

AML in Securities Market





Money Laundering

- Money Laundering is the process of making dirty money look clean.
- Disguising the illegal source of funds which could be fraud, theft, corruption, drug trafficking or any other criminal activity.
- Three stages in the process
 - Placement
 - Layering
 - Integration



Where do we fit in

- Placement
 - Low
 - Cash acceptance
 - Cash Transaction Reporting (CTR)

Layering & Integration stage

- High
- Transactions for disguising the origin and for integration
- Suspicious Transaction Reporting (STR)



Why Anti Money Laundering

- ✓ Reputational risk
- ✓ Operational risk
- ✓ Social Responsibility
- ✓ Legal risk



Prevention of Money Laundering Act 2002 (PMLA)

- PMLA came into effect from July 1, 2005.
- Government of India, MoF, Department of Revenue has issued notifications dated July 1, 2005 and December 13, 2005 in the Gazette of India, notifying the Rules under the Prevention of Money Laundering Act (PMLA), 2002.
- SEBI issued various guidelines on Anti Money Laundering Standards on January 18, 2006 .



What should be done

- Understand legal and regulatory requirements
- Prepare Anti-Money Laundering compliance program
 - Business and customer profiling
 - Appointment of Principal Officer
 - Customer acceptance procedures
 - Transaction monitoring
 - Reporting
 - Training
 - Audit



Know Your Client

- Full identification of the customer, source of funds and wealth
 - Full information as per KYC form
 - Copy of PAN card after verifying the original
 - Internal processes to verify
 - Address
 - Telephone numbers
 - PAN details
 - Documentation / back ground check
 - Occupation / business
 - Financial status
 - Source of funds
 - Risk profiling of client base



Red flags in KYC

- Unusual or suspicious identification documents
- Unwilling to provide personal background information
- Without references & local address
- Coming from outside service area
- Reluctant to provide service / business details
- Refuses to identify a legitimate source for funds
- False or misleading information



Example

- ABC Limited with major share holders Mr. A, Mr. B & Mr. C approached Best Profits Stock Brokers Ltd.
- B is a good friend of MD of BPSBL
- Since ABC Ltd. is a known entity what should the compliance team of BPSBL do?
 - Go ahead with the registration without regular customer verification?
 - Ask Mr. B about the details of ABC Ltd.?
 - Do an independent verification as per BPSBL's verification process
- Compliance Manager decides to do independent verification
 - Realizes that Mr. A is closely related to an alleged well known criminal
 - Escalates to top management.
 - Decides to go ahead with registration with extra monitoring



Monitoring & Reporting

- Cash Transactions - CTRs
- Internal procedures for identifying suspicious transactions
- Generation of alerts
- Evaluation of each instance
- Documentation of evaluation process
- Reporting to FIU
- Reporting to Board of FIU filings
- Employee training on detecting suspicious activity

Alert generation

- Customer activity profiling
- Customer classification – high, medium & low risk
- Periodic monitoring based on classification
- Alerts when current activity exceeds profile
- Software support
- Investigation
- Documentation of STR filing decision
- STR filing and Internal escalation procedures

Reporting time frame

- Cash Transaction Report for each month should be submitted by 15th of next month.
- STR should be submitted within 7 days of arriving at a conclusion of that transaction.
- Principal Officer is responsible for timely submission of CTRs & STRs to FIU
- Utmost confidentiality in filing of CTRs & STRs
- The Reports may be transmitted by speed / registered post / fax / on a CD at the notified address.

Suspicious Transactions



- Appears to be an agent of an undisclosed principal
- Multiple accounts (single or multiple names) with no apparent reason.
- Unexplained third party transfers
- Unexplained high activity
- Unexplained high level funds activity with low securities transactions
- Large deposits for long term investments. Immediate liquidation
- Pre-arranged trading & wash sales
- Excessive journal entries among unrelated entities
- Market manipulation / insider trading



Willful Blindness

Guard against willful blindness

- *Definition:*

In case a person deliberately ignores indicators of money laundering or other suspicious client activity & takes no steps to follow company's escalation procedures to report the activity.



Case study 1

- ABC Ltd. places routine small orders for a few months.
- After 3-4 months asks the dealer to place a high value buy order in Right Choice Ltd – a thinly traded scrip.
- Dealer enquires and is informed that there are positive reviews on many message boards and they would not want to miss out the opportunity to make profits.
- Dealer goes ahead with the order.
- ABC continues with activity for two more days.
- The dealer notes that price and traded volume of the security have shot up since the entry of ABC in the scrip



Case study 1

- What should the dealer do now?
 - Question ABC Ltd. again?
 - Quietly keep executing the orders?
 - Report the matter to the Principal Officer?
- The dealer decided to report the matter to the Principal officer for further investigation
- What should the Principal Officer do now?
 - Stop placing orders of ABC Ltd. in the scrip
 - Report the matter to FIU?
 - Act ignorant and continue accepting orders?



Case study 1

- Brokerage's internal AML policy requires such transactions to be reported to FIU
- The Principal Officer decided not to report since one of directors of ABC is related to MD of brokerage
- ABC Ltd. sold off all the accumulated stock in two days for large profit
- This led to fall in price
- Subsequent investigations based on filings by other financial intermediaries with FIU revealed money laundering issues
- Proceedings launched against ABC Ltd, the Principal Officer and the Brokerage
- Principal Officer should have followed written policy and reported the transactions FIU

Case study 2

- Back office official notices that pay-in of a newly registered client is coming from multiple national / international accounts
- On verification of paper work, he realizes that one of the directors' of the client is a well known public figure
- Brings to the notice of the Principal Officer.
- What should be the course of action of the Principal Officer?
 - Principal Officer, following the written policy, files an STR with FIU



Case study 3

- A large brokerage firm XXX Ltd. got a phone call from Mr. Z, an NRI.
- Mr. Z stated that he wanted to invest large amount of funds in Indian market
- Sales rep Mr. D started processing the registration by asking for details such as residence proof, source of funds, PAN, type of employment, bank details etc.
- Mr. Z promised to send all the documents
- Meanwhile wanted to place orders by giving his PAN and other details over telephone
- He wanted to buy shares of Good Books Ltd for Rs. 25 lakhs

Case study 3

- Good Books Ltd is a thinly traded scrip
- The request is not as per written AML policy
- Sought further clarification for doing the transaction before competing registration
- Z informed that he has an NRI friend Mr. Y who wanted a loan of Rs. 25 lakhs against shares he held in Good Books Ltd
- In the mean time, Mr. D got the PAN verified
- Decided to execute the buy order without consulting his principal officer

Case study 3

- The next day Mr. Z again wanted to buy Rs. 10 lakhs worth shares of another thinly traded scrip
- Documents still did not arrive.
- On enquiry, Mr. Z replied that due to some miscommunication documents were not couriered
- He offered to get the documents faxed but wanted new order to be put through immediately
- Mr. D went ahead with the buy order without alerting his principal officer



Case study 3

- Next day incomplete / unclear documents were received over fax
- Mr. D called and was told that documents would be faxed again
- In the mean time A wanted to sell the shares of Good Books Ltd bought earlier
- On enquiring, it was told that Z's friend no longer needed the money and hence they wanted to reverse the transaction
- Mr. D decided to execute sell transaction and then inform principal officer
- Sell transaction was executed at a lower price resulting in loss
- Mr. Z wanted to sell other company shares to cover the loss
- KYC formalities were still not complete
- Meanwhile, principal officer through his alert mechanism zeroed in on the transactions
- Filed STR with FIU and initiated action against D



Case study 4

- Mr. A registers with Trading Company Ltd.
- After due diligence, he is allotted a client code and commences trading on a low key
- One day, at the market open, he places a large order to buy shares of an illiquid scrip
- Entire quantity gets executed in one shot
- Later on, places sell order for those shares at a loss
- Again entire quantity goes in one shot
- On questioning, attributes activity to a wrong tip.
- Dealer reports the matter to principal officer
- Principal officer keeps the client on watch list as per policy and upon repeat activity files an STR



Case study 5

- Mr. Z approaches M/s Trust Us for registration. After due-diligence, the client is allotted a client code.
- As per the KYC, the annual income of the client is less than 5 lakhs and financial assets of about 4 lacs
- The client starts trading on a low scale
- After about 6 months, monitoring system of the brokerage generated an alert for excessive trading activity compared to known financial status of the client
- Average daily trading activity of the client jumped from less than 1 lac to 15 lacs
- Principal officer's enquires reveal that the client received a large inheritance in the recent past
- Principal officer records the details, obtains additional documentation and closes the alert following company policy



Thank you