Banks as Gatekeepers: A Critical Analysis of Anti-Money Laundering Obligations and Liabilities of Financial Institutions in India

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Abstract*—Money laundering is a systemic challenge to the financial integrity, economic stability and national security of India. Frontline frontline gatekeepers in the anti-money laundering (AML) architecture of India are banks and other financial institutions under the Prevention of Money Laundering Act, 2002 (PMLA). This article looks critically at the statutory requirements that banking firms, non-banking financial firms (NBFCs), securities mediators, and insurance firms have under the PMLA and the 20092023 amendments along with guidelines of the Reserve Bank of India (RBI), Securities and Exchange Board of India (SEBI) and Insurance Regulatory and Development Authority of India (IRDAI). It examines civil and criminal penalties of non-compliance, enforcement authorities of the Enforcement Directorate (ED) and Financial Intelligence Unit-India (FIU-IND), court interpretations of landmark cases, such as Vijay Madanlal Choudhary v. Union of India (2022) and Nikesh Tarachand Shah v. Union of India (2018), and emergent threats of fin The article uses a comparative and doctrinal examination of the critically missing links between procedural and substantive enforcement and suggests specific changes to enhance the AML system in India, which corresponds to the recommendations of the Financial Action Task Force (FATF).

Index Terms*—Anti-Money Laundering, Customer Due Diligence, Enforcement Directorate, FATF, Gatekeeper Theory, Know Your Customer, PMLA 2002, Reporting Entities, Suspicious Transaction Report, Virtual Digital Assets

I.INTRODUCTION

The fact that money forms the basis of all other economies in the world means that apart from facilitating legit business, it also provides avenues that are used to commit a monetary crime. money laundering, i.e. the procedure of legitimizing the ill-earned money, camouflaging the nature, source, and ownership of the former is one of the most serious dangers to the financial systems all over the world. money laundering operationalises, as defined by the financial action task force (FATF), and based upon the United Nations Vienna convention, 1988, in three well-known stages, to introduce illicit funds into the financial system, to launder those funds through complex transactions to obscure their source and to incorporate the now-cleansed proceeds into the legitimate economy [3]. predicate offences (corruption, drug trafficking, tax evasion, organised crime, and terrorism financing) have become closely associated with money laundering in India making it a multi-dimensional challenge. the swift growth of digital banking, trans-national trade and financial liberalisation has both increased opportunities in the economy and intensified the susceptibility to laundering. ever-increasing shell companies, benami, trade-based laundering, and advent of fintech and cryptocurrency platforms have added an additional layer of complexity to detection and enforcement. the parliament understood the severity of money laundering domestically, the obligation to stop this activity and the need for a complete law, the prevention of money laundering act, 2002 (PMLA) was passed as a comprehensive law, criminalising the act of money laundering, authority to seize the proceeds of crime and casino banks and other financial institutions as reporting entities (REs) with defined compliance obligations [4].

Indirect enforcement and oversight are done by regulators, including the Reserve Bank of India (RBI), the Securities and Exchange Board of India (SEBI), the Insurance Regulatory and Development Authority of India (IRDAI) as well as the Financial Intelligence Unit-(IND).This article is a critical assessment of the concept of a bank and a financial institution as a gatekeeper in the context of the Anti-money laundering policy in India, including their various statutory requirements, civil liability, criminal liability against failure in complying with its various statutory obligations, the existing enforcement mechanism of the ed and the Financial

Intelligence Unit (FIU-IND) the judicial trends and the challenges presented by emerging financial technology. it concludes with policy suggestions that will help the proportionality, effectiveness and fairness of the framework.

II. CONCEPTUAL FRAMEWORK: MONEY LAUNDERING AND THE GATEKEEPER MODEL IN INDIA

A. Definition and Stages of Money Laundering

Section 3 of the Prevention of Money Laundering Act,2002 (PMLA)provides the general definition of money laundering: any individual who knowingly or indirectly tries to indulge in, facilitate, or simply get involved in any transaction relating to proceeds of crime including concealment, possession, acquisition, use, or projecting of the same- commits the offence [5].Financial Action Task Force (FATF) has identified three stages in this analysis that can take place anywhere in the world: (i) Placement: introduction of illicit money into the financial system using smurfing, cash-heavy business, or casino chips; (ii) Layering: the hidden, complex, and transactional obscuration of the money trail by buying and selling securities, mixing bitcoin, or purchasing high-value assets; and (iii) Integration: the reintroduction of laundered funds into the legitimate economy via real estate, trusts, or fake invoicing.

B. Risk-Based Approach and Gatekeeper Theory: Theoretical Foundations.

The two theoretical pillars on the AML requirements of financial institutions are based on two theories. As the financial action task force (FATF), Recommendations (2012, as revised to 2025) endorse the Risk-Based Approach (RBA), the requirements include identifying, assessing, and mitigating money laundering risks proportional to the risk and using Enhanced Due Diligence (EDD) with high-risk relationships like Politically Exposed Person (PEP) and Simplified Due Diligence. This model is based on results rather than a mechanical checklist.

The Gatekeeper Theory of illicit financial flows names strategic intermediaries (banks, lawyers, accountants, real estate agents and trust service providers) as the front line of defence. Since they have sums of money that they can access to the formal financial system and are in a unique position to have transactional intelligence, they are placed in a position to prevent and detect laundering at its source. The theory is directly operationalised via mandatory filing of Know Your Customer (KYC), Customer CDD and Suspicious Transaction Report (STR) by the prevention of money laundering act (PMLA), which turns banks into quasi-regulatory bodies where they act both in a preventive and intelligence-gathering way [7].

C. Interconnection with Terrorism finances and Corruption

Money laundering goes hand in hand with terrorism financing and corruption which all have similar financial intermediaries and methods of concealment. The FATF Recommendations also criminalise money laundering and the financing of terrorist activities and states are obliged to adopt single universal Anti-money laundering/combating terror financing. In India, the proceeds of bribery and embezzlement are proceeds predicate offences under the PMLA, constitutions that antibiotic corruption offences and directly liable to then be attached and prosecuted. This nexus is further supported by the United Nations Convention against Corruption (UNCAC, 2003) that mandates the use of asset recovery and financial transparency measures [8].

III. EVOLUTION AND REGULATORY FRAMEWORK OF ANTI-MONEY LAUNDERING IN INDIA

A. Historical Development

Before the introduction of the PMLA, India did not have a specific money laundering law. Foreign exchange violation was dealt with under the Foreign Exchange Regulation Act, 1973 (FERA) and the Narcotic Drugs and Psychotropic Substances Act, 1985 (NDPS Act) which provided no overall scheme. The Prevention of Money-Laundering Bill, 1998 and the PMLA, 2002 which were eventually implemented in 2005 were the result of growing international pressure (particularly, FATF) in the global standard-setting since 1989), as well as the necessity to tackle domestic issues of black money, organised crime and drug proceeds [9].

B. The Prevention of Money Laundering Act,2002(PMLA) & Its Amendments

The fundamental structure of the PMLA consists of three pillars, one being criminalisation (Sections 34), another one being the asset attachment and confiscation (Sections 59), and another one being the preventive by obliging the Reporting Entities (Section 12). Its Schedule enumerates predicate offences the proceeds of which is used to initiate PMLA proceedings, covering corruption, fraud, drug trafficking, cybercrime, and other types. This framework has been enhanced through successive amendments. There was an updated definition of proceeds of crime and seizure jurisdictions in the 2009 Amendment. The Amendment of 2012 has expanded money laundering definition and officially changed financial institutions and intermediaries to be included as reporting entities. In 2015 and 2019, the Schedule of predicate offences was amended after which increased the powers of Enforcement Directorate to improve its enforcement. The Amendment of 2023, made a significant expansion to the list of Persons Carrying on Designated Business or Profession (PCDBPs), to include real estate agents, chartered accountants, company secretaries and virtual digital asset service providers (VDASPs)- making India more compliant with FATF Recommendations [10].

C. India's Compliance with FATF Standards

India became a full membership of FATF in 2010. In the 2024 FATF Mutual Evaluation Report (MER), India was rated highly in regards to technical compliance, also notable were the institutional framework, legislative provisions, and asset deprivation outcomes. Nevertheless, the MER has noted some ongoing areas of failure: low levels of conviction when compared to the volume of attachment, long investigation and prosecution process, poor oversight of Designated Non-Financial Businesses and Professions (DNFBPs), and the lack of beneficial ownership transparency [11].

D. Institutional Framework: FIU-IND, ED, RBI, SEBI, and IRDAI

Institutional Framework: FIU-IND, ED, RBI, SEBI and IRDAI. The AML regime in India is operationalised on multi-agency institutional framework. The main national body that receives, processes and disseminates financial intelligence produced by REs is Financial Intelligence Unit- India (FIU- IND). The main PMLA enforcement authority overseen by the Ministry of Finance is the Enforcement Directorate (ED), endowed with extensive investigative, summons, search and seizure, provisional attachment, arrest, and Special Courts prosecution authority [12]. Regulators of the sector, such as RBI (banks and NBFCs), SEBI (intermediaries in the capital market), and IRDAI (insurers) issue AML/CFT guidelines that enforce PMLA obliges on their regulated populations. Such regulators can issue sector specific fines, inspection as well as the radical removal of licences due to disobedience. Although the structure is well-constructed, observers report lapses in inter-agency coordination and delays in information sharing and disproportionate enforcement intensity among sectors.

IV. STATUTORY OBLIGATIONS OF BANKS AND FINANCIAL INSTITUTIONS

A. Classification of Reporting Entities

Section 2(1)(wa) of the PMLA defines Reporting Entities across four broad categories: (i) Banking Companies, including all scheduled commercial banks, cooperative banks, regional rural banks, small finance banks, and payment banks; (ii) Financial Institutions, including NBFCs, housing finance companies, payment system operators, and prepaid payment instrument issuers; (iii) Intermediaries regulated by SEBI, including stockbrokers, portfolio managers, mutual funds, merchant bankers, and depositories; and (iv) Persons Carrying on Designated Business or Profession (PCDBPs), including casinos, real estate agents, precious metal dealers, trust and company service providers, and—since March 2023—virtual digital asset service providers [13].

B. Customer Due Diligence and Know Your Customer

All REs should introduce a risk-based KYC/CDD model. Standard CDD entails identity and address checking with verifiable and independent sources. Enhanced Due Diligence(EDD) is applicable to high-risk clients, PEPS, non-face-to-face on-boarding, high-risk jurisdiction clients, who demand additional research on the source of funds, beneficial ownership, and the purpose of the transaction. SDD is applied to relationships that have a demonstrably low risk [14]. The 2016 updated version of the RBI Master Direction on KYC (2016, August 14, 2025) adds the digital verification software such as the Video-based Customer Identification Process (V-CIP) and Aadhaar-based authentication with liveness detection, as well as the Central KYC Registry (CKYCR). The 2025 amendments offer longer deadlines to update KYC (until June 30, 2026) to low-risk individual customers and allow address updates via Business Correspondents [15].

C. Record-Keeping, Reporting, and STR Obligations

Reporting Entities are required to keep transaction and CDD records not less than five years. Certain reporting requirements to FIU-IND are: Cash Transaction Reports (CTRs) on cash transactions that exceed INR 10 lakh; Suspicious Transaction Reports (STRs) within seven days of the development of suspicion; Cross-Border Wire Transfer Reports (CBWTRs) on transactions with an amount more than INR 5 lakh; Counterfeit Currency Reports (CCRs); and Non-Profit Organisation Transaction Reports (NTRs) [16].

D. Sectoral Frameworks: Banking, Securities, and Insurance

Reporting Entities (Res) in the banking sector complies with the KYC Master Direction of Reserve Bank of India which requires risk-based customer due diligence, ongoing transaction monitoring, and filing of electronic (suspicious transaction reports. The Securities intermediaries are required to operate under the Anti-money laundering /Counter Finance of Terrorism, the Master Circular of Securities Exchange Board of India (SEBI) (June 2024, updated 2025) which mandates beneficial ownership identification at 10% threshold and monitoring of transaction patterns. The insurance firms adhere to the Master Guidelines on AML/CFT by the IRDAI (August 2022), operationalised under the Insurance Fraud Monitoring Framework (2025), paying special attention to the single-premium policies and large cash payments [17].

V. LIABILITIES AND ENFORCEMENT MECHANISMS UNDER PREVENTION OF MONEY LAUNDERING ACT,2002 IN INDIA

A. Criminal Liability

Section 3 PMLA captures the main criminal offence involving any direct or indirect effort to deal with, conceal, possess, procure, use, or project proceeds of crime as untainted property. Section 4 provides rigorous imprisonment of three years (maximum of seven years) with a fine. In cases involving proceeds as related to NDPS Act offences, the maximum imprisonment goes up to ten years [18]. The crime is cognisable and bailable (Section 45). Before Special Courts (Sections 43–44) it is tried. Section 24 inverts the normal evidentiary presumption. Section 70 enforces corporate and vicarious liability: in situations where the company commits the offence, all the officers in charge will be guilty unless they can demonstrate the offence was committed without their knowledge or that they took reasonable care (due diligence).

B. Civil and Regulatory Liability

The method of civil liability is mainly the forfeiture of assets. The ED can temporarily seize property which he or she suspects to be the proceeds of crime up to a maximum of 180 days (Section 5). In the case of REs in particular, non-compliance with the requirements of Section 12 KYC, CDD, record-keeping or filing of any of the requirements of Section 12, leads to monetary fines under Section 13: the Director (FIU) can impose fines between INR 10,000 and INR 1 lakh per offense. Section 14 offers a safe harbour: REs who are reporting in good faith in accordance with Section 12 are not subject to civil or criminal action in respect of that reporting act [19]. Regulatory fines are sector-specific, providing another enforcement. RBI may issue hefty financial fines and cancel banking licences in cases of KYC/Customer Due Diligence failure- as has been the case with recent penalty orders against Central Bank of India (March 2026, INR 63.60 lakh) and HDFC Bank (November 2025). Securities Exchange Board (SEBI) can cancel or suspend intermediary registrations. Insurance Regulatory Development Authority of India (IRDAI) is enabled to give instructions, fines and revoke insurer certificates due to non-compliance with Anti-Money Laundering.

C. Enforcement Powers of the Enforcement Directorate

The ED has the powers over: (i) Summons and evidence collection (Section 50); (ii) Search, seizure, and freezing of premises and accounts (Section 17) which can be done without a prior First Information Report (FIR); (iii) Provisional attachment (Section 5) including up to 180 days; (iv) Arrest (Section 19) on written reasons; and (v) prosecution before In Vijay Madanlal Choudhary v. Union of India (2022), the Supreme Court upheld the constitutionality of Section 24's reverse burden, Section 45's twin bail conditions (as amended 2018), and the ED's arrest powers under Section 19, holding that ED officers are not police officers under Section 25 of the Evidence Act [21].

VI. JUDICIAL APPROACH TO PREVENTION OF MONEY LAUNDERING ACT,2002 ENFORCEMENT

A. Landmark Jurisprudence

In the case of *Nikesh Tarachand Shah v. Union of India (2018)*, the Supreme Court declared the initial twin terms of Section 45(1) as being unconstitutional. This was answered by Parliament with the Finance Act 2018, which directly linked the two conditions to the Section 3 PMLA offence, which the Court affirmed in *Vijay Madanlal Choudhary (2022)* [22]. In *Pankaj Bansal v. Union of India (2023)* put in place a vital procedural protection, a requirement that the ED provide written reasons of arrest to the arrested individual upon arrest; spoken word is inadequate [23]. In P*avana Dibbur v. Directorate of Enforcement (2023),* bona fide third-party interests such as banks with prior security over assets were not subject to Section 2(1)(u), and thus the property acquired prior to the predicate offence could not be considered proceeds of crime. The jurisprudence of the post-2024 period has come up with significant nuances of Article 21. Even in PMLA, the Supreme Court has provided bail in instances of extended pre-trial custody or longer than 1417 months without a realistic chance of commencing the trial and has applied the principle that bail will still be the rule. The *Sarla Gupta v. Enforcement Directorate (2025)* was a case that determined that accused individuals have a right to receive copies of the entire investigation documents, which underscores the right to fair trial [25]. *In Pradeep Nirakaranath Sharma v. Enforcement Directorate (2025),* the Supreme Court reconfirmed the fact that the Section 3 offence is continuing: if the proceeds of crime are being concealed, possessed, or projected as untainted, the offence continues. This increases the liability time frame of financial institutions that maintain or do business with assets later which have been revealed as crime proceeds [26]

B. Regulatory Enforcement: Case Studies

In *HDFC Bank Ltd. v. Directorate of Enforcement v. HDFC Bank Ltd. (Bombay High Court, 2026),* it was declared that PMLA attachment orders overrode secured creditor rights under SARFAESI, so long as bona fide lenders who can prove they're not knowing nature of the taint sought to have their rights restored in front of the Special Court [27]. Attachment of INR 64,920 crore in 1,105 cases of bank fraud PMLA was disclosed in the ED Bank Fraud Attachments Report (March, 2026) where only 150 out of 1,105 instances of attachment have been arrested and few cases have been convicted- indicating disproportionate levels between attachment and convictions [28].

VII. CRITICAL ASSESSMENT OF ANTI-MONEY LAUNDERING IMPLEMENTATION

A. Compliance vs. Substantive Effectiveness

The AML compliance system in India has significantly expanded. To banks, KYC procedures, CDD systems, and transaction mining tools have been implemented and STR filings have been escalating significantly. Nevertheless, one criticism that has been consistently made is that compliance has been highly procedural in nature: REs submits STRs to evade regulatory fines instead of producing actionable financial intelligence leading to high volumes of poor quality STRs that overstretch enforcement agencies without equity investigative returns [29]. This tension is captured by the FATF MER (2024), which states that conviction rates are low in comparison to the number of attachments. India is a success in terms of asset deprivation, but less successful in the conversion of investigations into successful prosecutions, which is a limitation of the ED in terms of the investigation capacity, the complexities of the trial process in PMLA, and tensions in the reverse burden of proof structure.

B. Costs on Technological Gaps and Compliance

There is an important gap between the AML technological capability of big banks, which implement machine learning and real-time monitoring of transactions, and more small financial institutions, cooperative banks, NBFCs and early-stage fintech platforms, which often have a semi-manual process. The pace of growth of DP UPI has surpassed regulatory preparedness, leaving systemic weaknesses [30]. Small institutions are disproportionately impacted by compliance costs. KYC infrastructure, CDD documentation engines, reporting portals, staff on-boarding and audit needs are large operation costs, threatening to lead to de-risking behaviour: forbidding services by customers or industries viewed to be high-risk, so disrupting financial inclusion objectives.

C. New Threats: Fintech, Cryptocurrencies and Cyber-Laundering.

Fintech applications enable transactions faster than usual and can be utilized by mule account networks, KYC bypasses created via deepfakes, and micro transaction layering. And VDASPs are recognised as REs since March 2023 (S.O. 1072(E)) and the updated AML/CFT Guidelines (January 8, 2026) of FIU-IND require more extensive KYC with liveness checking, geo-tagging, Travel Rule compliance, risk-based gradation and annual audit [31]. Cryptocurrencies pose unique problems: the pseudonymous transactions, protocols of DeFi, and coin-mixing services hide positive ownership and transaction histories. India was recognized as aware of these risks by the 2024 FATF MER, though it was still noted to have weaknesses in virtual asset controls. A growing menace that requires combined cybercrime and AML enforcement actions is cyber-laundering: conversion of cybercrime through crypto-currencies [32].

VIII. COMPARISON AND ANALYSIS WITH INTERNATIONAL BEST PRACTICES

By contrasting with established AML countries, especially the United States and United Kingdom, it becomes clear that there are significant gaps in India outcome effectiveness despite an increase in technical compliance measures. The implementation of the Bank Secrecy Act/AML regime in the United States is done by the FinCEN, Department of Justice, and those of the sector. Billion-dollar fines in AML failures are administered on the financial institutions, and top management is personally criminally liable, with supporting Deferred Prosecution Agreements. The National Crime Agency in the United Kingdom and the Financial Conduct Authority also provide hefty fines and the unexplainable wealth orders of the Proceeds of Crime Act as an effective asset preservation measure [33].

The enforcement results of India are lagging these standards though they are on the way to improvement. The criminal liability of institutions under Section 70 is applied infrequently. The lesson learned comparatively is that successful AML regimes are characterized by plausible deterrence, intelligence-based enforcement, and resultant assessment in terms of convictions and asset recovery and not in terms of volumes of STRs. The Indian structure needs to transform itself into a system of compliance-quantity into an intelligence-quality and enforcement-outcome system [34].

IX. POLICY RECOMMENDATIONS

the above analysis has provided the following recommendations on how to reform the anti-money laundering framework of India:

1- The proportional and risk-adjusted compliance. the regulators should differentiate compliance requirements based on the level of institution size, risk profile, and complexity of operations. the tiered system will decrease the cost of compliance on smaller bodies without jeopardizing the integrity of the regime.

2- Enabling the supervision of technology by Reserve Bank of India (RBI), Securities Exchange Board of India (SEBI) and Insurance Regulatory Department Authority of India (IRDAI) should oblige the minimum technology to track the transactions in any res, and large organizations will be required to install ai/ml-based fraud detection within certain periods. adoption of Reg-tech anti solutions would be quickened through regulatory sandboxes.

3- The use of enforcement based on intelligence, as opposed to defensive reporting. it is recommended that the financial Intelligence Unit-India (FIU-IND) should come up with certain formalized feedback mechanism to keep the res informed of the result of the intelligence based on str to allow the institutions to modify the reporting levels to receive superior reports. complex higher value laundering networks, compared to lower value attachments, should be of more value to ed.

4- Overall, the virtual asset regulation. the prevention of money laundering act,2002 extension breaching virtual digital assets service provider into India needs to be carried out with stringent checking periods. India required to actively engage in the ongoing procedure of the development of the stablecoin and defi by the financial Action Task Force (FATF) and a bilateral agreement on information sharing with the big jurisdiction's virtual digital assets service providers.

5- The greater corporate responsibility over the provisions of vicarious liability established in section 70 need to be more proximate in the future particularly when the top-level management did not file any adequate customer due diligence or suspicious transaction reports, which served to support predicate offences.

6- The rapid trial infrastructure. promising results could be achieved in the deterrence through the formation of special prevention of money laundering act,2002 benches and increasing the number of special court judges to transform the potential of the framework into actual outcomes.

7- An increased international cooperation and the expanding mutual legal assistance treaty (MLAT) system in India (42+ countries by 2025-26) needs to be functionally augmented with additional processing request-response rates and augmentations of connectivity to intelligence-sharing processes of the Egmont group.

X. CONCLUSION

The Anti-Money Laundering framework of India which is founded on the prevention of Money laundering act,2002 and successive amendments has now been a well-established statutory framework to a significant extent keeping pace with the Financial Action Task Force standards. the primary front-line positions in the process of money laundering prevention are reported entities and the gatekeeper actors (banks and other financial institutions) (has the obligation of monitoring transaction and reporting str). the implementation mechanism grounded on the colossal power of the ed and intelligence-gathering functions of the financial Intelligence Unit (FIU)is a reasonable institutional backup. courts have long moderated the rigour requirements in terms of enforcement with constitutional protection, creating substantial protections of process, but without bringing the core of the provisions of the prevention of money laundering Act,2002 (PMLA) into question.

But there still remain great difficulties. the disparity between compliance and procedural compliance and the enforcement of effectiveness significantly implied by low conviction rates, defensive reporting practices, technological distinction, and lack of control over Designated Non-Financial Businesses and Professions and Virtual Digital Asset Service Providers (VDASPs) are limiting to the effects of the framework in real life. something radical is needed: compliance-volume model to quality of intelligence, risk-based and outcome outcomes model. a well-balanced anti-money laundering framework, balancing the obligations of the financial institutions as gatekeepers against the rights of persons, the needs of financial inclusion and the nature of the needful enforcement is not an ideal in regulation, but a requirement towards the financial integrity and national security of India and the rule of law.

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