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SHADOW BANKS AND DIRTY MONEY: INVESTIGATING THE USE OF NBFCs IN MONEY LAUNDERING AND FINANCIAL CRIMES

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I. ABSTRACT

This paper examines how, despite their role in providing access to financial services, Non-Banking Financial Companies (NBFCs) have emerged as significant facilitators of money laundering in India. This is brought on by legal loopholes, lax enforcement of anti-money laundering regulations, and a lack of systemic openness. Using a qualitative doctrinal approach, augmented by a small amount of quantitative data, and by looking at actual instances of high-profile financial crimes like the PMC-HDIL fraud and the Chinese lending app scam, the paper dissects money laundering techniques like shell companies, round-tripping, hawala operations, and fake loans. The regulatory frameworks of banks and NBFCs are thoroughly compared, compliance with RBI and PMLA standards is assessed, and potential regulatory adjustments are delineated. The findings demonstrate that the NBFC sector is now more exposed due to inadequate monitoring, uneven enforcement of KYC/AML regulations, and a lack of agency cooperation. The study is limited, though, in that it only uses secondary sources; field interviews, direct data collecting, and access to internal compliance records are not included. The study comes to the conclusion that until India moves toward centralized risk intelligence and predictive, technology-integrated regulation, NBFCs will remain high-risk facilitators of illicit funding.

II. KEYWORDS

Anti-Money Laundering (AML), Digital Lending, Financial Crime, Financial Regulation, Financial Intelligence Unit – India (FIU-IND), Hawala Networks, Know Your Customer

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(KYC), Non-Banking Financial Companies (NBFCs), Prevention of Money Laundering Act (PMLA), Reserve Bank of India (RBI) Regulations, RBI Compliance, Shadow Banking, Shell Companies

III. INTRODUCTION

In India's changing financial landscape, non-banking financial companies, or NBFCs, have become important actors. They increase access to financial services for underprivileged groups and aid in closing important credit gaps. NBFCs cannot take demand deposits and do not have full banking licenses like traditional banks do. They are allowed to provide a variety of financial goods, though, such as loans, insurance, asset finance, and investment instruments. Despite being around since the 1960s, NBFCs started to grow quickly after liberalization in the 1990s. The demand for credit increased during this time due to economic reforms, especially from populations that were frequently overlooked by mainstream banks, like microbusiness owners, rural borrowers, and unorganized laborers. Lean business strategies, adaptable lending practices, and less stringent regulatory scrutiny allowed NBFCs to take advantage of this opportunity. The total number of NBFCs registered with the RBI was 9,306 on June 30, 2024.³ According to RBI data, there are 8,966 non-deposit-taking NBFCs (ND), 413 systemically important non-deposit-taking NBFCs, and just 39 deposit-taking NBFCs.⁴ Their contribution in advancing financial inclusion is highlighted by their quick loan disbursement systems, specialized lending solutions, and expanding presence in Tier-2 and Tier-3 cities. Additionally, NBFCs have expanded their sources of funding by using products such as commercial papers, non-convertible debentures (NCDs), and securitized assets. These monies are allocated to important industries such as infrastructure, equipment leasing, housing, auto finance, and microfinance. As of March

³ Anu Tiwari, Kush Wadehra, Naman Lodha & Vidisha Sharma, *FIG Paper (No 42 – Series 1): Regulatory Trends in NBFC Sector* (Cyril Amarchand Mangaldas blog, 29 March 2025)

⁴ Manish M. Suvarna, 'Number of NBFCs surrendering licences to RBI at four-year high' *Moneycontrol* (Mumbai, 5 July 2023) <https://www.moneycontrol.com/news/business/number-of-nbfc-surrendering-licences-to-rbi-at-four-year-high-10910831.html> accessed 29 August 2025.

2024, NBFCs made up about 24.5% of all credit disbursed by Scheduled Commercial Banks (SCBs), according to the RBI's Report on Trend and Progress of Banking in India 2023–24.⁵ This suggests that they are becoming more integrated into the formal credit system in India. But this quick growth has also brought to light a number of structural weaknesses. There are gaps in the comparatively liberal regulatory environment for NBFCs, particularly the smaller and non-deposit-taking ones. NBFCs frequently function under less stringent regulations pertaining to corporate governance, internal audits, Know Your Customer (KYC) standards, and anti-money laundering (AML) procedures than banks. Because of this regulatory laxity, NBFCs are vulnerable to abuse for corporate fraud, tax evasion, and massive money laundering. Strong internal controls and credit evaluation procedures are absent from many NBFCs. This leads to inadequate risk management, bad documentation, and dangerous lending practices. The issue is made worse by the lack of real-time regulatory supervision, which makes it possible for dishonest individuals to take advantage of NBFCs for illegal financial activity. Techniques include shell business layering, trade-based money laundering, round-tripping through foreign jurisdictions, and fraudulent loan disbursements have grown more prevalent. The manipulation of NBFCs to conceal ownership structures, inflate asset values, and transfer illicit cash through opaque networks has been made clear by high-profile instances, such as those involving IL&FS⁶, DHFL⁷, and Sahara⁸. These incidents have exposed long-standing governance flaws and shown how certain NBFCs are exploited to evade financial transparency and regulatory scrutiny. There are still issues with execution even though the RBI developed the Scale-Based Regulation (SBR) Framework in 2021 to categorize NBFCs according to their systemic

⁵ Report on Trend and Progress of Banking in India 2023–24, *Finance India Sector* (RBI, 2024) viii; see also K R Jain, *Give Credit and Prosper! Must RBI Lower Shields on NBFC Policies?* (CRFI India, May 2025)

⁶ *Union of India v Infrastructure Leasing & Financial Services Ltd and Others*, Company Petition No 3638/MB/2018 (NCLT Mumbai Bench)

⁷ *Reserve Bank of India v Dewan Housing Finance Corporation Ltd* [2019] CP (IB) No 4258/MB/2019 (NCLT Mumbai)

⁸ *Securities and Exchange Board of India v Sahara India Real Estate Corporation Ltd and Others* (2012) 10 SCC 603

relevance and degree of risk. Many small to mid-sized NBFCs continue to operate under the radar, and enforcement is inconsistent. These organizations provide increasing systemic risks as they become more entangled with banks, capital markets, and foreign investors. The purpose of this study is to make a significant contribution to the discussion of financial governance and regulation in India. The paper aims to help policymakers, regulators, and industry stakeholders strengthen oversight, close regulatory gaps, and protect the integrity of India's financial system by analyzing the dual nature of NBFCs—as promoters of financial inclusion and possible facilitators of financial crime.

A. Research Methodology

The research technique used in this study “*Shadow Banks and Dirty Money: Investigating the Use of NBFCs in Money Laundering and Financial Crimes*”, is **doctrinal**. This method, which is mostly qualitative in nature entails a critical analysis of RBI rules, case law, enforcement actions, and statutory provisions under the RBI's KYC/AML framework and the Prevention of Money Laundering Act, 2002. To demonstrate how NBFCs are misused in the real world, important case studies have been examined, such as Religare Finvest, PC Financial Services, WTC Faridabad, and HDIL-PMC Bank. Findings on STR filings, credit exposure, and compliance gaps have been bolstered by quantitative data from sources such as RBI statistics and FIU-IND reports. There is no fieldwork or interviewing involved, and the study is solely dependent on secondary sources.

IV. UNDERSTANDING NBFCs AND THEIR REGULATORY FRAMEWORK

A. A Non-Banking Financial Company (NBFC) is defined by the Reserve Bank of India (RBI) under Reserve Bank of India Act 1934, s 45I(f):

“(f)“non-banking financial company” means- (i)a financial institution which is a company;(ii)a non-banking institution which is a company and which has as its principal business the receiving of deposits, under any scheme or arrangement or in any other manner, or lending in any manner;(iii)such other non-banking institution or class of such

institu-tions, as the Bank may, with the previous approval of the Central Government and by notification in the Official Gazette, specify.”⁹

Furthermore, as explained by the Reserve Bank of India (RBI) in its official publications:

“A Non-Banking Financial Company (NBFC) is a company registered under the Companies Act, 1956 or Companies Act, 2013, and engaged in the business of loans and advances, acquisition of shares/stocks/bonds/debentures/securities issued by Government or local authority or other marketable securities of a like nature, leasing, hire-purchase, etc., as their principal business, but does not include any institution whose principal business is that of agriculture activity, industrial activity, purchase or sale of any goods (other than securities) or providing any services and sale/purchase/construction of immovable property. A non-banking institution which is a company and has principal business of receiving deposits under any scheme or arrangement in one lump sum or in installments by way of contributions or in any other manner, is also a non-banking financial company (Residuary non-banking company).”¹⁰

Furthermore, NBFCs differ from traditional commercial banks subject to the Banking Regulation Act of 1949 in that they are not licensed as banks and are expressly forbidden from taking demand deposits. As a result, even though NBFCs and banks may carry out comparable financial operations, there are notable differences in their regulatory environment, restrictions, and risk exposure.

NBFCs, though not licensed as banks, they do a lot of different financial things that help the Indian economy's credit intermediation process a lot. They act like shadow banks, providing services that are similar to those of banks but with more flexibility and reach, especially in areas where official banking is lacking or not available. Because they are so diverse, they can serve specialized markets, help people who can't get credit, and work

⁹ Reserve Bank of India Act 1934, s 45I(f).

¹⁰ Reserve Bank of India, *Non-Banking Financial Companies (NBFCs) and Asset Reconstruction Companies (ARCs)*(Reserve Bank of India, updated 23 April 2025) <https://www.rbi.org.in/commonman/english/scripts/FAQs.aspx?Id=1167> accessed 1 August 2025.

with the regular banking sector. NBFCs carry out a range of tasks that mimic, enhance, and occasionally replace those of traditional banking institutions. Important roles include:

1. Facilities for Loans and Credit: NBFCs offer business, consumer, and personal loans, especially to people and industries with little access to traditional banking.
2. Finance for Assets: A significant amount of NBFC portfolios is made up of financing for real estate projects, machinery, equipment, and automobiles.
3. Inclusive lending and microfinance: Numerous NBFCs focus on microfinance, particularly assisting self-help groups, women-led enterprises, and rural borrowers.
4. Purchasing Securities: Like investment firms, some NBFCs make investments in bonds, government securities, shares, and debentures.
5. Services for Leasing and Hire Purchase: NBFCs finance capital assets on a lease or hire purchase basis to support business operations.

NBFCs have become very important for bringing more people into the financial system in India, especially in rural and semi-urban areas where conventional banking is still limited. They can fill important credit gaps since they are flexible in their operations, can give out loans faster, and are prepared to work with high-risk clients. However, this flexibility has its downsides. For example, NBFCs are at danger of financial abuse and money laundering because they don't have to follow strict rules, don't have deposit protection, and have different compliance frameworks. This dual role makes NBFCs both helpful and potentially harmful to India's shadow banking sector.

B. RBI's role in regulating NBFCs

NBFCs have emerged as critical components of India's credit infrastructure, notably in terms of financial inclusion and informal-sector lending penetration. Their strengths include operational flexibility, faster loan disbursement processes, and the capacity to cater to high-risk or underserved areas, whereas traditional banks are frequently hampered by regulatory caps, formal collateral requirements, or risk-weighted exposure

frameworks. In rural areas and Tier II/III cities, NBFCs regularly outperform scheduled commercial banks in terms of loan volume and last-mile financial reach, increasing credit penetration in structurally underserved markets.

However, this flexibility makes NBFCs fundamentally prone to regulatory arbitrage and financial mismanagement. Their exemption from essential banking duties, including as accepting demand deposits and maintaining cash reserve ratios, creates an environment in which operational flexibility may outweigh financial discipline. The lack of uniform and severe Know Your Customer (KYC) and Anti-Money Laundering (AML) compliance, particularly among smaller NBFCs, exacerbates these vulnerabilities. This dichotomy between financial empowerment and regulatory exposure makes NBFCs powerful players in the so-called "shadow banking system," capable of both stimulating credit expansion and inadvertently enabling illicit financial flows. The Reserve Bank of India (RBI), which was founded by the Reserve Bank of India Act of 1934, regulates India's entire banking and financial system. The RBI is the central bank and primary regulator of the monetary and financial system, with authority over not only banks but also NBFCs and other financial institutions operating in and from India. The RBI conducts a number of vital roles, including:

1. Formulating and implementing monetary policy to maintain price stability and ensure adequate flow of credit to productive sectors;
2. Regulating and supervising India's financial system, including oversight of payment and settlement systems, credit intermediation, and systemic risk management;
3. Managing and regulating foreign exchange transactions under the Foreign Exchange Management Act, 1999 (FEMA); and
4. Issuing binding directions, circulars, and regulatory frameworks to which financial institutions, including NBFCs, are required to conform.

The RBI's regulatory framework is intended to promote both macroeconomic stability and institutional integrity. It has broad supervision and audit powers, including the

authority to review books, prescribe corrective actions, and impose penalties in the event of noncompliance. The introduction of the Scale-Based Regulatory (SBR) Framework in 2021 marks a significant regulatory milestone, categorizing NBFCs into layers based on size, risk profile, and systemic importance- Base Layer, Middle Layer, Upper Layer, and a possible Top Layer and applying differential regulatory norms proportionate to risk exposure.¹¹

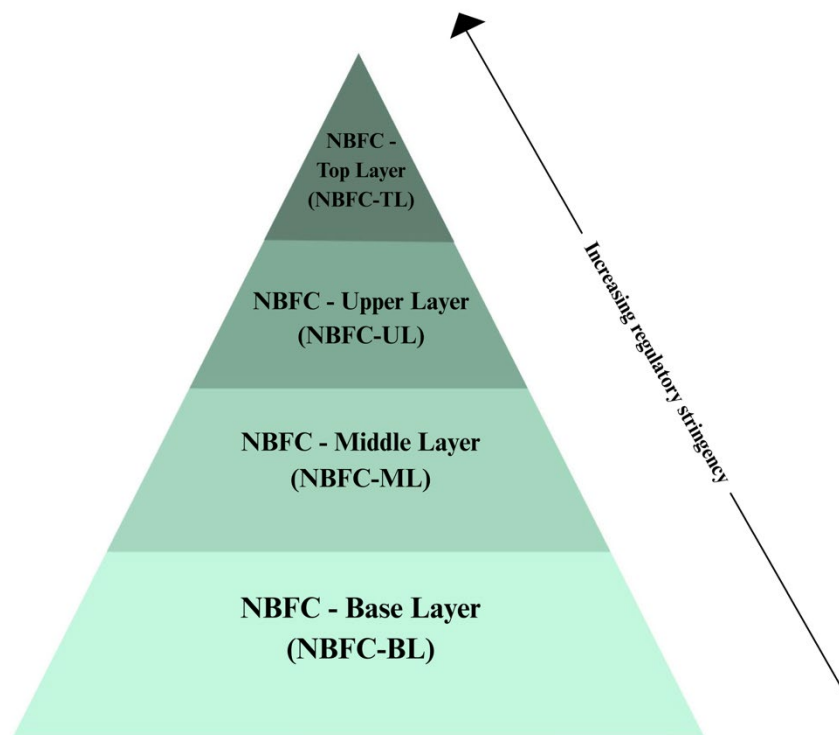


Figure 1: Scale-Based Regulatory Framework for NBFCs (RBI, 2021))

Despite these institutional safeguards, the regulatory regime is inconsistent in practice. Smaller NBFCs, particularly those that do not accept deposits and are confined to a specific territory, frequently operate with less stringent supervision. Furthermore, entities that provide financial services but are governed by other regulatory bodies, such

¹¹ Reserve Bank of India, *Scale-Based Regulation (SBR) Framework for NBFCs* (RBI, 22 October 2021) <https://www.rbi.org.in/scripts/NotificationUser.aspx?Id=12179&Mode=0> accessed 29 August 2025.

as insurance companies (regulated by IRDAI), stockbrokers (regulated by SEBI), and pension funds (regulated by PFRDA), are specifically exempt from the RBI's regulatory domain in order to avoid regulatory overlap. While this approach avoids dual regulation, it does generate pockets of regulatory insulation that sophisticated players may use to conceal illegal conduct.

In terms of anti-money laundering duties, NBFCs are subject to the Prevention of Money Laundering Act, 2002 (PMLA) and the RBI Master Directions on KYC (2016, frequently updated). India's membership in the Financial Action Task Force (FATF) obligates it to meet global standards for anti-money laundering compliance and financial transparency. However, in practice, NBFCs frequently lack the institutional ability and internal compliance procedures required to assure rigorous adherence to these standards. Many small businesses fail to perform proper consumer due diligence, risk profiling, or suspicious transaction reporting. The RBI's oversight, while important in theory, is frequently limited by bandwidth and capacity constraints, resulting in a mostly ex-post detection method rather than real-time enforcement.

These regulatory flaws have been linked to several high-profile defaults and financial crimes, most notably the IL&FS and DHFL scandals, in which structural regulatory gaps enabled systemic risk accumulation, masked financial misconduct, and allowed billions of rupees in bad loans to accumulate before being discovered. Such incidents highlight the importance of real-time surveillance, technological integration in regulatory audits, and improved collaboration between financial regulators and law enforcement agencies.

V. MECHANISMS OF MONEY LAUNDERING THROUGH NBFCs

Non-Banking Financial Companies (NBFCs) have developed into an essential component of India's financial system, particularly in industries with low levels of conventional banking penetration. But because of their more flexible operations, less inspection than commercial banks, and more lax regulatory framework, they are now more susceptible to abuse for a variety of financial crimes, especially money laundering. All phases of the money laundering process- placement, layering, and integration, are increasingly being

used against NBFCs through a variety of illegal means. These include making loans to shell businesses that don't actually operate, participating in roundabout transactions, creating inflated invoices, and making phony loan payments supported by false documentation. Additionally, NBFCs frequently serve as middlemen for international money transfers via tax havens, facilitate hawala-based transactions, and even assist in converting illegally obtained gold into official credit through gold loan products that are not closely monitored. The systematic misuse of NBFCs to hide black money, reroute funds abroad, and reintroduce them into the formal economy under the pretence of legitimate investment has been brought to light by a number of high-profile fraud cases, including those involving Religare Finvest and IL&FS. These advanced money laundering techniques seriously jeopardize India's economic stability and regulatory credibility in addition to interfering with financial openness. Therefore, establishing more efficient supervision and compliance frameworks for the NBFC industry requires an awareness of these paths.

A. Layering Illicit Funds via Shell Companies

Layering through shell companies is one of the most popular methods for money laundering through NBFCs. This method entails fabricating intricate, multi-layered financial transactions amongst paper firms (shell companies) in order to conceal the source of illegal cash and give them the appearance of legitimacy. Compared to scheduled commercial banks, NBFCs are especially susceptible to this type of exploitation because of their much laxer regulatory scrutiny. NBFCs frequently lend money to shell firms, which are organizations that don't actually have any assets or operations but serve as middlemen to transfer money between accounts and jurisdictions. These loans are frequently supported by false evidence, such as exaggerated values, phony project reports, or falsified invoices.

One such instance is the fraud case of Religare Finvest Ltd (RFL), in which the Singh brothers, who were once Fortis Healthcare's promoters, controlled Religare Enterprises, the parent firm of RFL, which reportedly embezzled ₹2,473.66 crores. The money was

given as loans to a number of organizations that turned out to be shell corporations connected to the promoters.¹² The money was layered over several accounts using these shell companies, and it was eventually taken out for personal benefit or to pay off unrelated debts. These loans, which were only meant to conceal the source and intended use of the funds, were never repaid even though they were documented in RFL's accounts as valid commercial transactions.

These instances demonstrate how structural manipulation and lax internal controls can be used to co-opt NBFCs into complex money laundering operations. By sacrificing asset quality and transparency, the use of shell firms in this way not only makes it more difficult to uncover financial fraud but also raises systemic risk in the NBFC industry.

B. Stages of money laundering and NBFC's role

In the three steps of money laundering - placement, layering, and integration, Non-Banking Financial Companies (NBFCs) are crucial, particularly in India's sizable informal economy with lax regulatory enforcement.

1. Because of their extensive presence in semi-urban and rural areas, cash-heavy operations, and laxer regulation than banks, NBFCs are easy entrance sites for black money at the placement stage. It is possible for illicit funds to enter the financial system by pretending to be advances, loan repayments, or collateral. Promoters frequently fabricate phony borrower profiles or business accounts to pass off these inflows as authentic transactions.
2. After the money is in place, layering starts, with the aim of hiding the money's source. NBFCs frequently lend money to shell corporations that have an indirect connection to the same promoter group. Through intricate activities like inter-corporate loans, phony invoices, or multi-layered circular trading, these shell companies successfully obstruct the money trail. Such networks are able to function covertly because to inadequate KYC regulation and lax internal controls.

¹² *Securities and Exchange Board of India v Religare Finvest Ltd and Others*, Final Order No WTM/AB/IVD/ID2/18060/2022-23, 28 July 2022 (SEBI).

NBFCs have been actively involved in prominent scams, either by intentionally supporting these networks or by neglecting to put in place sufficient protections.

3. During the last phase of integration, the money that has been laundered is put back into the economy in ways that seem authentic, such long-term loans, real estate investments, or stock transactions. In order to complete the laundering cycle and avoid raising regulatory red flags, fraudulent loans are occasionally settled through exaggerated asset appraisals or covertly written off as bad debts.

The fact that NBFCs are involved in these processes from beginning to end makes them especially vulnerable. Because of their structural flexibility, lack of oversight, and frequently poor compliance infrastructure, NBFCs are vulnerable to co-optation or manipulation from the time illegal funds are first inserted until they are finally reintegrated. They are therefore at the center of India's money laundering risk environment, which calls for immediate systemic change and regulatory tightening.

C. Use of fake loans and fictitious transactions.

The establishment of false transactions and fraudulent loans is a commonly used avenue for money laundering through NBFCs. NBFCs frequently function with more autonomy and less regulatory monitoring than traditional banks, especially when it comes to loan distribution procedures. Certain NBFCs take advantage of these weaknesses by lending money to front firms, shell corporations, or fictitious borrowers who don't actually run their businesses. These transactions conceal the illegal source of funds by being supported by falsified business credentials, KYC information, and income certificates. After being disbursed, the money is usually passed via a number of intermediary accounts to complicate the money trail and make it more difficult for law authorities to track down. This strategy is similar to the use of shell corporations described in the section on "Layering Illicit Funds." These loans are frequently routed to subsidiaries or associated parties under the control of the same promoter group, often utilizing fictitious contracts and exaggerated invoices to mimic commercial operations. Such loans frequently evade investigation due to inadequate internal controls, a lack of due

diligence, and political or promoter-related meddling. These loans are eventually closed through dubious settlements or surreptitiously wiped off, removing any official record of the money that was laundered. Such transactions not only aid in money laundering but also mislead investors, impede regulatory transparency, and distort the financial health of NBFCs.

D. Hawala Networks, Informal Lending, and Cross-Border Money Laundering

Non-Banking Financial Companies (NBFCs) have become important yet vulnerable participants in cross-border money laundering, primarily because of their connections to shadow lending conduits and informal hawala networks. Some NBFCs facilitate illegal financial flows that avoid official banking scrutiny by operating in semi-urban and rural areas with little oversight. The hawala system, which exchanges value without transferring actual currency, depends more on trust and anonymity than on openness in regulations. This makes it a popular way to launder illicit funds, particularly when combined with NBFCs' lax internal controls. Illicit funds are frequently disguised as legal business operations, such as transfers to shell businesses with unsubstantiated credentials, inflated disbursements, and false loans. These loans, which are rarely meant for repayment but rather to transfer money covertly across borders, are occasionally justified by NBFCs using falsified documentation. In many instances, NBFCs push out matching remittances under the pretense of business transactions or service payments, while hawala agents distribute comparable amounts within India. Tax evaders, smugglers, and even criminal networks can hide black money abroad and then reintroduce it into India as clean capital thanks to this cyclical process.

The HDIL-PMC Bank scam serves as an example, in which companies connected to NBFCs established hundreds of fictitious accounts in order to use fraudulent loans to divert more than ₹6,500 crore.¹³ Despite being largely a banking case, it demonstrated the connections between shell companies, fraudulent lending, and potential hawala

¹³ *Enforcement Directorate v Rakesh Kumar Wadhawan and Others*, PMLA Special Case No 8 of 2019, Special Court (PMLA), Mumbai, Prosecution Complaint dated 16 December 2019.

connections—indicating that NBFCs may potentially be involved in these kinds of laundering schemes.

E. Case of gold smuggling and illegal remittances.

Additionally, NBFCs have been directly and indirectly linked to the facilitation of unreported remittance transactions and the smuggling of gold. The gold trade is frequently utilized as a means of laundering black money or hiding undeclared income because of India's high liquidity and cultural demand for gold. A possible entry point for turning illegal cash into legal financial products is offered by specific NBFCs that focus on gold loans. For instance, people may pledge illegal or smuggled gold as security for loans, therefore converting illicit physical assets into structured credit without necessarily confirming the gold's legitimate provenance. Additionally, NBFCs in cash-heavy areas or industries sometimes evade strict due diligence standards, which facilitates the entry of smuggled gold into official lending networks. In certain instances, the loan is paid back nearly instantly after it is disbursed, or it may even default with no hope of recovery. This suggests that the transaction was never meant to be a valid credit operation but rather a way to make it easier for black money to be placed and layered.

Simultaneously, unofficial remittance networks, which frequently overlap with hawala systems, transfer money internationally through shell NBFCs or weakly regulated companies rather than through authorized banking channels. In order to facilitate illicit overseas transfers masquerading as valid company payments, consulting fees, or trade settlements, certain NBFCs may serve as fronts or middlemen for these networks. These transactions frequently use ambiguous service agreements and manipulated invoices to avoid examination, making it very challenging for law authorities to trace the source and destination of money.

F. Round-Tripping through Offshore Accounts

A sophisticated money laundering method known as "round-tripping" involves sending money overseas and then reintroducing it as legitimate foreign investments. Because of their laxer disclosure requirements, more flexible ownership structures, and less stringent

regulatory scrutiny than banks, NBFCs frequently play a critical role in facilitating this process. NBFCs typically give out substantial unsecured loans to Indian shell companies, which subsequently send the money abroad in the pretense of paying for investments, consultancy services, or imports. These monies subsequently reappear as structured debt, portfolio investments, or foreign direct investment (FDI); they are frequently transferred via tax havens like Singapore, Mauritius, or the British Virgin Islands.

External Commercial Borrowings (ECBs), which are designed to transfer money overseas and then return it to promoter-controlled businesses, have also been facilitated by NBFCs. Such transactions evade regulatory attention because of the lack of transparency in offshore jurisdictions and the lax enforcement of beneficial ownership disclosures. In addition to laundering illegal funds, this technique generates fictitious inflows that skew market perception, raise firm valuations, and destabilize stock prices, all of which contribute to wider economic instability.

G. Movement of money between NBFCs, foreign entities, and tax havens

NBFCs frequently serve as the initial link in international money laundering schemes. An NBFC typically starts the process by lending money or making investments in Indian shell corporations. These businesses then use fictitious import-export contracts, inflated invoices, or unclear service agreements to transfer the money overseas. The funds are transferred to foreign companies with headquarters in secretive jurisdictions with little ownership transparency, such as the Cayman Islands, Mauritius, or the British Virgin Islands. The funds may be temporarily parked in holding companies or further piled once overseas. The same funds eventually make their way back to India in the form of clean capital in the form of equity infusions, foreign direct investment (FDI), or NRI remittances into industries like finance or real estate.

Analyses of several smaller NBFCs in Gujarat and Kerala have shown trends in which money was transferred to businesses in Dubai and subsequently returned through FDI in real estate projects or NRI remittances. Since NBFCs usually operate in regulatory gray areas and lack robust supervision systems, they are less likely to set up quick bells for

such transactions. Due to India's traditionally limited access to beneficial ownership data in tax havens and the absence of comprehensive global tracking systems for capital movement, enforcement agencies find it difficult to track the money trail.

VI. CASE STUDIES OF FINANCIAL CRIMES INVOLVING NBFCs

The growing significance of Non-Banking Financial Companies (NBFCs) in India's financial ecosystem has brought both benefits and risks. While NBFCs have increased access to finance in underdeveloped areas, their lax regulatory environment, operational opacity, and variable compliance requirements have made them potential conduits for financial crime. Over the recent decade, several high-profile scandals have exposed the use of NBFC frameworks for money laundering, fraud, and regulatory avoidance. These case studies highlight the systemic risks in the current financial architecture and the critical need for coordinated oversight across the banking and non-banking sectors. Each instance demonstrates not only individual misbehaviour, but also institutional flaws that may be systematically used to shift, stack, and disguise illicit cash flows.

A. NBFC-Fintech Nexus in the Chinese Loan Apps Scam (2020-2024)

As India's financial ecosystem quickly digitizes, new types of economic malfeasance develop, often exceeding existing regulatory frameworks. One such occurrence is the rise of instant lending applications, particularly between 2020 and 2024, which took advantage of the intersections of fintech, shadow banking, and lax monitoring systems. The Chinese-funded digital lending app scam is a watershed moment in the abuse of Non-Banking Financial Companies (NBFCs), not just as lenders, but also as legal conduits for large-scale money laundering and regulatory arbitrage.

These apps, which often operated without official RBI authorization, followed the "rent-a-NBFC" model, in which RBI-licensed NBFCs rented out their regulatory identities to unregulated fintech operators in exchange for commission-based agreements. Foreign-controlled digital apps (such as CashBean and others) provided micro-loans at exorbitant interest rates, frequently charging 20-30% per month (annualized rates much more), and

in many cases did not adhere to standard KYC procedures, while some minimal KYC was occasionally conducted.

In many cases, Indian NBFCs acted solely as fronts, legally disbursing and collecting funds while handing over operational management to Chinese-backed shell businesses and developers. One of the more prominent examples was PC Financial Services Pvt. Ltd., which ran CashBean. The Enforcement Directorate (ED) discovered that PC Financial Services Pvt. Ltd. transported hundreds of crores of rupees to foreign jurisdictions, principally China, using the pretense of service fees and technical charges. The ED seized ₹131 crore in 2021 and attached assets worth ₹252.36 crore. In 2024, a penalty of ₹2146,48,26,480 was issued for FEMA violations.¹⁴ The ED attached ₹252.36 crore in assets under the Prevention of Money Laundering Act (PMLA), 2002, while the RBI cancelled PC Financial Services' NBFC license in 2022 for regulatory irregularities.

The laundering methods employed in these cases were extremely sophisticated. Borrowers' funds were diverted through tiered accounts that included shell businesses, payment aggregators, and fraudulent merchant invoices before being transported abroad. Several state cybercrime departments and the Financial Intelligence Unit (FIU-IND) identified these transactions as "high-risk, high-velocity, and structurally opaque" all hallmarks of sophisticated money laundering schemes.

Adding to the legal concern, these applications used extortionate recovery practices like as cyberbullying, public shaming, and pressure, frequently accessing borrowers' contact lists and personal data to threaten exposure. A large number of suicides were reported in Telangana, Andhra Pradesh, Maharashtra, and other states, compelling the central government to take immediate action. In a statement to the Lok Sabha in 2022, the Ministry of Finance stated that over 600 digital lending apps were being investigated, with many discovered to have foreign links and connections with Indian NBFCs. In

¹⁴ Enforcement Directorate, 'Press Release: PC Financial Services Pvt Ltd' (ED, 10 October 2024) <https://enforcementdirectorate.gov.in/sites/default/files/latestnews/Press%20Release%20-%20PC%20Financial%20Services-10.10.2024%204.pdf> accessed 29 August 2025.

response, the Reserve Bank of India released the Digital Lending Guidelines in September 2022, demanding that:

1. All digital loans must come from RBI-regulated firms.
2. Lending Service Providers (LSPs) must have contracts with licensed lenders.
3. All KYC, credit evaluation, and grievance redressal responsibilities fall on the NBFC or bank.

This scam exemplifies how unregulated digital players can misuse NBFCs, which were originally created to improve financial inclusion, transforming them into structurally vulnerable legal façades for money laundering. It also demonstrates the vulnerability of regulatory frameworks that fail to combine digital lending and NBFC activities under unified oversight, making this example an essential component of any study of shadow banks and dirty money.

B. Property-Based Laundering through Shadow NBFCs

India's real estate sector has long been a popular avenue for laundering black money, with NBFCs particularly unregulated private home finance companies playing a critical role in facilitating these transactions. Despite operating in the shadows of regular banking, these firms frequently resemble NBFC structures and play an important role in the layering of illegal monies through property transactions.

Based on reported case studies and media accounts, a notable proportion of high-profile money laundering cases have involved real estate and property finance intermediaries, including Ponzi-like investment schemes, shell firms, and shadow lenders. These intermediaries are primarily private NBFC-like lenders who provide short-term bridging loans to property developers without enough KYC, documentation, or realistic repayment assessments. While percentage breakdowns are not publicly disclosed, sectoral analysis suggests that real estate remains a substantial channel for illicit flows in ED investigations.

The ED attached assets worth ₹2,348 crore relating to the WTC Faridabad Infrastructure Pvt Ltd realty fraud, which collected over ₹2,700 crore from about 12,000 investors for commercial plot sales without any development. Instead of being used for construction, the monies were diverted through associated shell organizations and sent overseas to Singapore-based firms, which is a common layering method in NBFC-mediated laundering.

In the instance of Haryana's Shine City Properties Ltd., the ED discovered a network of Ponzi-funded real estate schemes camouflaged as NBFC finance. Investor funds were channeled through layers of loans and dummy companies. The ED's attachment of ₹264 crore in assets indicates the extent of such laundering operations.

Another pattern surfaced with hawala-related property laundering, in which unregistered financiers used NBFC-style entities to inject illicit funds into real estate. The ED has traced over ₹1,635 crore in hawala monies channelled into tiered real estate deals through shadow lenders. This strategy often entails first depositing cash via hawala, then stacking it through property-owning corporations or shell NBFCs, and then integrating the cleansed money through sale receipts, rental revenue, or secondary transactions.

This laundering model compromises several safeguards:

1. Non-bank entities avoid escrow norms by disbursing loans in an opaque manner.
2. KYC and AML rules are either laxly enforced or completely ignored.
3. NBFC-like lenders encourage round-tripping, transforming criminal capital into legitimate real estate assets in a regulatory environment with fewer eyes on them.

These incidents demonstrate how NBFC-based real estate laundering damages both financial integrity and public trust. They highlight the vital need for increased openness in housing finance, mandatory KYC standards, and real estate financiers' integration into India's AML/CFT regime particularly considering how important real estate is to the country's economy and how appealing it remains for laundering.

C. Nirav Modi Mehul Choksi Scam 2018 and NBFC Surveillance Failures

The PNB fraud of ₹13,700 crore¹⁵, which was planned by jewellers Nirav Modi and Mehul Choksi, is one of India's biggest financial scandals.¹⁶ The scam was carried out using fake Letters of Undertaking (LoUs) sent out from the Brady House branch of Punjab National Bank. However, it was able to last because of a bigger problem: scheduled banks, NBFCs, and AML-monitoring systems not working together and not being vigilant enough. According to news reports, the scammers got more than 1,200 LoUs from 2011 to 2017 to get credit from other countries without collateral or records in the Core Banking System (CBS). Only a tiny number of them were real, but the exact amount is still being checked by the government. Bank personnel collaborated to avoid system checks, transmitting SWIFT communications for credit guarantees without necessary CBS entries, a weakness identified by the RBI's deputy governor as early as 2016. This institutional dissonance, where CBS and SWIFT remained unintegrated, provided an exploitative pathway for large-scale fraud.

While the central bank worked slowly to destroy this scam, AML supervision gaps persisted. Notably, NBFCs and other financial entities had no direct involvement in the issuance or processing of these fraudulent LoUs, but the case demonstrated how flaws in the broader financial monitoring ecosystem, such as gaps in AML surveillance and data sharing, can allow such frauds to go undetected. Although Nirav Modi and associated organizations were the ED's primary targets, sources suggest that 17 banks were connected to the fraudulent activities through LoUs.¹⁷

¹⁵ 'PNB, CBI Move Special Court to Declare Nirav Modi, 2 Others Proclaimed Offenders' *Business Today* (New Delhi, 29 August 2019) <https://www.businesstoday.in/latest/economy-politics/story/pnb-cbi-moves-special-court-declare-nirav-modi-2-proclaimed-offenders-223785-2019-08-29> accessed 29 August 2025.

¹⁶ Central Bureau of Investigation, 'PC Financial Services Pvt Ltd – Press Release (2 October 2020)' (CBI, 2 October 2020) https://www.cbi.gov.in/assets/files/media/pc_20201002_1.pdf accessed 29 August 2025.

¹⁷ Khushboo Narayan and Deeptiman Tiwary, 'PNB fraud expands: Rs 3000 crore more from 17 banks, money laundering evidence' (*The Indian Express*, Mumbai, 16 February 2018) <https://indianexpress.com/article/india/pnb-fraud-expands-rs-3000-crore-more-from-17-banks-money-laundering-evidence-nirav-modi-5065807/> accessed 29 August 2025.

The institutional failure included inter-agency information gaps. An internal Income Tax (I-T) study issued in June 2017 identified questionable activities involving Choksi and Modi, such as inflated stock valuations and overseas transfers, but information was not shared across agencies due to the lack of a structured sharing process. Similarly, auditing companies and vigilance units have failed to correlate repeated RBI warnings about SWIFT usage to operational problems at individual bank branches.

Significant reforms were prompted by the aftermath:

1. The RBI banned the use of Letters of Comfort and Memorandums of Understanding as trade finance instruments.
2. To require the reconciliation of SWIFT with CBS entries and escalations, institutions modified their internal procedures.
3. SEBI chastised PNB for its delayed disclosures, and the Ministry of Finance made orders for external oversight of major loans.

This case highlights how financial crimes can spread in an ecosystem where banks, NBFCs, and monitoring agencies function in organizational silos, even though NBFCs were not directly involved in the fraud. Policymakers can learn a valuable lesson about the perils of a fragmented regulatory environment from this scam, which flourished due to the lack of real-time data exchange and coordinated AML surveillance throughout the banking sector.

VII. COMPARING NBFCs AND BANKS IN AML COMPLIANCE

Both commercial banks and non-banking financial companies (NBFCs) are essential to the enforcement of anti-money laundering (AML) laws in India because they are financial intermediaries. Their operational transparency, institutional capability, and regulatory responsibilities, however, varied greatly, leading to notable variations in their approaches to managing AML compliance. NBFCs have traditionally operated under a more permissive compliance framework, whereas banks are subject to intense regulatory

control, real-time monitoring systems, and strong Know Your Customer (KYC) standards because of their systemic importance. Many NBFCs, particularly smaller ones, have not shown the same level of diligence in keeping thorough customer records, keeping an eye on suspicious transactions, or timely reporting to the Financial Intelligence Unit (FIU), even though they are designated as "reporting entities" under Section 2(1)(wa) of the Prevention of Money Laundering Act (PMLA), 2002. The Reserve Bank of India (RBI), which regulates thousands of NBFCs with a fraction of the regulatory staff it devotes to scheduled banks, is also to blame for this discrepancy, in addition to the structural distinctions between banks and NBFCs. The nature of NBFC activities, which frequently entail cash-intensive transactions, lending to opaque or shell companies, and informal borrower networks, further exacerbates the compliance difficulty. Tracking layered or round-tripped funds, which are frequently employed in money laundering methods, is very challenging because of these features. With an emphasis on KYC implementation, reporting requirements, institutional difficulties, and enforcement gaps, this section of the study seeks to critically examine the relative AML duties of banks and NBFCs. The report aims to clarify how systemic weaknesses in the NBFC sector can jeopardize the nation's larger efforts to prevent money laundering by highlighting the regulatory asymmetries and compliance gaps between these two types of financial institutions.

A. KYC Requirements: NBFCs vs. Banks

Effective Know Your Customer (KYC) standards implementation is one of the core tenets of anti-money laundering (AML) compliance. The Reserve Bank of India's (RBI) Master Directions on KYC, which mandate a risk-based approach to customer due diligence, identity verification, and transaction monitoring apply to both banks and non-banking financial corporations (NBFCs) in India. Despite the apparent uniformity of the regulatory rules, banks and NBFCs differ greatly in terms of enforcement and compliance.

Commercial banks are subject to stricter regulation because of their place in the public eye and systemic significance. They must carry out comprehensive customer identification processes with the aid of cutting-edge technologies like biometric Aadhaar verification, PAN linkage, and real-time database checks, which are frequently aided by centralized eKYC systems and anomaly detection powered by artificial intelligence. On the other hand, many NBFCs, especially those that are smaller or have a regional emphasis, lack the institutional ability and technology infrastructure necessary to put such strict procedures in place. Because of this, they frequently use manual document gathering, which is vulnerable to falsification, and they might even contract out onboarding to outside agents, which further weakens accountability.

The quality of risk assessment and client profiling is directly impacted by this difference in operational competence. While banks regularly perform *enhanced due diligence (EDD)* for high-risk accounts, such as those belonging to entities on sanctions lists and politically exposed individuals (PEPs), the majority of NBFCs do not consistently follow these procedures. The issue is made worse in rural and semi-urban areas, where NBFCs frequently work with first-time borrowers who don't have official identification. This leads to gaps in identity verification and raises the possibility of onboarding clients who are fraudulent or untraceable. Despite the fact that financial inclusion is a justifiable goal, weak KYC checks leave gaps that can be used to launder money. In addition, the methods of enforcement are not uniform. In addition to facing severe financial and reputational consequences for KYC violations, banks are frequently inspected by the RBI. Due to the RBI's limited ability to oversee hundreds of organizations, NBFCs are subject to less stringent supervision, which delays the discovery of non-compliance or operational flaws.

These disparities have the effect of making India's AML framework structurally weak. NBFCs are vulnerable to being abused as channels for illegal financial flows, particularly those engaged in cash-heavy industries like microlending, auto financing, or gold loans. Black money is layered beneath the pretense of legal loans, mule accounts are created,

and benami transactions are made easier by these institutions' lax implementation of KYC regulations. As a result, although formal KYC requirements are established, their implementation is still disjointed.

B. Table: Key Differences in KYC and AML Regulations - Banks vs. NBFCs (2024-25 Guidelines)

Aspect	Banks	NBFCs
Regulatory Framework	RBI Master Direction - KYC (Updated 2025); PMLA (Amended 2023)	RBI Master Direction - KYC (Applicable to NBFCs); PMLA (Amended 2023)
Customer Due Diligence (CDD)	Mandatory with real-time PAN, Aadhaar, and CKYC verification	Required, but simplified norms allowed for low-risk and small borrowers
Enhanced Due Diligence (EDD)	Strictly applied for PEPs, NPOs, high-risk profiles	Often inconsistently implemented due to operational gaps
eKYC & Digital Verification	Fully integrated with Aadhaar, CKYCR, UIDAI, and RBI's digital onboarding systems	Limited adoption; digital KYC infrastructure varies widely
AML Reporting to FIU-IND	CTRs, STRs, NTRs, and monthly NIL reports mandatory and routinely filed	Mandatory, but many NBFCs underreport or delay submission
RBI Supervision Frequency	Regular audits, inspections, and strong regulatory oversight	Infrequent inspections due to limited RBI capacity across 9000+ NBFCs

Penalty for Non-Compliance	High monetary penalties; public disclosure of violations	Lower penalties; enforcement less consistent and often non-public
AML System Integration	Linked with FINnet, CKYCR, sanctions databases, and real-time AML monitoring tools	Many smaller NBFCs lack integration with centralized AML tracking systems

C. AML Reporting Obligations

As "reporting entities" under Section 2(1)(wa) of the Prevention of Money Laundering Act (PMLA), 2002, banks and non-banking financial companies (NBFCs) must notify the Financial Intelligence Unit – India (FIU-IND) of specific financial transactions. These consist of *Counterfeit Currency Reports (CCRs)*, *Non-Profit Organization Transaction Reports (NTRs)*, *Cash Transaction Reports (CTRs)*, and *Suspicious Transaction Reports (STRs)*. However, although being under the same legislative duties, NBFCs have a substantially worse compliance record in real reporting compared to commercial banks. Banks are able to recognize and report suspicious transactions in real time because of their established procedures and specialized compliance teams. In order to facilitate the smooth and prompt submission of regulatory reports to FIU-IND, they usually use sophisticated AML monitoring software that is integrated with transaction monitoring systems (TMS), artificial intelligence (AI)-based risk scoring models, and platforms like FINnet (Financial Intelligence Network). Additionally, banks ensure regular oversight by filing monthly NIL reports even in the absence of suspicious activities. On the other hand, many NBFCs, particularly smaller ones, lack the trained staff and infrastructure needed for accurate and timely reporting. This disparity is supported by empirical evidence. According to FIU-IND Annual Reports, *banks file more than 90% of STRs and CTRs each year¹⁸, whereas NBFCs make up a disproportionately small fraction*, despite the fact that some of them work

¹⁸ Financial Intelligence Unit – India, *Annual Report 2021–22* (FIU-IND, 2022) 24

in high-risk industries including microfinance, real estate, and gold loans. This pattern points to a systemic underreporting of potentially illegal activities by NBFCs in addition to a decreased volume.

D. Analysis of RBI Guidelines and Their Enforcement Gap

Uniform AML requirements for banks and NBFCs are outlined in the Reserve Bank of India's Master Direction on KYC¹⁹ (2016, revised frequently). These requirements include risk-based due diligence, increased checks for high-risk clients, and required reporting to FIU-IND. However, because of institutional constraints and inadequate supervisory ability, there is still a glaring enforcement gap, particularly in the NBFC industry. NBFCs, especially smaller or non-deposit-taking ones, function under less scrutiny than banks, which are subject to frequent audits and have sophisticated compliance systems. Inspections are rare and follow-up measures on compliance violations are frequently postponed or absent due to the RBI's limited workforce and the over 9,000 NBFCs. Due to their reliance on manual or third-party KYC procedures and inadequate digital infrastructure, many NBFCs are susceptible to abuse. Because they have historically been seen as lower-risk, NBFCs have also been subject to smaller sanctions, which has led to a weakened compliance culture. Therefore, NBFCs frequently perform poorly in practice even though they are subject to the same regulatory framework as banks, which impairs the overall enforcement of India's AML regime.

E. Challenges in Enforcement

There are substantial institutional, operational, and structural obstacles to the execution of anti-money laundering (AML) laws in India's Non-Banking Financial Company (NBFC) industry.

1. One of the primary issues is the Reserve Bank of India's (RBI) inadequate supervision capacity. The RBI plays a vital role in operationalizing anti-money

¹⁹ Reserve Bank of India, *Master Direction – Know Your Customer (KYC) Direction, 2016* (RBI/DBR/2015-16/18, DBR.AML.BC.No.81/14.01.001/2015-16, updated 12 June 2025)

laundrying (AML) standards through its own regulatory directives, even though the Ministry of Finance is ultimately responsible for enforcing the Prevention of Money Laundering Act, 2002 (PMLA), which is mainly carried out by the Enforcement Directorate and Financial Intelligence Unit-India (FIU-IND). Not the PMLA itself, but the RBI Act of 1934 and the Banking Regulation Act of 1949, provide it the authority to do so. However, the RBI's ability to successfully implement these rules across more over 9,000 registered Non-Banking Financial Companies (NBFCs) is hampered by logistical and human limitations. Numerous NBFCs are small, do not accept deposits, or are involved in specialized markets. Because of this, systemically important NBFCs (NBFC-SIs) receive a disproportionate amount of attention from the RBI's regulatory apparatus, leaving many smaller organizations without sufficient scrutiny. Because of the regulatory blind spots caused by this disparity in focus, cases of AML non-compliance might remain undiscovered for extended periods of time.

2. Second, many NBFCs still lack the institutional and technological capability to handle the intricate requirements of AML compliance. Most NBFCs still use antiquated manual procedures, in contrast to commercial banks that have access to automated monitoring systems, centralized compliance departments, and core banking platforms. They don't have automated methods to cross-verify identities with centralized KYC databases like CKYCR or Aadhaar, identify questionable activity, or conduct customer due diligence at scale. As a result, they have very little capacity to identify and disclose high-risk activities, such as structuring, layering, or abrupt significant cash moves.
3. The informal nature of the clientele and operational environment that many NBFCs operate in makes enforcement even more difficult. These companies frequently work with people and enterprises who lack official credit histories, valid identity, or steady income records in semi-urban and rural locations. This complicates consumer due diligence and raises the possibility of enrolling clients who are anonymous or misrepresented. Furthermore, a number of NBFCs provide

loans to front firms or shell corporations that are established specifically to layer and round-trip money – two traditional signs of money laundering. Because cash-based transactions are so common in these environments, it is more difficult to track down the financial trail, and the lack of real-time transaction reporting systems makes it possible for illegal flows to go undetected.

4. Furthermore, many NBFCs have an institutional and cultural complacency with regard to AML compliance. Compliance is frequently seen as a box-checking exercise rather than an integrated risk-management strategy because of its historically laxer regulatory treatment and little danger of criminal prosecution. Accountability is diluted since smaller NBFCs, in particular, typically rely on outside consultants for reporting and lack internal legal or compliance competence. Suspicious Transaction Reports (STRs), Cash Transaction Reports (CTRs), and other required disclosures to the Financial Intelligence Unit-India (FIU-IND) are underreported as a result of this reactive compliance culture.
5. Lastly, another degree of difficulty is created by the disjointed coordination between law enforcement and regulatory entities. AML enforcement and follow-up actions are slowed down by the absence of real-time data sharing and integrated investigation processes, even though the RBI, FIU-IND, and other financial authorities have explicit mandates.

In summary, a lack of adequate oversight, ineffective internal systems, unofficial operational procedures, and an immature compliance mindset all work against the NBFC sector's ability to enforce its AML requirements. Enhancing RBI's supervisory staff and technological capabilities, requiring NBFCs to have real-time reporting tools, imposing harsher sanctions for non-compliance, and above all creating a compliance culture based on proactive risk management rather than regulatory evasion are all necessary steps to strengthen enforcement.

VIII. LEGAL REFORMS AND POLICY RECOMMENDATIONS

India needs to go from reactive enforcement to proactive regulation if it wants to really stop the misuse of NBFCs in financial crimes. A modern legal system must use technology, encourage cooperation between agencies, and make sure that everything is clear without limiting new ideas. Many nations have implemented stricter and more consistent regulation of shadow banks and NBFC-like organizations, according to a comparative analysis of other jurisdictions. Under the Finance Companies Act of 1967, the Monetary Authority of Singapore (MAS) oversees financial firms in the country. MAS Notice 626 enforces strict anti-money laundering regulations, such as required beneficial ownership checks and automated transaction monitoring.²⁰ In the UK, the Financial Conduct Authority (FCA) implements "continuous monitoring" requirements under the Money Laundering, Terrorist Financing and Transfer of Funds Regulations 2017 and oversees non-bank lenders under the Financial Services and Markets Act 2000.²¹ The Dodd-Frank Wall Street Reform and Consumer Protection Act in the US increased the Federal Reserve's supervision of non-bank financial firms that were considered "systemically important," subjecting them to stricter prudential guidelines like capital requirements and stress tests.²² All non-bank lenders must register, maintain customer due diligence programs, and report suspicious transactions under Australia's system, which is overseen by the Australian Securities and Investments Commission (ASIC) and AUSTRAC under the Anti-Money Laundering and Counter-Terrorism Financing Act 2006.²³ India's NBFC laws still allow for regulatory arbitrage in comparison to these frameworks, especially for smaller, non-deposit-taking NBFCs where beneficial

²⁰ Monetary Authority of Singapore, *Notice 626: Prevention of Money Laundering and Countering the Financing of Terrorism – Banks* (MAS, 28 December 2020)

<https://www.mas.gov.sg/regulation/notices/notice-626> accessed 29 August 2025.

²¹ Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017, SI 2017/692.

²² Dodd-Frank Wall Street Reform and Consumer Protection Act 2010, Pub L No 111-203, 124 Stat 1376.

²³ Anti-Money Laundering and Counter-Terrorism Financing Act 2006 (Cth).

ownership transparency and real-time monitoring are still in their infancy. Here are five major changes that can help make this vision a reality:

1. **Unified Financial Intermediation Registry:** There needs to be a central registration for all NBFCs, fintechs, and shadow banks that the government runs and controls. Every player, no matter how big or small, should say who owns them, how they get their money, who they work with across borders, and who will benefit from their work. Regulators like the RBI, SEBI, FIU, and ED must be able to access this registry so they can check it in real time before big transactions or lending between companies. It lays the groundwork for openness in the system. The RBI's current powers under Section 45-IA of the Reserve Bank of India Act, 1934, which permits the central bank to specify requirements for NBFC registration, such as ownership disclosures and operational transparency, might be used to establish such a registry.
2. **Real-Time Risk Monitoring through Smart Tech:** India needs to make it illegal to use AI-powered tools for ongoing transaction monitoring. Similar regulations, like Singapore's MAS Notice 626 and the UK's Money Laundering, Terrorist Financing and Transfer of Funds Regulations 2017's Regulation 28, already mandate that financial institutions keep up-to-date transaction monitoring systems that can spot irregularities instantly. Machine learning algorithms should check risk scores across NBFCs and banks in real time and detect any unexpected patterns right away. High-risk activity would automatically trigger targeted audits or alerts to enforcement agencies, ensuring that supervision keeps up with the rapid pace of financial innovation.
3. **Integrated KYC and AML Compliance Infrastructure:** Uniform compliance is long overdue. For example, every reporting institution, including NBFCs, is required by Section 12 of the Prevention of Money Laundering Act, 2002 to retain records of all transactions, confirm the identity of clients, and provide information to the

Financial Intelligence Unit (FIU-IND) as part of their compliance requirements. In a similar vein, as part of the NBFC licensing system, the RBI may enforce extra AML/KYC requirements under Section 45-IA of the Reserve Bank of India Act, 1934. A single KYC-AML platform, which is accessible to all regulated companies such as NBFCs, payment banks, and fintechs, has the potential to eliminate regulatory arbitrage. To avoid tampering, each change should include a blockchain-backed audit trail. Those who regularly default face severe fines, public disclosures, and license revocation. Strong compliance should be the industry standard, not an afterthought.

4. **Fraud Command Centre for Cross-Agency Collaboration:** The lack of collaboration among enforcement agencies hampered the fight against money laundering. A dedicated Fraud Command Centre must be built, connecting the RBI, SEBI, FIU, ED, and Income Tax departments. Suspicious Activity Reports (SARs), irregular cross-border flows, and high-value transactions should be directed here for cooperative investigation via secure data pipelines and real-time dashboards. India might adopt the comparable coordination framework between AUSTRAC and ASIC that exists in Australia, which permits cooperative intelligence sharing for high-value transactions involving non-bank lenders.
5. **Crypto-Specific and Global Reciprocity Laws:** With NBFCs increasingly touching digital assets, India must enact crypto-specific legislation. These should include AML requirements, consumer verification, and jurisdictional traceability for digital platforms. Simultaneously, the law must empower Indian agencies to accept enforcement actions and blacklists issued by FATF-member nations, allowing for faster asset freezes and evidence collection across borders. In a similar move, the US closed a significant loophole used for cross-border money laundering by extending the Bank Secrecy Act's AML regulations to virtual asset service providers.

In essence, India requires a legal toolbox that is quick, clever, and globally compatible.

These reforms will not only close regulatory deficiencies, but also increase long-term credibility, investor confidence, and systemic trust in NBFC-led lending.

IX. CONCLUSION

The fast expansion of Non-Banking Financial Companies (NBFCs) has created both opportunities and risks in India's financial sector. As of March 2024, NBFCs accounted for roughly 24.5% of all credit provided by Scheduled Commercial Banks, demonstrating their systemic significance. Case studies show that structural flaws have led to billions of rupees being looted through NBFC-linked channels. For example, the Religare Finvest case included ₹2,473.66 crore, the HDIL-PMC Bank fraud diverted nearly ₹6,500 crore, and the WTC Faridabad scheme misappropriated ₹2,700 crore from 12,000 investors. In the PC Financial Services (Chinese loan applications) case, the Enforcement Directorate seized ₹252.36 crore in assets and levied a ₹2,146.48 crore penalty.²⁴

These examples demonstrate how regulatory arbitrage and ineffective compliance frameworks expose NBFCs to widespread abuse. Despite being designated as reporting companies under the Prevention of Money Laundering Act, NBFCs account for less than 10% of Suspicious Transaction Reports, compared to banks' 90%+ share, demonstrating a major enforcement and compliance gap. The report clearly admits its limitations, stating that it is mostly based on secondary sources and does not have access to field interviews or internal compliance data. Future study should look into real-time inter-agency data sharing, evaluating the effectiveness of the RBI's Scale-Based Regulation in practice, and assessing compliance methods in smaller non-bank financial institutions. A comparative analysis of FATF-compliant states may potentially yield insights into more successful reforms.

²⁴ Directorate of Enforcement, 'Press Release: PC Financial Services Pvt Ltd' (10 October 2024) <https://enforcementdirectorate.gov.in/sites/default/files/latestnews/Press%20Release%20-%20PC%20Financial%20Services-10.10.2024%204.pdf> accessed 29 August 2025.

Finally, NBFCs will continue to be a high-risk avenue for illicit financial flows unless India boosts real-time surveillance, improves inter-agency coordination, and enforces stronger KYC/AML regulations.

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