

[2023] 151 taxmann.com 466 (Article)

## Duties of The Financial Institutions Under PMLA, 2002

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### INTRODUCTION

Many financial institutions such as banks, Non-Bank Financial Companies (NBFCs) and other financial institutes play a critical role in the development, growth and stability of an economy. They primarily act as a catalyst for both domestic and foreign capital but they are also subjected to financial frauds, economic crimes and other illicit activities that threaten the financial stability and tranquillity of a State. Presently, money laundering has become one of the biggest challenges subsisting in India that not only reduces the overall productivity of these institutions but also threatens its financial stability and economic growth. Thus, in lieu of the International norms, (Das, 2023) India has enacted Prevention of Money laundering Act, 2002 (hereinafter referred as "**PMLA**" or "**Act**") which establishes the legal framework for combating money laundering and other illicit activities in India.

### SCOPE OF THE ACT

The primary objective of the Act is to prevent illicit activities in order to create an efficient economy. It aims to safeguard the integrity and stability of the financial system and promote transparency and accountability in financial transactions.

The Act defines Money laundering under section 3 as :-

*"Whosoever directly or indirectly attempts to indulge or 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 shall be guilty of offence of money-laundering."*

### ROLE OF FINANCIAL INSTITUTIONS TO PREVENT MONEY LAUNDERING

The Act mandates financial institutions to perform due diligence and compliance. It requires these institutions to follow procedures such as Client Due Diligence <sup>1</sup>(CDD), monitoring transactions, reporting of suspicious transactions<sup>2</sup> to regulating authorities (wikipedia), etc. The other various activities performed by banks in order to Prevent Money Laundering are mentioned herein below :-

### **a. Maintain records of transactions**

Financial institutions are required to maintain records pertaining to customer identification, account files, and transaction details. These records are to be retained for a period of at least five years<sup>3</sup> from the date of the transaction. In *Paypal Payments (P.) Ltd. v. Financial Intelligence Unit India*<sup>4</sup>, the Hon'ble Delhi High Court held that it is mandatory for intermediaries to maintain records of all transactions under Section 12(1)(a) of PMLA in electronic form on a secure server, located in India, for the same to be retrieved, if required

### **b. Client Due Diligence (CDD)**

The act provides that any suspicious transactions (STRs) should be reported to the appropriate authority within seven working days<sup>5</sup>. Thus, the Banks are required to perform due diligence to ensure the identification of their clients, obtain and verify documents and information.<sup>6</sup> Moreover, the Central Government in consultation with RBI has laid down various guidelines for conducting 'Know your customer' (KYC)<sup>7</sup> read with Section 15 of the PMLA<sup>8</sup>.

### **c. Power to investigate Banks and financial institutes**

The Enforcement Directorate (ED) has the authority to investigate financial institutions, and intermediary records. If the Director discovers that the financial institutions, or intermediaries did not keep the records, he or she has the authority to assess a punishment ranging from Rs.10,000 to Rs.1,000,000<sup>9</sup>. In *Financial Intelligence Unit-IND v. Corporation Bank and ors*<sup>10</sup> the Hon'ble Delhi High Court held that it would be unjust to impose a higher penalty than that provided under the current statute simply because the individual receiving such punishment committed an offence prior to the legislation being passed.

### **d. Report to Financial Intelligence Unit-India (FIU)<sup>11</sup>:**

Financial institutions are required to notify FIU of any suspicious transactions. Further ED and FIU has been given the authority to request and receive information, papers and records from banking firms, financial institutions, intermediaries, and other organisations. They can call for information to fulfil their obligations under the PMLA and to assist in the investigation of suspicious transaction.

It is *ipso facto* that the act provides mandatory provisions for the banking sector in order to Prevent Money Laundering activities. Further, these financial institutions also invest in risk management frameworks, staff development, technology and performing due diligence in order to combat money laundering. Thus, regulating authorities along with banks and other intermediaries collectively make efforts to tackle the subsisting issue of money laundering.

## **CHALLENGES FACED BY FINANCIAL INSTITUTIONS :-**

Despite the implementation of PMLA and compliance procedures, the financial institutions and regulatory agencies continue to face major hurdles in detecting and preventing the money laundering, because of the following reasons-

### **a. Incapacity of transactional monitoring system**

Financial institutions process a large number of transactions, making it difficult to differentiate between

legitimate and illegitimate activities. Due to the sheer volume, speed and diversity of financial transactions, it is challenging to manually detect patterns and anomalies indicating money laundering. It is important to implement an effective transaction monitoring system capable of managing large scale data analysis. In *Ambadi Venugopalan*<sup>12</sup>, it was held that the complaint suffered substantially due to inefficient transaction monitoring system of ICICI Bank.

### **b. Corruption in internal management of the banks**

Money laundering strategies can take advantage of flaws of any organisation. Employees may intentionally or unintentionally support money laundering transactions. Thus, financial institutions must develop strong internal controls, undertake extensive background checks, and provide continuing training and awareness programmes to reduce such unforeseeable risk. For example, In *Chanda Kochhar*<sup>13</sup> fraud case, former CEO-MD of ICICI Bank, the central agency claimed that Kochhar and her husband had committed fraud with Videocon International Electronics Limited between 2009 and 2011. Thereafter, in 2016, Kochhar came under the scrutiny of various revenue and law enforcement agencies after allegations of corruption and misconduct surfaced.

### **c. Issues regarding the attachment of the properties under PMLA**

Banks in India suffer difficulties related to the attachment of property under the Act<sup>14</sup>. ED has the powers for the investigation and prosecution of offences related to Money Laundering and it has the right to confiscate and attach properties suspected of being involved in proceeds of crime. Although, such actions of enforcement agencies impede upon the banks' ability to sell or dispose of the properties in order to recover their debts thereof resulting in financial losses. In *Standard Chartered Bank*<sup>15</sup> the Id. PMLA Tribunal ruled in favour of Standard Chartered Bank<sup>16</sup> stating that ED cannot claim rights over assets of people suspected of criminal activities, if financial institutions have created prior rights<sup>17</sup> over them through lending.<sup>18</sup> Further, the Hon'ble Madras High Court in *Indian Bank*<sup>19</sup> held that the section 5 of PMLA<sup>20</sup> cannot be used by the authorities to inflict injury of the victim i.e. the banks.

## **LEGAL REMEDY FOR FINANCIAL INSTITUTIONS TO RECOVERY THE LOSSES RELATED TO PMLA :**

PMLA Act provides the legal framework and enforcement procedures for money laundering. Both financial institutions and regulating authorities collaborate to maintain the financial system's integrity and stability and to combat financial crime. However, financial institutions often suffer huge financial losses that are hard to recover. Keeping this in mind, various legal remedies can be pursued by financial institutions such as :-

- a. Financial institution can obtained collateral security for loans and other financial transaction;
- b. Financial institution can exercise their rights by seizing and selling the collateral security;
- c. Financial institution can also recover their losses from guarantors or any other individual who is found liable under the crime;
- d. Financial institution can also cooperate with enforcement directorate or debt recovery tribunals or Financial Intelligence Unit etc. to recover the assets acquired through money laundering;
- e. Financial institution can claim their insurance from their insurance provider to recover the losses in incurred due to money laundering cases etc.

## CONCLUSION:

It is evident as per above discussion that the banking sector and other financial institutions are play essential role in implementation of PMLA. They can prevents financial crimes, terrorist financing, online fraud, economic fraud etc. However, in recent years banks and other financial institutes themselves facing various challenges which were also discussed by the Hon'ble Madras High Court in **Dr. V.M. Ganesan**,<sup>21</sup> Hence, it is the duty of Financial institutions to stay updated with the latest amendments and guidelines issued by the Regulatory Authorities to ensure ongoing compliance with the PMLA and associated regulations.

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1. Rule 9 of Rules and Regulations Framed under The Prevention of Money-Laundering (Maintenance of Records) Rules, 2005, inserted vide GSR730 (e), dated 22/9/2015 (w.e.f. 22/9/2015).
  2. Rule 8(2) of Rules and Regulations Framed under the Prevention of Money-Laundering (Maintenance of Records) Rules, 2005.
  3. Section 12 (4) of PMLA 2002(India).
  4. [\[2021\] 124 taxmann.com 488/164 SCL 259 \(Delhi\)](#)
  5. Rule 8(2) of Rules and Regulations Framed under The Prevention of Money-Laundering (Maintenance of Records) Rules, 2005
  6. Section 12(1(a) (e)) of PMLA, 2002(India).
  7. Rule 2 (c (ca)) OF Rules and Regulations framed under The Prevention of Money-Laundering (Maintenance of Records) Rules, 2005. See also, [Reserve Bank of India - Master Directions \(rbi.org.in\)](#).
  8. [fatfplatform.org](#)
  9. Section 13 of PMLA 2002(India).
  10. [\[2019\] 109 taxmann.com 80 \(Delhi\)](#)
  11. <https://fiuindia.gov.in/>
  12. *Ambadi Venugopalan v. ICICI Bank Ltd.* [C.C.NO.125 of 2015] (District consumer Disputes Redressal commission)
  13. *Chanda Kochhar v. Central Bureau of Investigation* [CRIMINAL WRIT PETITION (STAMP) NO. 22494 OF 2022, dated 9-1-12023]
  14. Section 5 of PMLA, 2002(India).
  15. *Standard Chartered Bank v. Deputy Directorate of Enforcement* [FPA-PMLA-1604, 1711, 1760 & 1761 (Mum.) of 2017, dated 2-8-2018].
  16. [Cfo.economicstimes.indiatimes.com](#)
  17. Section [31\(b\)](#) of the Recovery of Debts and Bankruptcy Act, 1993, Section [26\(e\)](#) of the SARFAESI Act, 2002.
  18. [Moneycontrol.com](#)
  19. *Indian Bank v. Government of India and Palpap Ichinichi Software International Ltd.* [Writ Petition Nos.4696 and 12854 of 2012, dated 11-7-2012]
  20. Section 5 of PMLA, 2002(India).
  21. *Dr. V.M. Ganesan v. Joint Director, Directorate of Enforcement* Writ Petition No. 24432 and 28235 of 2014, dated 17-11-2014]