

Summarised Provision on Applicability of Prevention of Money-Laundering Act, 2002 to Stock Brokers



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Stock Brokers have been mandated to verify identity of clients, maintain certain records and furnish certain information's to FIU. The emphasis has been placed upon continuous monitoring rather than mandated activities being one time event. Though intention of the legislature is very wide and clear and may also prove to be effective in combating Money Laundering but the only concern being Stock Brokers, as such, are placed with neck-deep compliance requirements and further compliance to provisions of PMLA 2002 will only add to their otherwise high compliance costs which can well be met in this bull market. But the effectiveness will really be put to test only in the bear market.

The issue of Money Laundering has been bothering the lawmakers of the country for long. From time to time different steps have been initiated to combat the Money Laundering menace and The Prevention of Money Laundering Act (PMLA), 2002 was promulgated to tackle the issue at the initial stages of transaction. The article provides a summarized provision on its applicability.

The Prevention of Money Laundering Act (PMLA), 2002 and the Rules notified thereunder came into force with effect from July 1, 2005. Stock Brokers, being one of the intermediaries registered

with SEBI, are under obligation to verify identity of clients, maintain records and furnish information to Financial Intelligence Unit-India. SEBI and NSE have from time to time issued different circulars for compliance of obligations placed upon Stock Brokers. This article is an attempt to analyze the provisions of PMLA 2002 as applicable to Stock Brokers.

Circular Reference

ISD/CIR/RR/AML/1/06 dated 18.01.2006 (SEBI)

ISD/CIR/RR/AML/2/06 dated 20.03.2006 (SEBI)

NSC/INVG/2006/09 dated 25.01.2006 (NSE)

NSC/INVG/2006/33 dated 24.03.2006 (NSE)

Basic Provisions

- o Formulation of a proper policy framework on anti-money laundering measures.
- o To designate an officer as 'Principal officer' and intimate their details to the Financial Intelligence Unit, India at the following address:-
Director – FIU – IND
Financial Intelligence Unit – India
6th Floor, Hotel Samrat,
Chanakya Puri,
New Delhi – 110021

Verification Of The Records Of The Identity Of Clients:

Rule 5 read with Rule 9 of the circular no. NSE/INVG/2006/33 dated 24.03.2006 casts responsibility on the Stock-Brokers to verify and maintain the record of identity, address, nature of business and financial status of the client.

Rule 9 of Prevention of Money-Laundering (Maintenance of Records of the nature and value of transactions, the procedure and manner of maintaining and time for furnishing information and verification and maintenance of records of the identity of the clients of the Banking Companies, Financial Institution and Intermediaries) Rules, 2005 contain elaborate provisions for verification and maintenance of the records of the identity of clients.

As per the above Rule, following should be verified at the time of Opening an account or executing any transaction with client:

- § Identity of the client
- § Current address or addresses including permanent address or addresses of the client
- § Nature of business of the client and
- § Financial status of the client

It may please be noted that verification referred to in Rule 9 is not limited to opening of an account but is extended to include verification at the time of execution of any transaction.

The rule further states that if it is not possible to verify the identity of the client at the time of opening an account or executing any transaction, the same should be verified within a reasonable time after the account has been opened or the transaction has been executed. The term “reasonable time” has not been defined.

Mandatory Documents to be Obtained From the Clients

The documents to be obtained from the clients are specifically provided for in sub-rule (2) to Sub-Rule (7) of Rule 9 of Prevention of Money-Laundering (Maintenance of Records of the nature and value of transactions, the procedure and manner of maintaining and time for furnishing information and verification and maintenance of records of the identity of the clients of the Banking Companies, Financial Institution and Intermediaries) Rules, 2005.

It may be noted that documents should also be obtained to substantiate nature of business and financial status of the client. In my opinion, it is advisable to obtain the Trade License (for nature of business) and Audited /Unaudited Accounts (for financial status).

Further, whereas for Individual Clients, only one certified copy should be obtained, for rest all categories of client, three certified copies should be obtained. It is relevant to state that rules have no specific mention of requirement for HUF. But, in my opinion, since HUF has a distinct legal entity separate from Individual and since no specific requirement has been provided for HUF, to comply with these rules the stock brokers would do well to obtain similar documents as prescribed for unincorporated association or body of individual.

Client Identification Programme

Sub-Rule 7 of Rule 9 of Prevention of Money-Laundering (Maintenance of Records of the nature and value of transactions, the procedure and manner of maintaining and time for furnishing informa-

tion and verification and maintenance of records of the identity of the clients of the Banking Companies, Financial Institution and Intermediaries) Rules, 2005 mandates a stock broker to:

- a) Formulate and Implement a client Identification Programme, and,
- b) Forward a copy of the Client Identification Programme to the Director, FIV- IND.

It appears that authorities want to know the system adopted by the Stock-Brokers for Identification of Client. It may be re-called that requirement of identification is not limited to opening of account but also includes execution of transaction, thereby implying that this is a continuous process and hence programme to be formulated should incorporate features of continuous identification. Some examples may be as under:

- (i) Periodical despatch of Statement of Accounts/Contract notes to the given address of the client (for verification of address).
- (ii) Obtaining Audited/ Unaudited accounts for each financial year (for verification of financial status).
- (iii) Periodical visit to clients' place or asking client to periodically visit the Intermediary place (identity proof).

Maintenance of the Records

Records of the Identity of Client shall be maintained in hard and soft copies in a manner as may be specified by the RBI from time to time.

The records of the identity of clients shall be maintained for a period of ten years from the date of cessation of the transaction between the Client and the Stock-Broker.

Cash Transaction Report (CTR)

Section 12(1) of the Prevention of Money Laundering Act, 2002 lays down obligation on the stock-broker to maintain record of certain types of transaction and furnish information of such transaction to Director, FIU-IND.

The transaction specified for maintenance of record and furnishing information thereof to the Director, FIU-IND are:

- (a) All cash transaction 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 valued below rupees ten lakhs or its equivalent in foreign currency where such series of transaction have taken place within a month.

Proviso to sec 12(1) provides that in case stock broker has reason to believe that a single transaction or series of transaction have been valued below Rs. 10 Lac to defeat the provisions of this section, such information shall also be furnished to the Director.

In terms of SEBI circular No. ISD/CIR/RR/AML/2/06 dated 20.03.2006, all Stock Brokers are required to maintain records for all cash transaction where forged or counterfeit currency notes or bank notes have been used as genuine and where any forgery of a valuable security has taken place. Similarly Information of such transaction is also to be given to the Director.

The information required under sec. 12(1) should be furnished by the 15th day of the succeeding month.

Such information shall be furnished in the prescribed format and may be filed either in manual or electronic format. Further it has been specifically provided that Reports shall be furnished in electronic format if the stock-broker has technical capability to do so.

Suspicious Transaction Report (STR)

Clause 3 (iv) in page 2 of SEBI circular No. ISD/CIR/RR/AML/2/06 dated 20.03.2006 states that a Stock Broker has to maintain record of transaction of all suspicious transactions where or not made in cash.

The term “Suspicious Transaction” has been defined as under:

Suspicious transaction means a transaction whether or not made in cash which, to a person acting in good faith:-

- (a) gives rise to a reasonable ground of suspicion that it may involve the proceeds of crime, or
- (b) appears to be made in circumstances of unusual or unjustified complexity, or
- (c) appears to have no economic rationale or bonafide purposes.

Suspicious Transaction Report Version 1.0 referred to in clause 6 of page 3 of SEBI Circular No. ISD/CIR/RR/AML/2/06 dated 20.03.2006 contains Broad categories of reason for suspicion and example of suspicious transaction for a Stock-Broker.

These Broad categories and examples are indicative and not exhaustive.

Wherever, the stock-broker has reason to believe a particular transaction to be of suspicious nature, the record thereof shall be maintained and information thereof shall be furnished to Director.

It appears that in respect of given Broad categories for suspicion and example of suspicious transaction, Stock-Brokers has not been given freedom to exercise their opinion but are mandatorily required to maintain records of transaction and furnish information thereof to the Director, even though, they may be of the opinion that such transaction is not suspicious. Further the examples itself are not free from ambiguity. For example: “Large number of accounts having a common account holder, introducer or authorized signatory with no rationale” or for that matter “unusual activity compared to past transaction”.

Now what may appear to be a large number to a particular Stock-broker may not appear to be a large number to another Broker. Hence such examples are subjective.

The information should be furnished to the Director within 7 working days of establishment of suspicion.

Similar to CTR, STR can also be filed in manual or electronic format, though Stock-broker having technical capability shall submit the report in electronic format.

Information to be maintained in respect of Cash Transactions & Suspicious Transactions

Stock-Brokers should maintain following information(s):

- (i) the nature of the transaction
- (ii) the amount of the transaction and the currency in which it was denominated
- (iii) the date on which the transaction was conducted; and
- (iv) the parties to the transaction.

And such record shall maintain for a period of ten years from the date of cessation of the transaction between the Client and the Stock-Broker.

Conclusion

It is obvious that with the unprecedented boom in the Capital Market, some unscrupulous persons try to get illegal and unethical advantage and in order to introduce necessary checks and controls, exercise has to begin from the point of origin of the transaction i.e. Stock-Broker. At the same time, with the given level of complexity in overall Management and administration, these measures will add to compliance cost of the Stock-Broker though efficacy of such measures in curbing the illegal and unethical will be tested by time. □