the Parliament. As the PMLA will soon come into force its provisions are discussed in detail below, however it has not been taken into account when allocating the ratings against each recommendation.

53. India has one legislative provision that criminalises money laundering - section 8A of the *Narcotic Drugs and Psychotropic Substances Act 1985* (NDPS Act). The NDPS offence has a very limited application as it only applies to drug offences committed under the NDPS Act. Once the PMLA comes into force, there will be a broader offence under section 3 of that Act; however it will only apply to the predicate offences listed in the schedule to the PMLA. The drug offences in the NDPS Act are listed as predicate offences under the PMLA, and therefore the Government may wish to consider repealing the money laundering offence provision in the NDPS Act.

54. India acceded to the Vienna Convention on 27 March 1990 and signed the Palermo Convention on 12 December 2002 but has not yet ratified it. The NDPS offence is based on the Vienna Convention. The PMLA offence is not based on the Vienna or Palermo Conventions; however it covers a number of the elements contained in them.

55. The PMLA creates an offence where someone “directly or indirectly attempts to indulge, knowingly assists or knowingly is a party or is actually involved in any process or activity connected with the proceeds of crime and projecting it as untainted property”.

56. The mental element of the offence of money laundering required by the Conventions is “knowledge” and this is satisfied in both the NDPS Act and the PMLA.

57. Although the PMLA offence largely covers the requirements of Article 6 of the Palermo Convention, it appears that it would not extend to the requirement in Article 6(1) (b) (i) – i.e. ‘the acquisition, possession or use of property’, unless the person was also projecting the property as untainted.

58. Under section 8A of the NDPS Act, while the person charged with money laundering does not need to have been convicted of a predicate offence, it is essential that a nexus with a predicate offence is proved. Therefore, according to the Narcotics Control Bureau (NCB), someone will need to have been charged with the predicate

offence before a money laundering charge can be laid. Law enforcement agencies can initiate investigations into the assets of drug traffickers once a person is arrested or a warrant for his arrest is issued under the NDPS Act. If the person charged with the predicate offence is acquitted, it is still possible to proceed with the money laundering conviction of that person, or another person.

59. Conversely, under section 3 of the PMLA, money laundering is not a stand alone offence, and therefore a conviction for a predicate offence is required before there can be a conviction for money laundering. This is because of the definition of 'proceeds of crime' which requires property to be "related to a scheduled offence". The Directorate of Enforcement stated that a person could be charged with a predicate and money laundering offence at the same time and the prosecutions could proceed together, however the conviction for the predicate offence would have to occur before the conviction for money laundering. If a third party has laundered the proceeds of crime, unless that third party is charged for criminal activity relating to a scheduled offence, he cannot be charged for the offence of money laundering. This requirement will cause obvious difficulties in securing convictions for money laundering.

60. The predicate offences relating to money laundering in the NDPS Act only extend to the drug offences under the Act and so the offence is very limited. In the PMLA, the predicate offences for money laundering are those listed in the schedule to the Act. These include offences under the Indian Penal Code, (i.e. offences against the state, waging war, murder, ransom, robbery, forgery etc), the NDPS Act, the *Arms Act*, the *Wildlife Act*, the *Immoral Traffic Act* (people trafficking), and the *Prevention of Corruption Act*. In some cases the offence only applies where the value involved is Rs.3 million or more (approximately US\$68,000). In India, offences are not categorised into serious/less serious offences, however it is still clear that not all "serious" offences are in the schedule to the PMLA. Many of the designated categories of offences in the FATF Recommendations are included, but a number of significant offences are missing such as organised crime, fraud, smuggling and insider trading. Tax evasion and illegal money value transfer are also not included, as they are civil offences in India. The Government of India has indicated that their money laundering laws are evolving, and that they may consider expanding the scheduled offences further, as appropriate.

61. A requirement of the international AML standards is that where money laundering is committed in India and the predicate offence occurred in another country, the money laundering can be dealt with under Indian law if the predicate crime would have constituted a predicate offence had it occurred domestically. Predicate offences for money laundering in the NDPS Act extend to drug offences that occurred in another country, provided it would have constituted an offence had it occurred in India. Section 8A specifically refers to "offences committed under this Act or under any other corresponding law of any other country".

62. Although it is not specifically provided for in the PMLA, the Directorate of Enforcement stated that predicate offences for money laundering in the PMLA will, through the predicate Acts, extend to conduct that occurred in another country. For example, the *Indian Penal Code* states that any person liable under Indian law who commits an offence outside India will be dealt with as if the offence had been committed within India. However there are only limited circumstances where people who commit an offence outside India are liable under Indian law. Reliance on these provisions may not be enough to ensure that offences committed in another country, which would have constituted a predicate offence had it occurred domestically, are included as predicate offences for money laundering under the PMLA. To ensure that these predicate offences are captured, the Government should insert a reference into the PMLA similar to the one in section 8A of the NDPS Act discussed above.

63. Both the NDPS Act and the PMLA provide for ancillary offences to money laundering of attempt and aiding and abetting. The NDPS specifically provides for conspiracy through section 29, however the PMLA does not. The Directorate of Enforcement argued that section 3 of the PMLA would cover conspiracy provided there was evidence of the conspiracy offence and the proceeds of crime; however this cannot be clearly inferred from the wording of the offence.

64. Both Acts apply an offence to natural persons who knowingly engage in money laundering. It is a principle of Indian law that the intentional element of the offence of money laundering can be inferred from objective factual circumstances.

65. The Government informed the Evaluation Team that offences under the NDPS Act and the PMLA apply to legal as well as natural persons. The *General Clauses Act 1897* defines 'person' to include any company or association or body of individuals, whether incorporated or not. In regard to the NDPS Act, the NCB stated that although the individuals involved will be identified where possible, a fine will also be imposed on a legal person if it is involved in the offence. A company's property can also be confiscated in line with the provisions in the Act. There are no other sanctions available for legal persons. Section 70 of the PMLA provides that where the contravention is committed by a company, the company and individuals in charge of the company will be deemed to be guilty of the contravention unless they did not have knowledge of the contravention or they exercised all due diligence to prevent it.

66. At the time of the onsite visit, it had not yet been determined whether a company could be held criminally liable in India. However a recent Supreme Court judgement has settled this matter. In 2003 a three member bench of the Supreme Court³ held that a legal person is incapable of being punished with a sentence of imprisonment and therefore prosecution against a legal person is not maintainable. This judgement was referred to a larger bench of the Supreme Court as a large number of petitions including the Directorate of Enforcement had challenged this judgement. In the appeal Supreme Court then held⁴ that companies committing criminal offences can be fined, but not imprisoned, although Directors and others in charge of the company can be imprisoned. Thus it is possible for a legal person to be held criminally liable.

67. The NDPS Act does not contain a specific sanction for the money laundering offence in section 8A. Instead, it comes under the general sanction provision in section 32, which imposes a standard penalty for all offences in the Act which do not have a sanction specified. The maximum penalty for money laundering under this Act is therefore six months in prison, regardless of the amount of money laundered. This cannot be considered to be an effective, proportionate and dissuasive sanction, particularly when large sums of money are laundered. As a comparison, other penalties under Indian law include:

- Manslaughter: imprisonment for 10 years or fine or both;
- Robbery: rigorous imprisonment for 10 years and fine;
- People trafficking: 3 to 7 years rigorous imprisonment and fine up to Rs.200,000;
- Drug import/export less than commercial quantity: rigorous imprisonment up to 10 years and fine up to 100,000; and

³ Assistant Commissioner, Assessment - II, Bangalore and others versus M/s Velliappa Textiles Ltd. and Another dated 16.09.2003

⁴ Standard Chartered Bank and others etc versus Directorate of Enforcement and others, etc dated 05.05.2005

- Drug import/export commercial quantity: 10 to 20 years and fine.

68. The sanctions for money laundering under the PMLA are rigorous imprisonment for 3 to 7 years and a fine of up to Rs.500,000 (approximately US\$11,500). Where the money laundering offence relates to a drug offence under the NDPS Act, the penalty can extend to a maximum of 10 years. This penalty is generally equivalent to the penalty for similar level offences (as described above) and could be seen to be effective, proportionate and dissuasive.

69. As the PMLA is not yet in force, there have been no charges, prosecutions or convictions under the Act. Although section 8A of the NDPS was inserted into the Act in 2001, there has only been one charge for money laundering under that Act, for which the prosecution is currently proceeding. The NCB stated that money laundering convictions were rarely pursued, because most offenders were charged with a drug offence which carried a much more serious penalty, and therefore it was not seen as necessary to also pursue the money laundering offence. It is clear that section 8A is a very low priority for law enforcement. The Evaluation Team spoke to a number of relevant agencies who were unaware of the provision and stated that there was no money laundering offence provisions in India prior to the introduction of the PMLA.

2.1.2 RECOMMENDATIONS AND COMMENTS

70. While the development of AML legislation is a good first step, there are a number of measures India should implement to produce a more effective and functional money laundering offence:

- The PMLA should be brought into force and India should work toward full implementation of the PMLA offence as soon as practicable and encourage investigations and prosecutions in this area.
- The money laundering offence in the PMLA should be a “stand alone” offence that does not require a conviction for a predicate offence in order to prove that property is the proceeds of crime.
- The predicate offences in the PMLA should be broadened to cover all serious offences or at a minimum should cover the 20 designated categories of offences set out in the FATF Recommendations. The predicate offences should not contain a threshold for the value of property involved in the offence.
- The PMLA offence should be brought in line with the elements of the offence in the Palermo Convention, particularly in relation to the acquisition, possession or use of proceeds of crime.
- India could consider repealing section 8A of the NDPS Act once the PMLA comes into force. While the provision is essentially sound, it will be made redundant by the PMLA and may cause confusion and divide resources between NDPS prosecutions and PMLA prosecutions.
- India could consider imposing penalties on legal persons additional to a fine such as civil or administrative penalties.
- To ensure certainty, the PMLA could be amended to specify that section 3 also applies when the predicate offence occurs in another country (as in section 8A of the NDPS Act).
- To ensure certainty, the PMLA could be amended to specifically include the ancillary offence of conspiracy to commit.

2.1.2 COMPLIANCE WITH RECOMMENDATIONS 1 & 2

	Rating	Summary of factors underlying rating
R.1	Partially Compliant	<ul style="list-style-type: none"> • Money laundering is only criminalised when related to drug offences and does not extend to other serious offences. • The money laundering offence does not fully cover the requirements of the Palermo and Vienna Conventions. • A charge for a predicate offence is required before a charge for a money laundering offence can be obtained. • The money laundering offence in the NDPS Act is not effectively used.
R.2	Partially Compliant	<ul style="list-style-type: none"> • The NDPS Act does allow fines to be imposed on legal persons; however there are no other criminal, civil or administrative penalties. The NDPS Act does not contain effective, proportionate and dissuasive criminal sanctions for money laundering.

2.2 CRIMINALISATION OF TERRORIST FINANCING (SR.II)

2.2.1 DESCRIPTION AND ANALYSIS

71. Terrorist financing was criminalised in India under the *Prevention of Terrorism Act 2002* (POTA); however this Act was repealed in 2004. The *Unlawful Activities (Prevention) Act 1967* (UAPA) was amended in 2004 to criminalise terrorist acts, including raising funds for terrorism. The amendments came into force on 21 September 2004. This essentially took over and enhanced the provisions in the POTA. As well as criminalising a number of terrorist acts, the UAPA allows ‘terrorist organisations’ to be listed in the schedule to the Act. There is a separate but related process to list organisations pursuant to UN Security Council Resolutions 1267 and 1373, which is discussed in part 2.4 below. The responsibility for terrorist financing rests solely with the Union and there are no terrorist financing offences in State legislation.

72. The UAPA contains three terrorist financing offences – sections 17, 21 and 40. Section 17 relates to raising funds for the purpose of committing terrorist acts. Section 21 relates to holding property derived from terrorist acts or acquired through the terrorist fund. The term “the terrorist fund” is not defined in the UAPA. The Ministry of Home Affairs (MHA), which is the lead agency on this issue, state that it refers to “proceeds of terrorism” as defined in section 2(g). While it could be assumed that the terrorist fund refers to funds derived from terrorist acts, its meaning is not clear from the UAPA. Section 40 only relates to raising funds for ‘terrorist organisations’ that are listed in the Schedule to the Act, but it is otherwise much broader than the other two provisions. It covers persons who (a) invite another person to provide money or property for the purposes of terrorism, (b) receive money or property for the purposes of terrorism, and (c) provide money or property for the purposes of terrorism.

73. India signed the UN Terrorist Financing Convention on 8 September 2000 and ratified it on 22 April 2003. India’s criminalisation of terrorist financing is generally consistent with that Convention, although some elements are not covered as set out below.

74. Both the UN Convention and FATF Special Recommendation II require that criminalisation of terrorist financing extends to the collection and provision of funds by any means with the intention that they should be used or in the knowledge that they are to be used for terrorism.

75. The 'collection' of funds is covered by sections 17 and 40 of the UAPA. The 'provision' of funds is covered in relation to terrorist organisations under section 40, but is only partly covered in relation to individual terrorists and terrorist acts by the word "holds" in section 21. Where a person does not actually raise any funds, but provides his own money or property to an individual terrorist, it appears unlikely that they could be charged under sections 17 or 21. The MHA disagrees with this interpretation and has stated that any person found providing his own money or property for the purpose of terrorism would be held liable under section 21.

76. The mental element of the offence required by the international standards may also not be adequately covered. The standards require that the offence should extend to persons who collect funds (a) with the *intention* that they be used for terrorism, or (b) in the *knowledge* that they are to be used for terrorism. Knowledge is a lower mental element which is less onerous to prove than intention. It does not appear that the mental element of knowledge is adequately encompassed in the UAPA. Section 17 refers to persons who raise funds for the *purpose* of committing a terrorist act. This can be equated with the mental element of intention. Similarly, section 40 refers to persons who raise funds for a terrorist organisation with the intention of furthering the activity of the terrorist organisation. Section 21 does encompass the mental element of knowledge by 'whosoever knowingly holds any property...', and so it meets the requirements. The MHA argued that a person who knowingly committed any of the acts under sections 17 and 40 would be captured; however this cannot be clearly inferred from the legislation.

77. The international standards also require that terrorist financing offences capture funds that are intended to be used (a) to carry out a terrorist act, (b) by a terrorist organisation or (c) by an individual terrorist. The UAPA covers 'carrying out a terrorist act' through section 17. Funds destined for terrorist organisations are effectively covered by section 40. There may be a deficiency however, where funds are to be used by an individual terrorist. It is doubtful whether a person who collects funds to give to an individual that he knows is a terrorist, but not necessarily for the specific purpose of carrying out a terrorist act, could be charged under section 17 or section 21. The MHA argued that if a person collects funds and gives them to an individual who he knows is a terrorist then it will fall within the ambit of section 17, as a terrorist is one who indulges in acts of terror and any funds given to him are likely or meant to be used for committing a terrorist act.

78. The UAPA does not define the term 'fund'. The Terrorist Financing Convention has a broad definition of fund, and to be fully compliant with the Convention and SRII a country would need to classify 'funds' in a similarly broad manner. The MHA stated that the intention of the Government is that the term fund where it appears in the Act covers all the aspects of the definition in the Terrorist Financing Convention and that it would be read this way in practice. For the sake of certainty it may be useful for 'fund' to be defined in the Act in accordance with the Terrorist Financing Convention. The definition of 'property' in the UAPA has similarities with the Convention's definition of fund and could add to the argument that 'fund' would be read broadly when read in conjunction with the word 'property'.

79. There is no indication that the terrorist financing provisions in the UAPA require that funds were actually used to carry out a terrorist act or be linked to a specific terrorist act. This interpretation has been confirmed by the Indian Government.

80. Section 18 of the UAPA sets out the offences for conspiracy, attempt, abetting, advising, inciting or knowingly facilitating the commission of a terrorist act or any act preparatory to the commission of a terrorist act. The Indian Government has stated that terrorist financing would fall within an 'act preparatory to the commission of a terrorist act', and therefore attempted terrorist financing would be covered under section 18.

81. Terrorist financing offences are not currently predicate offences for money laundering under the PMLA⁵.

82. Section 1 of the UAPA extends the reach of the Act to any person who commits an offence beyond India which is punishable under the Act, citizens of India who are outside India, Indian Government officers wherever they are, and persons on Indian registered ships and aircrafts wherever they are. Section 15, which establishes the offence of a terrorist act, includes circumstances where a foreign country is threatened or terrorised. It is therefore not necessary for the person who committed the offence to be in the same country to the one in which the terrorist is located or the terrorist act occurred, for the Act to apply.

83. As noted previously, the *General Clauses Act 1897* defines 'person' to include legal persons and this definition extends to the UAPA. The MHA stated that where a legal person is penalised under the Act, the management of that entity will be held vicariously liable, and the property of the entity can be confiscated. Other laws such as the income tax law can also come into play if a company has misused its funds for terrorist purposes.

84. Penalties under the Act include imprisonment from five years to life plus a fine for section 17 offences, imprisonment up to life and a fine for section 21 offences and imprisonment up to fourteen years for section 40 offences. The level of fines has not been set in the legislation and is at the discretion of the court. Taking into account the penalties for other serious offences as discussed in Part 2.1 above, penalties can be seen to be effective, proportionate and dissuasive.

85. There have been no charges or prosecutions under the terrorist financing provisions of the UAPA as yet. The Government notes that this is because they are still relatively new provisions, having only come into force on 21 September 2004. There were a number of prosecutions and convictions under the terrorist financing provisions of POTA, some of which are ongoing. The Government provided the Evaluation Team with details of terrorist financing cases under POTA, which noted that there have been 26 prosecutions with two convictions. A number of the prosecutions are awaiting trial. As there have been no prosecutions under UAPA, it is not possible to assess the implementation of the UAPA at this time. The Government noted that the State governments have been requested to make use of terrorist financing provisions of the UAPA wherever necessary so that it serves as an effective deterrent to the people likely to finance terrorist activities.

2.2.2 RECOMMENDATIONS AND COMMENTS

86. There are a number of technical areas that could be improved under the UAPA to ensure that the terrorist financing provisions capture all forms of terrorist financing.

⁵ As noted above, the PMLA has been passed by the Parliament but is not yet in force

- The provisions should be broadened to fully cover provision of funds to individual terrorists and for terrorist acts in all circumstances.
- The offence of terrorist financing should apply to persons who provide or collect funds in the *knowledge* that they are to be used for terrorism, as well as those who have the intent that they be used for terrorism.
- The provisions should extend to persons who provide funds to individual terrorists, regardless of whether they know the funds will be used for a terrorist purpose or not.
- To ensure certainty the term ‘fund’ should be defined in the Act in accordance with the Terrorist Financing Convention.
- Terrorist financing offences should be included as predicate offences for money laundering in the Schedule to the PMLA.
- Penalties that apply directly to legal persons should be expanded, including criminal, civil and administrative penalties.
- India should focus resources on investigations and prosecutions under the Act to ensure there is an effective deterrent and method for dealing with people who finance terrorist activities.

2.2.3 COMPLIANCE WITH SPECIAL RECOMMENDATION II

	Rating	Summary of factors underlying rating
SR.II	Partially Compliant	<ul style="list-style-type: none"> • The UAPA does not cover all situations where funds are provided for terrorist activities. • Two of the offence provisions do not cover the mental element of ‘knowledge’ • The provisions do not capture all circumstances where persons provide funds to individual terrorists. • Penalties that apply to legal persons should be broadened. • The UAPA has not been effectively implemented as there have been no charges or prosecutions under the terrorist financing provisions to date.

2.3 CONFISCATION, FREEZING AND SEIZING OF PROCEEDS OF CRIME (R.3)

2.3.1 DESCRIPTION AND ANALYSIS

87. In India, provisions that authorise the confiscation, freezing and seizing of proceeds of crime are spread across a number of legislative instruments, depending on what crime the proceeds are derived from.

88. The *Unlawful Activities (Prevention Act) 1967* (UAPA) enables seizure and forfeiture of proceeds of terrorism. The *Narcotic Drugs and Psychotropic Substances Act 1985* (NDPS) allows confiscation of illegal property of persons under arrest or convicted of an offence punishable by 10 years or more under the Act or an order of detention under other listed drug Acts. Once the PMLA comes into force, property will be able to be seized and forfeited where persons have been charged with a scheduled (i.e. predicate) offence. Although the PMLA is not yet in force its provisions are discussed below.

89. Chapter V of the UAPA allows for confiscation of property that is proceeds of terrorist financing but it only covers instrumentalities used in, or intended for use in,

terrorist financing in limited circumstances. Section 24(2) states that 'proceeds of terrorism' can be forfeited. The definition of 'proceeds of terrorism' includes property which is being used or is intended to be used for the purpose of a terrorist organisation (i.e. an organisation listed under the Act) but does not cover property intended to be used by an individual terrorist. Section 25(5) also allows an investigating officer to seize any cash which is intended to be used for the purposes of terrorism, or forms part of the resources of a 'terrorist organisation' listed in the Schedule to the Act. Therefore instrumentalities of terrorist financing can be confiscated if they are to be used for the purpose of a terrorist organisation, and cash found during a search which is intended to be used for terrorism can be confiscated. Non-cash assets which are to be used by an individual terrorist may not be able to be confiscated. The Act does not allow property of corresponding value to be confiscated.

90. Chapter V-A of the NDPS Act allows for the confiscation of proceeds of drug offences under the Act, but only, at the minimum, where a warrant for the arrest of a person has been issued for an offence punishable with imprisonment for more than 10 years (or a similar offence of another country) (section 68A). It only applies to proceeds of drug offences and drug related money laundering, not to instrumentalities of an offence. Property of corresponding value cannot be confiscated, except in the limited circumstance where the authorities are satisfied that some properties are illegally acquired but are not able to identify them specifically, they can specify which ones are illegally acquired to the best of their ability (section 68I (2)).

91. Chapter III of the PMLA will provide for confiscation of laundered property, but only when there has been a conviction for a scheduled offence. Where it is suspected that a person is in possession of any proceeds of crime and he has been charged with a scheduled offence, and the proceeds of crime are likely to be laundered or dealt with to avoid confiscation, the property can be attached (restrained) for 90 days (section 5). An adjudicating authority must be notified within 30 days to confirm the confiscation. Property seized during a search and seizure under sections 17 and 18 can be confiscated without an attachment order. The adjudicating authority may notify the accused, hear any arguments why the property is not proceeds of crime, then determine whether it should continue to be restrained. If so, the property will be restrained during court proceedings for the scheduled offence and will be confiscated only once the person is convicted of the offence.

92. The PMLA provides for the confiscation of the proceeds of crime, but not of instrumentalities used or intended to be used in an offence. The Directorate of Enforcement confirmed that the PMLA does not allow for property of corresponding value to be confiscated, despite indications that it can in the definition of 'proceeds of crime' in section 2(u). The onus will be on the accused to prove that assets are not the proceeds of crime.

93. The UAPA allows for property derived directly or indirectly from the proceeds of terrorism to be confiscated, regardless of whether it is held by the terrorist or not, through section 24(2) and section 2(g).

94. Similarly the property that can be confiscated under the NDPS Act encompasses a very wide category including assets that are derived from illegal proceeds of crime (section 68B (h)). Property can be confiscated from the person charged with a drug offence, their relative or associate, or anyone who holds the property that was previously held by someone charged, unless they acquired it in good faith for adequate consideration (section 68A(2)).

95. Confiscation under the PMLA is defined more narrowly. Property derived directly or indirectly from proceeds of crime can be confiscated (section 2u). However property held or owned by a person not charged with a predicate offence person cannot be confiscated. Section 5 provides that property can only be attached from a person who is in possession of proceeds of crime where such person has been charged with having committed a scheduled offence, and such property is likely to be concealed, transferred or dealt with in any manner which may result in frustrating any proceedings relating to confiscation of the proceeds of crime. This requirement will create fundamental difficulties when trying to confiscate the proceeds of crime. Person A, who has committed a predicate offence, merely has to give the proceeds to person B, who was not involved in the predicate offence, and it cannot be confiscated. This is the case even if person B launders the money, as person B was not charged with the predicate offence. Person B cannot be convicted of money laundering and the proceeds cannot be confiscated. It is unclear why the confiscation provisions of the PMLA are more restrictive than the confiscation provisions in other Acts under Indian law.

96. All three Acts (the UAPA, NDPS Act and the PMLA) allow for the initial seizing or freezing of property to prevent dealing with property subject to confiscation. Section 25 of the UAPA allows investigating officers to seize property to prevent the property from being transferred or dealt with. Section 68F of the NDPS Act allows the freezing or seizing of property to prevent any dealings. Authorities can attach all the property of the accused if needed, and the onus is then on the accused to prove the property is not the proceeds of crime (section 68J).

97. The PMLA allows for attachment of property once a person has been charged with a predicate offence under section 5. Premises can also be searched and property can be seized where there is reason to believe that a person has committed money laundering or is in possession of proceeds of crime related to money laundering. In order to do so a predicate offence must already have been registered with a magistrate under section 17 and 18, however the person does not have to be charged with money laundering at that time. Property can be frozen or seized without prior notice under all three Acts.

98. Section 68E of the NDPS Act gives broad powers to officers to trace and identify property that could be proceeds of crime, including inquiries, investigations and surveys of any person, place, property or financial institution etc. Law enforcement agencies also have broad powers to trace and identify property through sections 11, and 16 to 18 of the PMLA.

99. All three Acts provide protection for the rights of bona fide third parties. Under the NDPS Act property can be confiscated from the person charged with a drug offence or their relative, associate or holder of property that was previously held by someone charged. Holders that are transferees in good faith for adequate consideration are protected under sections 68A (2) (f) and 68B (g) (A). Under the PMLA third parties that have an interest in the property attached have an opportunity to prove that the property is not involved in money laundering. In addition, persons who have a right to enjoy immovable property can still do this when property is attached (section 5(4)).

100. The UAPA and the NDPS Act allow for steps to be taken to void actions where property is transferred after a notice for attachment or forfeiture is issued. There is no specific authority under the PMLA to void actions such as contractual actions that are conducted to prevent authorities from being able to seize proceeds of crime. The aim of section 5(1) (c) is to freeze proceeds before they are transferred.

101. Additionally, the UAPA allows the property of organisations listed as terrorist organisations in the Schedule to the UAPA to be frozen under section 7 and confiscated through the usual confiscation provisions. This Act also allows for proceeds of terrorism to be attached and confiscated without a conviction (section 24(2)).

102. There have been no charges, prosecutions or convictions under the UAPA, and therefore no property has been frozen or confiscated under this Act. As the PMLA is not yet in force there have been no actions under this Act either. The effectiveness of the confiscation provisions under the UAPA and the PMLA therefore cannot be assessed at this time. There have been a number of confiscation actions under the NDPS Act. The NCB provided the Evaluation Team with some information regarding seizures and confiscations; however they were not complete figures. The table below contains the value of property frozen and forfeited under the NDPS Act in Indian Rupees (Rs.).

Table: Value of Property Forfeited and Frozen under the NDPS Act
Amount in Rs. (US\$ equivalent in brackets)

Value of Property	1998 (million)	1999 (million)	2000 (million)	2001 (million)	2002 (million)
Forfeited	23.85 (5.68)	6.16 (1.47)	13.24 (3.15)	1.63 (0.39)	23.64 (5.63)
Frozen	30.64 (7.30)	7.46 (1.70)	5.37 (1.28)	2.09 (0.50)	5.23 (1.24)

2.3.2 RECOMMENDATIONS AND COMMENTS

103. It is recommended that:

- The PMLA should be brought into force as soon as possible.
- The PMLA should allow proceeds of crime to be seized and confiscated regardless of whose possession they are in, in line with the provisions of the UAPA.
- The NDPS Act, the UAPA and the PMLA should all provide for the confiscation of property that is an instrument used in, or intended for use in, the commission of money laundering, terrorist financing or predicate offences.
- All three Acts (the NDPS Act, the UAPA and the PMLA) should allow confiscation of property of corresponding value where it is not possible to positively identify and seize the specific proceeds of crime.
- India could consider consolidating all seizing and confiscation provisions into one Act, to provide a simpler system and consistent treatment for all proceeds of crime.

2.3.3 COMPLIANCE WITH RECOMMENDATION 3

	Rating	Summary of factors underlying rating
R.3	Partially Compliant	<ul style="list-style-type: none"> • The PMLA is not yet in force • The UAPA and NDPS Act do not provide for instrumentalities used in, or intended for use in the commission of offences to be confiscated (except in terrorist financing cases in limited circumstances). • The UAPA and NDPS Act do not allow property of corresponding value to be confiscated. • There have been no confiscations under the UAPA and so implementation of this Act cannot be assessed.

2.4 FREEZING OF FUNDS USED FOR TERRORIST FINANCING (SR.III)

2.4.1 DESCRIPTION AND ANALYSIS

104. India has drafted *the Prevention and Suppression of Terrorism (Implementation of Security Council Resolutions) Order 2004* (the Order) pursuant to the *United Nations (Security Council) Act 1947* to enable the Government to freeze assets pursuant to UNSCRs 1267 and 1373. The Order provides the Central Government with broad powers to prevent and suppress terrorist acts falling within Security Council resolutions. It contains a schedule which lists all the persons the Order shall apply to. The Order is very brief and sets out general principles and powers rather than detailed procedures. It allows the Government to issue directions to authorities in such manner as it may consider necessary for the implementation of the Order (section 5).

105. It should be noted that “terrorist organisations” can also be listed under a separate process in the schedule to the UAPA, which allows for the freezing and confiscation of the assets of organisations listed under it, as discussed in part 2.2 above.

106. Various agencies are involved in the process to freeze terrorist assets pursuant to UNSCRs 1267 and 1373 and at the time of the on-site visit there was some confusion over the process among the agencies, which has since been clarified. The Ministry of External Affairs (MEA) receives the UN 1267 terrorist lists directly from the Indian mission in New York, and is responsible for distributing the lists to the relevant departments. The Department of Economic Affairs (DEA) is responsible for actions to freeze financial assets and they issue the necessary instructions for the freezing of bank accounts to the Reserve Bank of India (RBI). The RBI then issues instructions to the relevant banks and financial institutions. The Ministry of Home Affairs (MHA) conducts investigations to determine whether any of the listed persons holds non-financial assets.

107. The MEA stated that the UNSCR 1267 list is automatically incorporated into the scheduled list as soon as the Ministries are notified of the new names (regardless of whether the name does not yet appear on the scheduled list).

108. The MEA also stated that the initial freezing is an administrative process and does not need a court order, as the necessary Gazette notification has already been issued through the UN Security Council Act, however if assets were to be confiscated, a court order would be required under the confiscation provisions of the UAPA. For this to occur, the Crown would need to prove to the court that the property was proceeds of terrorism.

109. The agencies were not able to inform the Evaluation Team of the number of people currently listed. They were also not able to inform the Evaluation Team how many people India has asked other countries to list, but stated that this has occurred on a number of occasions. India maintains its own list pursuant to UNSCR 1373 and shares this with other countries. Both MHA and MEA noted that the Minister for External Affairs can list and has listed persons when another country requests India to list someone pursuant to 1373. A request for listing will first go to the MEA which will pass it on the MHA to investigate and determine whether the person should be listed.

110. The Central Government's powers under the Order are very broad and include freezing funds and other financial assets or economic resources held by or on behalf of people listed in the schedule (section 4(c)).

111. The Government maintains that India has an effective system for communicating actions to the financial sector; however in practice this system is not clear. Two separate agencies (MHA and DEA) informed the Evaluation Team that they are responsible for informing the RBI when a new person has been added to the lists. The RBI stated that once they are sent an updated list they issue a circular to the head office of all Indian banks requesting that they inform RBI if they have an account in any of the names. There is no automatic notification system for non-bank asset holders. Names on the list are publicly available in the Government Gazette only. DEA do not notify other institutions such as the Security and Exchange Board of India.

112. Regardless of the process, the speed and effectiveness of this system is questionable. The RBI's most recent circular to financial institutions with an updated list of names was dated May 2004; however the circular prior to that was dated 15 April 2002. The RBI stated that it is not necessary to issue a circular every time a new list is circulated as banks are aware of their responsibility in this regard; however it is not clear that banks independently check the UN listings on a regular basis.

113. The obligations on financial institutions and other asset holders in regard to listed persons are not set out in the Order. The RBI's circular of 15 April 2002 enclosed the list of designated entities and individuals and asked that banks report promptly to RBI if any transaction was detected involving any of those entities. There are no instructions to or obligations on non-bank asset holders to take action as a result of resolutions 1267 and 1373, however it is assumed that MHA orders these assets to be frozen if they are discovered in the course of an investigation

114. There is no publicly known procedure for considering delisting. If a person is inadvertently affected by the freezing procedure there is no stated process to apply to unfreeze the assets. MHA stated that the person could go to court and apply to have their assets unfrozen. While sections 25, 26 and 28 of the UAPA provide an opportunity for the affected person to seek appeal in Court for unfreezing blocked assets, it should be made clear through the process of "designation" what the procedures in place for listing and de-listing are and any subsequent action that can be taken with respect to designated parties' assets.

115. The MHA stated that there is no provision to access part of frozen funds for basic expenses. The person affected could get free legal aid from the court.

116. The MHA stated they have not found any cases of non-compliance within Indian banks, however there is no evidence that compliance checks are ever conducted. According to MHA the banks are fully compliant with the requirements under the Order and therefore there is no need to conduct compliance checks. This feeling is echoed by

the RBI. RBI stated that banks are well educated in their obligations under the Order as there have been similar requirements to freeze terrorist assets in previous Acts. The RBI circular to financial institutions is issued under section 35A of the Banking Regulation Act and is therefore enforceable by sanctions.

117. The Government indicated that there has only been one freezing action in response to UNSCR1267 - Ariana Afghan Airlines. Accounts in this name were frozen in 2001. The Government stated that they have not had any name matches with any individual on the 1267 list. The RBI stated that they had a match in name "once or twice" but it was a mistake and was cleared up. They were not able to provide the Evaluation Team with any further detail. It could be presumed that any country with a reasonably large population would find preliminary matches with names on the 1267 list on a reasonably regular basis. The low number of preliminary matches may be because the updated 1267 list is not being communicated regularly enough to banks, or that banks are not adequately checking listed names against transactions, or are not reporting matches to the authorities.

118. India has provided reports to the United Nations 1373 and 1267 committees detailing their asset freezing and other counter-terrorist systems. India's most recent report to the 1267 committee was on 10 June 2003 and to the 1373 committee was on 21 April 2003.

2.4.2 RECOMMENDATIONS AND COMMENTS

119. It is recommended that the authorities:

- Develop a clearer procedure pursuant to UNSCRs 1267 and 1373 in order to ensure certainty and provide individuals and asset holders with a clear understanding of their rights and obligations. Provisions could be similar in nature to the terrorist organisation provisions of the UAPA.
- Conduct outreach programs to educate banks and other asset holders of their obligations.
- Develop clear, publicly available procedures either in legislation or in guidelines to deal with delisting requests, unfreezing requests and authorisation for access to funds for basic expenses.
- Ensure that the updated list of designated persons under both UNSCR 1267 and India's own designations under UNSCR 1373 are forwarded immediately to all banks and are available to all asset holders to ensure that any asset of a listed person is frozen immediately.
- Consider conducting compliance monitoring of banks to ensure they are applying proper procedures when they are notified of new designations.

2.4.3 COMPLIANCE WITH SPECIAL RECOMMENDATION III

	Rating	Summary of factors underlying rating
SR.III	Partially Compliant	<ul style="list-style-type: none"> • India does not have effective procedures to immediately freeze terrorist funds or other assets pursuant to UNSCRs 1267 and 1373. • There are no effective and publicly known procedures for considering de-listing and unfreezing requests in a timely manner. • Affected persons do not have access to funds for basic expenses.

2.5 THE FINANCIAL INTELLIGENCE UNIT AND ITS FUNCTIONS (R.26, 30 & 32)

2.5.1 DESCRIPTION AND ANALYSIS

120. India has not established a Financial Intelligence Unit (FIU) through a specific piece of legislation, although the PMLA provides for the appointment of a Director and other staff to administer and enforce the PMLA. An FIU has been established under a Ministerial directive but it is not in operation. The Director of FIU has been appointed pursuant to the powers under section 49 of the PMLA, and is now overseeing the establishment of the FIU office including the recruitment and training of personnel, and the infrastructure needed to commence operations. A technical team is working on choosing the appropriate software for the FIU to receive and process reports and was expected to take 3 months from the time of the on-site visit to complete this task.

121. Under Chapter IV of the PMLA, banking companies, financial institutions and intermediaries are required to report transactions as prescribed in the Rules, which include cash and suspicious transactions. As noted previously, the implementing Rules are yet to have come into force (see also section 3.7 below). The PMLA provides that the Director is the designated authority to receive the cash and suspicious transaction reports under Chapter IV of the PMLA, and has the power to impose fines on the reporting parties for failure to comply with the prescribed reporting requirements. The FIU is empowered to receive, process, analyse and disseminate all cash and suspicious transaction reports. The authorities advise that the FIU is intended to eventually become a national information centre undertaking research and analysis into money laundering typologies.

122. A total of 43 positions are being created within the FIU, including the Director's position. The detailed organisational structure of the FIU is yet to be finalised. Staffing of FIU will include personnel from other regulatory and enforcement agencies such as the RBI, and the SEBI. The Evaluation Team was advised that staff with extensive experience in combating economic crime would be sought and appointment would be through a secondment process. This would ensure that staff would have already been vetted by their substantive organisations and would therefore be of the highest calibre. It is also planned to send appointed officers overseas to examine the operation of FIUs in other countries and to attend appropriate training courses.

123. The FIU is not intended to operate as an investigate unit. Its primary role will be to receive, process and analyse the cash and suspicious transactions reports and then forward these reports to the appropriate enforcement agency for action as required. Transactions that appear to be related to money laundering offences under the PMLA will

be passed to Directorate of Enforcement for investigation. Information on the predicate offences such as drug, corruption and other offences will be passed on to the appropriate enforcement agencies for investigation. However, the practical operations of the FIU are at this early stage unclear, and there are no reports or statistics available to measure its effectiveness.

124. Given the introduction of an electronic reporting system, the Evaluation Team considers that the staffing level for the FIU will be adequate, although without being able to measure the volume of reported transactions that may occur, the Government should be prepared to increase the staffing levels of the FIU to meet demand.

125. Suspicious transaction reports must be made only in relation to the proceeds of crime emanating from the listed predicate offences. This reporting obligation is imposed only on banking companies, financial institutions and intermediaries and there is no express provision to allow the FIU to obtain additional information from reporting parties (see also section 3.7 below).

2.5.2 RECOMMENDATIONS AND COMMENTS

126. It is recommended that in order to ensure that India's FIU is an efficient and effective national information centre, the authorities must ensure that the FIU:

- Should be expressly authorised under the legislation to obtain additional information from the reporting parties and to disseminate the information to appropriate authorities for investigation, both domestic and overseas.
- Provide adequate and relevant training in financial analysis and money laundering investigations to staff so that the reports could be efficiently and effectively processed.
- Should be able to secure extra funding and to expand its manpower as if required.
- Should establish a clear mechanism for the exchange of information with domestic law enforcement agencies and international agencies.
- Apply for membership in the Egmont Group.
- Work with the supervisors and regulators of the reporting institutions to prepare consistent guidelines to assist in the identification of suspicious and unusual transactions so as to reflect both domestic and international trends and typologies.
- Maintain comprehensive statistics on the currency and suspicious transaction reports. Statistics should include breakdown on the type of institution making the report, breakdown of STRs analysed and disseminated, number of domestic and international requests for assistance.

2.5.3 COMPLIANCE WITH RECOMMENDATIONS 26, 30 & 32

	Rating	Summary of factors relevant to s.2.5 underlying overall rating
R.26	Non Compliant	<ul style="list-style-type: none"> The FIU is not operational.
R.30	Partially Compliant	<ul style="list-style-type: none"> The FIU appears to be an independent unit with reasonable manpower and resources allocated. However, the FIU is not operational and there is no basis to assess its operational independence and autonomy as well as its functional effectiveness in various aspects.
R.32	Non Compliant	<ul style="list-style-type: none"> There is no basis to assess the efficacy of the FIU as it is yet to commence operations and therefore there are no statistics on cash and suspicious transaction reports.

2.6 LAW ENFORCEMENT, PROSECUTION AND OTHER COMPETENT AUTHORITIES – THE FRAMEWORK FOR THE INVESTIGATION AND PROSECUTION OF OFFENCES, AND FOR CONFISCATION AND FREEZING (R.27, 28, 30 & 32)

2.6.1 DESCRIPTION AND ANALYSIS

127. Money laundering is criminalised under Chapter II of the PMLA, however PMLA has not yet come into force. The prosecution of money laundering offences under PMLA is to be undertaken before a Special Court, while the seizure and confiscation of the proceeds of crime is to be dealt by an Adjudication Authority, also set up under PMLA. Confiscation of proceeds can only occur once a conviction is recorded. Under section 54, certain officers are empowered and required to assist the authorities in the enforcement of the PMLA, including Customs and Central Excise, NCB, income-tax authorities, police, the RBI and the SEBI. See the table below for a guide to the legislation and the enforcement agencies responsible for its administration.

128. Pending the notification in the Official Gazette, the Directorate of Enforcement within the Ministry of Finance will be the designated law enforcement unit to investigate and prosecute money laundering offences and to provisionally attach the proceeds of crime and seize incriminating materials. Investigation officers are empowered with the power of survey, search and seizure, search of persons and arrest if there is reason to believe that a money laundering offence has been committed. However, unlike expressly provided in Section 50A of the NDPS Act⁶, there is no provision in the PMLA to undertake controlled delivery.

129. The Directorate of Enforcement advises that it intends to reorganise its structure so as to assume the responsibility for investigation of money laundering offence and attachment of proceeds of crime in addition to its responsibilities administering the *Foreign Exchange Management Act* (FEMA). Currently, the Directorate of Enforcement has 800 officers posted to seven regional offices and nine sub-regional offices all over the country. It is also intended to empower certain officers in the State police to enforce the

⁶ “The Director General of Narcotics Control Bureau constituted under sub-section (3) of section 4 or any other officer authorized by him in this behalf, may, notwithstanding anything contained in this Act, undertake controlled delivery of any consignment to a) any destination in India; b) any foreign country, in consultation with the competent authority of such foreign country to which such consignment is delivered, in such manner as may be prescribed.”

PMLA as State police have the power to investigate most of the predicate offences. See discussion at paragraph 281 below.

130. In addition to the State police, the Narcotics Control Bureau (NCB) and the Central Bureau of Investigation (CBI) are the Union investigation units that deal with the predicate offences under the PMLA. Both the NCB and the CBI have officers posted to various regional offices in India. The NCB was established in 1986 as the Central Authority to coordinate the activities of the various central agencies and State police involved in drug law enforcement under the NDPS Act. The NDPS Act empowers officers with the powers of controlled delivery, arrest, search and seizure as well as freezing, seizure and forfeiture of property derived from or acquired through illicit trafficking of drug. Under section 8A of the NDPS Act, it is an offence for any person to convert, transfer, conceal, disguise, acquire or possess any property knowingly derived from an offence under the Act. The CBI was set up in 1941 and is the main investigating agency into corruption and bribery cases committed by public servants, which are predicate offences under the PMLA. The CBI also investigates serious economic crimes and special crimes as directed by the Government.

131. As noted previously, terrorist activities, including raising funds for terrorist acts and holding proceeds of terrorism, are not included in the schedule of the PMLA at the time of the on-site visit. These activities are criminal offences under the *Unlawful Activities (Prevention) Amendment Act 2004* (UAPA). Proceeds of terrorism can be forfeited by court order irrespective of whether any prosecution is made. Evidence gathering through telecommunication interception is admissible evidence under UAPA. The CBI, a special unit in the State police, and the armed services are the main agencies which combat terrorism (including terrorist financing). The Directorate of Enforcement is also responsible for investigations into terrorist financing where there is contravention of the FEMA. Under the FEMA provisions, seized currencies are to be confiscated after adjudication but the offenders only incur civil penalties.

132. India has strict controls on currency importation and exportation and has a declaration system in place. Any monetary instruments exceeding US\$10,000 or currency notes exceeding US\$5,000 are required to be declared at the time of entry into India. The Indian authorities advise that there have been cases where foreign and Indian currencies have been smuggled out of India through cash couriers and concealed in baggage and parcels. Some suggestions have been made that the Indian currency is being exported to fund terrorist activity along India's borders. Counterfeit US currency is also being smuggled into India.

133. Measures for combating cash couriers include random searches, X-ray screening and intelligence-led operations. Customs officers are empowered under Chapter XIII of the *Customs Act* to search passengers, baggage, parcels and to arrest, screen and x-ray bodies of suspected persons and to seize and confiscate the concerned currency and to prosecute offenders. Customs officers also have powers under FEMA with respect to the export, import or holding of currency or currency notes. The Directorate of Revenue Intelligence has a database maintaining information on smugglers, methods of concealment, travel routes and enforcement statistics. Intelligence is also shared with countries in the Asia/Pacific region through the Regional Intelligence Liaison Office (RILO).

134. Each enforcement agency maintains its own enforcement statistics. The National Crime Records Bureau (NCRB) maintains statistics on a national level reported by police and other central law enforcement agencies such as the CBI, NCB, Directorate of Enforcement and Customs and Excise. The NCRB collects, collates and analyses crime statistics in India and publishes 'Crime in India' report annually. The latest report

was published in June 2004 which covers the year 2002. With the operation of the PMLA, statistics on money laundering offences, investigations and prosecutions will be included.

135. The Indian authorities advised that each enforcement agency has its own training program to train its officers in the rudiments of specific areas of enforcement. Some of the enforcement agencies, such as police and CBI, have their own training academy. The Directorate of Enforcement advises that it organises two 5-day special training programs in March 2004 and February 2005 for its officers on money laundering investigation techniques, surveillance techniques, collection and analysis of evidence, Cyber Forensics and a total of 46 officers have attended the training.

136. The predicate offences listed under the PMLA do not cover economic crimes such as tax evasion and foreign exchange violation, crimes which are, according to the authorities, widespread in India. These offences are investigated by various enforcement agencies specialising in economic crimes, including the Directorate General of Revenue Intelligence, the Central Board of Direct Tax and the Central Board of Excise and Customs, which are responsible for enforcing revenue related laws such as tax evasion, over-invoicing, under-invoicing and smuggling activities. The Directorate of Enforcement is responsible for the investigation of contravention of foreign exchange violations under FEMA and the Serious Fraud Investigation Office is responsible for investigating complex and serious cases involving corporation and public funds.

Economic Crimes	Acts of Legislation	Enforcement Authorities
Tax Evasion	<i>Income Tax Act</i>	Central Board of Direct Taxes
Illicit trafficking in contraband goods	<i>Customs Act, 1962</i>	Commissioner of Customs
Evasion of Excise duty	<i>Central Excise Act, 1944</i>	Commissioner of Central Excise
Cultural Objects Theft	<i>Antiquity & Art Treasures Act, 1972</i>	Police/CBI
Money Laundering	<i>Foreign Exchange Management Act, 1999</i>	Directorate of Enforcement
Foreign contribution manipulations	<i>Foreign Contribution (Regulation) Act, 1976</i>	Police/CBI
Land Hijackings/Real Estate frauds	<i>IPC</i>	Police/CBI
Trade in Human Body parts	<i>Transplantation of Human Organs Act, 1994</i>	Police/CBI
Illicit Drug trafficking	<i>Narcotics Drugs and Psychotropic Substances Act, 1985 & NDPS Act, 1988</i>	NCB/Police/CBI
Fraudulent Bankruptcy	<i>Banking Regulation Act, 1949</i>	CBI
Corruption and Bribery of Public servants	<i>Prevention of Corruption Act, 1988</i>	State/Anti-Corruption Bureau/Vigilance Bureau/CBI
Bank Frauds	<i>IPC</i>	Police/CBI
Insurance Frauds	<i>IPC</i>	Police/CBI
Racketeering in Employment	<i>IPC</i>	Police/CBI
Illegal Foreign Trade	<i>Import and Export (Control) Act, 1947</i>	DGFT/CBI
Racketeering in False travel document	<i>Passport Act, 1920/IPC</i>	Police/CBI
Credit Cards Frauds	<i>IPC</i>	Police/CBI
Terrorist Activities	<i>POTA – 2002</i>	Police/CBI

Illicit Trafficking in Arms	<i>Arms Act, 1959</i>	Police/CBI
Illicit Trafficking in Explosives	<i>Explosives Act, 1884 & Explosives Substances Act, 1908</i>	Police/CBI
Theft of Intellectual Property	<i>Copyright Act, 1957/ (Amendments 1984 & 1994)</i>	Police/CBI
Computer Crime/Software piracy/Cyber Law	<i>Copyright Act, 1957/ I.T. Act, 2000</i>	Police/CBI
Stock Market Manipulations	<i>IPC SEBI Act / SCR Act</i>	Police/CBI /SEBI
Company Frauds (Contraband)	<i>Companies Act, 1956/IPC MRTP Act, 1968</i>	Police/CBI

2.6.2 RECOMMENDATIONS AND COMMENTS

137. It is recommended that the authorities:

- Maintain a central database of statistics to enable review of the efficacy of AML/CFT provisions and an understanding of typologies.
- Coordinate training for enforcement agencies in relation to specific AML/CFT techniques.

2.6.3 COMPLIANCE WITH RECOMMENDATION 27, 28, 30 & 32

	Rating	Summary of factors relevant to s.2.6 underlying overall rating
R.27	Partially Compliant	<ul style="list-style-type: none"> • Designated law enforcement authorities on money laundering investigations are yet to be established pending the PMLA coming into force.
R.28	Partially Compliant	<ul style="list-style-type: none"> • The powers under PMLA on survey, search and seizure is pending the PMLA to come into force.
R.30	Partially Compliant	<ul style="list-style-type: none"> • The adequacy of financial, human and technical resources in combating money laundering is uncertain pending the PMLA coming into force.
R.32	Non Compliant	<ul style="list-style-type: none"> • There are no centrally maintained statistics kept on money laundering investigations, prosecutions, convictions, attachments and confiscations.

3 PREVENTIVE MEASURES - FINANCIAL INSTITUTIONS

Customer Due Diligence & Record Keeping

3.1 RISK OF MONEY LAUNDERING OR TERRORIST FINANCING

138. The Indian authorities have not undertaken an AML/CFT risk assessment of the financial sector. While there are currently gaps in the application of AML/CFT requirements across the different parts of the sector, the authorities have not sought to implement a regime that consciously excludes particular types of business from the minimum requirements on the basis of a risk assessment. The general principle appears to be that the same minimum standard will be applied to all relevant financial institutions, as covered by the RBI, but the appropriate laws and regulations have yet to be rolled out in anything near a comprehensive fashion. An emphasis on risk-based procedures is a feature of the guidelines published by the Reserve Bank of India (RBI), but this is only in relation to enhanced due diligence requirements for high risk customers, rather than any discretionary derogation from the minimum identification requirements for "normal" risk customers.

3.2 CUSTOMER DUE DILIGENCE, INCLUDING ENHANCED OR REDUCED MEASURES (R.5 TO 8)

3.2.1 DESCRIPTION AND ANALYSIS

139. There is no unified set of customer due diligence (CDD) standards for the financial sector. Some form of customer identification requirements are applied to most of the key financial institutions, but these vary enormously in the detail of the obligations imposed, many of which, outside the banking sector, have not been introduced specifically to enforce AML/CFT controls. The following are the principal requirements imposed on the different institutions:

140. **Banks:** The RBI has undoubtedly been taking the lead in developing CDD measures for the institutions that it supervises. For a number of years (since approximately 1987) it has issued a succession of circulars to the banking industry introducing a progressively more developed list of requirements. The most recent of these (which supersedes all previous notices) was issued on 29 November 2004 under the title "Know-Your-Customer Guidelines: Anti-Money-Laundering Standards". The text of this document follows very closely that of the Basel Committee's paper on "Customer Due Diligence for Banks" and addresses very specifically all the essential criteria covered by FATF Recommendations 5-8, although there is some uncertainty about the expected treatment of non-face-to-face customers (Recommendation 8). In discussions with both the RBI and the commercial bank visited during the evaluation, the Evaluation Team was advised that it was not possible to open an account in India other than through physical attendance at a branch. However, the guidelines recognise the growing phenomenon of electronic and telephone banking, and provide for non-face-to-face account opening in line with FATF requirements.

141. While the November 2004 guidelines are comprehensive in their coverage, there are two issues that pose an obstacle to full compliance with Recommendations 5-8 with respect to the banking sector. First, it is not clear whether all the relevant principles listed are mandatory, since the words "must", "should" and "may" are used at various stages in a somewhat arbitrary manner. The RBI argues that, by well established precedent, all the provisions are mandatory, regardless of the precise terminology used; and this interpretation was supported by the commercial bank visited by the Team during the

evaluation. However, a strict application of the principle that "may" is deemed to be mandatory causes confusion, since this term is used not only in cases where one would expect there to be a firm requirement (e.g. enhanced due diligence for higher risk customers, and the appointment of a money laundering reporting officer), but also where the intention was clearly to provide a degree of discretion (e.g. when listing a range of examples that banks might consider for inclusion within a particular category of client). In addition, there is some scope for confusion in the descriptive terms used in the title of the guidelines. The main body of the instructions are termed "guidelines", but these are accompanied by an attachment, listing specific customer identification procedures, that is entitled "indicative guidelines". If there is no distinction in the perceived enforceability of the respective documents, the question remains as to why the different terminology is used. The RBI has stated that the indicative guidelines are intended to offer the banks some latitude in satisfying the identification procedures without the need to refer to the regulator on specific issues. This is a perfectly reasonable approach, but if the word "may" in this context is intended to be discretionary, its use elsewhere as a mandatory concept serves only to underline the scope for confusion. It is essential that there be absolute clarity as to the obligation being imposed on the banks if effective enforcement is to be possible.

142. The second obstacle to full compliance with FATF standards relates to the general status of the circular. The guidelines have been issued under section 35A of the *Banking Regulation Act*, which empowers the RBI to give directions, generally or specifically, "in the interest of banking policy" and to modify or cancel those directions as it thinks fit. Penalties for non-compliance may be levied under section 47A of the same Act. However, such directions do not meet the definition of "law or regulation" required under FATF principles to implement the core elements of Recommendation 5 (i.e. those items marked with an asterisk in the Assessment Methodology), since they have not been directly issued or authorised by a legislative body. Therefore, it is important that the core elements be incorporated within the Rules issued directly under the PMLA (see discussion on "Implications of the PMLA" below).

143. The RBI circular envisages a two-phase implementation process of its requirements. By end-February 2005 (i.e. three months after the issue of the circular) all banks were supposed to have adopted a "proper policy framework" for AML, approved by the board of directors. Thereafter, they have until end-2005 to achieve full compliance with the provisions of the circular. The RBI confirmed that the initial target had not been met by a number of banks, but that it was not taking measures to enforce immediate compliance, since the Indian Bankers Association, in co-operation with the RBI, was engaged in preparing a model procedures manual that would capture the requirements of the circular. At the time of the Team's visit, this manual was nearing completion and was expected to be widely adopted within the banking sector. Since enforcement of the new standards is not provided for until end-2005, the basis for the CDD practices in many institutions may remain based on the previous RBI guidelines, issued in August 2002, although, technically under the terms of the November 2004 circular, all the previous CDD requirements cease to have effect from the date of implementation by the banks of their broad policy framework (required, in principle, by end-February 2005). These earlier guidelines are significantly less detailed and do not address the majority of the principles contained within Recommendations 5-8.

144. **Securities business:** The Securities and Exchange Board of India (SEBI) has imposed a number of customer identification requirements over the years on institutions that fall within its regulatory scope (primarily the stock exchanges, broker-dealers, portfolio managers, investment advisers and securities depositories). These are contained in a series of circulars addressed either to the exchanges or to individual sectors of the industry, in which the instructions range from the basic need to maintain a

customer database (circular of 11 February 1997) through to detailed formats for a client account opening form (circular of 11 April 1997) and proof of identity for opening a beneficial owner account with a depository (circular of 24 August 2004). However, while some of these measures address the fundamentals of customer identification procedures, they were promulgated in the context of seeking to preserve market integrity and prevent market manipulation, and no specific instructions have been issued in the context of AML. The National Stock Exchange, a self-regulatory organisation under the supervisory umbrella of the SEBI, confirmed that there is no direct reference to the notion of AML in its current rule book for members, which is broadly similar to that of all the exchanges.

145. In some cases, market integrity requirements have direct application to an AML objective. This is the case with the April 1997 requirements of the broker-client registration form, which includes both basic identification data and some more detailed due diligence elements relating to financial resources; and with the August 2000 instruction to depositories to verify the identity of the beneficial owners of accounts. Both these sets of requirements were issued in the form of SEBI circulars, which have similar enforceability to those of the RBI; but the obligations do not have nearly the scope necessary for compliance with the detailed criteria of Recommendation 5 (especially in relation to the high risk and enhanced due diligence provisions), and do not touch at all upon issues within Recommendations 6-8.

146. **Non-bank financial institutions (including insurance companies):** Since November 2004, the RBI has, at different dates, issued a circular to each of the other specialist banking sectors that it regulates for prudential purposes (specifically, the urban, state and district co-operative banks and the regional rural banks). This circular contains a cover letter, attaching the guidelines issued to the mainstream banking sector, and instructing the institutions to follow the same procedures insofar as they are relevant. The same requirements as for the commercial banks are stipulated in relation to the formulation of a board-approved policy within three months, and implementation of the overall instructions by end-2005.

147. The same circular was issued to the non-bank financial companies on 21 February 2005. Under section 45-I of the *Reserve Bank of India Act* such companies are defined to include those undertaking a range of activities including lending, hire-purchase, the acquisition of government stock, certain categories of investment schemes and insurance business. However, the authorities have indicated that, since legislation was enacted in 1999 to create the Insurance Regulatory and Development Authority (IRDA) with a mandate to regulate the insurance sector (although section 45-I was never amended), the RBI has formally exempted the insurance sector from its supervisory oversight in order to avoid dual regulation. Therefore, the circular of 21 February 2005 does not apply to insurance companies. Discussions with the IRDA indicated that there were currently no specific AML obligations imposed on, or planned for, the insurance sector, although there were some basic customer identification, fraud prevention and anti-tax evasion requirements in place. For example, payment for any premium in excess of Rs.50,000 (US\$1,250) must be paid by cheque or similar banking instrument.

148. **Exchange houses and money remitters:** These entities (excluding *hawala* dealers on which there is a discussion later in the report) are regulated by the RBI under the *Foreign Exchange Management Act* (FEMA). The extent of the CDD requirements currently imposed on these sectors is limited to preventing abuse of FEMA and potential tax evasion, and not specifically directed towards AML (except insofar as the activities are undertaken by banks that are covered by the RBI circulars described above). This limited scope is captured in section 10(5) of FEMA, which requires that "an authorised person shall, before undertaking any transaction in foreign exchange on behalf of any person, require that person to make such declaration and give such information as will

reasonable satisfy him that the transaction will not involve, and is not designed for the purpose of any contravention or evasion of the provisions of this Act.....". RBI guidelines require authorised businesses to obtain basic customer identification data for all transactions undertaken. Cash transactions in excess of Rs.20,000 (approximately US\$500) require customers (if Indian residents) to disclose their personal tax reference number, while any transaction in excess of Rs.50,000 (US\$1,250) may only be executed (purchase or sale) through a banking instrument.

149. **Implications of the PMLA:** The provisions of Chapter IV of the PMLA apply to "banking companies, financial institutions and intermediaries". Through cross-reference to the definitions of the RBI, SEBI and Banking Acts, these terms are defined under section 2 of the Act to embrace all entities that are regulated for prudential purposes by the RBI and SEBI, but also capture insurance companies within the definition of "non-bank financial companies" referenced above, since the exemption given to this sector by the RBI is administrative and does not affect the legal definition. The definition of covered institutions within the PMLA does not extend to foreign exchange houses and money remitters, both of which are on the FATF's list of financial institutions that are required to be subject to the full range of CDD standards.

150. Chapter IV of the PMLA is very brief, containing only four short sections, two of which (on record-keeping and reporting to the FIU) provide for further elaboration through measures that may be prescribed at a later date. Such measures are being introduced under section 73 of the Act, which provides the Central Government with rule-making powers. The structure of these rules is such that they qualify for consideration as "law or regulation" and, therefore, would be a suitable medium for the introduction of the core (asterisked) elements of Recommendation 5. This is based on the fact that, under section 74, the rules must be laid before both houses of parliament for a total period of thirty days to permit parliament either to modify or annul individual rules. In the following discussion it should be noted that, in issuing Rules under the PMLA, the authorities have adopted the practice of promulgating a series of individual "notifications", each of which addresses a particular topic and includes its own short title, date of commencement and set of definitions. As at the date of this report, no Rules had been issued, but the Team reviewed a set of draft Rules, which, it was informed, were intended to be promulgated in the near future⁷. Only two of these relate to CDD measures: one on the maintenance of transactions records, the other on the verification of customer identity.

151. Section 12(1) (c) of the PMLA imposes an obligation on all covered institutions to verify and maintain the records of the identity of all its clients, in such manner as may be prescribed. The corresponding rule (Verification and Maintenance of the Records of Identity of the Clients of Banking Companies, Financial Institutions and Intermediaries), to be issued under section 73 of the Act, requires every such institution, at the time of opening an account or executing any transaction, to verify the identity, address, nature of business and financial status of the client. The rule then stipulates the types of identification documentation that are relevant for different categories of customer (personal, corporate, partnership, trust, unincorporated association), but does not extend to addressing a range of key issues, specifically: an outright prohibition of anonymous accounts; verification of beneficial ownership; enhanced due diligence for high risk customers; ongoing due diligence for all customers; the need to establish the intended purpose of the business relationship; the specific measures for politically exposed persons, correspondent banking and non-face-to-face business; and the actions required

⁷ The draft rules have been reviewed and analysed in order to offer guidance to the authorities on their scope and relevance to the FATF Recommendations, but no account has been taken in the ratings since implementation did not take place prior to the finalisation of the report.

when CDD cannot be performed adequately or is subsequently thought to be incorrect. The absence of any reference to these features means that, even after the introduction of the Rules, only the institutions subject to prudential supervision by the RBI will be required, under the RBI guidelines, to take relevant measures to address a number of key FATF concerns, especially in relation to higher-risk customers and transactions. This would also imply that for any additional requirements, as indicated above, the substantive RBI guidelines only become fully enforceable at end of 2005, although some institutions are known to have implemented some or all of them already.

152. The authorities argue that compliance with the requirement (under section 3(7) of the draft rule on the customer verification) for institutions to implement a client identification programme would necessitate adoption of the RBI guidelines, which would have the effect of converting the guidelines into Rules. This might be the case if specific reference were made to the guidelines in the rule, but the current text simply states that the programme should "incorporate the requirements of the foregoing sub-rules of this rule, and such other additional requirements that it [the institution] considers appropriate to enable it to determine the true identity of its clients". At present, the only authority given to the RBI under this rule is to prescribe the manner in which records should be maintained, and, moreover, the RBI's guidelines are only applicable to institutions for which it has supervisory responsibility.

153. On the issue of beneficial ownership, the draft rule on customer verification requires an institution to implement a client identification programme incorporating the specific requirements "and any other additional requirements that it considers appropriate to enable it to determine the true identity of its clients". Since a "client" is defined to include someone on whose behalf the transaction is being conducted, it might be implied that this extends to beneficial ownership. However, the specific documentation mandated for different categories of client does not direct institutions to investigate beneficial ownership of corporate or other similar entities, as there is no obligation even to establish the identity of immediate shareholders. Further, this would dictate that the requirements as formulated through such a programme would neither be treated as mandatory nor enforceable under the law, given the discretionary nature in which this provision is stated. The Indian authorities suggest that whenever banks and financial institutions include the procedures specified in the RBI Guidelines in their client identification programme, such programmes will automatically be part of the PMLA Rules. It is difficult to see the basis for this, in view of the absence of any reference to the RBI guidelines in this rule, and the broad discretion given to the institutions as to what they might include within the programme.

154. The need to establish clearly the beneficial ownership of funds is particularly important in an environment where concealed ownership has been a cultural feature in the past, leading to the enactment in 1988 of the *Benami Transactions (Prohibition) Act*. Benami transactions are transactions conducted in the name of a person who does not pay any consideration for the asset, but merely lends his name while the real title remains vested in the true owner. The 1988 Act sought to prohibit such transactions (essentially by removing the ability of both parties to claim title to the asset), but it appears that the legislation has not yet been brought into force in its entirety, although there was some disagreement among the authorities on the exact status of the Act. The Evaluation Team was informed that the introduction of more rigorous identification requirements under tax legislation has helped reduce this practice, but it clearly remains a material risk.

155. The draft PMLA rule on customer verification requires that the client's identity must be established at the time of opening the account or executing the transaction, but provides that, if this is not possible, identification may be completed "within a reasonable time" after the account has been opened, or the transaction has been executed. This

offers a significant loophole in the basic rule, since there is no reference either to the limited circumstances in which verification may be delayed, to the conditions under which an account may be operated pending verification (although it would seem that immediate transactions would be executed without this verification), or to what actions an institution should take in the event that it cannot complete the verification successfully. Furthermore, it would appear that the definition of “reasonable” is determined by the institution itself, and does not make explicit an institution’s obligations under the law.

156. The draft PMLA Rules give rise to some confusion over the definition of "transaction", which helps determine the circumstances under which CDD will be required. The specific rule relating to customer identification states that it applies to "any transaction", but neither the Act nor the rule itself contains a definition of the term "transaction". However, a related rule, which governs record-keeping under section 12(1) (a) of the PMLA, does define the term, but in a manner that links it back directly to the undefined term in the Act (i.e. the definition becomes circular). The objective of using the term in this particular rule is to limit the obligations to those transactions in cash exceeding Rs.1mn (US\$23,000); those involving counterfeit currency; and any suspicious transactions, as defined. Therefore, there may be some confusion over whether the same definition applies to the rule governing customer identification, and whether institutions are expected to go through the identification process for all transactions or only those that are covered by section 12(1)(a). Although section 12(1)(c) states that an institution must "verify and maintain the record of identity of all its clients", the term "client" is defined only in the draft rules, and is done so on the basis of a person who engages in a transaction or activity, thus continuing the circularity of definitions. Clarity on this matter is essential to ensure even basic CDD requirements within the Rules. The Indian authorities have stated that the term “transaction” will be specifically defined in the revised draft Rules under Section 12(1) (a), (b) and (c) of the PMLA.

157. It appears to be the intention that the RBI guidelines and the PMLA Rules will sit side-by-side once the latter are implemented, although, the PMLA Rules are considered subordinate legislation, while the Guidelines put forth by the RBI are considered administrative executive instructions, and therefore can not take precedence over the Rules. It is important not only that the core issues are incorporated within the higher level Rules, but that there should be no discrepancy or confusion between the two sets of principles, such that financial institutions might be left in doubt about their actual obligation. If it can be made clear to the covered institutions that the Rules in fact supersede other guidance, financial institutions will have a much clearer understanding of their obligations under the law – better yet, the Rules and the Guidance should not differ. At present this is not the case, since there are variations in both the general coverage of the two sets of regulations and the very specific documentation that is prescribed for account opening purposes. In addition, section 71 of the PMLA indicates that the provisions of this Act override all other provisions currently in force under other legislation, notwithstanding any inconsistencies. The Evaluation Team understands that it is the intention to have the PMLA Rules take precedence over the RBI guidelines, but there remains scope for misunderstanding by institutions of their obligations as prescribed.

158. As both the RBI guidelines and the PMLA Rules are administrative instructions, they will clearly be secondary to the rules. However, given the relative advantage, in terms of efficiency and flexibility, of having the detailed provisions promulgated under administrative procedures, rather than the rules that need to be laid before parliament, it may be preferable to include a clause requiring covered institutions to comply with relevant guidelines issued by their respective regulatory agencies. In this case, all such guidelines (to be prepared by all the relevant regulators, not simply the RBI) would need to be issued with specific reference to the rules.

159. As the RBI guidelines are not fully enforceable until end-2005 and the PMLA rules were not in place at the time of finalisation of this report, there is no basis upon which to judge the effectiveness of implementation at this stage.

3.2.2 RECOMMENDATIONS AND COMMENTS

160. It is recommended that steps be taken to rationalise the obligation imposed on the banking sector, to ensure consistent application of the AML requirements across the entire financial sector, and to prevent possible misinterpretation of obligations by the sector. The following actions will help to achieve this:

- Amend the PMLA to extend the financial sector obligations to the exchange houses and money remitters.
- Consolidate the core elements of the CDD regime within the PMLA Rules and amend legislation such that the ambit of the Rules extends to all financial institutions, including exchange houses and money remitters. Particular note should be taken of those elements of Recommendation 5 that must be implemented by law or regulation, rather than regulatory guideline. Alternatively, consider giving the regulatory guidelines the force of rules by requiring compliance with them as a component of the rules themselves..
- Consider issuing a composite set of PMLA Rules that contains (to the extent possible) a single set of definitions applicable to all the individual Rules.
- Where there may be differing definitions, these should be remedied to create consistency in interpretation with regard to guidance provided by the RBI or provisions under the PMLA.
- Clarify the definition of "transaction" in relation to the rule on customer identification procedures, to determine whether it has a wider meaning than that attributed to it in the rule on records retention.
- Provide for more detailed, sector-specific AML guidelines to be issued by all the relevant regulatory authorities, ensuring that such guidelines are consistent with the PMLA Rules (where appropriate), are cross-referenced to the Rules, and impose equivalent obligations upon all institutions, while recognising relevant sectoral differences. Such guidelines should be drawn substantially from the model developed by the RBI, and should extend also to those financial institutions that are not subject to prudential supervision (specifically exchange houses and money remitters).
- Clarify the terminology used in the RBI guidelines to ensure consistent language to reflect those elements that are either mandatory or discretionary.
- Amend the draft rule on customer verification to define more tightly the timeframe within which a customer must be identified in circumstance where it is not immediately possible, and to specify what actions must be taken in the event that verification turns out not to be possible.

3.2.3 COMPLIANCE WITH RECOMMENDATIONS 5 TO 8

	Rating	Summary of factors underlying rating
R.5	Partially Compliant	<ul style="list-style-type: none"> • The Rules to bring the PMLA into force have not been promulgated (but the immediate introduction of the current draft Rules would not affect the rating due to the issues below). • The PMLA does not cover exchange houses and money remitters. • Although the core elements of Recommendation 5 are contained within the RBI guidelines, they have not been implemented through a mechanism that meets the definition of "law or regulation". • There are no detailed CDD rules or guidelines applied to the securities, insurance, foreign exchange and money remittance sectors. Further, there is a particularly low level of awareness of AML/CFT issues in the insurance sector. • Full compliance with the RBI's CDD guidelines for banks is not required until end-2005.
R.6	Partially Compliant	<ul style="list-style-type: none"> • Only the banks have been instructed to take special measures in respect of PEPs, and full compliance is not required until end-2005.
R.7	Largely Compliant	<ul style="list-style-type: none"> • Appropriate instructions have been issued to the banks, but full compliance with the RBI guideline is not required until end-2005.
R.8	Partially Compliant	<ul style="list-style-type: none"> • Specific instructions on non-face-to-face customers have only been issued to the banks, and nothing similar exists for other institutions.

3.3 THIRD PARTIES AND INTRODUCED BUSINESS (R.9)

3.3.1 DESCRIPTION AND ANALYSIS

161. There is some uncertainty about whether introduced business is permitted under the RBI guidelines. The commercial bank, with which the Evaluation Team met, stated that such introductions were not permitted, even where the introducer was a company within the same group. This belief was based on the fact that the guidelines clearly impose a responsibility upon the banks directly to obtain sufficient information to satisfy themselves about the identity of their customers. However, the guidelines do make reference to possible reliance on CDD undertaken by a professional intermediary, subject to the intermediary being regulated and having adequate AML systems and controls, but this reference is in the specific context of client accounts opened by intermediaries, and may not provide wider discretion to rely on third-party introducers. Clarification of this issue will be important.

162. The draft PMLA Rules do not address the issue of introduced business, although they impose a standard requirement on all covered institutions to "verify and maintain the record of identity and current address or addresses of the client, the nature of the

business of the client and his financial status". This direct obligation may be taken to exclude the possibility of reliance on a third-party introducer. There appear to be no relevant statements on this issue by the other regulatory authorities to help clarify the obligations for financial institutions.

3.3.2 RECOMMENDATIONS AND COMMENTS

163. The authorities should clarify the position on introduced business within the PMLA Rules and/or the RBI guidelines, either by stating overtly that third-party introductions are not permitted, or by defining the terms under which they are possible, in line with the conditions of Recommendation 9.

3.3.3 COMPLIANCE WITH RECOMMENDATION 9

	Rating	Summary of factors underlying rating
R.9	Largely Compliant	<ul style="list-style-type: none"> There is a lack of clarity on whether third-party introductions are permitted, but it is possible that reliance on third-party introductions may not be permitted under current requirements.

3.4 FINANCIAL INSTITUTION SECRECY OR CONFIDENTIALITY (R.4)

3.4.1 DESCRIPTION AND ANALYSIS

164. The rules as stipulated by the *Reserve Bank of India Act* state that banks, financial institutions and intermediaries are not allowed to disclose confidential information unless as stated by the RBI specifically. They must comply with disclosure requests by the RBI that include information such as "the persons to whom, and the purposes and periods for which, finance is provided." This rule provides the RBI with the authority to call for information from bank and non-bank financial institutions and to give directions to the same. The RBI may also, at any time direct that every non-banking institution furnish to the Bank, in a manner and form it prescribes, those statements and other information or particulars relating to or connected with deposits that it holds. This includes those disclosures that have been determined to be in the public interest and in accordance with the law. Additionally, the PMLA states that the Central Government may prescribe the procedure and the manner of sharing information to the appropriate authorities, and that banking companies, financial institutions, intermediaries and their officers shall not be liable to any civil proceedings against them for furnishing this information. This, of course, is pending the full coming into force of the PMLA and the formal issuance of the requisite implementing Rules.

165. Discussions with the RBI and the commercial banking sector revealed that this information was also available for sharing across departments, and where necessary for international cooperation purposes. The Serious Frauds Investigation Office (SFIO) is an office newly created by Executive Order to investigate financial crimes cases. For purposes of investigation, SFIO indicated that they too were given full authorities to call and access information from the relevant financial institutions, and are authorised to utilize the established mutual legal assistance treaties to share information with their international counterparts. They utilise both established mutual legal assistance treaties and other enhanced bilateral relationships.

166. Similarly, under the SEBI Act, the SEBI is authorised to call for any information from any of its stock exchanges, mutual funds, and other persons associated with securities market intermediaries and self-regulatory organisations. Additionally, they are able to access any information of publicly listed companies and share this information for financial investigation purposes.

167. Authorised money service businesses and exchange dealers are covered by similar disclosure requirements under section 11(2) of the FEMA empowers the RBI to direct any authorised person to furnish such information as the RBI deems fit.

3.4.2 RECOMMENDATIONS AND COMMENTS

168. While financial institution secrecy laws do not appear to inhibit the disclosure to and sharing of requisite information with the competent authorities, the regulations as stipulated by the PMLA are technically not in force at this time, and thus the provisions discussed above that are specific to AML/CFT requirements would not apply until and unless the law was formally brought into force, and the implementing Rules were also passed. This would affect the disclosure of information contained in certain reports provided by financial institutions such as large transaction reports and suspicious transaction reports. Furthermore, in terms of implementation, the RBI, SEBI and other regulators commented that there have not been any problems with accessing necessary records from the institutions they oversee, but there were no statistics available to show that secrecy laws were not in fact inhibitory to access by the regulators.

3.4.3 COMPLIANCE WITH RECOMMENDATION 4

	Rating	Summary of factors underlying rating
R.4	Compliant	

3.5 RECORD KEEPING AND WIRE TRANSFER RULES (R.10 & SR.VII)

3.5.1 DESCRIPTION AND ANALYSIS

169. Financial institutions covered under the *Banking Regulation Act 1949*, are obligated to prepare and maintain documentation on their customer relationships as well as transactions as specified by the RBI through directions they are authorised to deliver to the sector as they see fit. According to the *AML-KYC and cash transactions* directions issued in 2002, financial institutions were obligated to retain all financial transactions records for at least five years after the transaction had taken place and these transactions were supposed to be available for perusal and scrutiny of audit functionaries as well as regulators as and when required. The new *AML-KYC Guidelines* issued in 2004 stipulated that banks should “ensure that a record of transactions in the accounts is preserved and maintained as required in terms of section 12 of the PMLA, 2002.” Under these provisions, banks should ensure that its branches maintain proper records of all cash transactions (deposits and withdrawals) of Rs.1 million (US\$23,000) and above, series of cash transactions integrally connected to each other which together exceed the Rs.1 million threshold but having taken place within a month, all cash transactions where forged or counterfeit currency notes have been used, and suspicious transactions as stipulated by the implementing Rules.

170. The list of transactions covered under this provision is extensive, but may not in fact be comprehensive. Thus, while banks are, on the one hand, obligated to maintain records of all transactions under certain provisions for five years (even after termination of

the relationship), the PMLA Rules stipulate 10 years for only certain listed transactions. This can potentially cause confusion for financial institutions themselves with regard to their obligations, and/or create heavy burdens as per the determination they must make to what transactions are covered. It is noted that, as the Rules under the PMLA take precedence over the Guidelines stipulated by the RBI; from the standpoint of implementation, it is imperative that covered institutions understand that their obligations across different legislation are consistent. Any transaction effected through these institutions must be able to be reconstructed.

171. The RBI also stipulates that the maintenance of records on customer data be done in accordance with the PMLA's implementing Rules. Maintenance by every banking company or financial institution or intermediary of the identity of its clients must be done in both hard and soft copies as prescribed by the RBI, and for 10 years from the date of cessation of the transactions between the client and the institution. Records of transactions as illustrated above must be made available to the competent authority (FIU) pursuant to the PMLA and its implementing Rules, although the Act does not specifically make explicit the furnishing of customer identification data to the competent authority (only the verification and maintenance of such records).

172. The Securities and Exchange Board of India (SEBI) has implemented similar provisions for record keeping of transactions and customer identification data. Records of all transactions and customer identification data must be kept for five years by all trading members, and seven years after a client has terminated their account. However, the securities sector also relies on the guidelines set forth by the RBI insofar as record maintenance and reporting is concerned. This affects both domestic and international participants. However, although international participants are registered under SEBI provisions, their KYC/CDD Guidelines are stipulated within the regulatory domain in which they are domiciled. All securities transactions have accompanying bank transactions and therefore are supposed to be captured by the agent carrying out the transaction as well as the banks in which the transaction is being facilitated. Similar to banking institutions, the implementing Rules specify that transaction data be made available. The Rules under the PMLA only specify that this information, and not necessarily customer identification data be made available to the regulator or specified competent authority.

173. Money Service Businesses and Foreign Exchange Dealers must be licensed by the RBI and are governed by the Foreign Exchange Management Act, although they are not covered by the *Banking Regulation Act*. Thus, the Rules that govern the keeping of transaction and customer identification records fall within the purview of the RBI Guidelines mentioned above. However, several money exchange dealers, such as Thomas Cook and Travelex, reported that their obligations as they understood them were that they must maintain all transaction and customer identification data for eight years (ten years for tax purposes) and in fact send all sales transactions data to the RBI every fourteen days. Those institutions registered as authorised money changers (AMC) – authorised to conduct currency exchange only – were obligated to report all sales transactions once a month.

174. The Insurance Sector is governed by the Insurance Regulatory and Development Authority (Insurance Brokers) Regulations of 2002 which stipulate that all books of account, statements, documents, etc. should be maintained at the head office of the insurance broker or such other branch office as may be designated by him or her and notified to the Authority, and shall be available on all working days to such officers of the authority, authorised in this behalf by it for an inspection. All of these books are to be retained by the insurance broker for a period of at least ten years from the end of the year to which they relate. FATF requirements for customer identification and transaction

reporting are not applied, but the IRDA believes the legislative obligations on Insurers are comprehensive enough.

175. With respect to SRVII there are no specific obligations in relation to customer identification and the inclusion of identifier information on outgoing wire transfers. Such transfers are captured within the general definition of a transaction within the PMLA Rules, and are required to be treated accordingly. Under the Rules this means that the identity and address of the client must be obtained in line with other types of transaction, irrespective of whether the transfer is being made on behalf of either an established or an occasional customer. There is no requirement to attach specific information to the transfer. Under the Rules the explicit obligation to maintain the customer identification data is limited to cash transactions and those considered to be suspicious, as defined (see discussion under section 3.7.1 below). However, the Rules also impose an obligation on covered institutions to maintain a record of customer identifiers for a period of at least "ten years from the date of cessation of the transactions". The general nature of this latter requirement would appear to override the specifics of the cash and STR record retention provisions, implying that customer identifiers for any wire transfer should be retained for at least ten years.

176. The RBI guidelines issued in August 2002 require that "wire transfer transactions, the records of electronic payments and messages must be treated in the same way as other entries in the account" and mandates a retention period of five years. However, the subsequent set of guidelines issued in November 2004, which supersede the 2002 set, is silent on wire transfers, and cross-refers to the PMLA Rules in relation to general record-keeping.

3.5.2 RECOMMENDATIONS AND COMMENTS

5. While the criteria for Recommendation 10 are largely met insofar as the retention of the requisite information (customer identification and transaction data) is concerned, the requirements vary between sectors, between the legislation applicable to those sectors and the Rules as promulgated by the PMLA. It should be noted that the Rules under the PMLA list specific transactions that are covered under these obligations that narrow the scope regarding record keeping and thus provide some confusion as to the obligations that financial institutions, banks and non-banks, have to their respective regulator. In terms of their obligations under the specific money laundering provisions, the PMLA would necessarily need to be fully in force to have any obligatory affect – both for the retention of records as well as ensuring they are made available to the competent authorities. The authorities should:

- Introduce a consistent requirement between sectors governed by the PMLA and RBI Guidelines for customer identification and transaction record keeping.
- Ensure that there are consistent record-keeping requirements under PMLA for the securities sector in keeping with obligations as specified by the SEBI.
- Ensure that the Insurance Industry is fully obligated under the PMLA to the requirements under Recommendation 10.
- Ensure that money service businesses and exchange dealers are also required to maintain the necessary records under the PMLA.

177. While the basic customer identification and record-retention requirements appear to be met, a number of additional measures will need to be implemented for compliance with SRVII. Specifically the authorities should:

- Introduce a requirement for institutions to include full originator information in the message or accompanying payment form in respect of cross-border payments.
- Introduce guidelines to ensure that cross-border batch transfers comply with the relevant principles contained in SRVII.
- Require institutions to adopt risk-based procedures for handling inward payments that do not contain relevant originator information.

178. It should be noted that discussions are currently taking place within the FATF on a new interpretative note for SRVII. Consideration of what action should be taken might await publication of the new note, which may appear in the course of 2005.

3.5.3 COMPLIANCE WITH RECOMMENDATION 10 AND SPECIAL RECOMMENDATION VII

	Rating	Summary of factors underlying rating
R.10	Largely Compliant	<ul style="list-style-type: none"> • Requirements between the RBI Guidelines of 2002 and the implementing Rules for the PMLA are not consistent. • The PMLA record keeping requirements seem to extend only to a specified 'set' of transactions, and not all transactions. • Money Service Businesses do not seem to be covered by the PMLA record keeping compliance guidelines.
SR.VII	Partially Compliant	<ul style="list-style-type: none"> • There is no requirement to attach originator information to outgoing wire transfers • Institutions are not required to take any precautionary measures in respect of incoming wire transfers that do not have originator information included.

Unusual and Suspicious Transactions

3.6 MONITORING OF TRANSACTIONS AND RELATIONSHIPS (R.11 & 21)

3.6.1 DESCRIPTION AND ANALYSIS

179. The RBI guidelines for banks require that attention be given to complex and unusual transactions, and make cross-reference to section 12 of the PMLA with respect to the maintenance of record of such transactions. Section 12(1) (a) requires financial institutions to maintain records in relation to certain prescribed transactions, which have been defined in the draft Rules to include cash transactions over Rs.1million (US\$25,000), and suspicious transactions, which are further defined to include transactions that are "made in circumstances of unusual or unjustified complexity; or appear to have no economic rationale or bona fide purpose". However, the record-keeping requirement relates only to maintaining information on the nature, amount and date of the transaction, and the parties to it. The obligation to review the transaction in further detail, either in the RBI guidelines or the draft Rules, remains with the Principal Officer who will be responsible for implementation for KYC Guidelines at the institution, but there do not appear to be any obligations to retain a record of the outcome of the review. However, in order to have a structured review (open to both the regulators and auditors) of the unusual transactions reported by bank branches to their head office in

accordance with the RBI guidelines, the banks have been advised by the RBI to maintain a register with relevant particulars of the transactions.

180. The SEBI has certain transaction scrutiny requirements that are designed to combat market manipulation and insider trading, and there are provisions affecting the insurance sector to mitigate the risk of fraudulent claims, but in neither case is the focus directly on AML issues.

181. Under the draft Rules all suspicious transactions (defined to include unusual and complex transactions) would be required to be reported to the FIU. This would, in many cases, trigger a need for additional information to be supplied, or enquiries to be made, by the reporting institution, but this would not be systematic.

182. With respect to Recommendation 21, the RBI guidelines require banks to be "extremely cautious" in relations with respondent banks in countries with poor know-your-customer standards and countries identified as non-co-operative in the fight against money laundering, and also require Indian bank branches and subsidiaries operating in such countries to implement the normal CDD requirements with particular rigour. There are no requirements in the draft PMLA Rules to pay particular attention to transactions relating to countries with inadequate AML/CFT regimes. It would be possible, in principle, under the RBI's direction-making powers (and within the draft PMLA Rules), to issue specific instructions to financial institutions to guard against transactions involving designated countries, but no such course of action has been taken so far. However, some work is being undertaken in the context of the development of the Bankers Association's model AML compliance manual to develop some form of country-risk ladder, as a guide to the banks. There is also evidence of certain banks applying enhanced due diligence measures for higher-risk countries and clients.

3.6.2 RECOMMENDATIONS AND COMMENTS

183. It is recommended that the authorities:

- Implement measures to require financial institutions to examine the background to transactions that are complex, unusual or have no apparent economic or lawful purpose, and to retain a written record of the examination in line with the underlying transaction record.
- Provide that financial institutions should pay special attention in relation to transactions and relationships that involve persons from or in countries that do not adequately apply the FATF Recommendations.
- Introduce a mechanism to alert financial institutions to those countries that are considered not to apply the FATF Recommendations adequately.
- Introduce an inter-agency procedure for determining whether specific counter-measures should be taken, in particular circumstances, against countries that do not adequately apply the FATF Recommendations.

3.6.3 COMPLIANCE WITH RECOMMENDATIONS 11 & 21

	Rating	Summary of factors underlying rating
R.11	Partially Compliant	<ul style="list-style-type: none"> • Relevant guidelines have only been issued to institutions under the supervision of the RBI. • There are no specific requirements for financial institutions to investigate the background to complex and unusual transactions and to retain a copy of the results of the investigation.
R.21	Partially Compliant	<ul style="list-style-type: none"> • No guidance is currently provided to financial institutions on which countries fail to comply with FATF standards.

3.7 SUSPICIOUS TRANSACTION REPORTS AND OTHER REPORTING (R.13-14, 19, 25 & SR.IV)

3.7.1 DESCRIPTION AND ANALYSIS⁸

184. There has been a history of reporting cash and suspicious transactions by financial institutions, even before the introduction of AML measures. Various obligations have been imposed over the years under tax law, foreign exchange controls and general regulatory mandates requiring institutions to notify either specified agencies or whatever agency the institution might consider appropriate, whenever there is suspicion about a particular transaction. This approach is confirmed in the guidelines issued to the banks by the RBI in August 2002 and carried through into the November 2004 guidelines, which, among other things, require banks to have a process for collating centrally information on cash transactions above Rs.1million (US\$25,000), and for onward reporting to an appropriate authority if any transaction is considered suspicious by the bank.

185. Similarly, there are a number of automatic external reporting requirements for cash transactions above defined thresholds. In most cases the driving force for such obligations has been to counter tax evasion. For example, banks are required to report to the tax authorities all cumulative cash deposits exceeding Rs.1million (US\$25,000) made by a client in any one year. More generally, institutions are expected to report suspicious transactions to the regulators or to an investigative or law enforcement agency, but (with some exceptions) it is largely at the discretion of the institutions as to whom they report and in what circumstances. To date, there has been no operational FIU to which reports might be sent centrally on a consistent basis.

186. The recent creation of the FIU and the imminent introduction of the PMLA Rules will provide the first structured framework for filing cash and suspicious transaction reports relating specifically to money laundering. Section 12(1) (b) of the PMLA requires covered financial institutions to report to the FIU such transactions as may be prescribed. Prescribed transactions are defined in the Rules as cash transactions (including multiple linked transactions) in excess of Rs.1million (US\$25,000), cash transactions involving counterfeit currency, and suspicious transactions (whether in cash or otherwise) performed through a specified list of payment instruments within a defined range of different business relationships. This list is extensive, but may not be comprehensive, and will impose a significant burden on institutions in determining whether a particular transaction falls within the definition. In practice, they may ignore the list and simply

⁸ The description of the system for reporting suspicious transactions in s.3.7 is integrally linked with the description of the FIU in s.2.5, and the two texts need to be complementary and not duplicative.

report all suspicions. It is noted that once covered institutions begin submitting suspicious transaction reports, the Indian authorities plan to evaluate the practice by institutions to determine suspicion and to submit appropriate reports.

187. Most cash transactions have to be reported on a monthly basis, while those involving counterfeit currency, and all suspicious transactions, must be notified within 3 days. The cash reporting threshold is high relative both to international comparators and to the average income in India, but the authorities argue that a lower threshold would generate an excessive number of reports, given the continuing predominance of cash within the economy.

188. A particular problem arises from the definition of "suspicious transaction" in the Rules. This is deemed to include a transaction that "gives rise to a reasonable ground of suspicion that it may involve the proceeds of crime; or is made in circumstances of unusual or unjustified complexity; or appears to have no economic rationale or bona fide purpose". However, "proceeds of crime" within the PMLA itself is linked directly to the list of scheduled offences, which is not only limited in its coverage (as described in section 2.1 above), but is also circumscribed by a threshold requirement, whereby certain offences must generate in excess of Rs.3 million (US\$75,000) before they are considered to be a predicate for money laundering. Therefore, there would be no obligation upon an institution to report a suspicious transaction unless it believed that the funds related directly to proceeds exceeding Rs.3 million from one of the specified offences (or unless they believed that it was linked to one of the small number of offences for which there is no threshold limit, i.e. war against the state or narcotics offences). While some transactions below the threshold limit may be caught under the conditions of their being unusual, complex or having no economic rationale, it is perfectly possible that the proceeds of an offence would not meet any of these specific criteria, but should otherwise have been considered suspicious in objective terms. Because of the necessary direct linkage to the predicate offences, institutions will also have to be able to identify the likely predicate offence in order to determine whether the conditions for filing a report are met. This is an unreasonably high (and unworkable) test for filing an STR. While the definition of suspicion extends beyond the linkage to a listed predicate offence, it does not include "pure suspicion" even if one was to determine that a particular transaction did not meet any of the criteria as defined by the Rules.

189. The proposed STR requirement is further compromised by the restricted list of predicate offences (including the absence of several financial crimes), by the failure to require the reporting of attempted transactions, by the absence of any offence for tipping-off clients about STRs, and by the exclusion from the general PMLA requirements of the exchange houses and money remitters. Covered institutions and their officers are provided with statutory protection (under section 14 of the PMLA) in respect of any reports filed with the FIU, but only against civil proceedings.

190. Neither the PMLA nor the draft Rules appear to impose an obligation on the regulatory authorities themselves to report any suspicious activities or transactions that they encounter during their inspection or other work. While it may be presumed that this will be the practice, given the close relationship that has existed between the regulators and the investigative authorities historically, it is important that such reporting should be placed on a proper legal footing. SRIV specifically stipulates that financial institutions should be required by law to report to the FIU STRs

191. Transaction reporting has been an obligation for financial institutions even prior to the PMLA, as banks were instructed to provide reports (on suspicious and other large transactions) to the relevant agencies for follow-up as they determined. In discussions with commercial banking institutions as well as several agencies, there was no evidence

that explicit feedback was given as to the nature and value of their reports or the follow-up to the data received by these agencies. This includes acknowledgement of receipt of reports, statistics on disclosures, information on methodologies, techniques or trends of money laundering, processing of cases as initiated by suspicious transaction reporting, or other information. Other offices and agencies, including the SFIO and the Enforcement Directorate have also not provided this type of feedback on the application and implementation of measures to combat AML/CFT. As the FIU has only recently been established and has yet to receive reports from covered institutions, it has not yet provided the necessary guidance or feedback to the relevant sectors.

192. There are strict currency controls in India on both Indians and foreigners entering or leaving the country. Any person can bring into India foreign exchange without any limit. However, a declaration of foreign exchange/currency is required to be made in the prescribed Currency Declaration Form in the following cases:

- (a) Where the value of foreign currency notes exceeds US\$ 5,000 or equivalent
- (b) Where the aggregate value of foreign exchange (in the form of monetary instruments, currency notes, traveller cheques etc.) exceeds US\$ 10,000 or its equivalent.

193. Import and export of Indian currency is controlled. Indian residents returning from a visit abroad are allowed to import up to Rs.1,000, while residents going abroad are allowed to take with them up to Rs.5,000.

194. Indians going abroad are permitted to take with them foreign currency without any limit so long as it has been purchased from an authorised dealer in foreign exchange and endorsement to that effect has been made in the passport of the passenger by the concerned dealer. Tourists while leaving India are allowed to take with them foreign currency not exceeding an amount brought in by them at the time of their arrival in India. As no declaration is required to be made for bringing in foreign exchange / currency not exceeding equivalent of US\$ 10,000, generally tourists can take out of India with them at the time of their departure foreign exchange/currency not exceeding the above amount.

195. India has its declaration system in place and the threshold of declaration is reasonable. Enforcement action against cash couriers is discussed in Part 2.6. It is noted that the existing enforcement measures are primarily formulated to reinforce the existing revenue and foreign exchange management law. There is no specific reference as to the issue of money laundering and terrorist financing.

3.7.2 RECOMMENDATIONS AND COMMENTS

196. The reporting requirements within the PMLA and accompanying Rules require a number of key amendments to comply with the FATF standards, specifically:

- Redefine the term "transaction" in the widest possible generic way, rather than relying on a prescribed list (it is noted that the authorities plan to address this within the context of the prescribed Rules to the PMLA).
- Remove the linkage between a suspicious transaction and the threshold for the predicate offence, so that institutions are required to report any transaction that they have reasonable grounds to believe involve the proceeds of crime generally. (This recommendation must also be considered in the context of earlier recommendations in respect of the list of predicate offences.)
- Extend the STR requirement to include attempted transactions.

- Introduce a tipping-off offence in relation to STRs filed with the FIU.
- Extend the STR obligations to exchange houses and money remitters (which would mean that exchange houses and money remitters should be covered more generally to comply with the PMLA and other related legislation/guidelines).
- Provide that the regulatory authorities (including the self-regulatory agencies) should report to the FIU any suspicious activities that they discover in the course of their supervisory work.
- Extend the protection granted to financial institutions, when filing STRs, to include any potential criminal liability, not just civil liability.
- Build in mechanisms for feedback within the newly established FIU back to reporting entities.
- Review the existing currency declaration mechanism and introduce arrangements to pass the information obtained through the declaration process to the FIU.

3.7.3 COMPLIANCE WITH RECOMMENDATIONS 13, 14, 19 AND 25 (CRITERION 25.2), AND SPECIAL RECOMMENDATION IV AND IX

	Rating	Summary of factors underlying rating
R.13	Non Compliant	<ul style="list-style-type: none"> • The STR system has yet to be implemented, but even with the introduction of the proposed regime: • The obligation to report STRs only applies for most predicate offences when the alleged proceeds exceed a threshold of Rs.3mn (US\$23,000). • There is no obligation to report suspicions linked to terrorist financing as this is not a predicate offence. • Attempted transactions are not required to be reported.
R.14	Partially Compliant	<ul style="list-style-type: none"> • There is no tipping-off offence. • Legal protection in relation to filings STRs is provided in relation to civil liability only, and not criminal liability.
R.19	Compliant	
R.25	Partially Compliant	<ul style="list-style-type: none"> • As the FIU is not formally set up, no feedback has been provided as yet with regard to submitted reports. Implementation of this requirement has therefore not yet taken place. • No guidance/feedback has been issued with regard to existing reporting requirements by covered institutions to agencies directly.
SR.IV	Non Compliant	<ul style="list-style-type: none"> • There is no obligation to report suspicions linked to terrorist financing as this is not a predicate offence.
SR.IX	Partially Compliant	<ul style="list-style-type: none"> • As the FIU is not operation, there is no mechanism to pass the information obtained from the declaration process to the FIU.

Internal controls and other measures

3.8 INTERNAL CONTROLS, COMPLIANCE, AUDIT AND FOREIGN BRANCHES (R.15 & 22)

3.8.1 DESCRIPTION AND ANALYSIS

197. The RBI guidelines issued in November 2004 require banks and other financial institutions supervised by the RBI to implement effective AML procedures in line with all but two of the detailed criteria within Recommendations 15 and 22. The exceptions are the requirements to implement specific screening procedures to ensure high standards when recruiting employees (R15), and to apply the higher of the home or host country AML standards when they differ (R22). Banks had three months (from November 2004) within which to formulate an overall policy framework, but have until end-2005 to implement proper systems and controls to reflect the policy framework. The initial deadline has not been met by many institutions, partly because work is being coordinated by the Indian Bankers Association to prepare a model AML procedures manual for members. Some banks have undoubtedly progressed well beyond the timetable laid down by the RBI (for example, the commercial bank visited by the Evaluation Team showed a high degree of attention to these matters and had well-established systems), but no detailed review of the state of preparedness within the industry at large has been undertaken.

198. No such specific obligations have been extended to those sectors regulated by the SEBI and IRDA or to the exchange houses or the money remitters. Under the SEBI Rules there are a number of procedures required to mitigate the risk of market manipulation, but these do not have an AML focus, although some of the procedures are also relevant in the context of AML (e.g. know-your-customer principles and record-keeping requirements). The stock exchange rules that implement SEBI requirements do not contain any references to AML controls and procedures. Within the insurance sector, there is little evidence that institutions have considered the need for specific AML safeguards, and the IRDA has so far taken no action to sensitise them to the issues.

199. The PMLA and its accompanying draft Rules provide very limited direction to covered institutions with respect to internal procedures, policies and controls. These relate only to the implementation of a client identification programme, certain record-keeping requirements, the procedures for supplying information to the FIU, and the appointment of a designated person to act as the money laundering reporting officer (described as a "principal officer"). The defined role of the principal officer is far narrower than that of a money-laundering compliance officer and relates only to the transmission of reports to the FIU. The development of internal procedures to detect and report STRs appears only to be optional (institutions "may evolve an internal mechanism for furnishing such information in such form and at such intervals as may be directed...), and the draft Rules are silent on the need for a coordinated AML/CFT programme, independent AML/CFT audit procedures, and structured staff training.

200. Some of the draft Rules governing customer identification procedures, record-keeping and reporting procedures provide for supplementary instructions to be issued by either the RBI or the SEBI. In no case is reference made to the possibility of guidance being issued by the IRDA. The reason for this asymmetry is unclear, but the Rules should allow for comparable authority for all the regulators to issue instructions.

3.8.2 RECOMMENDATIONS AND COMMENTS

201. While the requirements imposed on the banking sector under the RBI guidelines are generally satisfactory, these require some strengthening, and similar obligations must also be applied to the other sectors of the financial industry. Specific recommendations are:

- Introduce a general principle under the PMLA that all covered institutions must have appropriate systems and controls to comply with their obligations under the Act.
- Publish specific instructions (in the form of regulatory guidelines) that are tailored to the needs of each of the sectors covered by the PMLA requirements, in line broadly with the RBI guidelines to the banks. Besides reference to the general control environment, these instructions should include requirements to have a specific AML compliance function, to institute an ongoing staff training programme, and to have procedures for effective screening of potential employees.
- Where applicable, require financial institutions that operate overseas branches or subsidiaries to implement the more rigorous of either the Indian or the host country AML obligations.
- Introduce a programme for those sectors regulated by the SEBI and IRDA to sensitise the institutions to the specific risks of money laundering and the need for effective systems and controls to mitigate those risks.

3.8.3 COMPLIANCE WITH RECOMMENDATIONS 15 & 22

	Rating	Summary of factors underlying rating
R.15	Partially Compliant	<ul style="list-style-type: none">• There is no general principle within the PMLA requiring financial institutions to have proper systems and controls with respect to AML/CFT.• The role of the principal officer in the PMLA Rules does not extend to a proper compliance function.• Full compliance with the RBI Rules is not required until end-2005.• No specific rules on AML/CFT systems and controls have been issued to the insurance or securities sectors, or to the exchange houses and money remitters.
R.22	Largely Compliant	<ul style="list-style-type: none">• No guidance has been issued to the banks requiring their foreign branches and subsidiaries to apply the higher of Indian or host country AML/CFT requirements.

3.9 SHELL BANKS (R.18)

3.9.1 DESCRIPTION AND ANALYSIS

202. The establishment of shell banks is not permitted in India. Provision exists for the creation of offshore banking units (OBUs) within the proposed special economic zones (which are being created for certain export-oriented businesses), but such OBUs

will be required to maintain properly staffed facilities and will be regulated by the RBI for prudential purposes on the same basis as domestic banks.

203. The RBI's November 2004 guidelines for banks prohibit the establishment of correspondent relationships with foreign shell banks, but make no reference to the need to establish that respondent banks are not, themselves, dealing with shell institutions.

3.9.2 RECOMMENDATIONS AND COMMENTS

204. It is recommended that the authorities:

- Amend the RBI guideline to impose an obligation on the banks to establish, as far as is reasonably possible, that their respondent banks are not offering services to shell institutions.

3.9.3 COMPLIANCE WITH RECOMMENDATION 18

	Rating	Summary of factors underlying rating
R.18	Largely Compliant	<ul style="list-style-type: none"> • Banks are not specifically required to establish that their respondent banks are not undertaking business with shell entities.

Regulation, supervision, monitoring and sanctions

3.10 THE SUPERVISORY AND OVERSIGHT SYSTEM - COMPETENT AUTHORITIES AND SROS ROLE, FUNCTIONS, DUTIES AND POWERS (INCLUDING SANCTIONS) (R.17, 23, 29 & 30)

3.10.1 DESCRIPTION AND ANALYSIS

205. There are three primary financial services regulators in India: the Reserve Bank of India, the Securities and Exchange Board of India and the Insurance Regulatory and Development Authority. The roles of the RBI and the SEBI are well established, with the former being responsible for the licensing and supervision of banking business (which embraces a wide range of differing types of institution covered by the Banking Regulation Act), and non-bank financial institutions (which are defined under the RBI Act to include finance companies, hire purchase companies, dealers in government securities, insurance companies, investment companies and lottery-type schemes); while the SEBI is responsible for the licensing and supervision of stock exchanges, market intermediaries (e.g. stock brokers, underwriters, portfolio managers and investment advisers), depositories and custodians, and collective investment schemes under the SEBI Act. The role of the IRDA is less clear. It was established by statute in 2000 "to regulate, promote and ensure orderly growth of the insurance business and re-insurance business", but it has been slow to develop its operations and has yet to roll out a full supervisory regime. Although insurance companies remain within the definition of non-bank financial institutions within the RBI Act, the authorities have advised that the RBI has formally exempted the insurance sector from any of its regulatory requirements in order to avoid dual supervision by both the RBI and the IRDA.

206. The RBI is the nation's central bank and it has only limited independence from central government. The government has extensive powers to appoint and remove

members of the board (sections 8 and 11 of the RBI Act), and the Banking Division of the Department of Economic Affairs (DEA) within the Finance Ministry has the general authority to make rules under the Banking Regulation Act (section 52), and to issue directions to the RBI. The DEA characterises the relationship as one under which powers are delegated to the RBI under a limited discretion. A similar relationship exists between the central government and the SEBI and IRDA. Under sections 16 and 17 of the SEBI Act the government has the authority to bind the SEBI on issues of policy, and may remove the board for failure to comply with directions issued by government. The same provisions apply to the IRDA under sections 18 and 19 of its governing Act.

207. The RBI has a well developed system of supervision based around licensing requirements and a combination of offsite surveillance and onsite inspection. The four main supervision departments have a total staff complement of about 1,750 people spread between the RBI's head office and its 16 branches nationwide. All regulatory staff undergo relevant training and there is a tradition of stable and long service within the RBI, which assists in developing a cadre of experienced, professional staff.

208. All financial institutions defined within the *Banking Regulation Act* and the RBI Act require a licence from the RBI, the granting of which is subject to "fit and proper" tests for management, to certain minimum financial standards, and to consideration of whether the business will be run in the interests of depositors and the public interest. However, there appears to be a very limited statutory basis for vetting the acquisition of shareholdings in licensed institutions (see section 3.11.1 below).

209. Annual inspections are undertaken of the head office operations of all supervised institutions, and individual branches are examined on the basis of materiality and risk. The RBI's authority to conduct inspections (under section 35 of the Banking Regulation Act) extends to overseas branches and subsidiaries, if necessary. Inspections concentrate on core assessments based on the well-established CAMELS model, which addresses capital adequacy, asset quality, management, earnings, liquidity and systems and controls. In recent years the RBI has sought to develop a more risk-based model of supervision that aims not only to allocate supervisory resources more effectively, but also places greater emphasis upon risk management within institutions. In the financial years 2003/4 and 2004/5 the RBI conducted 118 and 111 head office inspections, respectively. In addition, the RBI imposes mandatory external audit requirements, which can involve targeted work under instruction from the RBI, and can itself undertake special examinations of its own volition (section 35 of the Banking Regulation Act). The RBI inspection manual requires specific coverage of KYC principles and account-opening procedures under the module dealing with systems and controls, but the requirements introduced under the November 2004 AML guidelines remain in the implementation phase, and inspections are not yet being performed to ensure compliance with these principles. Similarly, since the PMLA Rules have yet to be implemented in substance, there is no basis yet for mounting compliance inspections relative to these obligations.

210. The SEBI has similar licensing and oversight powers and responsibilities to those of the RBI, although it has the authority to delegate some of its rule-making and compliance functions to the 24 exchanges, which are deemed to be self-regulatory organisations (section 19 of the SEBI Act). It has a total of about 150 staff in its inspection, surveillance and regulatory team, with the inspection function spread between four offices in the main financial centres. The principal exchange, the National Stock Exchange, has some 60 staff employed on inspections and investigations.

211. The SEBI's primary focus is to ensure investor protection, market stability and to counter market manipulation. It carries out annual inspections of market intermediaries (under the authority of section 11(2) of the SEBI Act), with the scope of the work being

determined by a risk assessment (mostly market risk), either sector-wide or institution-specific. The depositories are inspected twice a year. Overall, SEBI carried out 148 inspections of system and controls in the financial year 2003/4, and 151 in 2004/5. Section 11C of the SEBI Act also provides for extensive powers to carry out special investigations where there is reason to believe that business is being conducted contrary to the interests of investors, or that a breach of the Act has occurred. Similarly, the individual stock exchanges carry out annual inspections of their members. Overall, these inspections are aimed at ensuring compliance with the relevant rules issued by SEBI and the exchanges, and to ensure the completeness and integrity of the books and records. While the current rules address certain issues relating to KYC requirements, record-keeping and reporting, they contain no specifically defined AML obligations. As a result, the existing inspection programme does not address AML compliance, and SEBI inspection staff have yet to be trained in AML compliance procedures.

212. The IRDA is a relatively new creation and, therefore, its role is still developing. It has a staff of about 50 officers and a further six specialist auditors, but it intends to be reliant in part on outsourcing some of its duties to the auditing and accounting professions. In principle, the IRDA has similarly extensive powers to those of the RBI and the SEBI (section 14 of the IRDA Act), but these have not yet been tested in any meaningful way. The organisation was established in 2000 following the opening of the insurance industry to private sector participation. In 2003 it introduced an inspection process for the annual and quarterly financial returns, but will not be commencing an onsite examination programme until the second half of 2005. No focus has yet been applied to AML issues and no specific training has been provided to staff.

213. The precise role of the IRDA in respect of AML oversight is unclear in law. The insurance sector is brought within the scope of the PMLA by reference to Section 45-I of the RBI Act which continues to include insurance business within the definition of non-bank financial companies, and the draft PMLA Rules, when referring to prescribed regulatory procedures relating to record-keeping and the filing of STRs, only cite the RBI and the SEBI as relevant authorities for issuing guidelines.

214. Beyond the core financial sector, money remitters and foreign exchange houses are licensed by the RBI under the *Foreign Exchange Management Act* (FEMA), but are not subject to prudential supervision. They are subject to extensive routine transaction reporting requirements (fortnightly for the foreign exchange houses and monthly for the remitters), and have to undergo annual inspection by the RBI for compliance with the FEMA regulations, which include certain KYC and record-keeping requirements. However, there exists a very sizeable informal remittance sector that strictly operates outside the FEMA (see the separate discussion on *hawala*).

215. At the time of the Evaluation Team's visit it was expected that the Directorate of Enforcement would be given a major role to play in the oversight of AML compliance. The Directorate was established under sections 36-37 of the FEMA, and until now has been the primary agency responsible for investigating breaches of the regulations under that Act. The most immediate role expected to be assumed by the directorate within the AML regime will be that of primary investigator of alleged money laundering offences, and authorised Police officers, as defined by the Act, will also be charged with investigating money laundering offences up to a stated threshold. The authorities have advised that the Directorate will also exercise broader powers under certain sections of the PMLA, concurrently with the Director of the FIU who will be charged with the exclusive powers under Chapter IV of the PMLA. In addition, the authorities state that there is no single agency that will monitor general compliance with AML regulations, but that the appropriate regulatory bodies, the FIU, the Directorate of Enforcement and the Ministry of

Finance more generally will perform these duties. It would be helpful if clear delineation is made as to the charge for monitoring for AML compliance by covered institutions.

216. The RBI (under section 27(2) of the *Banking Regulation Act*), the SEBI (under section 11(2) of the SEBI Act) and the IRDA (under section 14(2) of the IRDA Act) all have similar powers to require regulated institutions to furnish information on demand. There is no restriction on the type of information that may be requested. The RBI (sections 46 and 47A) and the SEBI (section 15A) have the authority to impose penalties, on both individuals and institutions, for failure to comply with a disclosure request or to provide false and misleading information. Both agencies also have broader powers to impose penalties for failure to comply with any rules, orders or directions issued under the statutes. These penalties range from monetary fines, through to the removal of management and the revocation of the authority to conduct business. The IRDA is not granted any similar enforcement powers under the IRDA Act, and it is not clear on what legal authority it would seek to ensure compliance with the disclosure requirements, rules and regulations issued under the Act. To date, only the RBI has issued any instructions that specifically address AML/CFT, but it has not so far applied any sanctions for non-compliance.

217. With the exception of one provision in the RBI Act relating to credit information, none of the regulatory laws contain explicit confidentiality provisions that prohibit staff from disclosing information coming into their possession in the course of their work. The Evaluation Team was advised that, since the laws define all regulators as public servants, they are governed by the *Official Secrets Act*, in which there are severe penalties for disclosure and misuse of information.

218. Under the PMLA, section 13 empowers the Director (of the FIU) to impose a fine on those institutions failing to comply with the record keeping and reporting obligations as stipulated in section 12. The Director may call for records referred to in section 12, and make inquiries as he/she sees fit, and in the course of any inquiry finds that the financial institution, banking company or intermediary, or any of its officers has failed to comply with these obligations, may levy a fine not to be less than Rs.10,000 (US\$230) but may extend to Rs.100,000 (US\$2,300) for each failure. These are the extent of sanctions available to the authorities under the PMLA.

219. Violations of TF obligations generally are covered under the *Unlawful Activities (Prevention) Act*, but violations of obligations to adhere to TF provisions (re asset freeze of UN 1267 listed parties, etc.) are associated with violations of circulars and directions issued by the RBI itself and incur penalties as described above. Supervisors of the RBI, SEBI and other functional regulators are charged with ensuring compliance of directives issued by the Ministry of External Affairs/Department of Economic Affairs that relate to obligations imposed by UNSCR 1267 and 1373. In this case, once circulars of designated parties for asset freeze purposes, or other account/transaction monitoring have been disseminated to the RBI, the obligation to monitor and ensure compliance rests with the regulators themselves. At present, no obligations for TF purposes are extended to the SEBI, IRDA or money service businesses (unless specifically by the RBI), and therefore, supervisors do not include in their role mechanisms to ensure compliance with these requirements, nor do they sanction for the same.

3.10.2 RECOMMENDATIONS AND COMMENTS

220. It is recommended that the authorities:

- Clarify the role and powers for the regulatory agencies and the FIU to explicitly monitor for compliance with AML/CFT. It would be helpful if clear delineation is made as to the particular agency that would be in charge for monitoring for AML compliance by the relevant covered institutions.
- Establish a comprehensive training programme in AML/CFT issues for each of the regulatory agencies.
- Ensure that supervisory authorities and applicable sanctions apply for non-compliance specifically for AML/CFT purposes in the securities sector.
- Establish specific AML/CFT obligations and ensure supervisory authorities and appropriate sanctions powers are granted for violations in the insurance sector.
- Strengthen the supervisory capacity of money service businesses and exchange dealers by including AML/CFT provisions as part of inspection and auditing process that encompasses all the requirements as set forth by the FATF 40 Recommendations that must be applied to non-bank financial institutions.
- Strengthen sanctions authorities for non-compliance by money service businesses and exchange dealers.
- Ensure that supervisors are assessing compliance with terrorist financing obligations as defined by law, and apply effective and dissuasive sanctions for non-compliance.
- Review the powers of the government to issue directions to the supervisory agencies to ensure that these do not compromise operational independence.

3.10.3 COMPLIANCE WITH RECOMMENDATIONS 17, 23 (CRITERIA 23.2, 23.4, 23.6-23.7), 29 & 30

	Rating	Summary of factors relevant to s.3.10 underlying overall rating
R.17	Partially Compliant	<ul style="list-style-type: none"> • As PMLA has not yet come into force, nor has the FIU begun receiving required reports, there has been no implementation of penalties that are effective and dissuasive for non-compliance specifically with AML/CFT obligations listed in the PMLA. • There are no specific AML/CFT provisions in sectors outside banking, and so penalties for non-compliance with AML/CFT provisions cannot be applied. • The IRDA appears to lack any explicit enforcement powers. • Statistics on enforcement actions for non-compliance of AML/CFT obligations by functional regulators lacking in all sectors.
R.23	Partially Compliant	<ul style="list-style-type: none"> • To date, there has been no focus on AML/CFT compliance by industry regulators other than the RBI. • Oversight of the foreign exchange dealers and money remitters is directed primarily at compliance with FEMA, and not at AML/CFT issues. • The role and powers of the IRDA appear less well defined, both in law and practice, than for the other regulatory agencies.
R.29	Partially Compliant	<ul style="list-style-type: none"> • While supervisors outside the RBI may have the power to compel records, there is no obligation that they assess for compliance specifically for money laundering/terrorist financing obligations, nor impose required sanctions. • There is no implementation of supervisors assessing for compliance of TF obligations, or imposing sanctions for non-compliance with TF obligations in sectors other than the banking sector (securities, insurance, money service/exchange businesses, etc.).
R.30	Partially Compliant	<ul style="list-style-type: none"> • With the exception of the RBI, staff within the regulatory agencies have not been trained in key aspects of AML/CFT compliance. • The powers of the government to issue policy and other directions to the regulators may impact operational independence

3.11 FINANCIAL INSTITUTIONS - MARKET ENTRY AND OWNERSHIP/CONTROL (R.23)

3.11.1 DESCRIPTION AND ANALYSIS

221. All institutions engaged in banking business must be licensed and supervised by the RBI in accordance with the *Banking Regulation Act*. The grant of a licence is subject to fulfilment of a range of conditions, including both financial and good governance tests that are typical of many jurisdictions. However, in terms of the "fit and proper" criterion for persons associated with the institution, the Act focuses exclusively on the management and does not impose any standards with respect to shareholders or controlling interests. Section 22(3) (c) requires that "the general character of the proposed management of the company will not be prejudicial to the public interest or the interest of its depositors", while section 10A requires that the board of directors includes persons with specific professional experience. Section 36AA gives the RBI the power to remove from office any person involved with the management of a bank (from the chairman down) if it believes it would be in the public interest to secure the proper management of the bank.

222. The *Banking Regulation Act* makes no reference to controls over the acquisition of shares in a banking company, and this is addressed only through a guideline issued in February 2004. This provides for "prior acknowledgement" from the RBI for the acquisition of shares that will take the aggregate holding of an individual or group to 5% or more of the paid-up capital of the bank. There appears to be no explicit statutory power for the RBI to halt the acquisition of shares by undesirable persons, or to remove the voting powers of any person deemed not to be fit and proper. Section 12(2) of the Bank Regulation Act merely imposes a prohibition on the ability of any one shareholder to exercise more than 10% of the voting rights in a bank.

223. The role of the SEBI, under the SEBI Act, is to regulate the stock exchanges and to register and regulate "the working of stock brokers, sub-brokers, share transfer agents, bankers to an issue, trustees of trust deeds, registrars to an issue, merchant banks, underwriters, portfolio managers investment advisers and such other intermediaries who may be associated with securities markets in any manner". It also has regulatory responsibilities with respect to mutual funds, take over-overs, corporate restructurings, public issuance, norms for corporate governance and listing of equity capital by corporates. Section 12 of the Act specifies that none of the specified activities may be undertaken without first obtaining a certificate of registration from the SEBI. Regulations issued in March 2004 lay down the "fit and proper" criteria for senior management to include honesty, financial integrity, and good reputation and character. Further, the regulations automatically debar anyone from continuing in office if they are convicted of economic crimes, fraud or dishonesty. There are no equivalent provisions relating to shareholders, although the Takeovers Regulations require anyone acquiring more than 5% of shares or voting rights in a company to disclose the aggregate holding to the company, which in turn must inform the stock exchange. The SEBI can call for this information from both the company and the stock exchange under Section 9 of the Regulations.

224. Since 2000 the supervision of the Insurance sector has rested with the IRDA. Registration as an insurance company is governed by the *Insurance Act 1938*, but the registration criteria are set out in the IRDA (Registration of Indian Insurance Companies) Regulations, 2000. Before issuing a registration certificate, the IRDA is required, under the Regulations, among other things to consider "the record of performance of each of the promoters in the fields of business/profession they are engaged in", "the record of performance of the directors and persons in management of the promoters and the

applicant" and "the level of actuarial and other professional expertise within the management of the company". However, the grant of a certificate of registration under section 16 of the Regulations is not dependent, necessarily, on the standing of the shareholders, as reference is made only to the IRDA being satisfied that "the financial condition and general character of management of the applicant are sound". Section 34A (1) (b) of the *Insurance Act 1938*, requires prior approval by the IRDA of any subsequent appointments of a managing director, chief executive officer or manager. Section 34B (1) further provides that "where the Authority is satisfied that in the public interest or for preventing the affairs of an insurer being conducted in a manner detrimental to the interests of the policy-holders or for securing the proper management of any insurer it is necessary so to do", it may remove a managing director or chief executive from office.

225. Foreign exchange companies and money remitters are regulated under the provisions of the *Foreign Exchange Management Act* (FEMA). Section 10 of the FEMA provides that only persons authorised by the RBI may deal in foreign exchange or act as a money changer. Authorisation may be granted subject to such conditions as the RBI may determine, but the Act itself does not lay down any criteria for authorisation. Section 12 of the FEMA gives the RBI extensive powers to inspect authorised institutions for compliance with any provisions of the Act or associated rules, but no specific rules have yet been issued to the industry relating to AML/CFT controls.

3.11.2 RECOMMENDATIONS AND COMMENTS

226. It is important that there should be a clear statutory basis for exercising ongoing control over the integrity of both the management and principal shareholders of financial institutions. The following measures should be implemented:

- Amend the regulatory laws to give all the competent authorities similar statutory power to approve (on the basis of "fit and proper" tests) the principal shareholders and controllers of all regulated financial institutions.

3.11.3 COMPLIANCE WITH RECOMMENDATION 23 (CRITERIA 23.1, 23.3-23.5)

	Rating	Summary of factors underlying rating
R.23	Partially Compliant	<ul style="list-style-type: none"> • There are no direct statutory controls over the acquisition of shares and controlling interests in financial institutions. • Apart from the guidelines issued by the RBI in respect of the banking sector, there has been only limited extension of primary AML principles to the other sectors of the financial industry.

3.12 AML/CFT GUIDELINES (R.25)

3.12.1 DESCRIPTION AND ANALYSIS

227. As noted above, the RBI issued Guidelines initially in August 2002, and again in November 2004, to instruct covered institutions of their obligations specifically to KYC-CDD and other AML standards. These Guidelines included know your customer provisions for opening new accounts, CDD for existing accounts, monitoring of transactions, risk management, customer education, application to branches and subsidiaries outside of India, fiduciaries, etc. The November 2004 Guidelines are

expected to be fully implemented by December 2005, but additional guidance on implementation is being developed for the sector by the Indian Bankers Association – this Guidance will more specifically address internal money laundering controls for banks themselves. Additionally, the Rules developed as part of the PMLA also detail the customer identification and verification requirements as well as required transaction reporting and record keeping requirements (including the manner in which such records need to be maintained and reports need to be submitted to the FIU). While these apply to a range of financial institutions, they do not seem to cover money exchange and money services businesses specifically.

228. Apart from the guidance discussed above, in January 2004, the RBI issued guidelines to all non-banking financial companies, miscellaneous non-banking companies, and residuary non-banking companies. These included know-your-customer guidelines for new deposits and existing customers, customer identification, ceiling and monitoring of cash transactions (only Rs.1 million (US\$23,000) and greater transactions need to be recorded), internal control systems, internal audit, and inspection, and training of staff and management of KYC norms.

229. The SEBI has also issued Guidelines to stock exchanges, dealers and brokers, and other intermediaries as to their obligations, but all have revolved around the protections of market manipulation, insider trading and other fraudulent activity. There exists no specific guidance with regard to AML obligations specifically, to include methodologies, trends or other typologies. SEBI indicated directly that the term money laundering is not used in any of its formal guidance to the sector, and discussions also indicated that SROs also did not specifically address guidance and feedback specifically related to AML obligations and the FATF Recommendations. They did say that they relied on RBI Guidelines to apply to the sector.

230. The IRDA also indicated that they have not developed specific guidance nor provided any feedback on anti-money laundering methodologies, but they also do not have specific provisions/obligations that address AML/CFT. The PMLA is said to also implicate the insurance sector, but the statutory evidence for this is unclear. IRDA does provide the sector some guidance on risk assessment.

231. Money Services Businesses and other Remitters are governed by the FEMA and must be licensed by the RBI. Apart from the guidance discussed above, the RBI does not specifically provide guidance to these businesses on their obligations with regard to AML/CFT, nor does it appear that the PMLA addresses these institutions.

232. No DNFBPs have had explicit guidance on AML/CFT requirements or implementation/compliance except for accountants. The Institute of Chartered Accountants of India (ICAI) conducted a study on money laundering and published its findings for its members in January 2005, highlighting money laundering from an accountant's perspective and describing the international standards set forth by the FATF. Additionally, ICAI included information on the development of the PMLA. ICAI also circulated guidelines for non-bank financial institutions on KYC, but just as with the PMLA, their guidance has stemmed from those issued by the RBI, and help auditors ensure compliance with the law and the certification of financial statements. This includes what internal and external auditors should look out for and some illustrative examples. Guidance to the accounting sector has not included money laundering provisions for the practice of accountancy specifically.

233. None of the aforementioned regulators have specifically issued guidelines on complying with terrorist financing obligations, including the issuance of asset freezing

orders by banks on named/designated accounts of concern or those identified and designated for purposes of UNSCR 1267.

3.12.2 RECOMMENDATIONS AND COMMENTS

234. It is recommended that the authorities:

- Ensure RBI guidelines and those Rules under the PMLA with regard to AML/CFT compliance extend to money services businesses and other remitters.
- Ensure securities dealers/brokers and the stock exchanges are provided guidelines specifically addressing their obligations to comply with AML/CFT.
- Ensure DNFBP guidelines for AML/CFT compliance extend to all the appropriate sectors.
- Include studies on methodologies, trends and statistics on money laundering and terrorist financing to all relevant financial institutions and DNFBPs.
- Build in mechanisms for feedback within the newly established FIU back to reporting entities.

3.12.3 COMPLIANCE WITH RECOMMENDATION 25 (CRITERIA 25.1, FINANCIAL INSTITUTIONS)

	Rating	Summary of factors underlying rating
R.25	Partially Compliant	<ul style="list-style-type: none"> • RBI Guidelines do not seem to extend to money services/exchange businesses. • There are no specific AML/CFT guidelines or feedback from/to the SEBI/SROs for the securities sector. • No specific guidance has been given with regard to complying with counter-terrorist financing obligations, complying with asset freeze obligations, nor has there been any typologies given to the sectors as to how to identify terrorist financing activities within their respective sectors.

3.13 ONGOING SUPERVISION AND MONITORING (R.23, 29 & 32)

3.13.1 DESCRIPTION AND ANALYSIS

235. See discussion under section 3.10.1 in relation to Recommendations 23 and 29.

236. With respect to Recommendation 32, thus far India has not maintained any statistics on money laundering and terrorist financing to assess the effectiveness and efficiency of their system to combat these threats. This is due to the fact that the money laundering law itself has not yet come into force, thus no single money laundering case has been carried forward. No statistics for assessment purposes presently exist to show the compliance by covered institutions to the CDD, reporting and other directions set forth in Guidelines issued by the RBI. Additionally, the FIU is not yet operational. Thus no STRs and other transaction data have been filed with a central authority. For information regarding statistics pertaining to MLA requests, please see section 6.3.1.

3.13.2 RECOMMENDATIONS AND COMMENTS

237. It is recommended that the authorities:

- Ensure that the established FIU keeps adequate statistics on the number of STRs and other reports submitted to it by covered institutions. Statistics should also be kept by the appropriate authority on the compliance to other money laundering controls set forth by the new legislation as well as existing directions issued by the RBI.
- Ensure that the appropriate investigative agencies keep statistics on the number of money laundering and terrorist financing cases and prosecutions so as to adequately assess the effectiveness and efficiency of their AML/CFT efforts in general.

3.13.3 COMPLIANCE WITH RECOMMENDATIONS 23 (CRITERIA 23.4, 23.6-23.7), 29 & 32 (RATING & FACTORS UNDERLYING RATING)

	Rating	Summary of factors relevant to s.3.13 underlying overall rating
R.23	Partially Compliant	<ul style="list-style-type: none"> • To date, there has been no focus on AML/CFT compliance by industry regulators other than the RBI. • Oversight of the foreign exchange dealers and money remitters is directed primarily at compliance with FEMA, and not at AML/CFT issues.
R.29	Partially Compliant	<ul style="list-style-type: none"> • While supervisors outside the RBI may have the power to compel records, there is no obligation that they assess for compliance specifically for money laundering/terrorist financing obligations, nor impose required sanctions. • There is no implementation of supervisors assessing for compliance of TF obligations, or imposing sanctions for non-compliance with TF obligations in sectors other than the banking sector (securities, insurance, money service/exchange businesses, etc.).
R.32	Non Compliant	<ul style="list-style-type: none"> • There are currently no statistics available for assessment by the RBI on the efforts to date to comply with Guidelines set forth through their published directions. • There are currently no statistics available for assessment as the FIU is not yet operational.

3.14 MONEY OR VALUE TRANSFER SERVICES (SR.VI)

3.14.1 DESCRIPTION AND ANALYSIS (SUMMARY)

238. Money services businesses and foreign exchange houses are licensed by the RBI under the *Foreign Exchange Management Act* (FEMA) which replaced the *Foreign Exchange Regulation Act* (FERA), but are not subject to prudential supervision. The primary enforcement authorities overseeing this sector are the Department of Revenue Intelligence and the Enforcement Directorate within the Ministry of Finance. Money service businesses and Exchange dealers are considered “authorised persons” once licensed by the RBI to send and receive payments from overseas and to hold foreign

exchange. These businesses are subject to transaction reporting requirements that include every fourteen days for foreign exchange houses (of all sales transactions regardless of amount), and once a month for 'authorised money changers' (AMCs). They are also obligated to submit suspicious transaction reports and large currency transaction reports directly to the RBI, but at present there are no explicit guidelines (except for those listed in the Rules of the PMLA) on the manner and form of submitting these reports. They are also obligated by FEMA and the directions issued by the RBI to certain KYC provisions and record keeping requirements.

239. Money service businesses and exchange houses must also undergo annual inspection by the RBI and on a random basis for compliance with the FEMA regulations – including financial audits, as well as the implementation of CDD and record keeping requirements – they will however not be covered, and therefore not assessed for compliance with provisions under the PMLA. Larger and more established international institutions' offices in India have implemented internal audit and compliance measures, based on provisions stipulated by their headquarters domiciled abroad. However, the nature and scope of these controls are not known by smaller or domestic operations. Under FERA, operating as an unlicensed money exchanger, or *hawala/hundi*, was a criminal offence and penalties up to five times the amount involved in contravention. Offenders could also be prosecuted under section 56 of FERA, and those convicted could spend up to seven years in prison with additional fines when the amounts exceeded Rs.100,000 (US\$2,300). Under FEMA, violations have become a civil offence, with fines up to three times the amount contravened or Rs.200,000 (US\$4,600) (if no amount is contravened) and revolve around the recovery of revenues for tax purposes. Amounts seized can also be confiscated.

240. While legitimate businesses are captured under FEMA regulations, and regulated under the RBI, there exists a sizeable and demonstrated informal sector, or those entities operating without licenses. There seems to be disagreement on the size and scope of the informal/hawala/hundi sector, and the nature of the problem as it relates to money laundering and terrorist financing more specifically. While some have stated that the relaxation of capital controls and duties and increased access to formal financial channels has radically reduced the prevalence of hawala/hundi, many enforcement authorities discuss that transactions continue unabated. Some investigators have processed over 60 cases per directorate of hawala/hundi use purely for criminal purposes, including terrorist financing (cases include facilitation for groups such as LET, Hizb-ul-Mujahideen, Jammu and Kashmir Mass Movement, etc. – most have been prosecuted under FEMA). Amounts transferred through hawala/hundi have been upwards of 10,000,000 rupees or more per transaction. Licensed remitters are limited to conduct up to 12 transactions per beneficiary per year (per company) and all amounts transmitted above Rs.50,000 (US\$1,150) must be paid by cheque. Thus clients may conduct unlimited transactions for unlimited cash amounts as long as they are structured below given thresholds and among many different remitting companies. Additionally, trade and charitable contributions are not permitted through these remittance channels; however identification requirements need only stay between remitter and receiver, thus can be at the benefit for multiple beneficiaries.

241. The definition of *hawala/hundi* as stated by Indian authorities must include international transfers. Domestic transfers are not captured by FEMA rules and are addressed by tax authorities and the relevant tax regulations only. *Hawala/hundi* has been seen to be used for legitimate purposes as well as to facilitate invoice manipulation, compensatory payments, smuggling, terrorist financing, to offer services for travellers in multiple locations, in connection with the gold and diamond trading businesses, and there have been many cases of licensed money service businesses conducting hawala/hundi transactions (outside the scope of limits described above and without record).

3.14.2 RECOMMENDATIONS AND COMMENTS

242. While India regulates formal money service businesses and exchange dealers, they have declared alternative remittance systems such as hawala/hundi illegal. There is considerable confusion and disparity between multiple authorities on the scale and scope of use of hawala/hundi – it is noted that the fact that *hawala/hundi* is illegal in India would make it extremely difficult to assess the full scale of abuse in this sector. It is however known that there is continued widespread and prevalent use of *hawala/hundi*, and the imposition of FEMA has effectively reduced the penalties for their use, and may possibly facilitate more overt use given the lack of disincentives for legitimizing the trade with formal institutions. It is recommended that authorities:

- Increase the sanctions authorities, including re-criminalising illegal money remitters.
- Greatly strengthen the supervisory and regulatory environment on the money service businesses and ensure that these institutions come under regulation by the appropriate agency, (in this case, most likely the RBI), such that PMLA requirements apply to the sector.
- Consider putting together a task force to decipher the true scale of the problem, which includes all relevant policy, tax, enforcement, and investigative agencies.
- Put in place a system to monitor money service businesses and exchange houses and ensure compliance of the FATF 40 Recommendations.
- Conduct outreach/education campaigns to help bring illegal remitters into the formal financial structure through licensing.
- Address domestic hawala use by including them under the same supervisory structure and subject them to similar penalties for non-compliance.
- Consider making legal alternative remittance systems, and encouraging licensing by those engaged in this business.

3.14.3 COMPLIANCE WITH SPECIAL RECOMMENDATION VI

	Rating	Summary of factors underlying rating
SR.VI	Partially Compliant	<ul style="list-style-type: none"> • There seems to be a large discrepancy in understanding of the scale and scope of problem between regulatory and enforcement authorities and across sectors. • PMLA provisions do not seem to apply effectively to this sector. • Supervisory capacity is extremely lacking to ensure compliance with AML/CFT provisions. • Given illegality, sanctions are not nearly effective to dissuade <i>hawala/hundi</i>.

4 PREVENTIVE MEASURES – DESIGNATED NON-FINANCIAL BUSINESSES AND PROFESSIONS

4.1 CUSTOMER DUE DILIGENCE AND RECORD-KEEPING (R.12) (applying R.5 to 10)

4.1.1 DESCRIPTION AND ANALYSIS

243. DNFBPs identified and assessed in India as per the FATF Recommendations and associated criteria include lawyers, gold dealers, gem and jewellery dealers and accountants. For the most part, these businesses are only obligated insofar as they have requirements to report incomes derived from the course of business and that those incomes are declared for tax purposes. Accountants were questioned in two areas – as auditors – ensuring that adequate measures and due diligence was done on the part of institutions being audited pursuant to their AML/CFT obligations, and the practice of accountants themselves. However, there are no specific CDD requirements listed for accountants themselves, nor are there any obligations to maintain records of customer identification or transaction data.

244. Lawyers are a uniquely governed profession in India. The Bar Council of India – separated into State level offices – oversees the enrolment of lawyers, looks after their interests, and carries out disciplinary actions. There are no mandatory continuing education obligations processes for renewal of license. There are no specific obligations with regard to money laundering or terrorist financing made on lawyers in the course of their practice. Lawyers do not handle business outside the legal obligations to their client, and therefore do not handle or have any connection with a client's accounts. Lawyers are in fact prohibited from facilitating any financial transactions for their clients. There exists a separate role for solicitation, and fees are not allowed to be paid on a contingency basis. There are therefore no known AML/CFT requirements for specific customer due diligence, record keeping, or other obligations in this sector.

245. The RBI oversees the gem and jewellery sector from the standpoint of the export/bank finance side, and therefore must conduct KYC on wholesale account holders. All transactions are financed through banking channels, and gem and jewellery exporters are not permitted to accept cash as per FEMA. There are no known KYC or other AML/CFT obligations for gem and jewellery dealers themselves – specifically for those who sell in the retail markets.

246. Gold dealers are subject to an import regime, and must be registered entities (nominating agencies) with the RBI to transact payments for gold purchase. Retailers must go through a 'nominating agency', whose licensees are publicly listed. There exist about 20 nominating entities with associated accounts, through which gold can be purchased. These 'nominating agencies' are government or trading monopolies, and are either associated banks or agencies, such as the Ministry of Trade. Trading monopolies must set up an LLC with an established bank account in order to deliver Gold to a purchaser on request. Banks and Agencies must keep on hand a list of approved Gold exporters from whom to purchase.

247. As casinos are not legal in India, these criteria are not applicable. Nor are they applicable for trust and company service providers as this is not a discrete business sector in India.

4.1.2 RECOMMENDATIONS AND COMMENTS

248. It is recommended that the authorities:

- Conduct money laundering threat assessments for DNFBP sectors, and establish customer due diligence and record keeping requirements that adhere to the FATF Recommendations.
- Implement specific KYC and reporting requirements to comply with AML/CFT standards.

4.1.3 COMPLIANCE WITH RECOMMENDATION 12

	Rating	Summary of factors relevant to s.4.1 underlying overall rating
R.12	Partially Compliant	<ul style="list-style-type: none">• There are no known AML/CFT obligations for lawyers and accountants or gem and jewellery dealers.• There seem to be some customer due diligence and record keeping obligations for gold dealers, as importers and authorised purchasers are registered and under supervision of the RBI.• PMLA provisions do not apply to DNFBPs specifically.

4.2 MONITORING OF TRANSACTIONS AND RELATIONSHIPS (R.12 & 16) (applying R.11 & 21)

4.2.1 DESCRIPTION AND ANALYSIS

249. Please refer to explanation given in 4.1.1. There are no obligations for DNFBPs to pay special attention to unusually large or complex transactions, nor to furnish such records to a competent authority. DNFBPs are also under no existing obligation to conduct greater scrutiny on relationships and transactions with persons operating in countries with less stringent or satisfactory implementation of FATF standards. Gem and jewellery dealers, as wholesalers must transact business through banking channels and are subject through the holding of accounts by the bank to FEMA and other appropriate legislation for amounts exceeding US\$10,000. Transactions exceeding this amount must be declared. Gold dealers, as stated above, are only allowed to effect transactions through nominating agencies licensed and holding associated bank accounts. However, there are no known obligations for the sector at the retail level.

250. As casinos are not legal in India, these criteria are not applicable. Nor are they applicable for trust and company service providers.

4.2.2 RECOMMENDATIONS AND COMMENTS

251. It is recommended that the authorities introduce regulations to ensure that DNFBPs:

- Conduct a money laundering threat assessment for DNFBP sectors, and establish customer due diligence and record keeping requirements that adhere to the FATF Recommendations.

- Implement appropriate measures to monitor transactions that are complex in nature or with persons/entities working in countries with less stringent or satisfactory implementation of FATF standards.

4.2.3 COMPLIANCE WITH RECOMMENDATION 12 AND 16

	Rating	Summary of factors relevant to s.4.2 underlying overall rating
R.12	Non Compliant	<ul style="list-style-type: none"> • DNFBPs are not required to apply CDD or record keeping requirements
R.16	Non Compliant	<ul style="list-style-type: none"> • DNFBPs are not required to reports STRs

4.3 SUSPICIOUS TRANSACTION REPORTING (R.16) (applying R.13 & 14)

4.3.1 DESCRIPTION AND ANALYSIS

252. Accountants have been instructed to report on suspicion of a violation of law as set forth in the Guidelines issued by the ICAI, however, there exist no provisions, including within the PMLA, that obligate accountants to report suspicious transactions as a matter of course to the competent authority, such as the FIU. Similarly, lawyers are not obligated to report suspicious transactions to the FIU, but are obligated to report, by virtue of the Code of Conduct rules stipulated by the Bar Council of India, to the appropriate authorities when they suspect a client is involved in a “criminal act”. Given that money laundering is not yet a criminal act (other than in a very limited way under the NDPS Act), this rule is technically not yet in force. Gem and jewellery dealers, as well as gold dealers operating wholesale, must do so through an established banking channel and it is therefore the bank which is obligated under the PMLA to report suspicious transactions to the FIU, however no such obligation exists for retailers.

253. As casinos are not legal in India, these criteria are not applicable. Nor are they applicable for trust and company service providers.

4.3.2 RECOMMENDATIONS AND COMMENTS

254. It is recommended that authorities:

- Establish obligations for the DNFBPs to comply with the FATF Recommendations by setting up mechanisms to report suspicious transactions to the FIU.
- Ensure DNFBPs are covered under the PMLA.

4.3.3 COMPLIANCE WITH RECOMMENDATION 16

	Rating	Summary of factors relevant to s.4.3 underlying overall rating
R.16	Non Compliant	<ul style="list-style-type: none"> • DNFBPs are not covered under the PMLA nor are they obligated to report any suspicious transactions to a competent authority (FIU).

4.4 INTERNAL CONTROLS, COMPLIANCE & AUDIT (R.16) (applying R.15)

4.4.1 DESCRIPTION AND ANALYSIS

255. DNFBPs do not have mandatory programs or training of AML/CFT best practices, or to ensure that they are fulfilling their obligations to comply with AML/CFT provisions. Accountants must be certified by the central board in a manner keeping with the rules as stipulated by the *Chartered Accountants Act 1949*. This certification does not include, however, specific training on money laundering compliance, nor are there ongoing training programs for employees to ensure AML/CFT obligations are met within their profession. Accountants can be inspected by the ICAI for suspected violations of the code of conduct, and penalties can range from letter of reprimand to revoking of their license.

256. Similarly, lawyers' training (in general) is built into law school curricula, but does not include specific AML/CFT guidance. There is also no continuing education requirement or ongoing training specifically on AML/CFT compliance within their sector. Lawyers are supervised by the Bar Council, and are subject to the Code of Conduct and Professional Conduct as stipulated by the Council. These do not include AML/CFT compliance provisions.

257. Banks holding accounts of nominating agencies authorised to transact on the part of gold dealers or banks holding accounts of gem and jewellers are audited as described above and are obligated to comply with the PMLA provisions. However, there exist no auditing mechanisms for jewellers and gold dealers working at the retail level to ensure that they are not engaged in money laundering or terrorist financing.

258. As casinos are not legal in India, these criteria are not applicable. Nor are they applicable for trust and company service providers.

4.4.2 RECOMMENDATIONS AND COMMENTS

259. It is recommended that the authorities introduce regulations to ensure that:

- DNFBPs establish internal procedures to control for money laundering within their sectors.
- There is compliance with AML/CFT provisions once they have been established for the sector.

4.4.3 COMPLIANCE WITH RECOMMENDATION 16

	Rating	Summary of factors relevant to s.4.4 underlying overall rating
R.16	Non Compliant	<ul style="list-style-type: none">• There are no obligations for DNFBPs to develop internal programs and procedures specifically against money laundering and terrorist financing.

4.5 REGULATION, SUPERVISION AND MONITORING (R.17, 24-25)

4.5.1 DESCRIPTION AND ANALYSIS

260. No DNFBPs have had explicit guidance on AML/CFT requirements or implementation/compliance. The Institute of Chartered Accountants of India (ICAI) however conducted a study on money laundering and published its findings for its members in January 2005, highlighting money laundering from an accountant's perspective and describing the international standards set forth by the FATF. Additionally, ICAI included information on the development of the PMLA. ICAI also circulated guidelines for non-bank financial institutions on KYC, but just as with the PMLA, their guidance has stemmed from those issued by the RBI, and helps auditors ensure compliance with the law and the certification of financial statements for the sectors in which they practice. This includes what internal and external auditors should look out for and some illustrative examples. Guidance to the accounting sector has however not included money laundering provisions in the practice by accountants specifically.

261. The PMLA framework as described above is only applicable to banks and other financial institutions. There are no existing guidelines or mechanisms for monitoring and ensuring compliance specifically for DNFBPs, such as gem dealers, lawyers, accountants or real estate agents with regard to anti-money laundering or counter-financing of terrorism as developed by the FATF.

262. As casinos are not legal in India, these criteria are not applicable. Nor are they applicable for trust and company service providers.

4.5.2 RECOMMENDATIONS AND COMMENTS

263. It is recommended that:

- DNFBPs are brought into the framework of the PMLA.
- DNFBPs be educated on the AML/CFT risks in their sector and be provided guidance on how they can protect against/combat these risks.
- DNFBP regulatory organizations should be provided the tools to monitor and ensure effective compliance with AML/CFT obligations as per the FATF Recommendations

4.5.3 COMPLIANCE WITH RECOMMENDATIONS 17 (DNFBP), 24 & 25 (CRITERIA 25.1, DNFBP)

	Rating	Summary of factors relevant to s.4.5 underlying overall rating
R.17	Partially Compliant	<ul style="list-style-type: none"> • With the exception of the accountants, there has been no guidance (or feedback) on AML/CFT obligations to DNFBPs. Accountants have also only been given guidance on what they should include in audit/assessments, and these do not apply to practices by the sector itself. • DNFBPs are not covered by the PMLA.
R.24	Non Compliant	<ul style="list-style-type: none"> • There are no systems in place for monitoring or ensuring compliance with AML/CFT requirements. • There has been no assessment of risk of money laundering or terrorist financing in DNFBP sectors.
R.25	Non Compliant	<ul style="list-style-type: none"> • There are no existing guidelines for DNFBPs with regard to their obligations to comply with AML/CFT measures. • There is no guidance on the obligations faced by DNFBPs to report suspicious or other transactions to a competent authority (e.g. FIU).

4.6 OTHER NON-FINANCIAL BUSINESSES AND PROFESSIONS - MODERN SECURE TRANSACTION TECHNIQUES (R.20)

4.6.1 DESCRIPTION AND ANALYSIS

264. The application of the PMLA and those existing provisions as detailed above as they pertain to the FATF Recommendations has been understood by the Evaluation Team to only apply specifically to the formal financial community. Discussions with Government Agencies, enforcement authorities and others revealed potential threats of money laundering and terrorist financing in sectors such as the money services businesses and securities, insurance as well as other designated non-financial businesses and professions such as real estate, gem and jewellery and accountancy, but no specific AML/CFT obligations are in place, nor has there been much guidance provided to the same. The non-profit sector, as described below, was also noted to be particularly vulnerable to money laundering and terrorist financing given the lack of adequate regulatory and supervisory oversight.

265. Enforcement authorities noted that while casinos were illegal in India, there existed a significant gambling problem throughout India. Specifically, gambling brokers based in larger cities, such as Mumbai and Delhi coordinated with larger or “wholesale” brokers overseas to establish betting pools on a number of items including sports. Local brokers then accepted bets at the retail level to be included in pools overseas and eventual payment distribution to winners. Similarly lotteries were noted to pose potential criminal risks, although specific money laundering or terrorist financing provisions have not been developed to address this area.

266. As India is in its early stages of introducing the concept of money laundering to the formal financial sector, including the specific obligations to report suspicions to a central competent authority such as an FIU, little thought has been given to applying the

identified FATF Recommendations to other businesses as prescribed in Recommendation 20.

267. Various sectors have in fact developed, or are in the process of developing, robust use of modern and secure techniques for conducting financial transactions, although their specific applications to protect from money laundering has not been seen. For example, various stock exchanges, including the largest in India – the National Stock Exchange – are fully automated exchanges. A sophisticated system of electronic trading has been set up so that each transaction can be monitored and recorded, and algorithms, triggers and alerts have been put in place to identify nefarious or fraudulent activity. Furthermore, databases have been established to help house client identification and transactions data that can be easily accessed by regulators or investigative authorities. However, the NSE and the SEBI have noted that these technological advancements have been established to protect from general fraudulent practices, market manipulations, circular trading and the like – not money laundering specifically. Additionally the SEBI has noted that pyramiding and other forms of trade manipulation for fraudulent gain is a continuing problem.

268. The banking sector varies widely in terms of its scope and breadth of applied technologies for protective purposes. Large or international commercial banks, many of which are affiliated or have considerable overseas businesses, have been able to put in place robust internal AML/CFT controls, however, this type of implementation is unclear for smaller domestic and rural banks. India is still an intensely cash based society, especially in rural regions, and the introduction of credit cards, ATMs, internet and mobile banking poses certain risks that will need to be addressed as the formal financial sector continues to modernize.

4.6.2 RECOMMENDATIONS AND COMMENTS

269. The authorities and the financial sector should consider:

- The establishment of an electronic database of domestic and international terrorism lists such as the UN 1267 list, and creating the ability to electronically monitor activities when compared to entities on those lists. Updating pursuant to new designation to and from the international community would be greatly enhanced.
- Assembling a task force to identify sectors prone or more vulnerable to money laundering or terrorist financing and begin implementing appropriate measures to combat those risks.

4.6.3 COMPLIANCE WITH RECOMMENDATION 20

	Rating	Summary of factors underlying rating
R.20	Non Compliant	<ul style="list-style-type: none"> • Indian authorities have not yet considered applying FATF Recommendations beyond the formal financial sector. • Authorities have not considered developing modern and secure techniques for money management that specifically address the risks of money laundering.

5 LEGAL PERSONS AND ARRANGEMENTS & NON-PROFIT ORGANISATIONS

5.1 LEGAL PERSONS – ACCESS TO BENEFICIAL OWNERSHIP AND CONTROL INFORMATION (R.33)

5.1.1 DESCRIPTION AND ANALYSIS

270. Companies in India must register with the Registrar of Companies Affairs, which begins with the approval of a submitted name by at least two primary subscribers. Once the approval of a name has been granted, capital can be granted upon disclosure to the Reserve Bank of India (due to certain current account restrictions) and the relevant tax authorities. Subscribers are not required to determine or identify themselves as primaries or nominees, but are listed as subscribers for initial registration purposes.

271. There are three types of companies registered under the Registrar: private companies, unlisted public companies, and publicly listed companies. For private companies, subscribers must inform the Registrar of the any additional shareholders and describe the make up and changes to the board, as well as at each years end, the changes or relinquishing of ownership of shares. At year's end, an internal managerial and financial audit must be conducted to determine what the holding situation is, and what has transpired in terms of beneficial ownership for the year. Outside of the two initial subscribers, ownership can change, enter or divest in any way as determined. For unlisted public companies, the Registrar performs the technical scrutiny of the final accounts, and full disclosure requirements are necessary, similar to that of private companies. Finally, for publicly listed companies, shares are not held in physical form, and any changes to the make up of ownership must be submitted to the registrar yearly accompanied by formal third party audit. The Registrar does not intervene in a publicly listed company's affairs unless a shareholder specifically communicates to the registrar – at which time they can recommend for investigation to the SFIO. For these companies, there is no proactive audit mechanism on the part of the Registrar itself, however all records (on ownership, directors, financial statements, etc.) are open to investors and others – changes in management of publicly listed companies is regulated by the SEBI Act.

272. There are 21 Registrars throughout the country, and companies can register with any registry, even when conducting business or headquartered in a different region. Compliance on filing by companies listed by the Registrar falls between 80 and 90 percent a year, and companies are given six months to file. Failure to file can result in criminal action brought upon the company and associated directors by the Registrar. The Registrar has six months to file for a case regarding non-filing of documents by any one company. There are approximately 900 technical professionals working for the Registrar, 1/3 of them conducting technical scrutiny of listed companies, 10 percent dedicated to private companies, and the balance to unlisted public companies. There are now approximately 600,000 companies registered (about 200 are registered per day) of which 450,000 are private companies.

273. There are two types of investigations conducted: 1) those conducted by qualified persons in practice within the Registry, which only carry civil powers, and 2) those conducted by the SFIO. Records for any company listed are accessible by the investigative authorities, public and private alike. Approximately 31-32 cases have been filed with the SFIO (in the last two years since the SFIO has been formed), and have mainly involved false reporting or embezzlement of accounts, and fraudulent practices when making initial public offerings. For international cooperation on investigations, the

Registrar works through the Ministry of External Affairs – requests coming to India can come directly to the Registrar.

274. India does not permit the issue or holding of bearer shares. All transactions in securities is regulated through the 24 stock exchanges and ultimately by the SEBI. All investors and intermediaries must be identified and registered according to the rules stipulated by the SEBI.

5.1.2 RECOMMENDATIONS AND COMMENTS

275. It is recommended that the authorities:

- Improve the supervisory capacity of the Registrar of Companies;
- Provide more proactive scrutiny of publicly listed companies

5.1.3 COMPLIANCE WITH RECOMMENDATIONS 33

	Rating	Summary of factors underlying rating
R.33	Largely Compliant	<ul style="list-style-type: none"> • The identified vulnerability of publicly listed companies making fraudulent initial public offerings and lack of proactive scrutiny by the Registrar may prove detrimental.

5.2 LEGAL ARRANGEMENTS – ACCESS TO BENEFICIAL OWNERSHIP AND CONTROL INFORMATION (R.34)

5.2.1 DESCRIPTION AND ANALYSIS

276. Trusts are governed by general common law principles. As is common in such circumstances, there is no provision for a central registry of trusts or for the details of the parties to a trust to be filed with individual authorities. The financial regulators and range of government investigation agencies have extensive powers to access information from financial institutions and others, and they report no obstacles to the use of these powers to obtain relevant information, when necessary. Under the RBI's AML guidelines, banks are required to verify the identity of trustees, settlers, grantors, protectors, beneficiaries and signatories. Records of these parties are required to be maintained in line with standard record-keeping procedures, and will be available to the authorities in the course of inspections or on demand.

5.2.2 RECOMMENDATIONS AND COMMENTS

277. No Comments or recommendations

5.2.3 COMPLIANCE WITH RECOMMENDATIONS 34

	Rating	Summary of factors underlying rating
R.34	Compliant	

5.3 NON-PROFIT ORGANISATIONS (SR.VIII)

5.3.1 DESCRIPTION AND ANALYSIS

278. Non-profit organisations in India are regulated by the Registrar of Societies and for those charities that are tax exempt, are financially accountable to the Exemptions Department of the Central Board of Direct Taxes. The Registrar of Societies administers the *Societies Registration Act 1860*, and basically functions as the court of record for societies that are wishing to register as societies for the promotion of a number of issues to include the promotion of literature, science, sports, fine arts, social welfare or other charitable purposes. For purposes of registration, societies may be formed by a “memorandum or association and registration,” which means that any seven persons or more associated for one of the aforementioned objectives may subscribe their names to a memorandum of association and file officially with the Registrar. Registration is handled all at the State level, and does not make mandatory the legal headquarters or works to be confined to the State in which the society is registered.

279. The memorandum of association includes the name and objects of a society, the names, addresses and occupations of the governing committee and a copy of the rules and regulations as stipulated by the society. Along with a small fee of fifty rupees or less at time of registration, societies or non-profits are required to submit annual lists of managing bodies (or changes thereof) to the Registrar, and should a society be dissolved, this must be done by no less than three fifths of the members. The Societies Registration Act further lays down rules of conduct for the society insofar as re-defining objectives, and making changes to the board, but does not empower the Registrar itself to conduct any audit of management, financial health, or other activities as laid out by the society, nor can they levy fines or take punitive action against any Society for potential misconduct in these areas. After registration at the State level, all audit and supervisory capacity rests in with the Exemptions Department of Central Tax Authorities, whose role is limited to financial accountability for those societies having sought and received tax exempt status.

280. The Exemptions Department administers the Indian Tax Code, which stipulates that charities wishing to be exempt must be registered with this department under Section 12A. Registration includes a full disclosure of the area of work, makeup of management and board, mission/objective of the charity itself and other financial dealings such as the source and use of funds. Those societies such as clubs, and sports programs, and other non-profits not specifically exempt are not supervised by the Exemptions Department. Religious institutions are also not eligible for tax exemption unless they carry out charitable works (“charitable purpose” is defined in an inclusive manner: relief to the poor, education, medical relief, and any other object of general public utility).

281. Exempt charities must keep funds in a bank account, and hold all investments as dictated by the Exemptions Department in legally mandated ways for exempt institutions. KYC/CDD, record keeping and reporting requirements have not been specifically discussed with financial institutions holding accounts of charities, nor has there been education on the methodologies of funds diversion/manipulation by the Exemptions Department with those financial institutions. They are however bound to the guidelines as discussed above insofar as their obligations to the RBI. There exists no specific list of exempt organizations available to the public, but all exempt organizations have been ‘notified’ by the Exemptions Department, and one is able to search on their website by name to see if a specific charity has been granted tax exempt status – thus donors are able to take deductions based on contributions. Normally, deductions are up to 50%, but certain donations to specified charities as determined by the Commission are granted

different deduction schedules. These are described in sections 80G and 35(1) and (3) of the Tax Code.

282. The Exemptions Department conducts audits on about 5% of registered entities a year, the selection is based on a set of criteria determined by the Department in assessment of market reports and open source information. If funds are received from overseas, these organizations must also be registered according to FEMA with the RBI as receivers/remitters of funds from/to places outside India, and are governed by the *Foreign Contribution (Regulation) Act 1976*. Charities are also obligated to submit yearly financial tax returns that are scrutinized against all financial dealings of the institution from the source and utilization of funds to the keeping of accounts. The Exemptions Department plans to work with the SFIO, Central Excise, Customs, CEIB, CBI and Enforcement Directorate to share information on a monthly basis on potential investigations with regard to financial fraud.

283. Audits and inspections do not include managerial or administrative matters, but are limited to ensuring that financial dealings are in line with stated objectives and that the institution is in fact adhering to its tax exempt obligations. The most common fraud as noted by the Exemptions Department is the utilization of funds by trustees or members of the society itself outside the scope of stated objectives. Breach of obligations or using funds differently from stated objectives brings about civil penalties. If embezzlement or other criminal activities are found, criminal penalties can be levied on the organization's directors. The Tax Recovery Office (TRO) is also able to seize and confiscate funds when it is determined that violations are connected to a tax offence. If related to other activities, punitive actions must be handled by the appropriate and competent authorities.

284. Thus far, no specific assessment has been conducted as to the scope and scale of the sector, or the vulnerabilities they face. The Delhi Registrar of societies estimates 60,000 registered societies, 25,000 of which are operational (within Delhi alone). The Exemptions Department estimates that there are approximately 50-60,000 tax exempt charities/non-profit organisations registered in India, but have no estimate on the number that operate outside of formal registration. There are also, at present, no watchdog or intermediary organisations conducting due diligence or providing education on money laundering, terrorist financing or other fraudulent practices in the sector. The Exemptions Department opined that they were not aware of diversion of funds for terrorism or other purposes, and did not know how the new Rules under the PMLA would affect charities or other tax exempt organizations. They were interested in learning more about conducting a sector-wide assessment of their non-profit sector.

5.3.2 RECOMMENDATIONS AND COMMENTS

285. It is recommended that the authorities:

- Strengthen the powers of the Registrar of Societies to conduct yearly and spot audits to include managerial and administrative oversight (as well as financial) on societies they register.
- Conduct an entire sector wide assessment, noting the scale and scope of the sector, potential vulnerabilities, and risks for terrorist financing.
- Update the *Societies Registration Act* so as to increase the due diligence, record keeping and registration requirements of societies.

- Strengthen the punitive authorities of the Registrar of Societies to include the de-registration of societies and enforcement of other civil and criminal sanctions for misconduct.
- Work with other countries and the APG on amending their supervisory and regulatory environment of non-profits to conform with the best practices and guidelines set out by the FATF.

5.3.3 COMPLIANCE WITH SPECIAL RECOMMENDATION VIII

	Rating	Summary of factors underlying rating
SR. VIII	Partially Compliant	<ul style="list-style-type: none"> • The State Registrar of Societies has no supervisory or sanctions authorities on societies they register. • There has been no assessment of the overall makeup and vulnerabilities of the non-profit sector to terrorist financing or other abuse. • There has been no education to charities/non-profits on how to protect themselves from terrorist financing and other abuses. • The scope of supervision, although fairly robust, but the Exemptions Department, only effects those registered with the Tax Authorities.

6 NATIONAL AND INTERNATIONAL CO-OPERATION

6.1 NATIONAL CO-OPERATION AND COORDINATION (R.31)

6.1.1 DESCRIPTION AND ANALYSIS

286. The Economic Intelligence Council (EIC) has been established to enhance coordination between various enforcement agencies and departments in the Ministry of Finance. The EIC provides a forum for enforcement agencies to exchange intelligence, to formulate common strategies to combat economic offences, to strengthen operational coordination and to discuss cases requiring inter-agency coordination. Members of the EIC are from different government agencies, including Company Affairs, the RBI, the SEBI, Income Tax, the Director General of Revenue Intelligence, Customs and Central Excise, the NCB, the CBI, and the Intelligence Bureau. There are 18 Regional Economic Intelligence Committees (REIC) in India which function similarly as the EIC at the regional level. Meetings of the EIC and REIC are conducted monthly to enable all member agencies to update each other on recent developments relating to economic crimes.

287. The Central Economic Intelligence Bureau (CEIB) was been set up in 1985 as the secretariat for the Economic Intelligence Council. The CEIB was set up to coordinate the intelligence gathering and enforcement activities of economic intelligence in the area of economic offences. The CEIB also interacts with the National Security Council, Intelligence Bureau and Ministry of Home Affairs on matters concerning national security and terrorism. Enforcement agencies informed the Evaluation Team that they have close relationships with each other and cooperate freely with investigations.

288. The FIU, once operational, is intended to be an independent body reporting to the EIC. It is not clear how the FIU will co-operate with the other domestic authorities in relation to operational and policy matters.

6.1.2 RECOMMENDATIONS AND COMMENTS

289. India should ensure there is an effective mechanism to enable policy makers, the FIU, law enforcement and other competent authorities co-operate with each other to develop and implement policies to combat

6.1.3 COMPLIANCE WITH RECOMMENDATION 31

	Rating	Summary of factors underlying rating
R.31	Partially Compliant	<ul style="list-style-type: none"> The FIU is not operational and it is not clear as to how FIU will co-operate with the other domestic authorities in the relation to operational and policy aspects concerning money laundering and terrorist financing matters.

6.2 THE CONVENTIONS AND UN SPECIAL RESOLUTIONS (R.35 & SR.I)

6.2.1 DESCRIPTION AND ANALYSIS

290. India signed the United Nations Terrorist Financing Convention on 8 September 2000 and ratified it on 22 April 2003. India has largely implemented the Terrorist Financing Convention through the *Unlawful Activities (Prevention) Act (UAPA)*. For further discussion see Part 2.2 of this report. This Convention is also implemented through the *Code of Criminal Procedure 1973* and the *Extradition Act 1962*.

291. India acceded to the Vienna Convention on 27 March 1990 and signed the Palermo Convention on 12 December 2002 but has not yet ratified it. The Vienna Convention is largely implemented through amendments to the NDPS Act in 1989 and 2001, and the PMLA, however the PMLA has not yet come into force, and so the current legal system only criminalises money laundering based on drug offences. A5(5) of the Vienna Convention has not been implemented, as all confiscated assets in India go to consolidated government revenue, and are not available for sharing with other countries. For further discussion of India's implementation of the Vienna and Palermo Conventions see Part 2.1 of this report.

292. India's implementation of UNSCR 1267 and 1373 is discussed in part 2.4 above.

6.2.2 RECOMMENDATIONS AND COMMENTS

293. It is recommended the authorities:

- Bring the PMLA into force
- Ratify and fully implement the Palermo Convention
- Fully implement UNSCR 1267 and 1373 as discussed in part 2.4 above
- Fully implement the Vienna Convention and Terrorist Financing Convention

6.2.3 COMPLIANCE WITH RECOMMENDATION 35 AND SPECIAL RECOMMENDATION I

	Rating	Summary of factors underlying rating
R.35	Partially Compliant	<ul style="list-style-type: none"> • India has not ratified and fully implemented the Palermo Convention • India has not fully implemented the Vienna Convention and Terrorist Financing Convention
SR.I	Partially Compliant	<ul style="list-style-type: none"> • India has not fully implemented the Terrorist Financing Convention • India has not fully implemented UNSCRs 1267 and 1373

6.3 MUTUAL LEGAL ASSISTANCE (R.32, 36-38, SR.V)

6.3.1 DESCRIPTION AND ANALYSIS

294. The general power to provide mutual legal assistance (MLA) in criminal matters is through Chapter VIIA of the *Code of Criminal Procedure 1973*; however India can provide MLA for specific matters through a number of other Acts such as the NDPS Act and the Customs Act.

295. Chapter IX of the PMLA contains separate MLA provisions specifically for assistance in money laundering cases. However, as the PMLA has not yet come into force, India cannot yet provide MLA for money laundering matters, except those related to drug offences as provided for in the NDPS Act. At the time of the onsite visit, the Government had not yet considered the full operation of the MLA sections of the Act. Although the Evaluation Team requested to discuss these provisions with the relevant agency, the MoF stated they were not yet in a position to answer detailed questions on this. The CBI who coordinate MLA requests under the Criminal Procedure Code were unaware who would coordinate MLA requests under PMLA. The Government was also unsure whether they would negotiate additional mutual legal assistance treaties (MLATs) specifically for money laundering cases, or whether the existing MLATs would be used.

296. India has signed MLATs with 19 countries and a further 16 are being finalised. Requests for assistance can be executed even where there is no MLAT with the other country, however India will insist on reciprocity. India is a member of the Commonwealth Countries' Harare Scheme and is signatory to a number of treaties containing MLA provisions. India can action MLA requests through those provisions where there is no MLAT with the requesting or receiving country.

297. MLA requests usually come to the Central Government via diplomatic channels, and are then passed on to the relevant court or law enforcement agency. If an MLAT is in place it will specify the procedure to be taken to request assistance. As the PMLA has not yet come into force, there are no procedures yet in place to execute MLA requests under that Act.

298. India can provide a wide range of assistance under the Criminal Procedure Code for terrorist financing investigations and prosecutions. This includes warrants for arrest, warrants to attend court or produce a document (section 105B (3)), attachment or forfeiture (section 105C (3)), tracing and identifying proceeds of crime (where there is an

attachment or forfeiture order) (section 105D (1)), seizure (where there is an attachment or forfeiture order) (section 105E (1)), examination of persons and production of documents (section 166B).

299. The MLA provisions in the PMLA will allow for a broad range of assistance to be provided in money laundering cases. Most of the search and seizure powers available under the Act for domestic offences in sections 17 and 18 will be available for MLA requests. For example, production, search, seizure of documents and taking witness statements are available through sections 59(2) (d) (ii) and 59(2) (c), service of documents is available through section 59(2), sections 60(3) and 60(6) allow for tracing and ID of property and for attachment and confiscation of property in accordance with the Act (although this will not cover instrumentalities of an offence).

300. The Government indicated that assistance for MLA requests can be provided in a timely manner. The CBI does not have internal targets for how long a request should take, however they indicated that MLA requests receive appropriate priority. It is possible to fast-track requests where there is a case which is of high priority.

301. The MHA provided the Evaluation Team with a list of outstanding MLA requests, however there was no indication of how long they have been outstanding. The Government indicated that it was not possible to provide specific information on this; however they stated that the average time taken by CBI to action MLA requests is two to four months. Requests could take longer if a team of police officials from the requesting country were helping with the investigation in India, or if it were a complicated case. Without specific information on the time taken to action requests it is difficult to determine how timely India's mutual legal assistance is.

302. As the PMLA is not yet in force it is not possible to determine the amount of time it would take for a request to be actioned under that Act. This may depend on whether coordination of money laundering requests will remain with CBI or whether a new body will have responsibility for these requests. The provisions of the Act are straightforward, however timeliness of responses generally has more to do with practical constraints than the provisions of the Act.

303. India places very few conditions or restrictions on their provision of assistance. It is their policy to keep conditions at a minimum and ensure that other countries do the same when negotiating an MLAT. The Criminal Procedure Code does not list any conditions, and any conditions that are imposed would be contained in the MLAT. While it is at the discretion of the Central Government whether to pass a request on to the CBI (section 166B), in practice CBI state that MLA requests are rarely refused. (CBI stated they have only refused to action a request in two cases, when the original documents were not provided to them). They also state that all requests are actioned, even if they come through informal channels.

304. Similarly, the PMLA does not provide any conditions under which a request would be refused. Under the PMLA the central government has discretion over whether to pass on a request to the relevant court or law enforcement agency (section 58). It is assumed that India's policy on this would be in line with their general MLA policy and so it is unlikely that there will be any undue restrictions.

305. MLA requests are not refused on the grounds of secrecy or confidentiality by financial institutions or DNFBPs. CBI stated that banks readily assist with MLA requests in criminal matters.

306. All the powers that are available for domestic money laundering and terrorist financing cases will be available for MA requests through sections 17 and 18 of the PMLA and are available through section 166B of the Criminal Procedure Code.

307. Determination of the best venue for prosecutions (where prosecution would be possible in more than one jurisdiction) is settled on a case by case basis, through diplomatic channels.

308. Section 166B allows assistance to be provided where there is “an offence under investigation” in another country. The CBI indicated that there is a test of dual criminality, but it is not strictly applied. The dual criminality test in relation to extradition is applied more strictly than for other forms of mutual assistance, with the main requirement being that the offence has a penalty in India of imprisonment of over one year. Technical differences in the offences are not an impediment. This is discussed further under part 6.4 of the MER. In regard to requests under the PMLA, India has noted that the issues of dual criminality will be considered at the time of the finalisation of the MLATs. No policy on dual criminality has been put in place as yet.

309. India can provide assistance to requests for tracing, identification, attachment and forfeiture of property derived or obtained from the commission of an offence committed in the requesting State, however instrumentalities used in an offence cannot be confiscated (section 105C(3) Criminal Procedure Code). To date, India has only had one request for attachment of property from another country. That case is currently being progressed and the funds have not yet been attached.

310. Section 60(6) of the PMLA will allow the search, seizure, attachment and confiscation provisions of the Act to be used in MLA cases. This will include property laundered or proceeds of offences, but not instrumentalities to be used in offences.

311. Property of corresponding value cannot be confiscated under either Act, however section 105H of the Criminal Procedure Code allows the court to specify to the best of its ability which properties are proceeds of crime, where it is not possible to identify the exact proceeds.

312. As India has only had one MLA request for a seizure or confiscation action to date, it has not developed procedures dealing with seizure and confiscation requests such as coordinating actions with other countries, establishing a fund for the confiscated assets to be used for law enforcement and other purposes, or sharing assets with other countries.

6.3.2 RECOMMENDATIONS AND COMMENTS

313. It is recommended that the authorities:

- The PMLA be brought into force as soon as possible so that India can provide MLA for the full range of money laundering matters.
- Maintain accessible information on MLA requests made and received including the time taken to respond to requests.
- Continue to establish MLA relationships with other countries, including the development of MLATs.
- Give high priority to providing assistance in a timely manner.
- Allow for instrumentalities and property of corresponding value to be confiscated.

6.3.3 COMPLIANCE WITH RECOMMENDATIONS 32, 36 TO 38, AND SPECIAL RECOMMENDATION V

	Rating	Summary of factors relevant to s.6.3 underlying overall rating
R.32	Partially Compliant	<ul style="list-style-type: none"> • Full statistics could not be provided on the time taken to respond to MLA requests
R.36	Partially Compliant	<ul style="list-style-type: none"> • India does not provide MLA for money laundering cases, except for drug related offences under the NDPS Act • It is unclear whether India does in fact provide assistance in a timely manner
R.37	Partially Compliant	<ul style="list-style-type: none"> • India does not provide MLA for money laundering cases, except for drug related offences under the NDPS Act • The dual criminality test should not be applied for less intrusive and non compulsory measures
R.38	Partially Compliant	<ul style="list-style-type: none"> • India cannot confiscate the instrumentalities used in or intended for use in offences. • India cannot confiscate property of corresponding value. • India has not considered establishing an asset forfeiture fund or sharing confiscated assets with other countries.
SR. V	Partially Compliant	<ul style="list-style-type: none"> • It is unclear whether India does in fact provide assistance in a timely manner • The dual criminality test should not be applied for less intrusive and non compulsory measures • India cannot confiscate the instrumentalities used in or intended for use in offences. • India cannot confiscate property of corresponding value. • India has not considered establishing an asset forfeiture fund or sharing confiscated assets with other countries.

6.4 EXTRADITION (R.32, 37 & 39, & SR.V)

6.4.1 DESCRIPTION AND ANALYSIS

314. Terrorist financing is an extraditable offence under Indian law pursuant to the *Extradition Act 1962*. Money laundering will not be an extraditable offence until the PMLA comes into force, however extradition under the PMLA will only be possible if the money laundering offence relates to one of the predicate offences listed in the Schedule to the PMLA. India's limited list of scheduled offences may therefore cause extradition difficulties in some money laundering cases. The PMLA contains specific extradition provisions.

315. In order to comply with an extradition request, India requires there to be a bilateral treaty or extradition arrangement with the requesting country or both countries to be signatory to an international treaty that contains extradition provisions. India has signed extradition treaties with 29 countries, is currently finalising treaties with a further 33, and has extradition arrangements with 10 countries. India is also a party to regional

extradition treaties such as the London Scheme. India is currently in the process of ratifying the Palermo Convention which will broaden the range of extraditable offences.

316. India provided the Evaluation Team with details of its pending extradition requests to and from other countries. India currently has 14 cases in which it has requested extradition from other countries. India has 20 pending extradition requests from other countries. It is not known how long these cases have been pending.

317. The dual criminality test for extradition requires the offence to be punishable in India and the foreign country for not less than one year. MEA stated that provided the offence is punishable in India for more than a year, the penalty in the other country is not strictly applied. A substantial match of elements within the offence is required, but technical differences will not prevent extradition.

318. There is no bar to the extradition of Indian citizens. Where another country with which India has an extradition relationship bars the extradition of their citizens India may do the same; however this does not commonly occur.

319. The procedures for extradition appear to be straightforward. Requests generally arrive through diplomatic channels, and are then transferred to the MEA who will request the Court to consider whether the case is sound. The time taken to deal with extradition requests can vary largely. If the person surrenders, the case can be fast tracked and dealt with very quickly, however there can also be delays. India indicated that extradition cases could take from between five months to five years. Significant delays can occur due to court appeal processes; however some delays are to be expected in all countries. Extradition cases can pass through three levels of court proceedings – the Magistrates Court, the High Court then the Supreme Court. The final layer of appeal is to the External Affairs Minister.

320. It is unclear how extradition will apply once the PMLA comes into force; however the provisions of the Act indicate that it will operate in a similar manner to the Extradition Act.

6.4.2 RECOMMENDATIONS AND COMMENTS

321. It is recommended that the authorities:

- Bring the PMLA into force as soon as possible to allow extradition for money laundering offences.
- Continue to develop extradition relationships with countries including the development of bilateral treaties
- Do not limit extradition for money laundering to the predicate offences in the PMLA.
- Establish procedures for extradition under the PMLA.

6.4.3 COMPLIANCE WITH RECOMMENDATIONS 32, 37 & 39, AND SPECIAL RECOMMENDATION V

	Rating	Summary of factors relevant to s.6.4 underlying overall rating
R.32	Partially Compliant	<ul style="list-style-type: none"> • India maintains details of extradition requests – this rating is reflective of deficiencies in aspects of R32 not dealt with in this section.
R.37	Partially Compliant	<ul style="list-style-type: none"> • Money laundering is not an extraditable offence at this time
R.39	Non Compliant	<ul style="list-style-type: none"> • Money laundering is not an extraditable offence at this time
SR. V	Partially Compliant	<ul style="list-style-type: none"> • This rating is reflective of deficiencies in aspects of SRV not dealt with in this section.

6.5 OTHER FORMS OF INTERNATIONAL CO-OPERATION (R.32 & 40, & SR.V)

6.5.1 DESCRIPTION AND ANALYSIS

322. There are no explicit legal gateways allowing for regulatory co-operation with foreign counterparts in any of the Acts governing the operations of the RBI, the SEBI or the IRDA, and all employees of these agencies, as public servants, are covered by the Official Secrets Act. However, all three agencies indicated that, in practice, they were able to co-operate, on request, with foreign counterparts and did so on a regular basis. However, the absence of any clearly defined gateways means that there are also no statutory safeguards relating to the use of information given or received through any "informal" channels.

323. In the RBI Bulletin of January 2005 the banking supervisors' ability to share information is described as "need-based, though no formal MOUs exist", but from discussion with the RBI, it appears that information passed through this channel can only be of a general supervisory nature and must already be in the hands of the RBI (i.e. it has no power to seek disclosure from a regulated institution, or to carry out an investigation, on behalf of a foreign counterpart). There are no statistics for the number of requests for assistance received by the RBI from overseas counterparts, or for the number with which the RBI has been able to assist.

324. In the case of the SEBI, although there is no explicit gateway for co-operation, section 11(2)(la) of the SEBI Act provides for the "calling from or furnishing to any such agencies, as may be specified by the Board, such information as may be considered necessary by it for the efficient discharge of its functions". It is understood that SEBI uses this power to designate certain foreign counterparts, on a case-by-case basis, in order to respond to requests, although it is not clear what the mechanism is for this or how efficient it is in being able to deal with urgent requests. However, the SEBI is a signatory to the IOSCO Multi-lateral Memorandum of Understanding, which requires it have satisfied IOSCO that it has effective and unfettered statutory and operational gateways for co-operation with other signatories. In the past two years SEBI has received four requests for co-operation from overseas counterparts, and has, so far, been able to respond to three.

325. The IRDA described its approach to international co-operation as being "based on a philosophy, not a regulatory provision". It appears to be the view that, in the absence of any specific prohibition within the SEBI Act, it is permitted to co-operate with foreign counterparts, but, as with the RBI, there appear to be constraints on its ability to acquire information, and carry out investigations, on behalf of such counterparts.

326. The FIU is not operational and there is no specific provision in the PMLA concerning international cooperation. India is a member of the Interpol and the CBI is the official Interpol unit in India. All the State Police forces and other law enforcement agencies in India have a link through Interpol New Delhi to their counterparts in other member countries in dealing with criminal investigations. Indian Customs is member of the World Customs Organisation and enforcement information is shared with countries in Asia Pacific Region through RILO. The NCB maintains close liaison with its drug enforcement counterparts and provides assistance in investigation as required.

6.5.2 RECOMMENDATIONS AND COMMENTS

327. It is recommended that:

- Introduce statutory gateways to define clearly the terms under which the regulators may co-operate with their overseas counterparts.
- The FIU should be given a clear legislative mandate to share financial information and other relevant intelligence with its foreign counterparts either upon its own initiative or upon request as well as to make inquiries on behalf of its foreign counterparts.
- The FIU should establish a mechanism to ensure that foreign requests are responded to in a timely way.
- The FIU should maintain statistics on the number of requests for assistance made or received by the FIU, including a breakdown of the number of requests processed and refused.
- The Directorate of Enforcement and other law enforcement agencies involved in terrorist financing investigations should be able to exchange information and to provide investigative assistance to their foreign counterparts by either establishing a mechanism or utilizing existing gateways such as Interpol, the World Customs Organization etc.

6.5.3 COMPLIANCE WITH RECOMMENDATIONS 32 & 40, AND SPECIAL RECOMMENDATION V

	Rating	Summary of factors relevant to s.6.5 underlying overall rating
R.32	Non Compliant	<ul style="list-style-type: none"> • There are no statistics available for assessment as FIU is not operational, and PMLA has yet to take effect.
R.40	Non Complaint	<ul style="list-style-type: none"> • There are no statutory gateways for regulator-to-regulator co-operation. • No mechanism in place for the FIU to handle requests of assistance from its foreign counterparts.
SR.V	Partially Compliant	<ul style="list-style-type: none"> • Terrorist financing is not a predicate offence under PMLA and there is no reporting obligation to report to FIU.

7 OTHER ISSUES

7.1 OTHER RELEVANT AML/CFT MEASURES OR ISSUES

7.2 GENERAL FRAMEWORK FOR AML/CFT SYSTEM (SEE ALSO SECTION 1.1)

TABLES

Table 1: Ratings of Compliance with FATF Recommendations

Table 2: Recommended Action Plan to improve the AML/CFT system

Table 3: Authorities' Response to the Evaluation

Table 1. Ratings of Compliance with FATF Recommendations

The rating of compliance vis-à-vis the FATF Recommendations should be made according to the four levels of compliance mentioned in the 2004 Methodology (Compliant (C), Largely Compliant (LC), Partially Compliant (PC), Non-Compliant (NC)), or could, in exceptional cases, be marked as not applicable (na).

Note: *These ratings reflect the status of the legislation in force at the time of the mutual evaluation in March 2005: that is, they reflect the fact that the PMLA and the implementing Rules had not come into force. The significant measures that have been brought into place by India would result in increased levels of compliance with the FATF Recommendations and improve the ratings.*

Forty Recommendations	Rating	Summary of factors underlying rating ⁹
Legal systems		
1. ML offence	PC	<ul style="list-style-type: none"> • Money laundering is only criminalised when related to drug offences and does not extend to other serious offences. • The money laundering offence does not fully cover the requirements of the Palermo and Vienna Conventions. • A charge for a predicate offence is required before a charge for a money laundering offence can be obtained. • The money laundering offence in the NDPS Act is not effectively used.
2. ML offence – mental element and corporate liability	PC	<ul style="list-style-type: none"> • The NDPS Act does allow fines to be imposed on legal persons; however there are no other criminal, civil or administrative penalties. The NDPS Act does not contain effective, proportionate and dissuasive criminal sanctions for money laundering.
3. Confiscation and provisional measures	PC	<ul style="list-style-type: none"> • The PMLA is not yet in force • The UAPA and NDPS Act do not provide for instrumentalities used in, or intended for use in the commission of offences to be confiscated (except in terrorist financing cases in limited circumstances). • The UAPA and NDPS Act do not allow property of

⁹ These factors are only required to be set out when the rating is less than Compliant.

		<p>corresponding value to be confiscated.</p> <ul style="list-style-type: none"> • There have been no confiscations under the UAPA and so implementation of this Act cannot be assessed.
Preventive measures		
4. Secrecy laws consistent with the Recommendations	C	
5. Customer due diligence	PC	<ul style="list-style-type: none"> • The Rules to bring the PMLA into force have not been promulgated (but the immediate introduction of the current draft Rules would not affect the rating due to the issues below). • The PMLA does not cover exchange houses and money remitters. • Although the core elements of Recommendation 5 are contained within the RBI guidelines, they have not been implemented through a mechanism that meets the definition of "law or regulation". • There are no detailed CDD rules or guidelines applied to the securities, insurance, foreign exchange and money remittance sectors. Further, the IRDA, as the lead regulator for their sector, is not aware of, nor do they explicitly address AML/CFT obligations on their sector. • Full compliance with the RBI's CDD guidelines for banks is not required until end-2005.
6. Politically exposed persons	PC	<ul style="list-style-type: none"> • Only the banks have been instructed to take special measures in respect of PEPs, and full compliance is not required until end-2005.
7. Correspondent banking	LC	<ul style="list-style-type: none"> • Appropriate instructions have been issued to the banks, full compliance with the RBI guideline is not required until end-2005.
8. New technologies & non face-to-face business	PC	<ul style="list-style-type: none"> • Specific instructions on non-face-to-face customers have only been issued to the banks, and nothing similar exists for other institutions.
9. Third parties and introducers	LC	<ul style="list-style-type: none"> • There is a lack of clarity on whether third-party introductions are permitted, but it is possible that reliance on third-party introductions may not be permitted under current requirements.
10. Record keeping	LC	<ul style="list-style-type: none"> • Requirements between the RBI Guidelines of 2002 and the implementing Rules for the PMLA are not consistent • PMLA record keeping requirements seem to extend only to a 'set' of transactions, and not all transactions • Money Service Businesses do not seem to be covered by the PMLA record keeping compliance guidelines
11. Unusual transactions	PC	<ul style="list-style-type: none"> • Relevant guidelines have only been issued to institutions under the supervision of the RBI.

		<ul style="list-style-type: none"> • There are no specific requirements for financial institutions to investigate the background to complex and unusual transactions and to retain a copy of the results of the investigation.
12. DNFBP – R.5, 6, 8-11	PC	<ul style="list-style-type: none"> • There are no known AML/CFT obligations for lawyers and accountants or gem and jewellery dealers. • There seem to be some customer due diligence and record keeping obligations for gold dealers, as importers and authorised purchasers are registered and under supervision of the RBI. • PMLA provisions do not apply to DNFBPs specifically.
13. Suspicious transaction reporting	NC	<ul style="list-style-type: none"> • The STR system has yet to be implemented, but even with the introduction of the proposed regime: <ul style="list-style-type: none"> • The obligation to report STRs only applies for most predicate offences when the alleged proceeds exceed a threshold of Rs.3mn. • There is no obligation to report suspicions linked to terrorist financing as this is not a predicate offence. • Attempted transactions are not required to be reported.
14. Protection & no tipping-off	PC	<ul style="list-style-type: none"> • There is no tipping-off offence. • Legal protection in relation to filings STRs is provided in relation to civil liability only, and not criminal liability.
15. Internal controls, compliance & audit	PC	<ul style="list-style-type: none"> • There is no general principle within the PMLA requiring financial institutions to have proper systems and controls with respect to AML/CFT. • The role of the principal officer in the PMLA Rules does not extend to a proper compliance function. • Full compliance with the RBI rules is not required until end-2005. • No specific rules on AML/CFT systems and controls have been issued to the insurance and securities sectors or to the exchange houses and money remitters.
16. DNFBP – R.13-15 & 21	NC	<ul style="list-style-type: none"> • DNFBPs are not covered under the PMLA nor are they obligated to report any suspicious transactions to a competent authority (FIU). • There are no obligations for DNFBPs to develop internal programs and procedures specifically against money laundering and terrorist financing.
17. Sanctions	PC	<ul style="list-style-type: none"> • As PMLA has not yet come into force, nor has the FIU begun receiving required reports, there has been no implementation of penalties that are effective and dissuasive for non-compliance specifically with AML/CFT obligations listed in the PMLA.

		<ul style="list-style-type: none"> • There are no specific AML/CFT provisions in sectors outside banking, and so penalties for non-compliance with AML/CFT provisions cannot be applied. • The IRDA appears to lack any explicit enforcement powers. • Statistics on enforcement actions for non-compliance of AML/CFT obligations by functional regulators lacking in all sectors. • With the exception of the accountants, there has been no guidance (or feedback) on AML/CFT obligations to DNFBPs. Accountants have also only been given guidance on what they should include in audit/assessments, and these do not apply to practices by the sector itself. • DNFBPs are not covered by the PMLA.
18. Shell banks	LC	<ul style="list-style-type: none"> • Banks are not specifically required to establish that their respondent banks are not undertaking business with shell entities.
19. Other forms of reporting	C	
20. Other DNFBP & secure transaction techniques	NC	<ul style="list-style-type: none"> • Indian authorities have not yet considered applying FATF Recommendations beyond the formal financial sector. • Authorities have not considered developing modern and secure techniques for money management that specifically address the risks of money laundering.
21. Special attention for higher risk countries	PC	<ul style="list-style-type: none"> • No guidance is currently provided to financial institutions on which countries fail to comply with FATF standards.
22. Foreign branches & subsidiaries	LC	<ul style="list-style-type: none"> • No guidance has been issued to the banks requiring their foreign branches and subsidiaries to apply the higher of Indian or host country AML/CFT requirements.
23. Regulation, supervision and monitoring	PC	<ul style="list-style-type: none"> • To date, there has been no focus on AML/CFT compliance by industry regulators other than the RBI. • Oversight of the foreign exchange dealers and money remitters is directed primarily at compliance with FEMA, and not at AML/CFT issues. • The role and powers of the IRDA appear less well defined, both in law and practice, than for the other regulatory agencies. • There are no direct statutory controls over the acquisition of shares and controlling interests in financial institutions. • Apart from the guidelines issued by the RBI in respect of the banking sector, there has been only limited extension of primary AML principles to the other sectors of the financial industry.

24. DNFBP - regulation, supervision and monitoring	NC	<ul style="list-style-type: none"> • There are no systems in place for monitoring or ensuring compliance with AML/CFT requirements. • There has been no assessment of risk of money laundering or terrorist financing in DNFBP sectors.
25. Guidelines & Feedback	PC	<ul style="list-style-type: none"> • As the FIU is not formally stood up, no feedback has been provided as yet with regard to submitted reports. Implementation of this has therefore not been seen. • No guidance/feedback has been issued with regard to existing reporting requirements by covered institutions to agencies directly. • RBI Guidelines do not seem to extend to money services/exchange businesses. • There are no specific AML/CFT guidelines or feedback from/to the SEBI/SROs for the securities sector. • No specific guidance has been given with regard to complying with counter-terrorist financing obligations, complying with asset freeze obligations, nor has there been any typologies given to the sectors as to how to identify terrorist financing activities within their respective sectors. • There are no existing guidelines for DNFBPs with regard to their obligations to comply with AML/CFT measures. • There is no guidance on the obligations faced by DNFBPs to report suspicious or other transactions to a competent authority (e.g. FIU).
Institutional and other measures		
26. The FIU	NC	<ul style="list-style-type: none"> • There is no basis to assess the effectiveness of the FIU as it is not operational.
27. Law enforcement authorities	PC	<ul style="list-style-type: none"> • Designated law enforcement authorities on money laundering investigation are yet to be established pending the PMLA coming into force.
28. Powers of competent authorities	PC	<ul style="list-style-type: none"> • The powers under PMLA on survey, search and seizure is pending the PMLA to come into force.
29. Supervisors	PC	<ul style="list-style-type: none"> • While supervisors outside the RBI may have the power to compel records, there is no obligation that they assess for compliance specifically for money laundering/terrorist financing obligations, nor impose required sanctions. • There is no implementation of supervisors assessing for compliance of TF obligations, or imposing sanctions for non-compliance with TF obligations in sectors other than the banking sector (securities, insurance, money service/exchange businesses, etc.).
30. Resources, integrity and	PC	<ul style="list-style-type: none"> • The FIU appears to be an independent unit with reasonable manpower and resources allocated.

training		<p>However, the FIU is not operational and there is no basis to assess its operational independence and autonomy as well as its functional effectiveness in various aspects.</p> <ul style="list-style-type: none"> • The adequacy of financial, human and technical resources in combating money laundering is subjected to actual workload after the PMLA to come into force. • With the exception of the RBI, staff within the regulatory agencies have not been trained in key aspects of AML/CFT compliance. • The powers of the government to issue policy and other directions to the regulators may impact operational independence
31. National co-operation	PC	<ul style="list-style-type: none"> • The FIU is not operational and it is not clear as to how FIU will co-operate with the other domestic authorities in the relation to operational and policy aspects concerning money laundering and terrorist financing matters.
32. Statistics	NC	<ul style="list-style-type: none"> • There is no basis to assess the efficacy of the FIU as it is yet to commence operations and therefore there are no statistics on cash and suspicious transaction reports. • There are currently no statistics available for assessment by the RBI on the efforts to date to comply with Guidelines set forth through their published directions. • There are no centrally maintained statistics kept on money laundering investigations, prosecutions, convictions, attachments and confiscations. • Full statistics could not be provided on the time taken to respond to MLA requests.
33. Legal persons – beneficial owners	LC	<ul style="list-style-type: none"> • The identified vulnerability of publicly listed companies making fraudulent initial public offerings and lack of proactive scrutiny by the Registrar may prove detrimental.
34. Legal arrangements – beneficial owners	C	
International Co-operation		
35. Conventions	PC	<ul style="list-style-type: none"> • India has not ratified and fully implemented the Palermo Convention • India has not fully implemented the Vienna Convention and Terrorist Financing Convention •
36. Mutual legal assistance (MLA)	PC	<ul style="list-style-type: none"> • India does not provide MLA for money laundering cases, except for drug related offences under the NDPS Act • It is unclear whether India does in fact provide

		assistance in a timely manner
37. Dual criminality	PC	<ul style="list-style-type: none"> India does not provide MLA for money laundering cases, except for drug related offences under the NDPS Act The dual criminality test should not be applied for less intrusive and non compulsory measures Money laundering is not an extraditable offence at this time
38. MLA on confiscation and freezing	PC	<ul style="list-style-type: none"> India cannot confiscate the instrumentalities used in or intended for use in offences. India cannot confiscate property of corresponding value. India has not considered establishing an asset forfeiture fund or sharing confiscated assets with other countries.
39. Extradition	NC	<ul style="list-style-type: none"> Money laundering is not an extraditable offence at this time
40. Other forms of co-operation	NC	<ul style="list-style-type: none"> There are no statutory gateways for regulator-to-regulator co-operation. No mechanism in place for the FIU to handle requests of assistance from its foreign counterparts.
Eight Special Recommendations	Rating	<ul style="list-style-type: none"> Summary of factors underlying rating
SR.I Implement UN instruments	PC	<ul style="list-style-type: none"> India has not fully implemented the Terrorist Financing Convention India has not fully implemented UNSCRs 1267 and 1373
SR.II Criminalise terrorist financing	PC	<ul style="list-style-type: none"> The UAPA does not cover all situations where funds are provided for terrorist activities. The offence provisions do not cover the mental element of 'knowledge' The provisions do not capture all circumstances where persons provide funds to individual terrorists. Terrorist financing offences are not predicate offences for money laundering under the PMLA. Penalties that apply to legal persons should be broadened. The UAPA is not effectively implemented as there have been no charges or prosecutions under the terrorist financing provisions to date.
SR.III Freeze and confiscate terrorist assets	PC	<ul style="list-style-type: none"> India does not have effective procedures to immediately freeze terrorist funds or other assets pursuant to UNSCRs 1267 and 1373. There are no effective and publicly known procedures for considering de-listing and unfreezing requests in a

		<p>timely manner.</p> <ul style="list-style-type: none"> Affected persons do not have access to funds for basic expenses.
SR.IV Suspicious transaction reporting	NC	<ul style="list-style-type: none"> There is no obligation to report suspicions linked to terrorist financing as this is not a predicate offence.
SR.V International co-operation	PC	<ul style="list-style-type: none"> It is unclear whether India does in fact provide assistance in a timely manner The dual criminality test should not be applied for less intrusive and non compulsory measures India cannot confiscate the instrumentalities used in or intended for use in offences. India cannot confiscate property of corresponding value. India has not considered establishing an asset forfeiture fund or sharing confiscated assets with other countries.
SR VI AML requirements for money/value transfer services	PC	<ul style="list-style-type: none"> There seems to be a large discrepancy in understanding of the scale and scope of problem between regulatory and enforcement authorities and across sectors. PMLA provisions do not seem to apply effectively to this sector. Supervisory capacity is extremely lacking to ensure compliance with AML/CFT provisions. Given illegality, sanctions are not nearly effective to dissuade hawala/hundi.
SR VII Wire transfer rules	PC	<ul style="list-style-type: none"> There is no requirement to attach originator information to outgoing wire transfers Institutions are not required to take any precautionary measures in respect of incoming wire transfers that do not have originator information included
SR.VIII Non-profit organisations	PC	<ul style="list-style-type: none"> The State Registrar of Societies has no supervisory or sanctions authorities on societies they register. There has been no assessment of the overall makeup and vulnerabilities of the non-profit sector to terrorist financing or other abuse. There has been no education to charities/non-profits on how to protect themselves from terrorist financing and other abuses. The scope of supervision, although fairly robust, but the Exemptions Department, only effects those registered with the Tax Authorities.
SR. IX Cash Couriers	PC	<ul style="list-style-type: none"> As the FIU is not operational, there are no mechanisms to pass the information obtained from the declaration process to the FIU.

Table 2: Recommended Action Plan to Improve the AML/CFT System

AML/CFT System	Recommended Action (listed in order of priority)
1. General	No text required
2. Legal System and Related Institutional Measures	
Criminalisation of Money Laundering (R.1 & 2)	<p>While the development of AML legislation is a good first step, there are a number of measures India should implement to produce a more effective and functional money laundering offence:</p> <ul style="list-style-type: none"> • The PMLA should be brought into force and India should work toward full implementation of the PMLA offence as soon as practicable and encourage investigations and prosecutions in this area. • The money laundering offence in the PMLA should be a “stand alone” offence that does not require a conviction for a predicate offence in order to prove that property is the proceeds of crime. • The predicate offences in the PMLA should be broadened to cover all serious offences or at a minimum should cover the 20 designated categories of offences set out in the FATF Recommendations. The predicate offences should not contain a threshold for the value of property involved in the offence. • The PMLA offence should be brought in line with the elements of the offence in the Palermo Convention, particularly in relation to the acquisition, possession or use of proceeds of crime. • India could consider repealing section 8A of the NDPS Act once the PMLA comes into force. While the provision is essentially sound, it will be made redundant by the PMLA and may cause confusion and divide resources between NDPS prosecutions and PMLA prosecutions. • India could consider imposing penalties on legal persons additional to a fine such as civil or administrative penalties. • To ensure certainty, the PMLA could be amended to specify that section 3 also applies when the predicate offence occurs in another country (as in section 8A of the NDPS Act). • To ensure certainty, the PMLA could be amended to specifically include the ancillary offence of conspiracy

	to commit.
Criminalisation of Terrorist Financing (SR.II)	<p>There are a number of technical areas that could be improved under the UAPA to ensure that the terrorist financing provisions capture all forms of terrorist financing:</p> <ul style="list-style-type: none"> • The provisions should be broadened to fully cover provision of funds to individual terrorists and for terrorist acts in all circumstances. • The offence of terrorist financing should apply to persons who provide or collect funds in the knowledge that they are to be used for terrorism, as well as those who have the intent that they be used for terrorism. • The provisions should extend to persons who provide funds to individual terrorists, regardless of whether they know the funds will be used for a terrorist purpose or not. • To ensure certainty the term ‘fund’ should be defined in the Act in accordance with the Terrorist Financing Convention. • Subject to the court decisions on this subject, the penalties that apply directly to legal persons should be expanded, including criminal, civil and administrative penalties. • India should focus resources on investigations and prosecutions under the Act to ensure there is an effective deterrent and method for dealing with people who finance terrorist activities.
Confiscation, freezing and seizing of proceeds of crime (R.3)	<p>It is recommended that:</p> <ul style="list-style-type: none"> • The PMLA should be brought into force as soon as possible. • The PMLA should allow proceeds of crime to be seized and confiscated regardless of whose possession they are in, in line with the provisions of the UAPA. • The NDPS Act, the UAPA and the PMLA should all provide for the confiscation of property that is an instrument used in, or intended for use in, the commission of money laundering, terrorist financing or predicate offences. • All three Acts (the NDPS Act, the UAPA and the PMLA) should allow confiscation of property of corresponding value where it is not possible to positively identify and seize the specific proceeds of crime.

	<ul style="list-style-type: none"> • India could consider consolidating all seizing and confiscation provisions into one Act, to provide a simpler system and consistent treatment for all proceeds of crime.
Freezing of funds used for terrorist financing (SR.III)	<p>It is recommended that the authorities:</p> <ul style="list-style-type: none"> • Develop a clearer procedure pursuant to UNSCRs 1267 and 1373 in order to ensure certainty and provide individuals and asset holders with a clear understanding of their rights and obligations. Provisions could be similar in nature to the terrorist organisation provisions of the UAPA. • Conduct outreach programs to educate banks and other asset holders of their obligations. • Develop clear, publicly available procedures either in legislation or in guidelines to deal with delisting requests, unfreezing requests and authorisation for access to funds for basic expenses. • Ensure that the updated list of designated persons under both UNSCR 1267 and India's own designations under UNSCR 1373 are forwarded immediately to all banks and are available to all asset holders to ensure that any asset of a listed person is frozen immediately. • Consider conducting compliance monitoring of banks to ensure they are applying proper procedures when they are notified of new designations.
The Financial Intelligence Unit and its functions (R.26, 30 & 32)	<p>It is recommended that in order to ensure that India's FIU is an efficient and effective national information centre, the authorities must ensure that the FIU:</p> <ul style="list-style-type: none"> • Should be able to secure additional resources to expand as if required. • Should be expressly authorised under the legislation to obtain additional information from the reporting parties and to disseminate the information to appropriate authorities for investigation, both domestic and overseas. • Provide adequate and relevant training in financial analysis and money laundering investigations to staff so that the reports could be efficiently and effectively processed. • Should be able to secure extra funding and to expand its manpower as if required. • Should establish a clear mechanism for the exchange of information with domestic law enforcement

	<p>agencies and international agencies.</p> <ul style="list-style-type: none"> • Apply for membership in the Egmont Group. • Work with the supervisors and regulators of the reporting institutions to prepare consistent guidelines to assist in the identification of suspicious and unusual transactions so as to reflect both domestic and international trends and typologies. • Maintain comprehensive statistics on the currency and suspicious transaction reports. Statistics should include breakdown on the type of institution making the report, breakdown of STRs analysed and disseminated, number of domestic and international requests for assistance.
Law enforcement, prosecution and other competent authorities (R.27, 28, 30 & 32)	<p>328. It is recommended that the authorities:</p> <ul style="list-style-type: none"> • Maintain a central database of statistics to enable review of the efficacy of AML/CFT provisions and an understanding of typologies. • Coordinate training for enforcement agencies in relation to specific AML/CFT techniques.
3. Preventive Measures – Financial Institutions	
Risk of money laundering or terrorist financing	<p>The Indian authorities have not undertaken an AML/CFT risk assessment of the financial sector. While there are currently gaps in the application of AML/CFT requirements across the different parts of the sector, the authorities have not sought to implement a regime that consciously excludes particular types of business from the minimum requirements on the basis of a risk assessment. The general principle appears to be that the same minimum standard will be applied to all relevant financial institutions, but the appropriate laws and regulations have yet to be rolled out in anything near a comprehensive fashion. An emphasis on risk-based procedures is a feature of the guidelines published by the Reserve Bank of India (RBI), but this is only in relation to enhanced due diligence requirements for high risk customers, rather than any discretionary derogation from the minimum identification requirements for "normal" risk customers.</p>
Customer due diligence, including enhanced or reduced measures (R.5 to 8)	<p>It is recommended that steps be taken to rationalise the obligation imposed on the banking sector, to ensure consistent application of the AML requirements across the entire financial sector, and to prevent possible misinterpretation of obligations by the sector. The following actions will help to achieve this:</p>

	<ul style="list-style-type: none"> • Amend the PMLA to extend the financial sector obligations to the exchange houses and money remitters. • Consolidate the core elements of the CDD regime within the PMLA Rules. Particular note should be taken of those elements of Recommendation 5 that must be implemented by law or regulation, rather than regulatory guideline. Alternatively, consider giving the regulatory guidelines the force of rules by requiring compliance with them as a component of the rules themselves. • Consider issuing a composite set of PMLA Rules that contains (to the extent possible) a single set of definitions applicable to all the individual rules. • Clarify the definition of "transaction" in relation to the rule on customer identification procedures, to determine whether it has a wider meaning than that attributed to it in the rule on records retention. • Provide for more detailed, sector-specific AML guidelines to be issued by all the relevant regulatory authorities, ensuring that such guidelines are consistent with the PMLA Rules (where appropriate), are cross-referenced to the Rules, and impose equivalent obligations upon all institutions, while recognising relevant sectoral differences. Such guidelines should be drawn substantially from the model developed by the RBI, and should extend also to those financial institutions that are not subject to prudential supervision (specifically exchange houses and money remitters). • Clarify the terminology used in the RBI guidelines to ensure consistent language to reflect those elements that are either mandatory or discretionary. • Amend the draft rule on customer verification to define more tightly the timeframe within which a customer must be identified in circumstance where it is not immediately possible, and to specify what actions must be taken in the event that verification turns out not to be possible.
Third parties and introduced business (R.9)	The authorities should clarify the position on introduced business within the PMLA Rules and/or RBI guidelines, either by stating overtly that third-party introductions are not permitted, or by defining the terms under which they are possible, in line with the conditions of Recommendation 9.
Financial institution secrecy or confidentiality (R.4)	While financial institution secrecy laws do not appear to inhibit the disclosure to and sharing of requisite information the competent authorities – namely the

	<p>Reserve Bank of India, the regulations as stipulated by the PMLA are technically not in force at this time, and thus the provisions discussed above that are specific to AML/CFT requirements would not apply until and unless the law was formally brought into force, and the implementing rules and regulations were also passed. This would affect the disclosure of information contained in certain reports provided by financial institutions such as large transaction reports and suspicious transaction reports. Furthermore, in terms of implementation, the RBI, SEBI and other regulators commented that there have not been any problems with accessing necessary records from the institutions they oversee – there were no statistics available to show that Secrecy laws were not in fact inhibitory to access by the regulators.</p>
<p>Record keeping and wire transfer rules (R.10 & SR.VII)</p>	<p>While the criteria for Recommendation 10 is largely met insofar as the retention of the requisite information (customer identification and transaction data), they vary between sectors, between the legislation applicable to those sectors and the rules and regulations as promulgated by the PMLA. It should be noted that the rules and regulations under the PMLA list specific transactions that are covered under these obligations that narrow the scope regarding record keeping and thus provide some confusion as to the obligations that financial institutions, banks and non-banks, have to their respective regulator. In terms of their obligations under the specific money laundering provisions, the PMLA would necessarily need to be fully in force to have any obligatory affect – both for the retention of records as well as ensuring they are made available to the competent authorities.</p> <ul style="list-style-type: none"> • Introduce a consistent requirement between sectors governed by the PMLA and RBI Guidelines for customer identification and transaction record keeping. • Ensure that there are consistent record-keeping requirements under PMLA for the securities sector in keeping with obligations as specified by the SEBI. • Ensure that the Insurance Industry is fully obligated to the requirements under Recommendation 10 under the PMLA. • Ensure that money service businesses and exchange dealers are also required to maintain the necessary records under the PMLA. <p>While the basic customer identification and record-retention requirements appear to be met, a number of additional measures will need to be implemented for compliance with SRVII, specifically:</p>

	<ul style="list-style-type: none"> • Introduce a requirement for institutions to include full originator information in the message or accompanying payment form in respect of cross-border payments. • Introduce guidelines to ensure that cross-border batch transfers comply with the relevant principles contained in SRVII. • Require institutions to adopt risk-based procedures for handling inward payments that do not contain relevant originator information. <p>It should be noted that discussions are currently taking place within the FATF on a new interpretative note for SRVII. Consideration of what action should be taken might await publication of the new note, which may appear in the course of 2005.</p>
<p>Monitoring of transactions and relationships (R.11 & 21)</p>	<p>It is recommended that the authorities:</p> <ul style="list-style-type: none"> • Implement measures to require financial institutions to examine the background to transactions that are complex, unusual or have no apparent economic or lawful purpose, and to retain a written record of the examination in line with the underlying transaction record. • Provide that financial institutions must pay special attention in relation to transactions and relationships that involve persons from or in countries that do not adequately apply the FATF Recommendations. • Introduce a mechanism to alert financial institutions to those countries that are considered not to apply the FATF Recommendations adequately. • Introduce an inter-agency procedure for determining whether specific counter-measures should be taken, in particular circumstances, against countries that do not adequately apply the FATF Recommendations.
<p>Suspicious transaction reports and other reporting (R.13-14, 19, 25 & SR.IV)</p>	<p>The reporting requirements within the PMLA and accompanying Rules require a number of key amendments to comply with FATF standards, specifically:</p> <ul style="list-style-type: none"> • Redefine the term "transaction" in the widest possible generic way, rather than relying on a prescribed list. • Remove the linkage between a suspicious transaction and the threshold for the predicate offence, so that institutions are required to report any transaction that they have reasonable grounds to believe involve the proceeds of crime generally. (This recommendation must also be considered in the context of earlier recommendations in respect of the

	<p>list of predicate offences.)</p> <ul style="list-style-type: none"> • Extend the STR requirement to include attempted transactions. • Introduce a tipping-off offence in relation to STRs filed with the FIU. • Extend the STR obligations to exchange houses and money remitters. • Provide that the regulatory authorities (including the self-regulatory agencies) should report to the FIU any suspicious activities that they discover in the course of their supervisory work. • Extend the protection granted to financial institutions, when filing STRs, to include any potential criminal liability. • Build in mechanisms for feedback within the newly established FIU back to reporting entities. • Review the existing mechanism and to pass the information obtained through the declaration process to FIU.
<p>Internal controls, compliance, audit and foreign branches (R.15 & 22)</p>	<p>While the requirements imposed on the banking sector under the RBI guidelines are generally satisfactory, these require some strengthening, and similar obligations must also be applied to the other sector of the financial industry. Specific recommendations are:</p> <ul style="list-style-type: none"> • Introduce a general principle under the PMLA that all covered institutions must have appropriate systems and controls to comply with their obligations under the Act. • Publish specific instructions (in the form of regulatory guidelines) that are tailored to the needs of each of the sectors covered by the PMLA requirements, in line broadly with the RBI guidelines to the banks. Besides reference to the general control environment, these instructions should include requirements to have a specific AML compliance function, to institute an ongoing staff training programme, and to have procedures for effective screening of potential employees. • Where applicable, require financial institutions that operate overseas branches or subsidiaries to implement the more rigorous of either the Indian or the host country AML obligations. • Introduce a programme for those sectors regulated by the SEBI and IRDA to sensitise the institutions to the specific risks of money laundering and the need for effective systems and controls to mitigate those risks.

<p>Shell banks (R.18)</p>	<p>It is recommended that the authorities:</p> <ul style="list-style-type: none"> • Amend the RBI guideline to impose an obligation on the banks to establish, as far as is reasonably possible, that their respondent banks are not offering services to shell institutions.
<p>The supervisory and oversight system - competent authorities and SROs (R. 17, 23, 29 & 30).</p>	<p>It is recommended that the authorities:</p> <ul style="list-style-type: none"> • Clarify the role and powers for the regulatory agencies and the FIU to explicitly monitor for compliance with AML/CFT. • Establish a comprehensive training programme in AML/CFT issues for each of the regulatory agencies. • Ensure that supervisory authorities and applicable sanctions apply for non-compliance specifically for AML/CFT purposes in the securities sector. • Establish specific AML/CFT obligations and ensure supervisory authorities and appropriate sanctions powers are granted for violations in the insurance sector. • Strengthen the supervisory capacity of money service businesses and exchange dealers by including AML/CFT provisions as part of inspection and auditing process that encompasses all the requirements as set forth by the FATF 40 recommendations that must be applied to non-bank financial institutions. • Strengthen sanctions authorities for non-compliance by money service businesses and exchange dealers. • Ensure that supervisors are assessing compliance with terrorist financing obligations as defined by law, and apply effective and dissuasive sanctions for non-compliance. • Review the powers of the government to issue directions to the supervisory agencies to ensure that these do not compromise operational independence.
<p>Financial institutions - market entry and ownership/control (R.23)</p>	<p>It is important that there should be a clear statutory basis for exercising ongoing control over the integrity of both the management and principal shareholders of financial institutions. The following measures should be implemented:</p> <ul style="list-style-type: none"> • Amend the regulatory laws to give all the competent authorities similar statutory power to approve (on the basis of "fit and proper" tests) the principal shareholders and controllers of all regulated financial

	institutions.
AML/CFT Guidelines (R.25)	<p>It is recommended that the authorities:</p> <ul style="list-style-type: none"> • Ensure RBI guidelines and those rules and regulations under the PMLA with regard to AML/CFT compliance extend to money services businesses. • Ensure securities dealers/brokers and the stock exchanges are provided guidelines specifically addressing their obligations to comply with AML/CFT. • Ensure DNFBP guidelines for AML/CFT compliance extend to all the appropriate sectors. • Include studies on methodologies, trends and statistics on money laundering and terrorist financing to all relevant financial institutions and DNFBPs. • Build in mechanisms for feedback within the newly established FIU back to reporting entities.
Ongoing supervision and monitoring (R.23, 29 & 32)	<p>It is recommended that the authorities:</p> <ul style="list-style-type: none"> • Ensure that the established FIU keeps adequate statistics on the number of STRs and other reports submitted to it by covered institutions. Statistics should also be kept by the appropriate authority on the compliance to other money laundering controls set forth by the new legislation as well as existing directions issued by the RBI. • Ensure that the appropriate investigative agencies keep statistics on the number of money laundering and terrorist financing cases and prosecutions so as to adequately assess the effectiveness and efficiency of their AML/CFT efforts in general.
Money value transfer services (SR.VI and SR. IX)	<p>While India regulates formal money service businesses and exchange dealers, they have declared alternative remittance systems such as hawala/hundi illegal. There is considerable confusion and disparity on the scale and scope of use of hawala/hundi by multiple authorities. Despite continued widespread and prevalent use, the imposition of FEMA has effectively reduced the penalties for their use, and may possibly facilitate more overt use given the lack of disincentives for legitimizing the trade with formal institutions. It is recommended that authorities:</p> <ul style="list-style-type: none"> • Increase the sanctions authorities, including re-criminalising illegal money remitters. • Greatly strengthen the supervisory and regulatory

	<p>environment on the money service businesses and ensure that PMLA requirements apply to the sector.</p> <ul style="list-style-type: none"> • Consider putting together a task force to decipher the true scale of the problem, which includes all relevant policy, tax, enforcement, and investigative agencies. • Put in place a system to monitor money service businesses and exchange houses and ensure compliance of the FATF 40 Recommendations. • Conduct outreach/education campaigns to help bring illegal remitters into the formal financial structure through licensing. • Address domestic <i>hawala</i> use by including them under the same supervisory structure and subject them to similar penalties for non-compliance. • Consider making legal alternative remittance systems, and encouraging licensing by those engaged in this business.
4. Preventive Measures – Non-Financial Businesses and Professions	
Customer due diligence and record-keeping (R.12)	<p>It is recommended that the authorities:</p> <ul style="list-style-type: none"> • Conduct money laundering threat assessments for DNFBP sectors, and establish customer due diligence and record keeping requirements that adhere to the FATF Recommendations. • Implement specific KYC and reporting requirements to comply with AML/CFT standards.
Monitoring of transactions and relationships (R.12 & 16)	<p>It is recommended that the authorities introduce regulations to ensure that DNFBPs:</p> <ul style="list-style-type: none"> • Conduct a money laundering threat assessment for DNFBP sectors, and establish customer due diligence and record keeping requirements that adhere to the FATF Recommendations. • Implement appropriate measures to monitor transactions that are complex in nature or with persons/entities working in countries with less stringent or satisfactory implementation of FATF standards.
Suspicious transaction reporting (R.16)	<p>It is recommended that authorities:</p> <ul style="list-style-type: none"> • Establish obligations for the DNFBPs to comply with the FATF Recommendations by setting up

	<p>mechanisms to report suspicious transactions to the FIU.</p> <ul style="list-style-type: none"> • Ensure DNFBPs are covered under the PMLA.
Internal controls, compliance & audit (R.16)	<p>It is recommended that the authorities introduce regulations to ensure that:</p> <ul style="list-style-type: none"> • DNFBPs establish internal procedures to control for money laundering within their sectors. • There is compliance with AML/CFT provisions once they have been established for the sector.
Regulation, supervision and monitoring (R.17, 24-25)	<p>It is recommended that:</p> <ul style="list-style-type: none"> • DNFBPs be brought into the framework of the PMLA. • DNFBPs be educated on the AML/CFT risks in their sector and be provided guidance on how they can protect against/combat these risks. • DNFBP regulatory organizations should be provided the tools to monitor and ensure effective compliance with AML/CFT obligations as per the FATF Recommendations
Other designated non-financial businesses and professions (R.20)	<p>The authorities and the financial sector should consider:</p> <ul style="list-style-type: none"> • The establishment of an electronic database of domestic and international terrorism lists such as the UN 1267 list, and creating the ability to electronically monitor activities when compared to entities on those lists. Updating pursuant to new designation to and from the international community would be greatly enhanced. • Assembling a task force to identify sectors prone or more vulnerable to money laundering or terrorist financing and begin implementing appropriate measures to combat those risks.
5. Legal Persons and Arrangements & Non-Profit Organisations	
Legal Persons – Access to beneficial ownership and control information (R.33)	<p>It is recommended that the authorities:</p> <ul style="list-style-type: none"> • Improve the supervisory capacity of the Registrar of Companies; • Provide more proactive scrutiny of publicly listed companies

Legal Arrangements – Access to beneficial ownership and control information (R.34)	No recommendations.
Non-profit organisations (SR.VIII)	<p>It is recommended that the authorities:</p> <ul style="list-style-type: none"> • Strengthen the powers of the registrar of societies to conduct yearly and spot audits to include managerial and administrative oversight (as well as financial) on societies they register. • Conduct an entire sector wide assessment, noting the scale and scope of the sector, potential vulnerabilities, and risks for terrorist financing. • Update the Societies Registration Act so as to increase the due diligence, record keeping and registration requirements of societies. • Strengthen the punitive authorities of the Registrar of Societies to include the de-registration of societies and enforcement of other civil and criminal sanctions for misconduct. • Work with other countries and the APG on amending their supervisory and regulatory environment of non-profits to conform with the best practices and guidelines set out by the FATF.
6. National and International Co-operation	
National co-operation and coordination (R.31)	India should ensure there is an effective mechanism to enable policy makers, the FIU, law enforcement and other competent authorities co-operate with each other to develop and implement policies to combat money laundering and terrorist financing activities.
The Conventions and UN Special Resolutions (R.35 & SR.I)	<p>It is recommended the authorities:</p> <ul style="list-style-type: none"> • Bring the PMLA into force • Ratify and fully implement the Palermo Convention • Fully implement UNSCR 1267 and 1373 as discussed in part 2.4 above • Fully implement the Vienna Convention and Terrorist Financing Convention
Mutual Legal Assistance (R.32, 36-38, SR.V)	<p>It is recommended that the authorities:</p> <ul style="list-style-type: none"> • The PMLA be brought into force as soon as possible so that India can provide MLA for the full range of money laundering matters. • Maintain accessible information on MLA requests

	<p>made and received including the time taken to respond to requests.</p> <ul style="list-style-type: none"> • Continue to establish MLA relationships with other countries, including the development of MLATs. • Give high priority to providing assistance in a timely manner. • Allow for instrumentalities and property of corresponding value to be confiscated.
Extradition (R.32, 37 & 39, & SR.V)	<p>It is recommended that the authorities:</p> <ul style="list-style-type: none"> • Bring the PMLA into force as soon as possible to allow extradition for money laundering offences. • Continue to develop extradition relationships with countries including the development of bilateral treaties • Do not limit extradition for money laundering to the predicate offences in the PMLA. • Establish procedures for extradition under the PMLA.
Other Forms of Co-operation (R.32 & 40, & SR.V)	<ul style="list-style-type: none"> • Introduce statutory gateways to define clearly the terms under which the regulators may co-operate with their overseas counterparts. • The FIU should be given a clear legislative mandate to share financial information and other relevant intelligence with its foreign counterparts either upon its own initiative or upon request as well as to make inquiries on behalf of its foreign counterparts. • The FIU should establish a mechanism to ensure that foreign requests are responded to in a timely way. • The FIU should maintain statistics on the number of requests for assistance made or received by the FIU, including a breakdown of the number of requests processed and refused. • The Directorate of Enforcement and other law enforcement agencies involved in terrorist financing investigations should be able to exchange information and to provide investigative assistance to their foreign counterparts by either establishing a mechanism or utilizing existing gateways such as Interpol, the World Customs Organization etc.
7. Other Issues	
Other relevant AML/CFT measures or issues	
General framework – structural issues	

Table 3: Authorities' Response to the Evaluation

1. The Mutual Evaluation Report has taken into consideration the legislative framework as it existed at the time of the on-site visit in March 2005 and immediately thereafter.
2. However, significant developments in the AML legislative position have taken place since then. As also acknowledged by the assessors in their report, these developments would improve the compliance with FATF recommendations and would also improve the ratings which have been given in the Mutual Evaluation Report on the basis of the position obtaining in March 2005.
3. At the time of the on-site visit, the PMLA 2002 had been enacted but had not been brought into force, on account of certain procedural and legal deficiencies noticed in the Act. Similarly, though the implementing Rules had been finalized, their enforcement required that the PMLA came into force.
4. The PMLA has since been amended to remove the deficiencies stated above, through an amendment Act that has been passed by the Parliament in May 2005 and has received Presidential Assent. As per provisions of the Act, it has been notified and has come into force with effect from 1st July 2005.
5. Similarly, the implementing Rules, after incorporation of certain amendments, which also took into account the suggestions made in the MER, have been notified and have come into force with effect from 1st July 2005.
6. Powers for receiving information on cash and suspected transactions have been conferred, under the relevant provisions of the PMLA, on the Director, Financial Intelligence Unit, India (FIU-IND).
7. Powers for investigation and prosecution of money laundering offences have been conferred under the relevant provisions of the PMLA on the Director of Enforcement. This is an existing Directorate presently dealing with offences under the Foreign Exchange Management Act, 1999.

8. Similarly, an Adjudicating Authority and an Appellate Tribunal, as required to be set up under the provisions of the PMLA, have been notified.
9. It would therefore be seen that since the time of the on-site visit of the Mutual Evaluation Team in March 2005, India has taken significant steps to bring its AML regime into force. This would significantly enhance the compliance levels with the FATF recommendations and also substantially improve the Ratings, as compared to those contained in the March 2005 Mutual Evaluation Report.
10. It may also be added that the legal framework to deal with the CFT-related issues continues to be in force to meet the requirements of the UN Convention on Suppression of Financing of Terrorism 1999 and the UN Security Council Resolution 1373. In fact, the Unlawful Activities Prevention Act (UAPA), 1967 as amended in September 2004, is now the comprehensive legislation in India that aims to counter all aspects of terrorist financing.
11. In conclusion, it may be stated that India has taken substantially significant steps in the past few months to strengthen its AML/CFT regime. This is in line with India's deep and continuing commitment towards the global fight against money laundering and terrorist financing.

8 ANNEXES

ANNEX 1: LIST OF ABBREVIATIONS

AGC- Attorney-General's Chambers
AML – Anti-Money Laundering
APG – Asia/Pacific Group on Money Laundering
CBI – Central Bureau of Investigations
CDD – Customer Due Diligence
CEIB – Central Economic Intelligence Bureau
CFT – Combating the Financing of Terrorism
DEA – Department of Economic Affairs
DNFBP – Designated Non-financial Business and Profession
EIC – Economic Intelligence Council
EOU – Export Oriented Unit
FATF – Financial Action Task Force
FI – Financial Institutions
FIU – Financial Investigation Unit
FT – Financing of Terrorism
GDP – Gross Domestic Produce
ICAI – Institute of Chartered Accountants of India
IRDA – Insurance regulatory and Development Authority
KYC – Know Your Customer
MEA – Ministry of External Affairs
MHA – Ministry of Home Affairs
ML – Money Laundering
MLA – Mutual Legal Assistance
MLAT – Mutual Legal Assistance Treaty
MoF – Ministry of Finance
MOU – Memorandum of Understanding
NCB – Narcotics Control Bureau
NCCT – Non-compliant Countries and Territories
NDPS – Narcotic Drugs and Psychotropic Substances
OBU – Offshore Banking Unit
PMLA – Prevention of Money Laundering Act
POTA – Prevention of Terrorism Act
RBI – Reserve Bank of India
SEBI – Securities and Exchange Board of India
SEZ – Special Economic Zones
STC – State Trading Corporation
STR – Suspicious Transaction Report
UAPA – Unlawful Activities (Prevention) Act
UN – United Nations
UNSCR – United Nations Security Resolutions
UNTOC – United Nations Convention against Transnational Organised Crime
UT – Union Territory

**ANNEX 2: DETAILS OF ALL BODIES MET ON THE ON-SITE MISSION -
MINISTRIES, OTHER GOVERNMENT AUTHORITIES OR BODIES, PRIVATE SECTOR
REPRESENTATIVES AND OTHERS.**

1. Minister for Finance
2. Ministry of Law
3. Serious Frauds Investigations Officer (SFIO)
4. Central Board of Excise & Customs (CBEC)
5. Central Board of Direct Taxes (CBDT)
6. Central Bureau of Investigations (CBI)
7. Ministry of Home Affairs (MHA)
8. Thomas Cook Ltd (Currency Exchange)
9. Gems & Jewellery Export Promotion Council
10. Reserve Bank of India (RBI)
11. Security & Exchange Board of India (SEBI)
12. ICICI Bank
13. National Stock Exchange
14. National Security Council Secretariat (NSCS)
15. Institute of Chartered Accountants
16. Directorate of Enforcement
17. Narcotics Control Bureau (NCB)
18. Central Economic Intelligence Bureau (CEIB)
19. Financial Intelligence Unit (FIU)
20. Department of Economic Affairs
21. Lawyers
22. Ministry of External Affairs
23. Societies Registrar
24. UAE Exchange & Financial Services Ltd
25. Travelex
26. Indian Banks' Association
27. Insurance Regulatory and Development Authority
28. Life Insurance Corporation of India

ANNEX 3: LIST OF ALL LAWS, REGULATIONS AND OTHER MEASURES

Banking Regulation Act, 1949

Customs Act, 1962

Foreign Contribution (Regulation) Act, 1976

Foreign Exchange Management Act

Foreign Exchange Regulation Act

Insurance Regulatory and Development Authority Act, 1999

Narcotic Drugs and Psychotropic Substances Act, 1985

Prevention of Money Laundering Act, 2002

Securities and Exchange Board of India Act, 1992

Societies Registration Act, 1860

Unlawful Activities (Prevention) Act, 1967