



# Money Laundering & Its Effects

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*Abstract:* Money laundering is the most harmful thing that any country can have to destroy its financial wealth. Money laundering refers to an illegal process where money earned illegally is laundered to make it look clean in the eyes of the current government. It tells about how money laundering works in our country and its history. It tells how it has impacted our nation and with a few famous cases of India.

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## What is money laundering?

Money laundering refers to an illegal process where money earned illegally is laundered to make it look clean in the eyes of the current government.

1. Businessmen who have black money or criminals who have black money use an extensive variety of money-laundering techniques to make illegally obtained funds appear clean.
2. Online banking and crypto markets have made it hassle free for criminals or businessmen to transfer and withdraw money without any detection.
3. Anti-money laundering has become one of the foremost international efforts, and now terrorist financing is one of its targets. The financial sector also has its own strict anti-money laundering (AML) measures.

## How Money Laundering Works?

Money laundering is an essential step for criminal organizations that desire to use illegally gained money more effectively. Dealing in hefty amounts of illegally obtained money is ineffective and dangerous. Criminals need a way to deposit the money in recognized financial institutions.

The process of laundering money typically involves three steps:

1. **Placement-** In this stage, money launderers inject or pass criminal money into the financial system. This is often done by depositing money into a bank account registered with an unknown or anonymous company or professional broker.
2. **Layering-** The money is injected or passed in such a way that it is transferred or dispersed in different transactions to different accounts in the same country and in other countries where anti-money laundering laws are less strict, making it difficult to trace the source. Asset stratification can also include transactions such as the purchase of exchangeable assets such as expensive vehicles, works of art, expensive or luxurious properties, etc.
3. **Integration-** Such well-placed and layered money re-enters the financial system, removing the original link to crime and using the laundered money as if it came from clean sources and thus defeating the laws and policies made or maintained for money laundering.

The criminal can then either invest the clean money in a legitimate or registered business that insists on payment by issuing fake invoices, or even start a dummy charity and apply with a huge amount of salary.

Historically, money laundering has existed for at least 2,000 years. Chinese businessmen channeled money through various companies and complex financial transactions to hide income from government bureaucrats. But the term gained glamor only when Al-Capone's accountant found it difficult to explain the source of the money from illegal activities. This accountant bought money launderers and used them as leverage to hide the source of black money from prostitution, liquor sales and other criminal activities

It is widely believed that the term "money laundering" originated with Italian mobsters in the United States, such as Al Capone.

The amount of cash flowing into the laundry operations was difficult for law enforcement to monitor, meaning that large sums of money could slip through the system unnoticed.

India forensic, which imparts training and certifications on Anti Money Laundering, defines money laundering as any procedure that cleans funds of their criminal origins, permitting them to be utilized inside the financial system.

The laundering of illegal money occurs when the perpetrators move the ill-gotten cash through one or more several legitimate businesses or the bank accounts of the unsuspecting individuals to legitimize the illegally obtained amount of money.

Capone's connection to laundromats may have given us the glamorous phrasing, however the act was going on from a long time before the twentieth century.

Frauds have been happening for a very long time. Whenever a person uses some new ways to commit a fraud, it comes into the limelight. This is exactly what happened in the case of money laundering. If it wouldn't have been Al Capone, then today the money laundering fraud would have had some different name.

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### What are the Types of Money Laundering?

There are 3 basic types or forms of money laundering used in today's world and all other methods fall under them. The major three types of money laundering used by criminals or businessman includes:

#### 1. Smurfs-

Smurf is the term commonly used to describe a money launderer who's trying to avoid or bypass government agencies and scrutiny. Essentially, they achieve this by employing the three stages of money laundering - placement, layering and integration to mask or hide the money from regulatory authorities or financial sectors of government. Most times, large sums of unlawful or illegal money are deposited or transferred in different banks through smaller transactions.

Depending on the jurisdiction, anti-money laundering laws state that sums above certain amounts or above a fixed amount are to be reported to financial regulators and authorities directly referring to the current government. For example, this could be 10,000rs and in such a case, money launderers break down and deposit bits of the illegal sum without going above the 10,000rs threshold, therefore, their transactions are not flagged suspicious or caught and reported to the regulators.

#### 2. Mules

Unlike smurfs, mules refer to the individuals and not the activity itself. Essentially, mules are individuals who are hired by criminals or businessmen to help them to carry out money laundering schemes or activities. A good or perfect example is money mules who are recruited knowingly or unknowingly to smuggle money from one place to another.

Money launderers usually recruit those who can easily fall under the radar, especially people who are financially vulnerable and without criminal records. Most of the time, these individuals are ignorant of the larger scheme and are enticed or tempted by job offerings with large or hefty amounts of money in return.

Mules mostly have specific responsibilities - to open up bank accounts and deposit the money they're given in them. After that, the launderers continue making wire or a chain of transfers to move the money around the financial system or the in world to avoid detection.

### 3. Shells

Shell Corporation is one of the most used terms in money laundering today. A very popular type of money laundering, it refers to companies that don't have any physical operations, business activities, employees or assets. Basically, they are legitimate business entities that are used to raise money and finance a merger, acquisition or operations of a startup company.

Their mode of existence and operation gives room for launderers to use them as an avenue to hide illegal activities or avoid paying taxes. For example, people do this by setting up shell companies in countries that guarantee anonymity so they can easily make deposits and move money under the radar to different accounts. Shell companies also allow individuals to avoid paying taxes and reporting income to authorities.

#### *The Economic Cost of Money Laundering-*

Money laundering harms the financial sector institution critical to economic growth. Money laundering promotes a huge amount of crime and corruption that slows economic growth and even reduces productivity in the real sector of the economy. Money laundering is a problem both in the world's major financial markets and in emerging markets. As emerging markets develop their economies and financial sectors, they are increasingly becoming suitable targets for money laundering activities or cases. In addition to creating unpredictable money demand changes, money laundering causes large or huge amounts of fluctuations in international capital or money flows and exchange rates. The adverse effects of money laundering on the economy can be discussed in many subjects, such as money demand, growth rates, income distribution, tax revenues, and financial institutions.

#### 1. The impact on money demand

This occurs more frequently in countries where the risk of money laundering is low. The ratio of the shadow economy to the national economy is high in economies where there is no money laundering regulation, where there is a system to store bank or customer information, and where bank secrecy is strictly controlled. Money laundering makes it simple to move money in and out of the country. Consumption rates, particularly luxury consumption, are rising as a result of the uncontrolled flow of money. Significant increases in exports, imports, the foreign payments deficit, inflation, interest rates, and unemployment rates, on the other hand, can be significant.

False signals about money laundering obstruct the implementation of necessary measures to address issues such as budget deficits and high inflation, particularly in developing countries, and have a negative impact on economic management efficiency. Market stability is affected by the global aspect of operations, and financial crises in one country can be reflected in other countries as well. The influence of central banks on monetary policy is determined by whether or not money demand is predictable. Failures in central bank policies can be seen in money demand as a result of black money.

#### 2. Impact on growth rate

The real sector may suffer significantly as a result of the country's economic insecurity. As a result, foreign investors have become critical for businesses. However, attracting foreign investors to money-laundering countries is difficult. Because the price instability caused by black money in the financial system affects the economy's reliability in the external environment, rational entrepreneurs find it difficult to invest in the country because they also consider the risk of the country when investing. Interest rates on investments will not rise if legal money flees the country. As a result, there will be a long-term decline in economic growth.

Countries with a lot of money are thought to be risky for investors. The fight against black money is an important message that gives investors' confidence for those who want to attract international capital to their country. The effectiveness of the struggle increases the number of investors, which benefits the growth rate and the economy.

#### 3. The Effect on Income Distribution

Large losses to sources of income caused by black money cause serious problems with the financial system's operation. These economic issues have social ramifications. The increasing wealth of some individuals and groups causes social disintegration. One of the most serious and quantifiable consequences of black money is its impact on income distribution. Although the negative impact of reduced income sources and income distribution differentiation is difficult to quantify, compensating for social losses is also difficult. The disparity in income distribution between individuals increases the likelihood of crime and makes money appealing.

Furthermore, those in the registered industry are somewhat penalized because money distorts competition. Because tax evasion is common in the informal economy, the tax burden on those working in the public sector rises and income distribution deteriorates.

#### 4. The effect on tax revenues

Taxation is the most important source of government revenue. If those revenues are low, the likelihood that public sector revenues will not cover public sector costs increases, and when this occurs, budget deficits will occur. Income that is not taxed by states is referred to as black money. These profits result in a decrease in tax revenue.

Borrowing is one of two options for a country with declining tax revenue. The crowding out effect of the state, which attracts productive investors by borrowing from the private sector, reduces productive investment by the private sector. Furthermore, when the value of bonds rises as a result of borrowing, market interest rates rise, causing a slew of issues. Another way to address the shortcomings is through emissions policy. The outcomes of this policy are similar to those of others. As a result, both alternatives have a negative impact on the economy.

## 5. Financial Institutions' Impact

Sudden changes in financial institutions' assets and liabilities that are unknowingly used in money laundering may occur, posing a risk to the institutions. The news of these financial institutions' money laundering catches the attention of the public authorities. In that case, the pressure on these institutions' auditing will increase, and the institution's reputation will suffer.

### Anti-Money Laundering – Controls

#### 1. Criminalization

To prevent money laundering, many governments, financial institutions, and businesses impose controls. The first is government criminalization. The United Nations Convention on Transnational Organized Crime established guidelines to assist governments in prosecuting individuals involved in money laundering schemes.

#### 2. Get to Know Your Customers

To help prevent money laundering, financial institutions must also implement "know your customer" policies. This entails monitoring client activity and identifying the types of transactions that should raise red flags. Financial institutions are required to notify a financial investigation unit of any suspicious activity.

#### 3. Software Filtering and Record Management

Financial institutions and businesses also keep detailed transaction records and use software that detects suspicious activity. Customer data can be classified based on various levels of suspicion, and transactions can be denied if certain criteria are met.

#### 4. Holding Time

Many banks require deposits to be held in an account for a set period of time (usually around five). This holding period helps manage risk associated with money being moved through banks to launder money.

#### 5. Innovative Technology

The technology used to detect suspicious activity associated with money laundering is evolving and becoming more accurate. AI and Big Data software, for example, enable these systems to become more sophisticated.

### Initiatives taken at international level to deal with the problem of money laundering-

Since money laundering is an international phenomenon, transnational cooperation is of critical importance in the fight against this menace. A number of initiatives have been taken to deal with the problem at international level which are given below:

1. The UN or the Bank for International Settlements, took some initiatives in 1980's to address the problem of money laundering.
2. With the creation of the Financial Action Task Force (FATF) in 1989, regional groupings, such as the European Union, Council of Europe, and organization of American States also established anti-money laundering standards for their member countries.
3. The major international agreements addressing money laundering include the UN Convention against Illicit Trafficking in Drugs and Psychotropic Substances (the Vienna Convention) and Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds of Crime.
4. The role of financial institutions in preventing and detecting money laundering has also been the subject of pronouncements by the Basle Committee on Banking Regulation Supervisory Practices, the European Union and the International Organization of Securities Commissions.

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To protect the integrity of the market and prevent money laundering, the Indian authorities have placed multiple laws and regulations. Various acts have covered provisions relating to money laundering are:

1. Prevention of Money Laundering Act, 2002 is enacted to prevent money laundering and to provide for confiscation of property derived from money laundering. The person found guilty under this act will be punishable with imprisonment. Moreover, it gives the right to Confiscate and seize the property of parties involved in money laundering.
2. FEMA and FERA have placed detailed restrictions on the hawala market to prevent its use as a conduit for money laundering activities and terrorism financing. FEMA is focused on improving surveillance and preemptive measures rather than relying solely on rules and regulations for prevention.
3. Indian Customs Act, 1962 also plays a vital role in curbing money laundering by imposing stiff penalties including imprisonment for offenses under the Customs Act such as smuggling, improper imports and exports, and wrong declaration of exports.
4. Since banking channels are seriously susceptible to money laundering activities, the Indian Banks Association (IBA) has taken a lead role in evolving a self-regulatory code aimed at combating money laundering activities in the banking system. Most of these institutions are asked to have anti-money laundering (AML) policies in place to detect and prevent any such activities from happening.
5. The Income Tax Act, 1961 provides a framework for combating money laundering by penalizing acts of tax evasion.
6. Punishment for money laundering [Section 4]-Whoever commits the offense of money-laundering shall be punishable with rigorous imprisonment for 3 years which may extend to 7 years and shall also be liable to fine. However, where the proceeds of crime involved in money laundering relates to any offense specified under the Narcotic Drugs & Psychotropic Substances Act, 1985 the punishment may extend to rigorous imprisonment for 10 years instead of 7 years.

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### **Famous Money Laundering Cases in the Financial World**

The stock market has always been on the target of the launderers. The fact that making money in the stock market requires patience and time, lures financial criminals to commit fraud.

One of the common techniques used by them is money laundering. Some of the biggest money laundering cases in India are:

#### **1. The Kingfisher airlines case – Vijay Mallya**

There was a time when people used to call him the ‘King of good times, but today things are far from being good for him.

It all started in 2007 when his company Kingfisher Airlines decided to purchase the low-cost carrier Air Deccan, which was under debt at the time. Soon after that, the carrier started making losses as the oil prices were rising at the time.

To keep his business up and running, Mallya started raising huge amounts in debt from various banks in the country. A couple of years later the debt was around 50% of its net worth.

Inevitably, Kingfisher Airlines Ltd failed and Mallya defaulted on loans worth over Rs 9000 crore from more than a dozen Indian banks around 2013.

In March 2016, Mallya fled India for the UK and in February 2017, India sent an extradition request. He was recently declared a fugitive economic offender under the Fugitive Economic Offenders Act.

#### **2. Punjab National Bank fraud case – Nirav Modi**

“Diamonds are a man or woman’s best friend, but diamantaires like Nirav Modi are not.” This was the tagline trending when Nirav Modi’s 10,000-crore scam unfolded.

His uncle Mehul Choksi and two senior PNB officials were also involved in this fraud. This is one of the most controversial scams of all time which took place through Punjab National bank’s Brady house brand.

Bankers used fake Letters of Undertakings (LoUs) worth more than ₹10,000 crores which were opened in favor of branches of Indian banks for the import of pearls for a period of one year.

The central bank’s guidelines layout a total time period of 90 days from the date of shipment, which was ignored by overseas branches of Indian banks. Modi got his first fraudulent guarantee from PNB in March 2011 and managed to get 1,212 more such guarantees over the next 74 months.

These LoUs made the bank liable in case of any default. In 2018, PNB filed a case with CBI accusing Nirav Modi and the companies he was connected to of obtaining these Letters of Undertaking (LoUs) from PNB without paying up the margin amount against loans.

This meant that if those companies failed to pay the loan, PNB would have had to pay the amount. He is now a fugitive and has sought asylum in the UK.

### 3. Satyam scam – Byrraju Ramalinga Raju

India's largest corporate scam, also known as 'India's Enron Scandal', revolves around B Ramalinga Raju and his Satyam Computer Services Ltd. At the time, Satyam was the fourth largest IT software exporter in the industry after TCS, Wipro, and Infosys.

The information about the company which is primal for investors before making investment decisions such as revenues, operating profits, interest liabilities, and cash balances were all manipulated by the promoters of the company.

The purpose was to meet the analyst's expectations and lure more investments. Mr Raju used to create a number of bank statements in order to inflate the balance sheet with cash that simply did not exist.

The Satyam scam was finally exposed early in 2009 when the country was already in the middle of a recession. The company admitted that it misrepresented, manipulated, and falsified its accounts of over Rs 7,000 crores, in front of its board, stock exchanges, investors, and other stakeholders.

After the confession was made Raju was arrested and charged with criminal conspiracy, breach of trust, and forgery. PwC, the auditor of the company, was also found guilty and its license was temporarily revoked for 2 years.

### 4. Saradha Group Financial Scandal

It was a scheme run by Saradha Group which was an umbrella company with 200 private players. The Ponzi scheme was launched in the early 2000s and gained popularity very soon as the promised returns were extremely high in a short span of time.

The company was able to raise 2500 crores within a few years.

In 2012, SEBI asked the group to stop accepting money from investors and obtain the regulator's permission to run its schemes. This led to a severe outflow of cash from the scheme. In 2013, a huge crisis emerged and the scheme collapsed.

The West Bengal government initially set up a Special Investigation Team (SIT), headed by the then Kolkata Police Commissioner, Rajeev Kumar, to probe the case. The case was transferred to the CBI in 2014 at the behest of the Supreme Court.

CBI considers Kumar as a potential accused in the case and has accused him of not handing over crucial documents to the agency.

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#### What is the highest risk of money laundering?

##### 1. Customers with ties to risky countries

Some countries are more vulnerable to money laundering than others. This is because many countries around the world have been found to have strategic deficiencies in their anti-money laundering and counter-terrorism financing (AML/CTF) regimes, including the Democratic People's Republic of Korea, Iran, and Myanmar. As a result, many fraudulent actors establish connections in these countries in order to launder their money.

##### 2. Customers with ties to high-risk industries

Similarly, some industries are thought to be more vulnerable to money laundering than others. For example, if a customer is linked to a cash-intensive business, such as a launderette or a nail salon, and the earnings are suspiciously high, this may indicate that the business is involved in money laundering.

Furthermore, it is important to note that high-risk customers attempting to launder money will also target businesses in specific industries. They might try to buy art, real estate, or cars with cash, for example. This is due to the fact that if the fraudster is successful, they can launder a large sum of money in a single transaction.

##### 3. Customers with a variety of ownership structures

If you notice a company with a complicated ownership structure, this could be a money laundering red flag. This is because complex structures are typically built to conceal the proceeds of crime.

Financial institutions must determine who a company's ultimate beneficial owner is. The FATF defines a beneficial owner as "the natural person(s) who ultimately owns or controls a customer and/or the natural person on whose behalf a transaction is being conducted. Persons who have ultimate effective control over a legal person or arrangement are also included.

**4. Customers who have unusual account activity**

After a customer is on boarded, you must monitor their account activities and transactions to ensure that they are in line with the risk profile you initially established. For example, if a customer suddenly begins to deposit large sums of cash, regularly transfers funds to another country, or begins to send money to another high-risk individual, this is an indication that the customer's risk profile is changing and must be closely monitored.

**5. Politically exposed people**

(PEPs) Politically exposed people (also known as politically exposed persons) are people whose prominent positions in public life make them vulnerable to corruption. The FATF defines a PEP as "an individual who is or has been entrusted with a prominent public function. Because of their position and influence, many PEPs are in positions that can be abused for the purpose of committing money laundering (ML) and related predicate offenses, such as corruption and bribery, as well as conducting terrorist financing (TF) activity." In addition to the individual in question, the PEP definition includes this person's family members and known associates.

**6. Customers with a bad reputation**

You should screen your customers for negative media both during the onboarding phase and throughout the business relationship. If a number of news sources link this customer to alleged involvement in money laundering, terrorist financing, trafficking, sanctions, and other forms of illegal activity, this indicates that they are a high-risk customer who should be closely monitored. Traditional news sources and media, international databases, blogs, web articles, and newswires are all examples of adverse media sources. A number of customer due diligence solutions, including ours, can automatically screen for adverse media and notify you if anything changes.

**7. Customers who are not residents**

Finally, if a customer attempts to open an account with your company but is not a resident, this indicates that they are a high-risk individual. This is especially true if there is no business case for the customer to open an account with your company. In these cases, the customer may be attempting to launder money through your company. They could also be attempting to avoid reporting requirements by opening accounts with multiple companies in various jurisdictions.

