INDIAN COUNCIL OF WORLD AFFAIRS

ISSUE BRIEF

Financial Action Task Force: An Indian Perspective

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“Money laundering and the financing of terrorism are financial crimes with economic effects. They can threaten the stability of a country’s financial sector or its external stability more generally…Action to prevent and combat money laundering and terrorist financing thus responds not only to a moral imperative, but also to an economic need.”[1] The objective of understanding the problems of money laundering and terrorist financing have long been recognised as important in mitigating the risks that they pose to the maintenance of national security within and beyond the borders. In fact, several regional and international organizations like the International Monetary Fund (IMF), United Nations (UN), Asian Development Bank (ADB) and others are involved in countering the twin problems of money laundering and terrorist financing.

The Financial Action Task Force (FATF) established in 1989 at a Group of Seven (G7) Summit held in Paris recognised the need to step up efforts to ensure strict action on illicit financing of crimes such as terrorism and prevent attempts to conceal or disguise the identity of illegally based profits. The objectives of the FATF as identified are therefore “to set standards and promote effective implementation of legal, regulatory and operational measures for combating money laundering, terrorist financing and other related threats to the integrity of the international financial system.”[2] It acts as a policy-making body working to bring about national legislative and regulatory reforms in these areas.

Simply speaking, terrorist financing is provision of finances to support and promote the cause of individual terrorists or terrorist groups. However, the requirements of terrorist financing fall into two categories, as stated by FATF in its report on terrorist financing in 2008. These two broad areas are, firstly, funding specific terrorist operations and secondly, broader organisational costs to develop and maintain the organisational support as well as to promote the ideology of a terrorist organisation.[3] On money laundering, the FATF mentions, "The goal of a large number of criminal acts is to generate a profit for the individual or group that carries out the act. Money laundering is the processing of these criminal proceeds to disguise their illegal origin."[4]

The FATF comprises of 35 member countries including two regional organisations, namely European Commission and the Gulf Cooperation Council.[5] It also consists of Observer countries like Israel and Saudi Arabia as well as Associate Members and Observer Organisations. India was given 'Observer' status at the FATF in 2006. Since then, India had been working to achieve a full-fledged membership. It was in the year 2010 that the country gained complete membership of the inter-governmental body.

The Gravity of the Problem and role of FATF:

Right from 2001, when the FATF first expanded its mandate to incorporate efforts to combat terrorist financing, this issue has been on top of the FATF's agenda. Latest trends point out that terrorist attacks have become more deadly and more lethal across the world since 2014.[6] The five most deadly terrorist groups were responsible for 74 per cent of all deaths from terrorism by known actors in 2014. Among them were groups such as Boko Haram , Islamic State of Iraq and the Levant (ISIL/Da'esh), the Taliban, the Fulani militants and the Al-Shabab.[7] The FATF Report on "Emerging Terrorist Financing Risks" (ETFR) released on October 2015 revealed that the traditional terrorist financing methods like proceeds of criminal activity, abuse and misuse of non-profit organisations, private donations, kidnapping for ransom, extorting local and Diaspora populations and businesses and illegal money transfers are still considered to be significant terrorist financing risks.[8] The Report also identified emerging terrorist financing threats and vulnerabilities. Mention may be made of foreign terrorist fighters who are "considered one of the main forms of material support to terrorist groups".[9] The funding by recruitment and facilitation networks and self-funding by individuals have been estimated to be the two most common methods used to raise funds for foreign terrorist fighters. The platform of social media has been used by terrorist groups not only to raise funds but also attract followers who seek to support the cause of the terrorists. The ETFR Report highlighted that various social media platforms are today used by terrorists for fund-raising campaigns. Other emerging terrorist financing threats include crowdfunding, using prepaid cards for social network fundraising, promotion of virtual currencies and internet-based payment services. The control and exploitation of natural resources like oil, gas, timber, diamonds, gold etc. by terrorists to extract revenues for supporting their causes have also been identified as significant terrorist financing risks.

The escalation of terrorist activities along with the increasing need for terrorists to raise, move and use funds for their cause prompted the FATF in December 2015 to come to an agreement that further concerted action was needed to be taken to strengthen global counter-terrorist financing regimes to tackle the threat of terrorist financing. Thus, the FATF Consolidated Strategy on Combating Terrorist Financing laid out five focus areas. They are:

(1) Improve and update the understanding of terrorist financing risks, in particular the financing of ISIS/Da'esh.
(2) Ensure that the FATF Standards provide up-to-date and effective tools to identify and disrupt terrorist financing activity.
(3) Ensure countries are appropriately and effectively applying the tools, including UN Targeted Financial Sanctions, to identify and disrupt terrorist financing activity.
(4) Identify and take measures in relation to any countries with strategic deficiencies for terrorist financing.
(5) Promote more effective domestic coordination and international cooperation to combat the financing of terrorism.[10]

Money laundering as an issue can have serious economic repercussions considering the fact that unchecked money laundering can infiltrate financial institutions and affect the political institutions of the society as well. According to a report by the United Nations Office on Drugs and Crime, criminals, especially drug traffickers, may have laundered around 1.6 trillion US dollars or 2.7 per cent of global GDP in 2009.[11]

The FATF has set out recommendations by which countries can first identify, assess and understand the risks associated with the fight against money laundering and terrorist financing. These recommendations set an international standard by which countries can then implement measures to counter their effects. The recommendations that are unique to terrorist financing are set out in Section C of the FATF Recommendations. These are: Recommendation 5 "the criminalisation of terrorist financing", Recommendation 6 "targeted financial sanctions related to terrorism & terrorist financing", and Recommendation 8 "measures to prevent the misuse of non-profit organisations".[12]

The FATF also supports and gives advice to countries for the implementation of the FATF standards. Section B states the recommendations regarding the problem of money laundering. The Vienna Convention, the Palermo Convention and the Terrorist Financing Convention have been taken up as the basis for countries seeking to criminalise money laundering.[13] The recommendations state that competent authorities must be empowered to seize and confiscate the property laundered, proceeds from money laundering or predicate offences and property that is the proceeds of, or used in the financing of terrorism, terrorist acts or terrorist organisations.[14]

FATF and India's Legal and Institutional Frameworks:

Money laundering has evolved as a serious concern in India considering the fact that the country is one of the largest growing economies in the world. Illegal activities committed within and outside the country, like drug trafficking; fraud, counterfeiting of Indian currency; transnational organised crime; human trafficking; and corruption are the sources of money laundering in India.[15]

In case of domestic crimes, the most common money laundering methods are opening multiple bank accounts, intermingling criminal proceeds with assets of a legal origin, purchasing bank cheques against cash, and routing through complex legal structures. In the case of transnational organised crimes, the use of offshore corporations and trade based money laundering are some of the methods used to disguise the criminal origin of the funds.[16]Besides, terrorists also use *hawala (illegal)* transfers to move money within and outside the country.

As far as the legislative framework in the country is concerned, the first parliamentary law provided for the prevention of certain unlawful activities of individuals and associations and for matters connected therewith. It was known as the Unlawful Activities (Prevention) Act, 1967 (UAPA) which was amended in 2004 to criminalise terrorist financing. It was further amended in 2008 to broaden its scope and confirm with the requirements of the United Nations Convention on the Suppression of the Financing of Terrorism.

The Conservation of Foreign Exchange and Prevention of Smuggling Activities Act, 1974 was introduced to prevent smuggling and the Smugglers and Foreign Exchange Manipulators Act, 1976 provided for the forfeiture of illegally acquired properties of smugglers and foreign exchange manipulators.

The Foreign Contribution (Regulation) Act, 1976 dealt with regulating the acceptance and utilization of foreign contribution and foreign hospitality by persons and associations working in the important areas of national life.

The Narcotic Drugs and Psychotropic Substances Act, 1985 made stringent provisions for the control and regulations of operations relating to narcotic drugs and psychotropic substances and the Foreign Exchange Management Act (FEMA), 1999 was enforced to regulate the development and maintenance of foreign exchange market.

The Prevention of Money Laundering Act, 2002 (PMLA) which came into force in 2005 and amended in 2009 and 2012 was introduced to counter the trend of money laundering.

Since the publication of the Mutual Evaluation Report on 24 June, 2010, India has been reporting to the FATF on a regular basis on the progress made in the implementation of its Action Plan to strengthen India's counter-financing and money laundering system. India has particularly focussed its attention on:

- Amending nearly all of the technical deficiencies identified with respect to criminalisation of money laundering and terrorist financing.
- 'Substantially addressing' the technical deficiencies related to customer due diligence and other preventive measures.
- Augmenting its outreach programme to provide guidance to the financial sector on suspicious transaction reporting obligations and engaging in extensive compliance monitoring; and
- Bringing several of the Designated Non-Financial Businesses and Professions within the scope of anti-money laundering and countering terrorist financing measures.[17]

At the June 2013 Plenary Meeting, the FATF decided that India had reached a 'satisfactory level' of compliance with all the core and key recommendations and could be removed from the regular follow up process. Though it pointed out that India had considerably stepped up its investigations in money laundering and terror funding, yet the 8th Follow-Up Report (Mutual

Evaluation of India) released in June 2013 mentioned that the rate of convictions in cases of money laundering remained low.[18] The Report said that according to the update provided in May 2013, the number of money laundering investigations increased from 798 on 31 December 2009 to 1405 on 15 December 2011, to 1510 on 31 August 2012, to 1530 on 30 November 2012, and 1561 on 30 April 2013.[19] This shows that the number of investigations conducted increased consistently.

On prosecutions, the FATF noted that it had increased from 6 on 31 December, 2009 to 36 on 31 March, 2011, however there was only a marginal increase of 37 on 30 November, 2011 to 42 on 30 November, 2012. As of March 2013, 7 new prosecution complaints were filed. With regard to the number of persons accused of terrorist financing and the number of cases under the probe, the Report said that it had increased and stood at 470 and 143 respectively between 2006 and March 31, 2013.

The number of persons convicted for terror financing had remained low, namely five in total between 2006 and March 2013.[20]

India's compliance with global standards in countering money laundering and terror funding is on the right track, however the gaps need to be addressed and worked upon.

In its report on 'Terrorist Financing', FATF Report to G20 leaders, released in November 2015, the FATF presented a review of 194 jurisdictions in the global anti-money laundering and combating financing of terrorism (AML/CFT), to determine whether they had implemented key measures to create hostilities to check AML/CFT. The report revealed that India had seized assets worth 3 lakh Euros (over 2.12 crore INR) of 37 entities, till August 2015.[21]

The significance of coordination between different agencies to tackle money laundering and terrorist financing in developing CFT standards and policy responses, and supporting and monitoring implementation, must not be understated here. In this connection, the Ministry of Finance, Government of India and Reserve Bank of India (RBI), the central banking institution of the country issues updated circulars and notifications from time to time to identify the risks associated with financial issues including on money laundering and terrorist financing and thereby suggest appropriate actions to ensure that criminals are not allowed to misuse banking/financial channels. For instance, in March 2015, the RBI had issued instructions to its regional offices to undertake scrutiny of 489 Urban Cooperative Banks (UCB) to determine compliance of Know Your Customer (KYC), Anti-Money Laundering and Combating the Financing of Terrorism guidelines.

India has adopted its own model to fight money laundering and terrorist financing based on its specific domestic and regional considerations. The Ministry of Home Affairs (MHA) monitors the system to track terror funding. In fact, a special cell called Combating Financing of Terrorism (CFT) Cell was created in the Internal Security Division of MHA in 2011 to coordinate with Central Intelligence Enforcement Agencies and the State Law Enforcement Agencies to develop an integrated approach to tackle the problem of terror funding. The MHA also coordinates with the FATF Cell in the Department of Economic Affairs, Ministry of Finance. The Financial Intelligence Unit-India (FIU-IND) established under the Ministry of Finance in 2004 receives, analyses and disseminates information relating to suspicious financial transactions involving suspected money laundering and terrorist financing to Intelligence / Enforcement Agencies and Regulatory Authorities.

To enhance the functionality of the FATF in India, government agencies have launched a National Risk Assessment exercise on January 2016 so as to identify the sectors that are most susceptible to money laundering and terror funding and thereby plug deficiencies, if any. This conforms with the FATF recommendations. The World Bank had made a customisable self assessment software tool available to Indian agencies which emphasises on all vital aspects of money laundering, including terror financing risks, and helps identify threats and vulnerabilities in different sectors.[22]

Conclusion:

India has taken important steps in the fight against money laundering but it would be necessary for the administration not to be complacent. Modalities keep changing and offenders and terrorists exploit different channels to raise money for planning and carrying out crimes in support of their cause. As such, criminalizing terrorist financings, freezing terrorist's assets and ensuring that financial intelligence units are operationally independent must be consolidated for a sustainable and consistent programme to fight money laundering and terrorist financing. Some other recommendations can be mentioned below:

- A review from time to time to check the effectiveness of systems and their functioning would also be desirable.
- Measures should not only be undertaken at the national level, but they can be complemented by strengthening cooperation at the local level to create constrictions for terrorist financing and money laundering.
- Better information sharing between states and the centre on national risk assessment and threats is desirable.
- There is also need for financial data by which rogue companies and individuals indulging in money laundering can be identified.
- Implementation of a monitoring system and a system of proper checks and balances can help ensure that money laundering is prevented in the real estate sector.
- Adherence to KYC norms needs strict compliance.
- In order to bring transparency in receipt and use of foreign donations, random checks can be undertaken to verify the last five years' transactions of select non-governmental organisations having dubious records.
- Besides, financial intelligence needs cadre-based support which means direct recruitment and training of select cadres having a security background.
- Agencies such as Serious Fraud Investigation Office and Central Economic Intelligence Bureau need to be strengthened to take up this aspect of terrorist financing.
- Under the objectives of Economic Intelligence Council and Regional Economic Intelligence Committees, the terror financing issue has been left untouched. This needs to be incorporated into these two core coordination committees.

The fight against terrorism financing and money laundering thus requires an expanding and consistent effort with regard to prevention, detection and prosecution of offences. Only then can financial systems and national security within and beyond the borders be protected. Lesser threats to the economy also imply financial sector integrity which contributes to strengthening overall safety and security.

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Disclaimer: Views expressed are of authors and do not reflect the views of the Council.

Endnotes:

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3 "Terrorist Financing", FATF, http://www.fatf-gafi.org/media/fatf/documents/reports/FATF%20Terrorist%20Financing%20Typologies%20Report.pdf accessed June 23, 2016.

4 FATF http://www.fatf-gafi.org/faq/moneylaundering/ accessed July 20, 2016.

5 The 35 member countries are namely Argentina, Australia, Austria, Belgium, Brazil, Canada, China, Denmark, European Commission, Finland, France, Germany, Greece, Gulf Cooperation Council, Hong Kong, Iceland, India, Ireland, Italy, Japan, Republic of Korea, Luxembourg, Malaysia, Mexico, Netherlands, New Zealand, Norway, Portugal, Russian Federation, Singapore, South Africa, Spain, Sweden, Switzerland, Turkey, United Kingdom and United States.

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7 Ibid.

8 "FATF Report: Emerging Terrorist Financing Risks", October 2015, http://www.fatf-gafi.org/media/fatf/documents/reports/Emerging-Terrorist-Financing-Risks.pdf accessed June 21, 2016.

9 Ibid.

10 "FATF: Terrorist Financing", FATF, http://www.fatf-gafi.org/publications/fatfgeneral/documents/terroristfinancing.html accessed June 20, 2016.

11 FATF on Money Laundering, FATF, http://www.fatf-gafi.org/faq/moneylaundering/ accessed on June 22, 2016.

12 "International Standards on Combating Money Laundering and the Financing of Terrorism and Proliferation: The FATF Recommendations", February 2012 (Updated October 2015), http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF_Recommendations.pdf accessed June 22, 2016.

13 The United Nations Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances was adopted in December 1988 in Vienna. It was the first international instrument to address the issue of proceeds of crime and required States to establish money laundering as a criminal offence. The United Nations Convention Against Transnational Organised Crime was adopted by the General Assembly in November 2000. The purpose of this Convention was to promote cooperation to prevent and combat transnational organized crime more effectively. The International Convention for the Suppression of the Financing of Terrorism was adopted by the UN General Assembly in December 1999 to enhance international cooperation among States in devising and adopting effective measures for the prevention of the financing of terrorism.

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22 "Operation begins to curb money laundering, terror funding", The Hindu, January 26, 2016, http://www.thehindu.com/news/national/operation-begins-to-curb-money-laundering-terror-funding/article8152688.ece accessed July 18, 2016.