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## **Trade Based Money Laundering At Bank Of Baroda: "In Good Faith"?**

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*“There is not an iota of doubt whatsoever in my mind that the instant transactions appear to have been made in circumstances of unusual or unjustified complexity or appear to have no economic rationale or bona fide purpose”<sup>1</sup>*

**Director, Financial Intelligence Unit, India, FIU Bank of Baroda Judgement, Point no.51, p.39.**

## **I. BACKGROUND**

On 27th March 2018, the Financial Intelligence Unit (FIU), Ministry of Finance, Government of India imposed a total fine of Rs 9 crore on Bank of Baroda under the Prevention of Money Laundering Act, (PMLA) 2002<sup>2</sup>. In the written directive, Shri Pankaj Kumar Mishra, Director, Financial Intelligence Unit also cautioned Bank of Baroda to be observant in the future with regard to discharging its obligations under the PMLA Act 2002.

Financial Intelligence Unit (FIU), India was set up by the Government of India on 18th November 2004. It is the central national agency responsible for receiving, processing, analysing and disseminating information relating to suspect financial transactions<sup>3</sup>.

The Prevention of Money Laundering Act, 2002 (PMLA), which came into force from 2005, is core of the legal framework to combat money laundering in India. The PMLA imposes obligation on banking companies, financial institutions and intermediaries to verify identity of clients, maintain records and furnish information to FIU.

A landmark case in the history of Indian money laundering, Bank of Baroda fell victim to complex money laundering scheme between 2014 and 2015, in its branches located at India's capital city, New Delhi. Bank of Baroda had raised several points with regard to the case in the FIU hearing, underlining why they should not be fined and that there were no regulatory violations in this regard. However, the FIU decision remained unchanged.

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<sup>1</sup> From Bank of Baroda judgement, ref F.No.9-28/BOB/FIU/IND/2015  
[https://fiuindia.gov.in/pdfs/judgements/BOB\\_1\\_2018.pdf](https://fiuindia.gov.in/pdfs/judgements/BOB_1_2018.pdf)

<sup>2</sup> Refer to Appendix A

<sup>3</sup> <https://fiuindia.gov.in/>

- **Was Bank of Baroda right in its handling of the case?**
- **Was the FIU correct in imposing a penalty on Bank of Baroda?**

## **II. THE CASE**

The laundering process: The facts of the case, as pointed out in the Show Cause Notice (SCN) of FIU are as follows:

1. It was noted that 59 current accounts were opened at two New Delhi branches of Bank of Baroda: Ashok Vihar (58) and Shalimar Bagh (1)
2. KYC (Know Your Customer) in some of these accounts was subsequently found to be deficient.
3. Out of these 59 accounts, 33 accounts had frequent high-value cash deposits.
4. Besides cash transactions there were a large number of high-value remittances in these accounts from other banks. For example, in one of the accounts, remittances were made from 11 banks, namely, Standard Chartered Bank, ICICI Bank, Canara Bank, Axis Bank, Punjab National Bank, State Bank of Bikaner and Jaipur (SBBJ), HDFC Bank, Citizen Cooperative Bank, Central Bank of India, City Urban Union Bank and Tamilnad Mercantile Bank Ltd.
5. During the period May 13, 2014 to August 2015, 5853 outward foreign remittances aggregating to USD 546.10 million (Rs. 3500 crores approximately) were made from these 59 current accounts mostly for the purpose of "Advance Remittance for Imports". The remittances were made to around 400 overseas parties based in Hong Kong and 3 in the UAE. Out of the 5853 outward remittances, 414 remittances involving approximately USD 50 million were for the purpose of "non-import remittances".
6. Credit reports on the parties were either not obtained or obtained but found unsatisfactory.
7. Transaction amounts were kept below the regulatory threshold limit of USD 100,000 in the majority of cases.
8. While reporting the foreign exchange remittance transactions to the centralized forex Treasury desk, the branch had clubbed multiple entries of different

customers and made a single reporting taking a single rate. This resulted in unreconciled entries in the NOSTRO reconciliation.

9. Bills of entries (documentary proof of imports made) were not obtained by the branch and no follow-up for the same was found on record.

***Do you think these are red flag indicators and should come under the money laundering scanner?***

### **III. AFTERMATH AND PENALTIES ON BANK OF BARODA:**

On 12<sup>th</sup> October 2015, Bank of Baroda issued a clarification in response to an article in the New Indian Express dated 12.10.2015, where the bank stated that 59 current accounts were opened with its Ashok Vihar Branch which was used to remit foreign exchange to the tune of Rs.3500 crores. It further stated that of the total only 10% was by way of cash deposits with it and the remainder was received through RTGS/NEFT from various banks<sup>4</sup>.

The bank stated that the matter came to their attention in the middle of July 2015, post which they ordered an internal investigation which was submitted on 31.08.2015 to the regional office. The matter was further escalated to corporate office, who ordered a detailed investigation by the bank's Internal Audit division which commenced on 22.09.2015.

The matter was reported to the investigative agencies i.e., CBI and enforcement directorate on 24.09.2015 and also to Ministry of Finance on the same day. The matter was reported on 26.09.2015 to RBI by CGM on 29.09/2015 in writing. The bank further stated that there was no financial loss to the bank or the same was insignificant<sup>5</sup>.

On 25<sup>th</sup> July 2016, the bank informed the Bombay Stock Exchange<sup>6</sup> that the Reserve Bank of India has imposed a penalty of INR 50 million (Rupees Fifty Million) on Bank of Baroda under Banking Regulation Act, 1949. In October 2015, following the internal

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<sup>4</sup> Source-clarification issued by bank vide letter red BCC:ISD:107/16/529-A dated 12,10.2015 to BSE

<sup>5</sup> Source-clarification issued by bank vide letter red BCC:ISD:107/16/529-A dated 12,10.2015 to BSE

<sup>6</sup> This is a requirement under Disclosure pursuant to Regulation 30 of SEBI (LODR) Regulation

audit, Bank of Baroda had found certain irregularities pertaining to this case. The same was informed to the regulatory and investigative authorities.

The investigation carried out by RBI highlighted a weak internal control system, specifically with regards to certain AML related activities including periodic reporting to FIU, monitoring of transactions, and creation and assignment of UCIC (Unique Customer Identification Code) to customers<sup>7</sup>. Bank of Baroda stated that they fully cooperated with the inspection process, and also implemented a comprehensive corrective action plan aimed at further strengthening internal controls to prevent recurrence of similar events<sup>8</sup>.

#### **IV. CONCERNS RAISED BY FIU**

The Financial Intelligence Unit (FIU) issued a show cause notice on 24<sup>th</sup> January, 2017 under section 13 of the Prevention of Money Laundering Act, 2002. The imposition of fines on Bank of Baroda in 2018 was under the PMLA act.

Bank of Baroda informed the Financial Intelligence Unit of its centralized Anti-Money Laundering Software, Financial Crime Manager, which generated daily AML alerts on the basis of 90 transaction-based definitions and 27 behavioural-based alert definitions, entered through branches in CBS.

The process flow for identification and escalation of alerts was as follows:

- The alerts generated daily by the Financial Crime Manager were automatically assigned to the identified Anti-Money Laundering Reporting Offices (AMLRO) located at regions for scrutiny or examination for money laundering and terrorist financing angle.
- The AMLRO were assigned the duty to examine the alerts and report suspicious transactions to head office, Baroda, for onward filing of Suspicious Transaction Reports (STRs) with FIU and to investigate or examine or close the alerts.
- The AMLROs were to escalate the suspicious transactions to the Principal Officer (PO) for filing a Suspicious Transaction Report (STR) with FIU.

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<sup>7</sup> Refer to Appendix B

<sup>8</sup> Source-clarification issued by bank to BSE vide letter ref BCC:ISD&CS/16 dated 25/07/2016

- The PO would scrutinize such escalated suspicious transactions and file STRs to FIU under his signature.
- The Deputy regional managers of the regions were designated as the Money Laundering Reporting Officers (MLRO) for monitoring the functions of AMLROs and to audit the closed alerts on a random basis.
- A weekly report was sought from the regions on alerts audited by MLROs
- Quarterly compliance certificates were to be obtained from the regions with regard to scrutiny /examination of alerts by AMLRO and random audit by MLRO.

For the period August 2014 to August 2015, a total of 79 CTRs were filed in respect of the 59 accounts referred to in this case. 13 STRs, where overseas remittances and telegraphic transfers of high values, were also filed from July 2014 to August 2015.

Following investigations, FIU noted the following irregularities in the Bank of Baroda case:

**A. Improper internal mechanisms for detecting and reporting STRs**

In the 59 accounts, 8408 alerts were generated but these alerts were closed in a routine manner at the branch level on the basis of comments of the branch with regard to the bona fides of the transaction, as 'closed not suspicious'. No reason was given for the same.

The AML team of Delhi Metro Region- I had examined and closed 8408 alerts using their judgment and discretion. None of these alerts (barring two) were escalated to the Principal Officer, who is responsible for taking a view on these before disposal of the alerts. PO got the same scrutinized and filed the STRs with FIU.

**B. Deficient due diligence and KYC**

From perusal of documents submitted by the bank it was also observed by FIU that all the 59 accounts were opened on the basis of PAN card and proof of premises of business. The other details that such as identity of clients, verification of identity, information on the purpose and intended nature of business relationship, identification of beneficial owner etc which are required at the time of commencement of account-based relationship were either incomplete or not given. In some cases, the same

account opening form was used to open multiple accounts on different dates. The Know Your Customer (KYC) was deficient at the time of opening bank accounts.

### **C. Delayed/ Not Filing of Electronic Fund Transfer Reports for remittances from India**

FIU noted that the cumulative period of delay in filing 6181 ETFs was 114 months. In some cases, ETF reports were not filed.

### **D. Late Filing of CTRs**

FIU noted lapses in filing 9 CTRs for 63 transactions from August 2008 to July 2016.

## **V. BANK OF BARODA'S RESPONSE**

1. Bank of Baroda responded to the FIU's concerns raised in the Show Cause Notice (SCN) with regard to the filing of STR as follows "the regional AML team had investigated enclosed alerts as per their judgment/ satisfaction....". For four accounts belonging to one family opened between 2009 and 2015, in which high-value transactions took place, 84 alerts that were generated were closed as either "closed, not investigated or closed, not suspicious", with comments by the branch that "to the best of our knowledge the transaction appears genuine".
2. With reference to foreign remittances allowed under 'advances remittances for imports', Bank of Baroda iterated that these accounts were for the "purpose of trading" and therefore frequent transactions are allowed as well as remittances to foreign accounts as per the FEMA regulations of RBI. In these 59 accounts, only 15% of the funds were deposited as cash in the bank and remaining was remitted into these accounts through RTGS by other banks. As per FEMA guidelines, advance remittances were made and it is not a scheduled offence under PMLA.
3. Bank of Baroda pointed out that "ongoing due diligence" is, as the word suggests, an ongoing process depending upon the best judgment of the banker. In the absence of any specific direction from RBI it works on the *bona fide* best judgment of the banker.
4. Bank of Baroda points out that before a transaction has to be reported to FIU as 'suspicious' it has to "fulfil the requirement of the definition of 'suspicious' as laid down in the rules" and SCN does not specify any the grounds of such alleged

"suspicious transactions" in regard to these accounts due to which the said transactions could be said to be 'suspicious transaction'.

5. The bank contended that the said alerts were scrutinized by the AMLROs by applying their individual best judgment and prudence.
6. Further 'suspicious transactions' as defined in the rules do not specify any monetary threshold for the transactions to qualify as 'suspicious transactions.
7. Additionally, nowhere in the PMLA rules is it provided that all alerts escalated are to be put to the PO.
8. The bank further contended that the system installed by the bank is bound by its regulator (RBI) and any deficiency cannot constitute failure in complying with obligation as laid out in chapter IV of the PMLA and invite fine on the RE at the hands of the director, FIU, The bank disputed the authority of the director FIU contending that the PMLA and the rules, 2005 envisage compliance with the guidelines, etc issued by the regulator i.e., RBI and that it had complied with such guidelines issued by RBI from time to time.
9. In January 2015, the Bank had sought guidance from FIU with regard to filing to ETF reports. From May 2015 onwards, ETFs have been filed regularly and the ETFs for the backlog was also filed.

***Given the concerns of the FIU, and the response of the bank, do you think the Bank failed to act in accordance with the provisions of the PMLA Act?***

***Should FIU have imposed the penalty on Bank of Baroda?***

## **References**

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## ***Appendix A***

### **Relevant provisions of PML (Maintenance of Records) Rules 2005 (Source: [fiuindia.gov.in](http://fiuindia.gov.in))**

- **Rule 3**

#### **Maintenance of records of transactions (nature and value)**

- (1) Every reporting entity shall maintain the record of all transactions including, the record of
  - (A) all cash transactions of the value of more than rupees ten lakhs or its equivalent in foreign currency;
  - (B) all series of cash transactions integrally connected to each other which have been individually valued below rupees ten lakh or its equivalent in foreign currency where such series of transactions have taken place within a month and the monthly aggregate exceeds an amount of ten lakh rupees or its equivalent in foreign currency; (BA) all transactions involving receipts by non-profit organisations of value more than rupees ten lakh, or its equivalent in foreign currency;
  - (C) all cash transactions where forged or counterfeit currency notes or bank notes have been used as genuine or where any forgery of a valuable security or a document has taken place facilitating the transactions;
  - (D) all suspicious transactions whether or not made in cash and by way of-
    - (i) deposits and credits, withdrawals into or from any accounts in whatsoever name they are referred to in any currency maintained by way of:
      - (a) cheques including third party cheques, pay orders, demand drafts, cashiers cheques or any other instrument of payment of money including electronic receipts or credits and electronic payments or debits, or
      - (b) travellers cheques, or

- (c) transfer from one account within the same banking company, financial institution and intermediary, as the case may be, including from or to Nostro and Vostro accounts, or
  - (d) any other mode in whatsoever name it is referred to;
- (ii) credits or debits into or from any non-monetary accounts such as d-mat account, security account in any currency maintained by the banking company, financial institution and intermediary, as the case may be;
  - (iii) money transfer or remittances in favour of own clients or non-clients from India or abroad and to third party beneficiaries in India or abroad including transactions on its own account in any currency by any of the following:-
    - (a) payment orders, or
    - (b) cashiers cheques, or
    - (c) demand drafts, or
    - (d) telegraphic or wire transfers or electronic remittances or transfers, or
    - (e) internet transfers, or
    - (f) Automated Clearing House remittances, or
    - (g) lock box driven transfers or remittances, or
    - (h) remittances for credit or loading to electronic cards, or
    - (i) any other mode of money transfer by whatsoever name it is called;
  - (iv) loans and advances including credit or loan substitutes, investments and contingent liability by way of:
    - (a) subscription to debt instruments such as commercial paper, certificate of deposits, preferential shares, debentures, securitized participation, inter bank participation or any other investments in securities or the like in whatever form and name it is referred to, or
    - (b) purchase and negotiation of bills, cheques and other instruments, or

- (c) foreign exchange contracts, currency, interest rate and commodity and any other derivative instrument in whatsoever name it is called, or
- (d) letters of credit, standby letters of credit, guarantees, comfort letters, solvency certificates and any other instrument for settlement and/or credit support;
- (v) collection services in any currency by way of collection of bills, cheques, instruments or any other mode of collection in whatsoever name it is referred to.
- (e) all cross border wire transfers of the value of more than five lakh rupees or its equivalent in foreign currency where either the origin or destination of fund is in India;
- (f) all purchase and sale by any person of immovable property valued at fifty lakh rupees or more that is registered by the reporting entity, as the case may be.

- **Rule 4:**

**Records containing Information**

The records referred to in rule 3 shall contain all necessary information specified by the Regulator to permit reconstruction of individual transaction including the following information:-

- (a) the nature of the transactions;
- (b) the amount of the transaction and the currency in which it was denominated;
- (c) the date on which the transaction was conducted; and
- (d) the parties to the transaction.

- **Rule 8:**

**Furnishing of information to the Director.**

- (1) The Principal Officer of a reporting entity shall furnish the information in respect of transactions referred to in clauses (A), (B), (BA), (C) and (E) of sub-rule (1) of rule 3 every month to the Director by the 15th day of the succeeding month.

- (2) The Principal Officer of a reporting entity shall furnish the information promptly in writing or by fax or by electronic mail to the Director in respect of transactions referred to in clause (D) of sub-rule (1) of rule 3 not later than seven working days on being satisfied that the transaction is suspicious.
- (3) The Principal Officer of a reporting entity shall furnish, the information in respect of transactions referred to in clause (F) of sub-rule (1) of rule 3, every quarter to the Director by the 15th day of the month succeeding the quarter.

- **Rule 9:**

**Client Due Diligence.**

- (1) Every reporting entity shall
  - (a) at the time of commencement of an account-based relationship-
    - (i) identify its clients, verify their identity, obtain information on the purpose and intended nature of the business relationship; and
    - (ii) determine whether a client is acting on behalf of a beneficial owner, and identify the beneficial owner and take all steps to verify the identity of the beneficial owner

## **Appendix B**

**RBI master circular on KYC (Source: [https://www.rbi.org.in/scripts/BS\\_ViewMasCirculardetails.aspx?id=8179#f2](https://www.rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=8179#f2))**

### **2.20 Maintenance of records of transactions/Information to be preserved / Maintenance and preservation of records/Cash and Suspicious transactions reporting to Financial Intelligence Unit- India (FIU-IND)**

Government of India, Ministry of Finance, Department of Revenue, vide its notification dated July 1, 2005 in the Gazette of India, has notified the Rules under the Prevention of Money Laundering Act (PMLA), 2002. In terms of the said Rules, the provisions of PMLA, 2002 came into effect from July 1, 2005. Section 12 of the PMLA, 2002 casts certain obligations on the banking companies in regard to preservation and reporting of customer account information. Banks are, therefore, advised to go through the provisions of PMLA, 2002 and the Rules notified there under and take all steps considered necessary to ensure compliance with the requirements of Section 12 of the Act *ibid*.

#### **i) Maintenance of records of transactions**

Banks should introduce a system of maintaining proper record of transactions prescribed under Rule 3 of PML Rules, 2005, as mentioned below:

- a. all cash transactions of the value of more than Rupees Ten Lakh or its equivalent in foreign currency;
- b. all series of cash transactions integrally connected to each other which have been valued below Rupees Ten Lakh or its equivalent in foreign currency where such series of transactions have taken place within a month and the aggregate value of such transactions exceeds Rupees Ten Lakh;
- c. all transactions involving receipts by non-profit organisations of value more than rupees ten lakh or its equivalent in foreign currency [Ref: Government of India Notification dated November 12, 2009- Rule 3,sub-rule (1) clause (BA) of PML Rules]

- d. all cash transactions where forged or counterfeit currency notes or bank notes have been used as genuine and where any forgery of a valuable security or a document has taken place facilitating the transaction and
- e. All suspicious transactions whether or not made in cash and by way of as mentioned in the Rules.

#### **ii) Information to be preserved**

Banks are required to maintain all necessary information in respect of transactions referred to in Rule 3 to permit reconstruction of individual transaction, including the following information:

- a. the nature of the transactions;
- b. the amount of the transaction and the currency in which it was denominated;
- c. the date on which the transaction was conducted; and
- d. the parties to the transaction

#### **iii) Maintenance and Preservation of Records**

- a) Banks should ensure that records pertaining to the identification of the customer and his address (e.g. copies of documents like passports, identity cards, driving licenses, PAN card, utility bills etc.) obtained while opening the account and during the course of business relationship, are properly preserved for at least five years **after the business relationship is ended** as required under Rule 10 of the Rules *ibid*. The identification records and transaction data should be made available to the competent authorities upon request.
- b) In paragraph 2.10 of this Master Circular, banks have been advised to pay special attention to all complex, unusual large transactions and all unusual patterns of transactions, which have no apparent economic or visible lawful purpose. It is further clarified that the background including all documents/office records/memorandums pertaining to such transactions and purpose thereof should, as far as possible, be examined and the findings at branch as well as Principal Officer level should be properly recorded. Such records and related documents should be made available to help auditors in their day-to-day work relating to scrutiny of transactions and also to Reserve Bank/other relevant

authorities. These records are required to be preserved for five years as is required under PMLA, 2002.

#### **iv) Reporting to Financial Intelligence Unit - India**

- a) In terms of the PMLA Rules, banks are required to report information relating to cash and suspicious transactions and all transactions involving receipts by non-profit organisations of value more than rupees ten lakh or its equivalent in foreign currency to the Director, Financial Intelligence Unit-India (FIU-IND) in respect of transactions referred to in Rule 3

#### **B. Suspicious Transaction Reports (STR)**

- i) While determining suspicious transactions, banks should be guided by definition of suspicious transaction contained in PMLA Rules as amended from time to time.
- ii) It is likely that in some cases transactions are abandoned/aborted by customers on being asked to give some details or to provide documents. It is clarified that banks should report all such attempted transactions in STRs, even if not completed by customers, irrespective of the amount of the transaction.
- iii) Banks should make STRs if they have reasonable ground to believe that the transaction involve proceeds of crime generally irrespective of the amount of transaction and/or the threshold limit envisaged for predicate offences in part B of Schedule of PMLA, 2002.
- iv) The Suspicious Transaction Report (STR) should be furnished within 7 days of arriving at a conclusion that any transaction, whether cash or non-cash, or a series of transactions integrally connected are of suspicious nature. The Principal Officer should record his reasons for treating any transaction or a series of transactions as suspicious. It should be ensured that there is no undue delay in arriving at such a conclusion once a suspicious transaction report is received from a branch or any other office. Such report should be made available to the competent authorities on request.