Anti-money laundering and counter-terrorist financing measures

Sri Lanka

Mutual Evaluation Report

September 2015

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APG members and observers are committed to the effective implementation and enforcement of internationally accepted standards against money laundering and the financing of terrorism, in particular the Forty Recommendations of the FATF.

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The photograph on the front page is of Sigiriya, the Lion Rock Fortress built by King Kasyapa in the 5th Century.

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Executive Summary

1. This report provides a summary of the Anti-Money Laundering/Countering the Financing of Terrorism (AML/CFT) measures in place in Sri Lanka as at the date of the onsite visit, 1 to 12 December 2014. It analyses the level of compliance with the FATF 40 Recommendations and the level of effectiveness of Sri Lanka's AML/CFT system, and provides recommendations on how the system could be strengthened.

A. Key Findings

Overall Level of Compliance and Effectiveness

- Sri Lanka has an acute understanding of terrorist financing (TF) risks, shaped by years of war between the Sri Lankan Government and the Liberation Tigers of Tamil Eelam (LTTE) that ended in 2009. Sri Lanka's National Security Strategy focuses on security threats and risks, including LTTE financing from abroad. The Chief of National Intelligence, reporting to the Secretary of Defence, comprehensively coordinates activities and information sharing among all relevant agencies to address TF risks including disrupting possible re-emergence of the LTTE through financing from abroad.
- Sri Lanka has a reasonable understanding of its money laundering (ML) risks. This understanding has not manifested in a national AML strategy, nor have there been coordinated activities to address key ML risks such as corruption or drug trafficking.
- Sri Lanka has not implemented a risk-based approach to AML/CFT activities informed by the results of its first national risk assessment (NRA), completed in October 2014. Recommendations made in the NRA are still awaiting approval as at the end of the onsite.
- Sri Lanka's use of financial intelligence and other information for ML/TF and associated predicate offence investigation does not extend to the full range of potentially relevant information. The FIU uses limited available and obtainable police information in its operational analysis of STRs, which has had a negative consequential impact on the quality of intelligence products disseminated to the police.
- The financial intelligence unit (FIU) is not using financial intelligence or other available information to undertake strategic analysis, including in identifying emerging ML/TF trends and threats.
- Sri Lanka possesses the foundation for an effective AML system, but to date there has been limited demonstration of effectiveness with only one ML conviction. The low prosecution and conviction rates for ML are mostly explained by the jurisdiction's lack of capacity and policy imprimatur to investigate and prosecute the ML offence. Sri Lankan authorities find it easier to prosecute the predicate offence, as it is a quicker process and less challenging given existing skills and resources.
- Sri Lanka's counter-terrorism and TF regime's success is a result of high-level governmental commitment, multi-pronged and well-coordinated efforts amongst agencies, and the focus and dedication of terrorism investigative units such as the Terrorist Investigation Division (TID) and Criminal Investigation Division (CID).
- Sri Lanka's has clear and high national-level policy focus on deterring terrorist activities especially through confiscating the assets of terrorists. This has been effective in countering the LTTE's operations in Sri Lanka. It is evident from the statistics that this avenue has been broadly and effectively used, including successfully disrupting recent attempts at LTTE resurgence since 2012.
- The Prevention of Terrorism Act No. 48 of 1979 as amended (PTA), with its non-conviction based, administrative mechanisms, has been the preferred legislative tool to successfully deprive the LTTE of funds and property. It is particularly useful in instances where access to evidence is challenging, such

as where the evidence or the offender lies abroad and there are challenges in obtaining international cooperation to obtain the evidence or the offender.

- However, Sri Lanka has been less effective in prosecuting TF cases especially with foreign elements given the challenges with international cooperation to obtain evidence to prosecute terrorist financiers. Moreover, there have been only three TF convictions under the PTA as well as three indictments for the TF offence under the Convention on the Suppression of Terrorist Financing Act (CSTFA) with no convictions yet.
- Sri Lanka has not yet dealt with proliferation financing.
- Sri Lanka has not fully assessed the ML/TF risk in respect to the use of legal persons and arrangements and there are significant technical and implementation deficiencies in respect to obtaining and making available beneficial ownership information on a timely basis.
- Sri Lanka's dependence on using existing information, including reliance on using existing information held by financial institutions and designated non-financial businesses and professions (DNFBPs) to mitigate the abuse of legal persons and arrangements, is not an effective mechanism as there are gaps in this information, including on beneficial ownership
- Since the last MER, Sri Lanka has made progress in promulgating enforceable rules under the Financial Transactions Reporting Act (FTRA). However, significant gaps still exist in prescribed requirements in a number of key areas such as customer due diligence (CDD), politically exposed persons (PEPs), high-risk countries, internal controls, correspondent banking, wire transfer and money value transfer service (MVTS) providers, among others. These gaps inhibit the effective implementation of preventive measures across all financial sectors.
- Financial institutions' (FIs) level of understanding of ML/TF risks and obligations is variable across sectors and, within a sector, across institutions. There is a need for a stronger application of the risk-based approach (RBA) across sectors to more effectively implement the full range of preventive measures.
- Apart from banks, the relevant supervisory authorities lack clear powers to prevent criminals from participating as beneficial owners in FIs and DNFBPs, while the directors and senior officers of FIs and DNFBPs in sectors identified as higher risk are not subject to any fit-and-proper requirements. The infrastructure for regulation and AML/CFT supervision of the gaming industry remains unclear.
- The recent completion of the NRA has not translated into risk-based supervision of FIs by the FIU and prudential supervisory authorities, with the FIU being significantly under-resourced in its role as the primary AML/CFT supervisor. Sanctions for AML/CFT non-compliance have been focused mainly on the banking sector, and do not appear to be sufficiently dissuasive.
- There are significant legal and structural limitations to Sri Lanka's effective ability in relation to its formal international cooperation mechanisms, in particular the fact that their legislation requires a mutual legal assistance arrangement between Sri Lanka and the State requesting assistance; it is not clear whether coercive assistance can be provided in absence of such arrangement. This limits Sri Lanka's ability to provide assistance where a court order is required, namely assistance for freezing of funds and confiscation of assets.
- The central authority does not adequately maintain and monitor the status and timeliness of requests made and obtained. In combination with varying levels of inter-agency coordination, this leads to a cumbersome system where the progress of requests is not always apparent. However, there appears to be more effective international cooperation amongst the law enforcement agencies and their respective foreign counterparts, where assistance is initiated and monitored at an informal level.

B. Risks and General Situation

2. Sri Lanka's ML/TF risks involve cross-border illicit flows because of Sri Lanka's geographic location. As a major transhipment port, Sri Lanka receives 70% of all vessels sailing to and from South Asia, exposing Sri Lanka to associated drug and human trafficking. Authorities consider that the proceeds of drug trafficking are mostly laundered back to their source jurisdictions, and for human smuggling, to end destinations or transit points, and not just within Sri Lanka. Overall, Sri Lanka is not considered an end destination for foreign proceeds of crime. Conversely, Sri Lanka is an end destination for terrorist funds raised abroad in support of the LTTE.

3. Corruption and drug-related proceeds pose the highest ML risk. Drug trafficking proceeds originate primarily from the trafficking of heroin from India and Pakistan for consumption in Sri Lanka, and as a transit point for heroin heading to other destinations. Corruption-related ML risk originates from domestically generated proceeds and is compounded by a lack of corruption-related ML investigations, prosecutions, and convictions.

4. Sri Lanka's terrorist threat has greatly diminished since the end of the civil war in 2009, but TF risk remains with LTTE-related incidents occurring since then, most recently in April 2014. Sri Lanka is cognizant of other TF risk associated with the Islamic State of Iraq and the Levant (ISIL).

C. Overall level of compliance

C.1 Assessment of risk, coordination and policy setting

5. Overall, Sri Lanka's NRA conclusions reasonably reflect its main ML/TF risks, with some exceptions: the self-assessment on national vulnerability is overly optimistic, the assumptions of structural or inherent vulnerabilities of the DNFBP sectors are not always sound, and ML/TF risks of legal persons and arrangements have not been adequately assessed.

6. Sri Lanka has a sound understanding of most of its ML threats including corruption and drug trafficking. However, levels of understanding of ML risk are not universal across all competent authorities or reporting entities.

7. Sri Lanka has an acute understanding of TF risks, shaped by years of war between the Sri Lankan Government and the LTTE that ended in 2009. Although the terrorist threat has greatly diminished, the TF risk remains with LTTE-related incidents occurring since then, most recently in April 2014. This has been documented in the non-sanitised version of the NRA (viewed by the assessment team) and the National Security Strategy, and confirmed by agencies met during the onsite that work on TF-related issues.

8. Sri Lanka does not have an articulated national AML strategy, nor did authorities, either law enforcement or supervisory, provide the assessment team with any evidence of sector-specific strategies related to AML. There is the National Security Strategy that focuses on countering terrorism, including TF. AML/CFT activities in general are coordinated via the Advisory Board to the FIU, and the Office of the Chief of National Intelligence coordinates matters specifically relating to terrorism, including TF.

9. The NRA contains comprehensive proposed actions to address the identified deficiencies, including technical, operational and capacity but at the time of the onsite had not been approved.

10. Sri Lanka has not used the results of its first NRA, completed in October 2014 two months before the onsite, neither has it adopted a national strategy informed by the NRA or undertaken targeted activities to mitigate key ML risks such as corruption or drug trafficking proceeds, although there are plans to do so. There are targeted activities to address TF risks based on the National Security Strategy.

11. There has been limited interagency coordination on proliferation financing.

C.2 Financial intelligence, ML and confiscation

12. Sri Lanka's use of financial intelligence and other information for ML/TF and associated predicate offence investigations does not extend to the full range of potentially relevant financial intelligence. The FIU does not use obtainable and available police information in its operational analysis of STRs, which has a negative impact on the quality of intelligence products disseminated to the police. For TF, the use of financial intelligence gathered from the Chief of National Intelligence coordination mechanism has arguably yielded more effective results in disrupting TF from abroad to support the resurgence of the LTTE.

13. There are insufficient resources devoted to operational and strategic analysis and a backlog of STR analysis up to three to four months.

14. Despite adequate foundations for an effective investigative system, to date there has been limited demonstration of effectiveness with only one ML conviction. The low prosecution and conviction rates for ML are mostly explained by the jurisdiction's emphasis on investigating and prosecuting the predicate offence, with a focus on domestic cases.

15. The authorities conduct ML investigations but results are hampered by a lack of clear policy direction and capacity. While there is an operational willingness to investigate ML, outcomes are constrained by capacity and lack of a comprehensive national AML policy, internal police directive or guidance on ML investigations.

16. Despite a sound legal framework for tracing, freezing, and conviction-based confiscation of proceeds of crime under the PMLA, confiscation is achieved at only a low level. This is a result of the lack of national or agency-level AML strategy. In particular, the agencies that deal with the two identified high-risk areas of drug trafficking and corruption do not appear to have developed any confiscation policies or strategies to proactively counter ML or the proceeds of predicate offences. The low rates of investigation and prosecution of ML offences also contribute to a lack of confiscation of criminal proceeds. There has been only one ML-related confiscation under the PMLA and the amount remains low at LKR 7 million (USD 53 294[1]).

17. There is, however, a clearer focus on depriving terrorists of their funding. Substantial cash assets amounting to LKR 89 million (USD 677 600[1]) and land assets worth LKR 70 million (USD 533 000[1]) relating to terrorists and terrorist financing have been frozen, while cash and non-cash assets amounting to LKR 843 757 793 (USD 6.5 million[1]) relating to terrorists and terrorist financing have been confiscated under the PTA No. 48 of 1979 (as amended). However, there has yet to be any conviction or confiscation under the CSTFA.

C.3 Terrorist financing and proliferation financing

18. Sri Lanka's counter-terrorism regime reflects high-level governmental commitment as well as multi-pronged and well-coordinated efforts, with a clear and high national-level policy focus on deterring terrorist activities especially through confiscating the assets of terrorists. The NRA and National Security Strategy found TF risk as mainly relating to the movement and use of funds within Sri Lanka from funds raised abroad and funnelled into Sri Lanka in support of potential LTTE activities.

19. The Public Security Ordinance No. 25 of 1947 as amended (PSO) and the PTA have provided an efficient avenue for the authorities to pursue terrorists and their assets and it is evident from the statistics that this avenue has been broadly and effectively used. This reflects the focus and dedication of terrorism investigative units such as the TID as well as the CID. However, the statistics provided by Sri Lanka show that under the PTA, there have been only three convictions relating to terrorists resulting in forfeiture of

[1] Approximate figures based on LKR 1 equalling USD 0.00761, as at the end of the onsite visit, 12 December 2014, www.oanda.com

their assets. Notwithstanding those successes, there has been no conviction for the TF offence under the primary TF legislation, the CSTFA, and only three indictments.

20. Deficiencies in the mutual legal assistance regime, in particular, being restricted in its ability to provide coercive assistance, including assistance for freezing and confiscation to a limited number of prescribed and specified countries rather than on the basis of reciprocity, also limit Sri Lanka's ability to obtain assistance and evidence to support and pursue TF prosecutions and confiscations with foreign elements.

21. Sri Lanka has implemented targeted financial sanctions on United Nations Security Council Resolution (UNSCR) 1267, such as UN Regulation No. 2, gazettal of the Taliban and Al-Qaida Lists, and 14 subsequent amendments to December 2014. To date there have been no positive matches against the lists. This is consistent with the relatively lower TF risk profile for Al-Qaida and the Taliban in Sri Lanka.

22. For UNSCR 1373, Sri Lanka has designated natural persons, legal persons, groups and entities, principally those associated with the LTTE. All individuals designated are based in foreign jurisdictions. While some jurisdictions have designated the LTTE, they have not designated the Tamil organisations and individuals listed. The authorities have approached those jurisdictions for support to designate LTTE affiliates, with no positive outcome at the time of the onsite. Eight domestic bank accounts have been frozen based on matches against the designated lists.

23. Implementation of UNSCR 1267 and 1373 is undermined by the lack of implementation of CDD beneficial ownership and preventive measures, the relatively recent amendments to extend freezing requirements to cover persons or entities acting on behalf of, or at the direction of, designated persons or entities, and the lack of monitoring and support for the NPO sector in respect to TF issues.

24. Sri Lanka has taken no material steps to implement the requirements for targeted financial sanctions concerning UNSCRs 1718 and 1737.

C.4 Preventive measures and supervision

25. Sri Lanka's regulatory framework for preventive regime has progressed since the last mutual evaluation report of 2006. This includes issuance of enforceable rules under the FTRA to various constituents of the financial sector. However, significant gaps still exist in prescribed requirements in a number of key areas such as CDD, PEPs, high-risk countries, internal controls, correspondent banking, wire transfer and MVTS, among others. These gaps inhibit the effective implementation of preventive measures across all financial sectors.

26. FIs' level of understanding of ML/TF risks and obligations is variable across sectors (with banks exhibiting relatively better understanding) and within a sector, across institutions. In general, while financial institutions exhibit some understanding of such risks and obligations, there is lack of a comprehensive risk-based approach to understanding, addressing and taking mitigating measures. Concerns also exist over the contribution of various constituents of the financial sector to STRs.

27. Apart from banks, the relevant supervisory authorities lack clear powers to prevent criminals and their associates from holding or being the beneficial owner of a significant or controlling interest in FIs and designated non-financial businesses and professions (DNFBPs). The directors and senior officers of FIs and DNFBPs in sectors identified as higher risk are not subject to any fit-and-proper requirements. The infrastructure for regulation and AML/CFT supervision of the gaming industry remains unclear, with the five casinos continuing to operate without licence.

28. The formulation of the NRA has improved supervisors' basic understanding on ML/TF risks in financial sectors and institutions, but this has not translated into risk-based supervision of FIs by the FIU and prudential supervisory authorities. The FIU is significantly under-resourced in its role as the primary AML/CFT supervisor, yet there is a marked absence of mechanisms to facilitate collaboration between the FIU and other supervisory authorities.

29. Sanctions have been focused mainly on the banking sector, and do not appear to be sufficiently dissuasive, while supervision has not resulted in significant improvements in compliance. Nevertheless, awareness activities conducted by the FIU have contributed to improved awareness on AML/CFT reporting obligations among FIs and the relevant supervisory authorities.

30. Significant gaps remain with respect to understanding of ML/TF risks in the DNFBP sector. The lack of detailed know-your-customer (KYC) and CDD rules and the absence of supervisory resources further constrain effectiveness of overall AML/CFT supervision.

C.5 Transparency and beneficial ownership

31. Sri Lanka has not yet fully identified, assessed and understood the vulnerabilities and the extent to which legal persons and arrangements created in the country can be, or are being misused for ML/TF. This has led to the lack of a formal strategy to prevent legal persons and arrangements from being used for criminal purposes.

32. Sri Lanka's dependence on using existing information, including reliance on using existing information held by FIs and DNFBPs to mitigate the abuse of legal persons and arrangements, is not an effective mechanism as there are gaps in this information, including on beneficial ownership (refer IO.4 & 5).

33. Whilst there is some publicly available basic information on legal persons and arrangements, this is unverified and outdated.

C.6 International Cooperation

34. There are significant legal and structural limitations to Sri Lanka's formal international cooperation mechanisms, in particular the fact that their legislation requires a mutual legal assistance arrangement between Sri Lanka and the State requesting assistance before coercive assistance can be provided. This limits Sri Lanka's ability to provide assistance where a court order is required, namely assistance for freezing of funds and confiscation of assets. Sri Lanka has, however, provided non-coercive assistance such as instances where voluntary statements were recorded from witnesses in Sri Lanka based on requests from states that do not have a mutual legal assistance arrangement.

35. The central authorities for mutual legal assistance and extradition do not adequately maintain and monitor the status and timeliness of requests made and obtained, combined with varying levels of inter-agency coordination, this leads to a cumbersome system where the progress of requests is not always apparent.

36. However, there is evidence of international cooperation amongst the law enforcement agencies where assistance is initiated and monitored at an informal level. This is mainly for terrorism and TF investigations. Statistics also show evidence of requests made and received through the Egmont Group, with at least two case examples that led to information exchanged that assisted in criminal investigations in Sri Lanka and abroad.

D. Priority actions

37. The prioritised recommended actions for Sri Lanka, based on these findings, are:

Risk, policy and coordination

38. Sri Lanka should prioritise documentation of a national AML/CFT strategic plan for the next five years to manage and mitigate the risks identified in the NRA. As per the strategic plan, the competent authorities should develop their own strategies for the next three to five years and specific action plans to implement the national AML/CFT strategies

Money laundering and the use of financial intelligence

- There should be a clear policy and police directive to focus efforts on combating ML in line with the NRA. ML should be given prominence whereby, parallel investigations, and prosecutions for ML should be encouraged instead of relying on the prosecution of predicate crimes as deterrence.
- Authorities promulgate and implement policies and strategies to pursue confiscation, including repatriation, sharing and restitution, of criminal proceeds, instrumentalities, and property of equivalent value, particularly proceeds from corruption and drug trafficking.
- There is a need to develop and increase the competent authorities' technical expertise (including in financial investigations) to pursue ML investigations, prosecutions and asset recovery, particularly in anti-corruption, counter drug trafficking and other areas identified as top-tier risks in the NRA.
- The FIU should enhance its operational analysis procedures to ensure that essential and critical information, beyond what is provided in STRs/CTRs/EFTs, is included in the initial analysis stage.
- The FTRA should be amended to allow CID or police to have a legal basis to request all relevant information held by the FIU to facilitate ML and predicate crime investigations.
- The FIU should obtain and use all available and obtainable police information to augment the quality of operational analysis. To facilitate this, information exchange should be enabled which can be by way of written information exchange agreements between the competent authorities.
- There should be information exchange between other law enforcement agencies apart from CID and TID, such as the Narcotics Bureau and Commission to Investigate Allegations of Bribery or Corruption (CIABC), to enable pursuing of asset forfeiture as a means of depriving criminals of their criminal proceeds.

Terrorist financing and proliferation financing

- Authorities should use the CSTFA to prosecute the financiers of terrorism.
- Investment should be made in enhancing technical expertise to improve the effectiveness of terrorist financing prosecutions and asset confiscation proceedings under the CSTFA.
- The authorities should improve their databases and maintain data and statistics in relation to assets restrained and confiscated that relate specifically to the financing of terrorism.
- Sri Lanka should support effective implementation of targeted financial sanctions for TF by:
  - implementing all aspects of targeted financial sanctions pursuant to UNSCR 1373 as required by Recommendation 6, and
  - establishing effective supervision of FIs and DNFBPs for targeted financial sanctions.
- Material steps needs to be taken to implement targeted financial sanctions concerning UNSCRs 1718 and 1737 relating to the combating of financing of proliferation. These steps should include effective supervision and monitoring of compliance.
- Sri Lanka should implement measures to address the requirements of Recommendation 8, particularly to build a solid framework of preventive measures to apply to those NPOs that account for a significant portion of the financial resources under control of the sector, and a substantial share of the sector's international activities.

Preventive measures and supervision

- The relevant supervisory authorities should enhance assessment of fitness-and-propriety of key responsible officers in the banking, insurance and securities sectors, which should extend to the level of the ultimate beneficial owner or natural persons with material controlling interest.
- The development of a risk-based approach to AML/CFT supervision should be expedited, to assist the FIU and sectoral supervisors in better allocating their scarce supervisory resources to reporting institutions, products, services or delivery channels that have been identified as posing higher ML/TF risks. The immediate priority should be to develop and operationalize the AML/CFT risk-based supervision framework for the banking sector. The lack of clarity in the functions and accountabilities between the FIU and sectoral supervisors in monitoring AML/CFT compliance by FIs under each authority's purview should also be addressed.
- The supervisory authorities should take measures including issuing guidance to FIs to encourage the implementation of simplified CDD for certain products, particularly in sectors identified as lower risks in support of financial inclusion.
- All the constituents of the DNFBP sector (casinos, real estate agents, dealers in precious stones and metals, lawyers, notaries, accountants and trust and company service providers) should be brought within the ambit of the AML/CFT regulatory framework.
- The FIU should issue necessary guidance to financial institutions on risk-based approach to be followed by them for identifying, addressing and mitigating their ML/TF risks faced by them.
- Supervisory authorities should ensure the application of preventive measures by financial institutions on a risk-based approach to address and mitigate ML/TF risks faced by them.
- The FIU should issue enforceable rules under the FTRA to fully address the existing gaps in preventive measures. Consistent application of key requirements across financial sector on issues such as CDD, PEPs, beneficial ownership, high-risk countries, wire transfers requirements etc., must be applied by the FIs.

Transparency and beneficial ownership

- Complete an assessment of the risks relating to the misuse of legal persons and arrangements, and then undertake measures to mitigate the identified risks.
- Introduce mechanisms to ensure information on the beneficial owner of a legal person is maintained and accessible to competent authorities in a timely manner, and made publicly available.
- Revise the Trust Ordinance to require trustees to obtain and hold adequate, accurate and current information on the identity of settlors, trustees, protectors (if any), and beneficiaries of trusts, including natural persons who exercise ultimate effective control over a trust, and make that information available to competent authorities.

International cooperation

- Ensure that the Mutual Assistance in Criminal Matters Act (MACMA) framework allows Sri Lanka to be able to provide/obtain a wide range of mutual legal assistance regime (including coercive assistance) from a broader range of jurisdictions.
- Central authorities should implement a much more robust and efficient case management framework to ensure better coordination and monitoring of mutual legal assistance and extradition requests.
- Maintain more comprehensive statistics on mutual legal assistance and extradition requests in order to better monitor the efficacy of its international cooperation framework.

- Establish a mechanism to improve provision of beneficial ownership information for foreign requests beyond the basic information Sri Lanka is currently able to provide.

Table 1: Effective Implementation of Immediate Outcomes

EFFECTIVENESS – IMMEDIATE OUTCOMES
1. Risk, Policy and Coordination – *moderate level of effectiveness*
Sri Lanka is achieving Immediate Outcome 1 to some extent. Sri Lanka has reasonably assessed its ML and TF risks. Competent authorities have a sound understanding of the TF risks and coordinate comprehensively to address these risks. There is a clear government policy and imprimatur on countering TF, and disciplined inter-agency direction under the Chief of National Intelligence to achieve the objectives outlined in the National Security Strategy. This coordination mechanism, while initially focused on LTTE activities, now includes other national security threats, in particular drug and human trafficking, and to a lesser extent ML activities. Sri Lanka has a reasonable understanding of its ML risks. This understanding has not manifested in a national AML strategy, nor have there been coordinated activities to address key ML risks related to corruption or drug trafficking. The 2014 NRA is generally reasonable, although the self-assessment on national vulnerability is overly optimistic, the assumptions of structural or inherent vulnerabilities of the DNFBP sectors are not always sound, and the risks associated with legal persons and arrangements have not been adequately assessed. There has been limited interagency coordination on proliferation financing.
2. International Cooperation – *low level of effectiveness*
Immediate outcome 2 on international cooperation is achieved to a negligible extent. There are significant legal and structural limitations to Sri Lanka's formal international cooperation mechanisms. The central authority does not maintain and monitor the status and timeliness of requests made and obtained. This, combined with varying levels of interagency coordination, leads to a cumbersome system where the progress of requests is not always apparent. Given the acknowledged risk of LTTE funding from abroad, the limited statistics provided to the team on outgoing MLA requests and other requests are not consistent with the identified risks. There is evidence of more international cooperation amongst the law enforcement agencies where assistance is initiated and monitored at an informal level. Sri Lankan authorities have cited various platforms upon which such information sharing takes place, including Interpol, the Egmont Group, multilateral memorandums of understanding (MOUs) under International Organization of Securities Commissions as well as MOUs between the FIU and its foreign counterparts, including four with the South Asian Association for Regional Cooperation (SAARC) members.
3. Supervision – *low level of effectiveness*
Effective AML/CFT supervision is achieved to a negligible extent. Apart from banks, supervisory authorities lack clear powers to prevent criminals and their associates from holding or being the beneficial owner of a significant or controlling interest in FIs or DNFBPs. In addition, the directors and senior officers of FIs and DNFBPs in sectors identified as higher risk are not subject to any fit-and-proper requirements. The infrastructure for regulation and AML/CFT supervision of the gaming industry remains unclear, with the five casinos continuing to operate without licence. The formulation of the NRA has improved supervisors' basic understanding on ML/TF risks in financial sectors and institutions, but significant gaps remain with respect to DNFBPs. Sectoral risk assessments in the NRA have not manifested into the application of a risk-based approach to supervision of FIs. The FIU is significantly under-resourced in its role as the primary AML/CFT supervisor, yet there is a marked

absence of mechanisms to facilitate collaboration between the FIU and sectoral supervisors, that is, Central Bank of Sri Lanka, Securities and Exchange Commission and Insurance Board of Sri Lanka, to ensure robust monitoring of AML/CFT compliance by FIs on a risk-informed basis. AML/CFT supervision conducted by the FIU and other supervisory authorities on FIs are mainly rule based, with no specific focus on products, clients, channels, or institutions that pose higher ML/TF risk. The scope of supervision does not extend to assessment of FIs' effectiveness in identifying and addressing ML/TF risks.

With respect to DNFBPs, the lack of detailed KYC and CDD rules and the absence of supervisory resources further constrain effectiveness of overall AML/CFT supervision.

Apart from banks, no sanctions have been imposed on other FIs or DNFBPs. Efforts to widen the breadth and depth of enforcement activities are necessary for more effective implementation of AML/CFT preventive measures by all reporting institutions, particularly sectors identified as higher risk.

Supervision has not resulted in any significant improvements in compliance, with one noticeable exception, namely the discontinuation of transferable Certificate of Deposits by banking institutions in 2013.

Despite the resource constraints, the FIU should be commended for its ongoing awareness and engagement activities that have contributed to improved awareness on AML/CFT reporting obligations and supervisory expectations among FIs and the relevant supervisory authorities respectively.

As a priority, the relevant supervisory authorities should enhance assessment of fitness-and-propriety of licensed FIs in banking, insurance and securities sectors to the level of the ultimate beneficial owner or natural persons with material controlling interest. Sri Lanka should develop a risk-based approach to AML/CFT supervision to assist the FIU and sectoral supervisors in better allocating their scarce supervisory resources to reporting institutions, products, services or delivery channels that have been identified as posing higher ML/TF risks. This includes extending supervisory coverage to higher-risk DNFBPs, and then to all DNFBPs.

4. Preventive Measures – *low level of effectiveness*

Preventive measures have been achieved to a negligible extent. A risk-based approach to AML/CFT is yet to be introduced in a meaningful manner across the financial sector. In the absence of specific risk-based AML/CFT obligations, FIs across sectors view the compliance requirements more from a rule-based perspective rather than of risk. There are overall systemic issues concerning understanding, awareness and mitigating measures for ML/TF risks across the financial sector and DNFBPs. There has been no implementation of preventive measures amongst DNFBPs, even though the FTRA includes some AML/CFT requirements. There is a low level of awareness, understanding and appreciation of ML/TF risks in the DNFBP sectors as a whole.

Implementation of AML/CFT requirements varies across financial sectors and within each sector with regard to areas such as written AML/CFT policies, client profiling procedures, and transaction monitoring systems. This leads to inconsistent implementation. Technical and implementation deficiencies exist with CDD obligations, beneficial ownership, ongoing monitoring and consolidated group level compliance. STR reporting is uneven across the financial sectors. There are significant gaps in implementation of preventive measures in some key areas such as PEPs, wire transfers, MVTS, correspondent banking and higher-risk countries.

5. Legal Persons and Arrangements – *low level of effectiveness*

Immediate Outcome 5 is achieved to a negligible extent. The relevant competent authorities have not yet

fully identified, assessed and understood the vulnerabilities and the extent to which legal persons and arrangements created in the country can be, or are being misused for ML/TF. The recent national risk assessment only undertook a cursory analysis of this issue, and concluded that corporate and trust transparency needs to be improved.

Given a lack of risk assessment, there is no formal strategy to prevent legal persons and arrangements from being used for criminal purposes. There have been limited measures undertaken to mitigate the risks posed by share warrants.

There is information publicly available on the types of legal persons and arrangements in Sri Lanka. The majority of legal persons are companies registered with the Registrar-General of Companies. However, limited verification of information is undertaken at registration and information may be dated, as there is limited compliance with annual reporting requirements.

Sri Lanka's reliance on using existing information held by FIs and DNFBPs to mitigate the abuse of legal persons and arrangements is not an effective mechanism. There are significant gaps in preventive measures on CDD and beneficial ownership (refer IO.4 & 5).

There is no requirement for trustees to disclose their status to FIs and DNFBPs when forming a business relationship or carrying out an occasional transaction above the threshold.

The company registration system is manually based with limited monitoring and application of sanctions. Sri Lanka acknowledges that the Trusts Ordinance is outdated.

6. Financial Intelligence – *low level of effectiveness*

Sri Lanka has achieved a low level of effectiveness on financial intelligence. Sri Lanka's use of financial intelligence and other information for ML/TF and associated predicate offence investigations does not extend to the full range of potentially relevant information. The FIU receives STRs, cash transaction reports and electronic funds transfer reports from FIs, but not from DNFBPs. In general, information from reporting entities is limited to banks. Nevertheless, the FIU develops intelligence from the information contained therein. It is a solid foundation for intelligence building but development of a more comprehensive product is compromised by the FIU's failure to use systematic information on known or suspected criminals in Sri Lanka. The FIU uses limited available and obtainable law enforcement information in its operational analysis of STRs, which has had a consequential negative impact on the quality of intelligence products disseminated to the police.

There is no formal mechanism between the FIU and police to allow for more comprehensive information exchange between the police and the FIU, and particularly from the police to the FIU. There are insufficient resources devoted to operational and strategic analysis and a backlog of STR analysis of up to three to four months.

Sri Lanka's law enforcement agencies (LEAs) access a wider range of information than that of the FIU, but the lack of complex financial investigation and forensic accounting expertise has hampered the ability of the designated ML/TF investigation units to maximise the use of available information. The FIU has played a significant role in supporting the CID investigations of the Tamil Rehabilitation Organisation's finances.

7. ML Investigation and Prosecution – *low level of effectiveness*

Investigation and prosecution of ML are achieved at a low level. Sri Lanka possesses the foundation for an effective AML system, but there has been limited demonstration of effectiveness with only one ML conviction to date. The ML offence in the PMLA is technically sound, aside from some missing predicate offences, and there are two designated ML investigation teams within the police.

EFFECTIVENESS – IMMEDIATE OUTCOMES

The low prosecution and conviction rates for ML are mostly explained by the jurisdiction's overemphasis on prosecuting the predicate offence due to a lack of sufficient expertise and AML policy directive. Sri Lankan authorities find it less challenging to prosecute the predicate offence, as it is a quicker process given existing skills and resources. The same reasoning applies to cases involving foreign nationals. As such, ML investigations are predominately on local predicate offences, with little consideration of offences committed overseas, and nor are they focused on higher-risk areas such as corruption and drug trafficking. Furthermore, Sri Lankan authorities view the punishment of the predicate offence as sufficient deterrence and sanction, without the need to consider the additional ML offence.

8. Confiscation – *low level of effectiveness*

Confiscation for ML/TF and predicate crimes are achieved at a low level. Overall, aside from the efforts of the TID and CID for TF, and Sri Lanka Customs facilitated by their respective asset forfeiture legislation, Sri Lanka does not demonstrate characteristics of an effective system for confiscating proceeds and instrumentalities of crime. The low rates of investigation and prosecution of ML offences and proceeds of crime translate to even lower confiscation of criminal proceeds, and results in criminals substantially retaining their profits of crime. There is no indication that confiscation efforts are focused on the higher-risk areas. In particular, the agencies that deal with the two identified high-risk areas of drug trafficking and corruption do not appear to have developed any confiscation policies or strategies to proactively counter ML.

Sri Lanka has taken effective measures under the PSO and PTA to confiscate assets related to terrorism. In the seven-year period from 2007 to 2014 Sri Lanka confiscated LKR 507.6 million (USD 3.86 million[1]) in land and buildings; LKR 77.5 million (USD 590 000[1]) in vehicles; LKR 86.3 million (USD 657 000[1]) in equipment; and LKR 172.4 million (USD 1.3 million[1]) in money. A total of LKR 843.8 million (USD 6.4 million[1]) of LTTE assets has been confiscated.

9. TF Investigation and Prosecution – *Substantial level of effectiveness*

Investigation and prosecution of TF and confiscation of TF assets are achieved at a substantial level. Sri Lanka's counter-terrorism regime reflects high-level governmental commitment as well as multi-pronged and well-coordinated efforts, with a clear and high national-level policy focus on deterring terrorist activities especially through confiscating the assets of terrorists. This has been effective in countering the LTTE's operations in Sri Lanka.

High-level governmental coordination has also ensured that through intelligence sharing and investigation, action is taken against re-emerging terrorist and TF threats. However, it has been less effective in prosecuting TF cases with foreign elements given the challenges with international cooperation to obtain evidence to prosecute terrorist financiers. The Prevention of Terrorism Act (PTA) has provided an efficient avenue, including administrative means, for the authorities to pursue terrorists and their assets and it is evident from the statistics that this avenue has been broadly and effectively used; resulting in confiscation of significant funds and assets used for and intended to be used for TF being seized. This reflects the focus and dedication of the CID and the TID, which work effectively with the FIU and other government authorities.

There have been only three TF convictions under the PTA as well as three indictments for the TF offence under the CSTFA, with no convictions yet. CID and TID have nevertheless expressed that they are committed to shifting their focus to proceeding with charges under the CSTFA for appropriate future cases.

10. TF Preventive measures & financial sanctions – *low level of effectiveness*

Preventive measures and financial sanctions for TF are being achieved at a low level. Sri Lanka has

implemented targeted financial sanctions on UNSCR 1267, such as UN Regulations No. 2, gazettal of the Taliban and Al-Qaida Lists, and 14 subsequent amendments to December 2014. To date there have been no positive matches against the lists. This is consistent with the relatively lower TF risk profile for Al-Qaida and the Taliban in Sri Lanka.

Sri Lanka has designated entities and persons under UNSCR 1373, principally those associated with the LTTE. There are some issues with the implementation of 'freezing without delay' to date, but UN Regulations No.1 allow for freezing to be implemented forthwith upon designation and ex parte. All those designated are based in other jurisdictions. Authorities have approached those jurisdictions for support but with very limited positive outcomes to date. Eight domestic bank accounts have been frozen based on matches against the designated lists.

However, the lack of implementation of CDD beneficial ownership and preventive measures undermines the implementation of targeted financial sanctions for UNSCRs 1373 and 1267. Compounding this challenge for UNSCR 1373 is that until the amendments were made to UN Regulations No.1 on 11 December 2014, the previous freezing requirements did not cover persons or entities acting on behalf of, or at the direction of, designated persons or entities.

Sri Lanka displays awareness of the risk of NPOs being used for TF, although no outreach or other targeted activities have been conducted on TF to protect the sector in this regard. The NGO Secretariat exercises oversight of the sector and, inasmuch as it receives information from those organisations seeking registration, is able to conduct adequate background checks. However, the secretariat is not able to effectively monitor and support the sector.

11. PF Financial sanctions – *low level of effectiveness*

Financial sanctions for proliferation financing (PF) are achieved at a low level. Key agencies are aware of Sri Lanka's obligation under UNSCRs 1718 and 1737 (and successor resolutions). There is also some awareness amongst the more sophisticated FIs. However, no material steps have been taken to implement the requirements for targeted financial sanctions concerning UNSCRs 1718 and 1737. There is no legal regime for PF.

Table 2: Compliance with FATF Recommendations

Compliance with FATF Recommendations		
Recommendation	**Rating**	**Factor(s) underlying the rating**
1. Assessing risks & applying a risk-based approach	PC	• NRA process lacked a critical review mechanism that has affected the reasonableness of some conclusions on national and sectoral vulnerability, and no substantive assessment of legal persons and arrangements. • Lack of clear mechanisms for the dissemination of the results of the NRA to FIs and DNFBPs. • No national level risk-based approach to allocating resources and implementing measures to mitigate ML. • Exclusion of some deposit taking institutions from AML/CFT requirements or the application of simplified measures is not based on identified low risks. • No enforceable requirement for FIs and DNFBPs to take enhanced measures in areas identified as higher risks in the NRA or to ensure that this information is incorporated into their risk assessments. • No enforceable requirement for FIs and DNFBPs to undertake risk assessments or apply a risk-based approach to mitigating identified risks. • No regulatory instruction has been promulgated that would permit FIs and DNFBPs to take simplified measures to manage or mitigate risks if lower risks have not been identified, nor are criteria 1.9 to 1.11 met to allow for such an approach.
2. National cooperation and coordination	PC	• No documented national AML policies. • Few significant formal cooperation mechanisms between agencies, such as between financial supervisors. • Only preliminary cooperation on PF.
3. Money laundering offence	LC	• Predicate offences of counterfeiting and piracy of products, illicit trafficking in stolen and other goods (other than on a habitual basis), and tax crimes, are not covered.
4. Confiscation and provisional measures	PC	• Gaps in predicate offences. • There are no confiscation measures under the PMLA in respect to third parties. • Lack of ability to confiscate in the absence of a conviction where the offender has absconded or died. • No details of mechanisms or processes for managing or

Compliance with FATF Recommendations		
Recommendation	**Rating**	**Factor(s) underlying the rating**
		disposing of property frozen, seized and confiscated.
5. Terrorist financing offence	C	
6. Targeted financial sanctions related to terrorism & TF	LC	• Rights of bona fide third parties are not provided for in respect to UNSCR 1373 or 1267 implementation.
7. Targeted financial sanctions related to proliferation	NC	• No material/formal steps have been taken towards implementation.
8. Non-profit organisations	PC	• No indications as to review of the sector for TF vulnerabilities. • Outreach to NPOs does not include discussion of sector vulnerabilities to TF and how to protect the sector. • It is not clear that the national secretariat oversees NPOs that account for a significant portion of the financial resources or a substantial share of the sector's international activities. • Limited monitoring for compliance with registration and inadequate sanctions. • No contacts or procedures for NPO/TF matters for exchange of information outside of MLA, for example, bilateral exchange with foreign charities regulators.
9. Financial institution secrecy laws	LC	• Lack of clarity regarding ability of FIs to share CDD information among themselves in the absence of any specific provisions.
10. Customer due diligence	NC	• No specific obligation for authorized moneychangers and non-bank MVTS to conduct independent customer identification process based on reliable source documents. • No explicit obligation across financial sector to identify and verify the identity of person purporting to act on behalf of a customer. • No clarity, definition or consistent interpretation or application of term 'beneficial owner' across financial sector. • No direct obligations to proactively identify and verify the identity of beneficial owners across financial sector. • No requirements for authorized moneychangers and MVTS to obtain information on the purpose and intended

Compliance with FATF Recommendations		
Recommendation	**Rating**	**Factor(s) underlying the rating**
		nature of business relationship with clients. • No specific obligation across financial sector to ensure that document, data or information collected under CDD process is kept up to date and relevant. • No specific obligations for authorized moneychangers and non-bank MVTS to understand the nature of business, ownership, and control structure of legal persons and arrangements. • No specific documentary requirements in securities sector for identification of legal arrangements such as trusts. • No specific obligations for authorized moneychangers and non-bank MVTS where customers are legal persons and arrangements. • No specific documentary requirements for non-bank MVTS and authorized moneychangers put in place to identify and verify the identity of beneficial owners in case of legal persons and arrangements • In banking and securities sector, no specific requirements with regard to the timing of verification of beneficial owners. No explicit requirements with regard to the timing of verification of customers and beneficial owners for authorized moneychangers and non-bank MVTS. • No requirements for enhanced due diligence across financial sector in cases of higher ML/TF risks. • No specific basis for application of simplified CDD measures in sectors other than securities and insurance. • No enabling provision, generally allowing FIs not to pursue CDD process for possible tipping off concerns.
11. Record keeping	LC	• No specific obligations for FIs to maintain account files. • Period of 6 years for maintaining business correspondence records is linked to the date of transaction/correspondence and not from termination of business relationship.
12. Politically exposed persons	NC	• Other than in the insurance sector, no specific obligations exist for putting in place a risk management system: to determine whether a customer or the beneficial owner is a foreign PEP; for obtaining senior management approval for continuing business relationship for existing customers and beneficial owners identified as foreign

Compliance with FATF Recommendations		
Recommendation	**Rating**	**Factor(s) underlying the rating**
		PEPs; for taking reasonable measures to establish the source of wealth and the source of funds of customers and beneficial owners identified as foreign PEPs; and, for conducting enhanced ongoing monitoring of that relationship. • Requirements in insurance sector do not extend to identification of beneficial owners of PEPs, for taking senior management approval for continuing business relationship with PEPs and for taking reasonable measures to identify source of wealth and funds of beneficial owners. • International organizations not specifically covered. No additional measures put in place for domestic PEPs. • Business associates and close relatives not specifically covered under relevant requirements due to shortcomings identified as above. • No requirements in insurance sector to determine whether the beneficiaries and/or the beneficial owner of the beneficiary are PEPs.
13. Correspondent banking	NC	• KYC/CDD rules do not include specific requirements for FIs to understand fully the AML/CFT responsibilities of each institution, and to obtain approval from senior management, before establishing new correspondent relationships. • Absence of requirements pertaining to payable-through accounts and specific prohibitions from dealing with shell banks in KYC/CDD rules for all FIs. • Rules do not explicitly preclude shell banks.
14. Money or value transfer services	NC	• There remains an absence of a proper licensing/registration regime for legal non-bank MVTS providers. • Efforts by authorities to identify illegal MVTS providers and to apply appropriate sanctions are not commensurate with the high risk posed by the sector. • Inadequate monitoring of MVTS providers for AML/CFT compliance, with over reliance on foreign MVTS providers to ensure AML/CFT compliance by local MVTS providers. • Absence of specific requirements in relation to agents of MVTS providers.

Compliance with FATF Recommendations		
Recommendation	**Rating**	**Factor(s) underlying the rating**
15. New technologies	PC	• FIs are not required to identify and assess the ML/TF risks that may arise in relation to the development of new products and business practices, and to undertake ML/TF risk assessments prior to the launch or use of new products, practices, and technologies.
16. Wire transfers	NC	• No de minimis threshold prescribed in KYC/CDD rules, nor are there any requirements for all cross-border wire transfers to be accompanied by the necessary beneficiary information. • No specific requirements relating to wire transfers for intermediary FIs, beneficiary FIs, or for MVTS providers or their agents.
17. Reliance on third parties	NC	• No requirements in relation to introducers for securities sector. • KYC/CDD rules do not explicitly require banks and finance companies to be ultimately responsible for CDD information of business relationships obtained through introducers, and to have regard to information available on country risk when dealing with non-resident customers. • No requirements in relation to financial group for all FIs.
18. Internal controls and foreign branches and subsidiaries	PC	• No explicit requirements to have independent audit function to test the AML/CFT systems across financial sector. • No requirements for financial groups to have group-wide programmes and measures against AML/CFT. • No specific requirements for FIs across financial sector to apply additional measures to manage ML/TF risks in case host country does not permit implementation of home country AML/CFT measures.
19. Higher-risk countries	NC	• No enforceable requirements across financial sector to apply enhanced CDD measures, proportionate to the risks, when called upon to do so by FATF. • No enforceable requirements across financial sector to apply countermeasures proportionate to the risks when called upon to do so by FATF or independent of any call. • No measures put in place across financial sector to proactively identify countries having weaknesses in the AML/CFT systems and advise FIs of such concerns.
20. Reporting of suspicious	C	

Compliance with FATF Recommendations		
Recommendation	**Rating**	**Factor(s) underlying the rating**
transaction		
21. Tipping-off and confidentiality	C	
22. DNFBPs: Customer due diligence	NC	• The requirements in the Financial Transactions Reporting Act No. 6 of 2006 (FTRA) do not cover the scope of CDD mandated under R.10, nor does it set thresholds for CDD by casinos and dealers in precious stones and metals. • No detailed KYC/CDD rules have been issued for all DNFBPs, and no enforceable requirements are in place with respect to PEPs, new technologies or reliance on third parties.
23. DNFBPs: Other measures	PC	• The gaps in relation to R.18 (internal controls and foreign branches) and R.19 (higher-risk countries) for FIs also apply to DNFBPs.
24. Transparency and beneficial ownership of legal persons	NC	• No substantive assessment of the ML/TF risks associated with legal persons and arrangements. • The mechanisms that identify and describe types, forms and basic features of legal persons, and processes for creation of those legal persons, do not require obtaining and recording beneficial ownership information. • There are no mechanisms to ensure that information on the beneficial ownership of a company is obtained by the company and available to a competent authority. • The use of existing information does not allow for beneficial ownership to be determined in a timely manner by a competent authority given the gaps in CDD beneficial ownership requirements under R.10. • The lack of beneficial ownership information has a cascading impact on c.24.7, 24.8, 24.10 and 24.14. • There are no mechanisms to ensure that share warrants are not misused for ML or TF. • There is no evidence that Sri Lanka monitors the assistance it receives from other countries in response to requests for basic and beneficial ownership information, or requests for assistance in locating beneficial owners residing abroad.
25. Transparency and beneficial ownership of legal arrangements	NC	• There is no requirement that: – trustees of any express trust governed under the law obtain and hold adequate, accurate, and current

Compliance with FATF Recommendations		
Recommendation	**Rating**	**Factor(s) underlying the rating**
		information on the identity of the settlor, the trustee(s), the protector (if any), the beneficiaries or class of beneficiaries, and any other natural person exercising ultimate effective control over the trust; – trustees of any trust hold basic information on other regulated agents of, and service providers to, the trust, including investment advisors or managers, accountants, and tax advisors; or – professional trustees maintain this information for at least five years after their involvement with the trust ceases. • There are no measures to ensure that trustees disclose their status to FIs and DNFBPs when forming a business relationship or carrying out occasional transactions above the threshold. • This has a cascading impact, e.g., c.25.5 and 25.6. • There is no requirement that any information held by trustees is up to date or updated on a timely basis. • There are no proportionate and dissuasive sanctions available to enforce the requirement to exchange information with competent authorities in a timely manner.
26. Regulation and supervision of financial institutions	PC	• No uniform obligations for fit-and-proper criteria across financial sector. Criteria do not extend to significant shareholders and beneficial owners in case of finance companies, insurance companies, securities sector, authorized moneychangers and non-bank MVTS. • Other than in banking sector, provisions for consolidated and group supervision not laid down in statute, operational requirements or otherwise. • AML/CFT supervision of FIs not explicitly informed by AML/CFT risks (institutional or country risk). • No specific requirement to review the AML/CFT risk profile of FIs/group periodically or events based.
27. Powers of supervisors	C	
28. Regulation and supervision of DNFBPs	NC	• Casinos remain unlicensed and are not subject to AML/CFT supervision. • No system in place for monitoring DNFBPs compliance to AML/CFT requirements, be it on a risk-sensitive basis

Compliance with FATF Recommendations		
Recommendation	**Rating**	**Factor(s) underlying the rating**
		or otherwise. • No designated competent authority or self-regulatory body responsible for ensuring AML/CFT compliance by other DNFBPs.
29. Financial intelligence units	PC	• There is no provision under the FTRA for the FIU to disseminate upon request from law enforcement. • The FTRA only provides for request for additional information from reporting entities that have made a report (s), or has given information to the FIU, and not from reporting entities that have not filed a report (s). • The FIU does not access the widest possible range of information, in particular police information, to undertake its analytical functions. • Only preliminary strategic analysis on certain areas of ML typologies was conducted in 2013.
30. Responsibilities of law enforcement and investigative authorities	C	
31. Powers of law enforcement and investigative authorities	LC	• There is no specific provision in any legislation empowering police to use special investigation techniques such as undercover operations, intercepting communications, assessing computer systems and controlled delivery. • Lack of mechanism to identify accounts in a timely manner.
32. Cash couriers	PC	• The declaration requirement is only applied to foreign currency, not Sri Lankan currency. • The declaration requirement for foreign currency does not cover the full range of bearer negotiable instruments as restricted by the definition of foreign currency in the Exchange Control Act. • There is no mechanism for the declaration information to be shared with the FIU.
33. Statistics	PC	• Statistics are not sufficiently comprehensive on matters relevant to the effectiveness and efficiency of Sri Lanka's AML/CFT system, particularly: – property frozen, seized and confiscated; and – mutual legal assistance or other international requests for cooperation made and received.

Compliance with FATF Recommendations		
Recommendation	**Rating**	**Factor(s) underlying the rating**
34. Guidance and feedback	PC	• Other than on UNSCRs 1267 and 1373, limited supervisory instructions issued. • The guidelines and circulars are limited to banks, licensed finance companies, stockbrokers, and insurance companies. • FIU has not provided any substantive feedback on STR reporting to FIs.
35. Sanctions	PC	• While a range of sanctions is in place for FIs and DNFBPs, the available sanctions are not sufficiently dissuasive. • Absence of proportionate and dissuasive sanctions for DNFBPs with respect to KYC/CDD rules, and in relation to NGOs given the deficiencies observed in R.8.
36. International instruments	LC	• The Vienna, Palermo and Merida Conventions have not been fully implemented.
37. Mutual legal assistance	PC	• The MACMA does not provide for the application of its provisions on the basis of reciprocity. For this reason, the range of assistance that requires coercive use of powers is only available under the MACMA to prescribed Commonwealth countries and specified countries with which Sri Lanka has an agreement. • Sri Lanka does not have a comprehensive case management system that puts in place standard procedures, accountability and clear time lines for handling MLA cases.
38. Mutual legal assistance: freezing and confiscation	PC	• The MACMA does not provide for the application of its provisions on the basis of reciprocity. For this reason, assistance cannot be provided for freezing and confiscation to non-prescribed/specified countries. The exception to this is assistance relating to offences under the Convention on the Suppression of Terrorist Financing Act where the full range of assistance under the MACMA can be provided on the basis of the Terrorist Financing Convention. • Assistance in identifying, locating or assessing the value of property, and possibly freezing and confiscation, do not extend to instrumentalities intended for use and property of corresponding value. • There is insufficient clarity in relation to the ambit of the provisions in the MACMA for asset tracing, freezing and confiscation. There is no documented guidance material

Compliance with FATF Recommendations		
Recommendation	**Rating**	**Factor(s) underlying the rating**
		or mechanisms that suggest that the provisions in the MACMA for asset tracing, freezing and confiscation are wide enough to cover a wide range of foreign orders.
39. Extradition	LC	• Sri Lanka does not have a comprehensive case management system that establishes clear timelines, processes for prioritisation or that provides clarity on the coordination between the various agencies involved in dealing with extradition requests. • Sri Lanka does not have simplified extradition arrangements with other jurisdictions such as fellow members of the South Asian Association for Regional Cooperation, or a simplified extradition mechanism for consenting persons who waive formal extradition proceedings.
40. Other forms of international cooperation	PC	• There does not appear to be any mechanism or examples of international cooperation between the Commission to Investigate Allegations of Bribery or Corruption with its foreign counterparts. • There does not appear to be any mechanism or examples of exchange of information between financial supervisors for combating money laundering and terrorism financing. • A court order may be required for exchange of banking information. • There does not appear to be any documented mechanisms or examples of exchanging information with foreign non-counterparts.

SRI LANKA 2015 MUTUAL EVALUATION REPORT

Preface

This report summarises the AML/CFT measures in place in Sri Lanka as at the date of the onsite visit. It analyses the level of compliance with the FATF 40 Recommendations and the level of effectiveness of Sri Lanka's AML/CFT system, and recommends how the system could be strengthened.

This evaluation was based on the 2012 FATF Recommendations, and was prepared using the 2013 Methodology. The evaluation was based on information provided by Sri Lanka, and information obtained by the evaluation team during its onsite visit to Sri Lanka from 01 to 12 December 2014 and during a face-to-face meeting with Sri Lanka from 18 to 22 May 2015.

The evaluation was conducted by an assessment team consisting of:

- Mr Russell Wilson, General Counsel, Legal and Policy, Australian Transaction Reports and Analysis Centre (AUSTRAC), Australia, legal expert
- Ms Ravneet Kaur, Deputy Senior State Counsel, International Affairs Department, Attorney General's Chambers, Singapore, legal expert
- Ms Lim Hsin Ying, Deputy Director, Financial Intelligence and Enforcement Department, Bank Negara Malaysia, Malaysia, financial expert
- Mr Ashish Kumar, Deputy General Manager, Office of International Affairs, Securities and Exchange Board of India, India, financial expert
- Mr Bernard Law, Police Superintendent, Head of Joint Financial Intelligence Unit, Hong Kong, China, law enforcement/financial intelligence unit expert
- Mr Tshering Dhendup, Deputy Head of FIU, Royal Monetary Authority of Bhutan, Bhutan, additional law enforcement/financial intelligence unit expert
- Mr Lindsay Chan, Principal Executive Officer, APG Secretariat
- Ms Jennifer Ford, Executive Officer, APG Secretariat

The report was reviewed by:

- Ms Ragni Singh, Manager, Financial System Supervision, Reserve Bank of Fiji, Fiji
- Ms Diana Firth, Deputy Director, CFATF Secretariat
- Mr Stuart Yikona, Senior Financial Sector Specialist, Financial Market Integrity, The World Bank
- Ms Lia Umans, Policy Analyst, AML/CFT, FATF Secretariat

Sri Lanka previously underwent an APG mutual evaluation in 2006, conducted according to the 2004 FATF Methodology. The 2006 evaluation has been published and is available at www.apgml.org.

Sri Lanka's 2006 mutual evaluation concluded that the country was compliant with three Recommendations, largely compliant with four, partially compliant with 24, and non-compliant with 18. Sri Lanka was rated compliant or largely compliant with only one of the 16 core and key Recommendations. At the conclusion of the APG's follow-up for Sri Lanka in 2013, Sri Lanka had four of the 16 core/key Recommendations still at the partially compliant/non-compliant level.

1. MONEY LAUNDERING/TERRORIST FINANCING (ML/TF) RISKS AND CONTEXT

1. The Democratic Socialist Republic of Sri Lanka is an island country that covers a total area of 65 610 km². Its coastline is 1 340 km long. The capital is Sri Jayawardenepura Kotte and is a suburb of Sri Lanka's largest city, Colombo. Sri Lanka has a population of approximately 20.3 million people, and in 2013, its gross domestic product (GDP) was USD 71 billion[2]. Sri Lanka's main economic sectors are tourism, tea exportation, clothing manufacture, rice production, and other agricultural products. In addition to these economic sectors, overseas employment contributes substantially in foreign exchange.

2. Sri Lanka is a democratic republic and a unitary state. The head of state is the president and the government is comprised of the President of Sri Lanka and the Parliament of Sri Lanka, including a cabinet of ministers designated by the president. The parliament serves as a unicameral legislature. Sri Lanka uses a primarily common-law system, with criminal law largely formed by its British colonial past. Primary legislation is in the form of laws. Secondary legislation is in the form of regulations.

3. Sri Lanka has nine autonomous provinces. The governors of the provinces may pass particular statutes consistent with the Constitution and any laws passed by the parliament. Anti-money laundering/counter-terrorist financing (AML/CFT) regulatory powers reside at a national level.

1.1 ML/TF Risks

4. This section of the mutual evaluation report presents a summary of the assessment team's understanding of the ML/TF risks in Sri Lanka. Sri Lanka's assessment and understanding of the risk is set out in Chapter 2.

5. This summary is based on material provided by Sri Lanka, including the October 2014 National Risk Assessment (NRA) and National Security Strategy, and open source material, in addition to information gathered from discussions with competent authorities and the private sector during the onsite visit and face-to-face.

6. **The assessment team considers the following two as the main risk areas for ML because they pose greater systemic challenges and broader, negative societal impact than other ML risks**:

> *Drug trafficking:* According to the NRA, drug-related offences and proceeds are the highest among all predicate crimes for ML. The drug trafficking threat originates primarily from the trafficking of heroin from India and Pakistan for consumption in Sri Lanka, and as a transit point for heroin heading to other destinations. The measures undertaken have been limited by capacity constraints and existing sectoral and national vulnerabilities.
>
> *Corruption:* Corruption is also identified in the NRA's top-tier category of predicate crimes for ML. Corruption-related proceeds are a significant risk given the systemic negative impact on society. Compounding this risk is the lack of corruption-related ML investigations, prosecutions, and convictions. Based on statistics provided by Sri Lanka, there were 7706 reported cases of bribery and corruption between 2008 and 2013. Of those, 336 were prosecuted, with only one leading to an ML investigation.

7. **The assessment team considers other predicate offences identified in the NRA as important ML risks, but not in the same categories as illicit proceeds from corruption and drug trafficking.** These other risks include fraud (cheating, criminal breach of trust, criminal misappropriation), robbery, credit and debit card fraud, human smuggling/trafficking, extortion and counterfeiting of currency. Fraud and human trafficking are recurrent risks. According to Sri Lanka's crime statistics there were 39 068 and 11 344 cases of fraud investigations and prosecutions respectively between 2008 and 2012. On human

[2] International Monetary Fund (IMF) estimate for gross domestic product in USD, 'current prices'

trafficking, Sri Lanka is primarily a source country. There are about 1.1 million unskilled Sri Lankans working abroad, some in conditions of forced labour. The risk posed by human smuggling has declined in recent years with successful cooperation between Sri Lanka and Australia in deterring people smuggling. Credit card and debit card fraud is increasing as the economy grows and card usage increases, although it is more limited to hotels and higher end retail outlets.

8. **Terrorist financing associated with the Liberation Tigers of Tamil Eelam (LTTE) remains, despite its military defeat in 2009.** The LTTE international network is still actively pursuing the objectives of the LTTE and certain elements of the Tamil diaspora are providing support for possible LTTE resurgence. However, according to Sri Lankan authorities the funding base has declined by 80% post 2009. Nevertheless, there have been three LTTE incidents over the last two years, the most recent in April 2014, which involved an attempted resurgence of the LTTE in the Jaffna Peninsula. The National Security Strategy covers comprehensively the issue of the ongoing threat and risk associated with the LTTE and other emerging threats. The non-sanitised version of the NRA also goes into further detail than the summary provided in the sanitised version. Universally, competent authorities demonstrate a high level of understanding of the ongoing terrorist threats and TF risks, and remain vigilant against any possible LTTE resurgence, or other activities that may cause internal conflict. The NRA, National Security Strategy and officials met during the onsite indicate that the banking sector had been used to facilitate financing of terrorist activities. NGOs and MVTS hawalas have also been used to channel funding for terrorism.

9. There is a nexus between LTTE TF and ML. The LTTE was known to engage in criminal activities, including human trafficking, people smuggling and arms trafficking to support its activities. There are also publicly available reports of LTTE affiliates based overseas being investigated and prosecuted for ML. Likewise, as noted in the National Security Strategy, as a result of the rise of terrorism and the civil war Sri Lanka experienced previously, and the response required from the state, a considerable amount of arms and ammunition inadvertently fell into the hands of criminals.

10. **The cross-border connection is not limited to the financing of LTTE, as Sri Lanka's ML/TF risks also involve transnational illicit flows because of Sri Lanka's geographic location.** Sri Lanka is a major transhipment port and accounts for 70% of all ships sailing to and from South Asia. Many of the world's most important sea-lanes are located in close proximity to Sri Lanka. This structural feature has exposed Sri Lanka to drug trafficking, human trafficking and people smuggling. Authorities consider that the proceeds of drug trafficking are mostly laundered back to their source jurisdictions and for human smuggling, to end destinations or transit points and not just within Sri Lanka.

11. **Overall, Sri Lanka is not considered an end destination for proceeds of crime.** Sri Lanka is not an important regional financial centre and the civil war years have deterred private sector flows into the country, although that is changing in the hotel sector because of increased tourism.

12. **It is more likely that proceeds of crime are exported to foreign jurisdictions from Sri Lanka**, **a reverse of the situation with TF, where funds are imported into Sri Lanka.** There have been reported cases of proceeds of corruption being laundered into overseas bank deposits or property offshore, and law enforcement investigations have indicated that drug money is laundered offshore.

13. **The NRA reasonably considers the non-bank financial sector and certain designated non-financial businesses and professions (DNFBPs) as higher risks.** In addition to the usual higher risks associated with the banking and securities sector based on international typologies, casinos, real estate agents and dealers in precious stones pose higher risks in Sri Lanka because of the absence of any meaningful prudential and AML supervision, although there is some basic prudential supervision for precious stones. While the casino sector is currently limited to five small operations, and no junket tours, there is potential for further expansion. The commercial real estate sector is experiencing significant growth because of the booming economy, and Sri Lanka is one of the world's major producers of precious stones.

14. **Informal money or value transfer service (MVTS) providers pose significant vulnerabilities and TF risks**. The NRA appears correct in identifying the informal MVTS sector as the highest risk sector. Based on the NRA the alternative remittance sector accounts for 15% to 43% of all private remittances. Most remittances, either formal or informal, come from Sri Lankans living or working in the Middle East region. Informal remittances are commonplace in Sri Lanka, particularly to facilitate Sri Lankans working overseas in sending money home. Although the LTTE has exploited this channel for TF, most funds remitted from abroad are for legitimates purposes, such as overseas workers remitting funds to their relatives in Sri Lanka.

1.2 Materiality

15. **Sri Lanka was engaged in a civil war between the government and the LTTE for nearly 30 years until the conflict ended in May 2009.** Some laws or statutes enacted before or during the civil war are still used. These include legislation such as the Prevention of Terrorism Act and Public Security Ordinance (PSO) No. 25 of 1947 (as amended). Given the climate in which they were previously enacted or amended, they give greater powers of search, arrest, and detention, including detention without charge and reverse burden of proof on the accused.

16. **Sri Lanka is an emerging economy reaping the peace dividends from the end of the civil war in 2009**. Per capita income growth has been averaging over 7% since that time. It is attracting increasing foreign investment and tourism because of the stable security environment. The commercial real estate sector is growing rapidly because of broader economic growth, international and domestic investment, including the government making significant investments in infrastructure. Overall, China and India are the two largest bilateral partners, both with significant trade with and investments in Sri Lanka. Sri Lanka has other close bilateral relationships with jurisdictions in the Indian Ocean and South Asia, and is a member of the South Asian Association for Regional Cooperation (SAARC), which is an economic and geopolitical organisation of eight jurisdictions that are primarily located in South Asia.

17. **The banking sector accounts for 92% of all financial sector deposits**. There are 33 licensed banks, of which six are systemically important from a domestic perspective. Two state-owned banks account for half of the sector's assets. There are 12 foreign banks; they have a relatively small share of the banking sector's deposits. The financial sector is changing as Sri Lanka is undergoing a process of consolidation of the banking sector and non-banking financial sector.

18. **The DNFBP sector includes five casinos and a vibrant gems industry**. The casinos are relatively small operations and there are no apparent junket operations. However, DNFBPs are not currently supervised for AML/CFT, although there are basic customer due diligence (CDD) and suspicious transactions reporting (STR) requirements in the Financial Transactions Reporting Act (FTRA). The NRA has also identified ML/TF risks arising from unregulated DNFBPs.

19. **The size of the informal economy is significant**. According to a World Bank assessment in 2010, the overall informal economy is estimated at 44% of GDP.

20. Sri Lanka has active policies in support of financial inclusion. According to the World Bank Global Findex Database 2014[3], Sri Lanka has achieved a high level of financial inclusion compared to other South Asian countries. Approximately 80 percent of adults (15 years old and above) in Sri Lanka have formal accounts with financial institutions (FIs), which is the highest in South Asia. A wide range of FIs provide services such as loans, savings, pawning, leasing and finance, and remittance and money transfer facilities to vulnerable groups.

21. Commercial banks have introduced several measures to provide financial services to migrant workers. Migrant remittances are the highest foreign exchange earner in Sri Lanka, but 45 % of total

[3] Source: http://datatopics.worldbank.org/financialinclusion/country/sri-lanka

remittances of migrant workers are sent through informal channels. To try and capture such transfers, commercial banks have introduced innovative products to bring these remittance flows into the formal financial sector.

22. **There are strict controls on the cross-border movement of currency and gold as prescribed principally in the Foreign Exchange Control Act**. In addition to the declaration threshold of USD 15 000 for foreign currency or equivalent, cross-border movement of gold, jewellery and gemstones must also be declared on arrival or departure. Failure to declare can lead to forfeiture of legally acquired valuable assets. There have been recent surges in gold imports into Sri Lanka. This may be because of attempts to achieve arbitrage profits from importing gold and then exporting to India.

1.3 Structural Elements

23. **The building blocks for a legal framework required for a sound AML/CFT system are generally in place in Sri Lanka**, **but resources and skills required are incomplete and pose ongoing obstacles to effective implementation.** There are also challenges to implementation of the rule of law, as in most other developing economies. Further enhancements are required to the legal and regulatory framework to bring Sri Lanka into greater compliance with the international FATF standards.

24. **There are issues associated with the resourcing of the judicial system**. The system is somewhat overloaded although there are efforts to address this. Criminal court proceedings can take five to eight years to conclude. The system is hindered somewhat by outmoded technology and the previous decades' dedication to combating the LTTE; however, the judicial system is generally capable and resilient.

25. **The governing institutions of Sri Lanka are well established**. Most institutions such as the central bank, supervisors, police and the justice system function as expected but at varying levels of effectiveness in terms of AML/CFT. The government has made a commitment to AML/CFT through the establishment of the FIU and the national AML/CFT coordination body, the Advisory Board to the FIU.

26. **The professions of law and accountancy are well developed**. Legal professionals in Sri Lanka are regulated by the Supreme Court. The Bar Association of Sri Lanka acts as the self-regulatory body (SRB) for the profession. Notaries are governed by the Notaries Ordinance, which is administered by the Registrar General's Department (RGD). Several professional bodies offer professional accounting qualifications and serve as SRBs for their respective members such as the Institute of Chartered Accountants of Sri Lanka (ICASL), Chartered Institute of Management Accountants of the United Kingdom (CIMA), Association of Chartered Certified Accountants (ACCA), Association of Accounting Technicians of Sri Lanka (AAT) and Certified Management Accountants of Sri Lanka (CMA).

1.4 Other Contextual Factors

27. **Sri Lanka's anti-corruption body, the Commission to Investigate Allegations of Bribery or Corruption (CIABC), seems mostly focused on low-level bribery crimes and is lacking in effective intra-government connexions when undertaking its work**. CIABC is cognisant of the problem of corruption and noted that the Chair is appointed by the President. However, the anti-corruption framework itself is limited by its exclusive legal purview of public servants and by the effectiveness of the responsible institutions. There are policies and processes to enhance transparency, including the provision of annual reports and staff inductions on behaviour and ethics. The effectiveness of such measures has not been independently evaluated.

28. The results of international perception indicators, such as the World Justice Project's Rule of Law Index and Transparency International's Corruption Perception Index are not consistent, with the former placing Sri Lanka 39th out of 99 jurisdictions in 2013, and the latter placing it 91st of 177 jurisdictions.

1.5 Scoping of Higher-Risk Issues

29. During the onsite visit, and in consultation with the Sri Lankan authorities, the assessment team gave increased focus to the following areas identified in the scoping note. The areas detailed are not only issues related to higher ML/TF risks, but also other aspects of the AML/CFT regime in Sri Lanka based on information provided to, or gathered by the team before or during the onsite:

- **Predicate offences particularly drug trafficking and corruption were examined in detail to assess Sri Lankan institutions' understanding of the ML and TF risks from such illicit activities and measures undertaken to mitigate such risks.** This included measures undertaken by law enforcement and preventive measures, the latter including more detailed investigations of enhanced CDD, cash transactions, beneficial ownership concerns and politically exposed persons (PEPs).

- **TF issues,** including the use of other criminal justice provisions to disrupt TF activities, domestic coordination and implementation of UNSCR 1373 designations.

- **Risk-based approach by supervisors and the financial sector,** not only in relation to higher risks but also to lower-risk areas.

- **ML investigations and convictions**, in particular, focus on why there has only been one ML conviction to date.

- **Unregulated sectors** and the ML/TF risks posed, in particular casinos and alternative remittance providers.

- **Staffing and resourcing issues** among key competent authorities and the Supreme Court of Sri Lanka, given the obstacles posed by inadequate resources to effective implementation in the criminal justice system.

2. NATIONAL AML/CFT POLICIES AND COORDINATION

Key Findings

- Sri Lanka has an understanding of most of its ML threats. However, the demonstrated levels of understanding of ML risks are not high across all competent authorities or reporting entities, with the DNFBPs exhibiting the lowest level of understanding, and there is some underestimation of ML risks by some authorities and financial institutions.
- Sri Lanka has an acute understanding of TF risks shaped by years of war between the Sri Lankan Government and the Liberation Tigers of Tamil Eelam (LTTE) until 2009. Although the terrorist threat has greatly diminished, the TF risk nevertheless remains as shown by LTTE-related incidents since 2009, with the most recent one in April 2014. This has been documented in the non-sanitised version of the NRA, National Security Strategy and confirmed by TF-related agencies met during the onsite.
- Overall, the NRA conclusions reasonably reflect Sri Lanka's main ML/TF risks. However, its self-assessment on national vulnerabilities is overly positive, assumptions for some sectoral vulnerability assessments are not sound, and assessment of legal persons and arrangements is lacking. Nevertheless, the overall conclusions on ML and TF risks are reasonable.
- Generally, the views on threats and on ML/TF risks expressed by officials and private sector representatives to the assessment team are consistent with the findings in the NRA.
- Sri Lanka's National Security Strategy focuses on countering terrorism, including TF, and other security threats such as drug trafficking and human smuggling. This strategy does not cover AML or corruption.
- There is no articulated national AML strategy, the Security Strategy does not cover AML, and law enforcement or supervisory authorities did not provide the assessment team with any evidence of sector-specific AML strategies.
- There is sound coordination via the Office of the Chief of National Intelligence on terrorism, including CFT, and there are ongoing activities to identify and mitigate TF risks.
- AML activities are not well coordinated. While there is some coordination of AML activities at the weekly meetings chaired by the Chief of National Intelligence, this does not cover ML risks associated with corruption and predicate offences as they are not considered national security concerns. The FIU Advisory Board coordination role has been limited to specific outputs such as amendments to legislations, NRA and preparations for the mutual evaluations. Moreover, there is a fundamental concern that the authorities are not giving sufficient priority to combatting ML.
- There has been little interagency coordination on proliferation financing.

2.1 Background and Context

(a) Overview of AML/CFT Strategy

30. **Sri Lanka does not have an articulated national AML strategy, nor did authorities, either law enforcement or supervisory, provide the assessment team with any evidence of sector-specific strategies related to AML.** The FIU, which is based within the Central Bank of Sri Lanka, did provide its strategy as part of the Central Bank of Sri Lanka's strategy.

31. There is a National Security Strategy that focuses on countering terrorism, including TF, and predicate crimes that are considered national security threats such as drug trafficking and human smuggling. The strategy does not extend to ML.

32. The national risk assessment (NRA) includes a list of recommendations that, once adopted, will provide the basis for an AML/CFT strategy. Nevertheless, despite the absence of these measures Sri Lanka was able to mobilise resources and amend AML/CFT laws on more than one occasion in the last few years to bring its AML/CFT regime further into compliance with the FATF standards.

(b) The Institutional Framework

33. The following are the primary ministries, agencies and authorities responsible for formulating and implementing the government's AML/CFT policies:

- Attorney General's Department (AGD): Administratively located in the Ministry of Justice. AGD conducts prosecutions and provides advice to law enforcement and other related agencies on investigations and briefs. ML prosecutions are conducted by the AGD on indictment before the High Court.
- Central Bank of Sri Lanka (CBSL): The Central Bank holds responsibility for much of the financial supervision. It also houses the financial intelligence unit. At the time of the onsite visit, the CBSL, under Ministry of Finance, was broadly structured as follows:
    - Department of Banking Supervision, responsible for the administration of the Banking Act 1988, relating to licensing and the supervision of commercial banks and licensed specialised banks.
    - Financial Intelligence Unit (FIU), provided for in section 15 of the Financial Transactions Reporting Act No. 6 of 2006 (FTRA), which empowers the FIU to receive reports, conduct analysis and disseminate to either the relevant law enforcement or supervisory authority.
    - Department of Supervision of Non-Bank Financial Institutions is responsible for the administration of the provisions of the Finance Companies Act, which imposes responsibilities relating to licensing and the supervision of all deposit taking companies other than institutions licensed as commercial banks and licensed specialised banks.
    - Exchange Control Department, whilst primarily responsible for management of the foreign exchange function in Sri Lanka on behalf of the government also supervises moneychangers.
- Commission to Investigate Allegations of Bribery or Corruption (CIABC): Investigate allegations of bribery or corruption of public servants and to direct AGD on offences under the Bribery Act and the Declaration of Assets and Liabilities Law, No. 1 of 1975.
- Department of Cooperative Development, within the Ministry of Food Security, has regulatory oversight of rural banks and thrift and credit cooperative societies.
- Department of Immigration and Emigration: Regulates the entry and exit of persons, and provides citizenship services. For AML/CFT the department coordinates with other agencies on the identification of people as they cross Sri Lankan borders.
- Department of Inland Revenue: Collect taxes, and deters and detects tax evasion and tax avoidance, through the Inland Revenue Act 2006 and subsequent amendments. Inland Revenue is currently the only department with oversight of casinos.
- Insurance Board of Sri Lanka: Regulates and supervises the insurance industry through the Insurance Industry Act 2000.

- Ministry of External Affairs: Also called the Ministry of Foreign Affairs oversees Sri Lanka's foreign policy, foreign missions and consular services. For AML/CFT, MEA is the primary agency responsible for Sri Lanka's engagement with international instruments including those of the UN Security Council.
- Ministry of Finance and Planning: Is responsible for formulation of national economic and financial policies and strategies of the country. MEA also has to approve any foreign funding entering the country. At the time of the onsite visit, it had responsibility for the central bank.
    - The External Resources Department: has to approve any foreign funding entering the country.
    - Sri Lanka Customs: Implements the provisions of the Customs Ordinance as well as several other fiscal and social protection statues. It has the power to confiscate goods and order further forfeiture or penalty in the event of the contravention of the provisions of the law.
- Ministry of Justice: Oversees the Attorney-General's Department, and the court structure. MOJ attends to implementation of policies, plans and programmes in respect of justice and law reforms. The Secretary to the Minister for Justice is the central authority for mutual assistance matters.
- Non-Government Organisations Secretariat (NGO Secretariat): Located within the Ministry of Defence, the NGO Secretariat has primary oversight of the not-for-profit sector, including registration, outreach and supervision.
- Office of the Chief of National Intelligence (Ministry of Defence): Oversees coordination of Sri Lanka's counter-terrorism efforts and other national security threats, with some role in investigations, and is the competent authority for UNSCR 1267 obligations.
- Registrar of Companies/Registrar General Department: Registration of legal persons pursuant to the Companies Act, legal arrangements pursuant to the Trust Ordinance No. 9 of 1917, and notaries pursuant to the Notaries Ordinance.
- Secretary to the Minister for Defence: Appointed by the Minister for External Affairs, in consultation with the Minister for Defence, is the competent authority appointed by the minister for UNSCR 1373 obligations.
- Securities and Exchange Commission: Established under Ministry of Finance the SEC regulates the activities of the capital market in Sri Lanka. The SEC has the power to provide directions, carry out inspections, and to cancel licences of the sector.
- Sri Lanka Police
    - Criminal Investigation Division (CID): Has two financial investigation units and, in addition to other criminal investigations, is responsible for predicate crime and money laundering investigations.
    - Terrorist Investigation Division (TID): Is responsible for investigating terrorist activities, including the financing of terrorism.
    - Narcotics Bureau: Investigates drugs and related crimes, occasional referral of information to CID or TID as appropriate.
    - Interpol Bureau: Maintains official contact on behalf of domestic law enforcement agencies with other law enforcement agencies, through its Interpol connections, in foreign member countries in criminal investigations.

- Human Trafficking/People Smuggling Division: Responsible for investigating human trafficking and people smuggling cases, occasional referral of information to CID or TID as appropriate.

34. The primary national coordination body is the Advisory Board to the FIU, made up of senior officials from a selection of the above agencies and described in the technical compliance annex under the analysis of Recommendation 2.

(c) Coordination and Cooperation Arrangements

35. The Governor of the CBSL chairs the FIU Advisory Board, which consists of 17 competent authorities. Meetings are called when needed but normally on a quarterly basis. The focus recently has been on the national risk assessment, preparations for the APG evaluation and general awareness events. There is no evidence of discussion of strategic direction and priority setting, except in the context of the recommendations contained in the NRA.

36. The Chief of National Intelligence chairs meetings on a weekly basis with participants from all agencies that have a role in national security, including from the police, military and intelligence services. The focus has been on monitoring and investigating financing from abroad in support of the attempted re-emergence of the LTTE, and designations under UNSCR 1373. Since the demise of the LTTE, meetings have also focused on other emerging national security threats, including from organised crime, human trafficking and people smuggling. These meetings have provided a platform for the sharing of financial intelligence on ML activities associated with these criminal activities, but to a significantly lesser extent than TF. Outside of these two arrangements, few policy or operational arrangements are in place to support or reflect the actual and potential cooperation that exists. The noted exception is the close working relationship between the FIU, AGD and CID.

(d) Country's assessment of Risk

37. **Sri Lanka should be commended for completing its first NRA**. Prior to the NRA, there had not been any national ML or sectoral risk assessments, or any comprehensive review undertaken of its AML regime by Sri Lankan authorities.

38. **Sri Lankan authorities conducted the NRA as a self-assessment using the *National Money Laundering and Terrorist Financing Risk Assessment Tool*, developed and provided by the World Bank**. The World Bank's role was limited to delivery of the tool, providing guidance on technical aspects of it and review/feedback to assist with the accurate use of it. The FIU took the lead role in coordinating the NRA under the ambit of the FIU Advisory Board. Around 80 representatives from key government and private sector stakeholders participated in the process. The NRA process was carried out over nine months from February to October 2014. Authorities intend to update the NRA but have not decided on any specific schedule for this to occur.

39. **The Ministry of Defence made publicly available in 2014 the National Security Strategy focused on national security, including terrorism and TF**. This strategy essentially consolidates and documents authorities' understanding developed over the years of national security threats and risks. The strategy focuses primarily on terrorism, including its financing, but also examines maritime security issues (including organised trafficking of persons, human smuggling and drug trafficking) and organised crime. The strategy includes an analysis of security threats, vulnerabilities and risks, both foreign and domestic, including terrorism and TF. Similar to the NRA, authorities intend to update the strategy but have not yet decided on a schedule to do so. The document covers three areas:

- Sri Lanka's overall national security context
- The primary threats to Sri Lanka's national security

- The strategies being formulated in response to these threats

40. **Sri Lanka has assessed its TF risks primarily through the National Security Strategy, and to a lesser extent the NRA; overall the conclusions of both documents are reasonable.** The NRA is focused more on ML threats and risks, although the analysis of sectoral and national vulnerabilities is relevant for both ML and TF. In the NRA, the non-sanitised version provides significantly more information and analysis of both ML and TF threats and risks than the sanitised version. There is also more comprehensive assessment of national and sectoral vulnerabilities in the NRA than in the security strategy paper, which focuses on known TF vulnerabilities, including the informal money or value transfer services (MVTS) sector and non-government organisations (NGOs). Conversely, the security strategy analyses in more detail potential terrorist threats and TF risks than the NRA. Nevertheless, the conclusions on TF threats and risks are similar in both documents. More importantly, the key recommendation contained in the National Security Strategy has already been adopted and implemented, while the recommendations contained in the NRA were still awaiting formal approval at the time of the onsite.

41. The assessment team's findings on the NRA are detailed in the following sections on technical compliance and effectiveness.

2.2 Technical Compliance (R.1, R.2, R.33)

42. See the technical compliance annex for the full narrative on these Recommendations.

- Recommendation 1 – Assessing Risks and applying a Risk-Based Approach is rated partially compliant
- Recommendation 2 – National Cooperation and Coordination is rated partially compliant
- Recommendation 33 – Statistics is rated partially compliant

2.3 Effectiveness: Immediate Outcome 1 (Risk, Policy and Coordination)

43. **Sri Lanka exhibits some characteristics of an effective system, particularly in authorities' understanding of TF and having strategies and coordinated activities to mitigate LTTE terrorist and TF activities. Nevertheless, major improvements are needed to develop national AML policies informed by the national risk assessment, including enhanced AML coordination and proliferation financing (PF) coordination**. These policies should address major ML risks associated with corruption and drug trafficking, and continued implementation of the national security strategy and coordination on TF.

(a) Jurisdiction's understanding of its ML/TF risks

44. **Sri Lanka has an acute understanding of TF risks shaped by years of war between the Sri Lankan Government and the LTTE until its conclusion in 2009**. Sri Lanka's understanding of TF risks is documented in the National Security Strategy and NRA, and was demonstrated during meetings with government officials. All sources noted the peace dividends from the end of the war in 2009, and that while public safety has improved, the threat remains, as demonstrated by attempted resurgences of the LTTE post 2009, most recently in April 2014. According to Sri Lankan authorities and press reports, individuals were arrested for distributing LTTE propaganda. An investigation was conducted which discovered a LTTE network supported financially by LTTE supporters offshore with funds remitted using hawala. There were numerous arrests and confiscations of arms caches, vehicles and other instruments.

45. **The National Security Strategy and NRA conclusions on TF are reasonable, noting that the LTTE threat remains and that there are other emerging global threats.** Both documents assess the TF

risk as mainly relating to the movement and use of funds within Sri Lanka from funds raised abroad and funnelled into Sri Lanka in support of potential LTTE activities. This offshore threat is evidenced by numerous publicly available cases of LTTE TF-related investigations and convictions in other jurisdictions over the last few years. There are also reported cases of other disruptive measures taken against LTTE activities aside from TF.

46. Using intelligence gathered through the years Sri Lankan authorities have developed a good understanding of the potential geographic locations where LTTE resurgence or fund raising may be supported, both within Sri Lanka and outside of Sri Lanka. Funds come from three sources: front organisations conducting legitimate businesses; profit-driven criminal activities such as human smuggling; and donations. The channels with which such funds would be transmitted back to Sri Lanka, if raised externally, include through the banking sector, informal MVTS providers and NGOs. Authorities have observed that a significant number of TF offences have a foreign connection in view of the involvement of the Sri Lankan diaspora. Sri Lanka is also monitoring other TF risks, including that of ISIL, but considers such risks limited at this stage.

47. **Overall, Sri Lanka has an understanding of most of its ML threats and risks as demonstrated in the NRA and in meetings with officials during the onsite.** The NRA conclusions are informed by quantitative data and qualitative information. The group of some 80 experts, public and private sector, utilised reported crime statistics, estimated and actual confiscated proceeds, as well as a number of input variables, statistics, interviews, surveys, and research. This was then underpinned by qualitative information and operational knowledge of senior, expert officials. The NRA identifies the ML major threats and risks as arising from drug trafficking, fraud (cheating, criminal breach of trust, criminal misappropriation), robbery, credit and debit cards fraud, bribery and corruption, human smuggling/trafficking, extortion and counterfeiting of currency. Given statistical and qualitative indicators provided in the NRA, ML risks associated with drug trafficking stood out from all other predicate crimes. The majority of officials and private sector representatives met during the onsite concurred with drug trafficking being the major predicate crime for ML.

48. **However, the levels of understanding of ML risks are not universal across all competent authorities and reporting entities**. Key competent authorities such as the FIU, CID and TID in the police, and the AGD demonstrate a sound understanding of ML threats and risks. Law enforcement authorities have a clear understanding of ML risks, including those identified in the NRA. Other competent authorities underestimate the ML risks, or did not connect their understanding of the threats posed by corruption and drug trafficking with the risks arising from vulnerabilities in their sectors. There are even lower levels of understanding from authorities and entities that have not been directly involved in the implementation of AML measures, including those in the DNFBP sector, although self-regulatory bodies in the legal and accountancy professions have a reasonably sound understanding, despite the lack of AML/CFT implementation. Within the financial sector, there is also some underestimation of ML risks among some financial institutions (FIs), particularly non-banking FIs.

49. **There are some issues with authorities' understanding of the inherent risk posed by the designated non-financial businesses and professions (DNFBPs) in Sri Lanka.** Given contextual factors in Sri Lanka, the NRA reasonably concludes that the casinos, real estate and precious stones sector have higher levels of vulnerability than lawyers, accountants and company service providers. There is no prudential supervision of casinos, the real estate sector is growing and Sri Lanka is one of the largest gem producers in the world. Conversely, Sri Lanka is not known for formation of offshore companies or arrangements. However, the internal logic to arrive at these conclusions is neither entirely consistent nor clear – in determining the final vulnerability rating, all DNFBP sectors are assigned the same level of structural or inherent vulnerability as a starting point, before other factors are considered.

50. **Sri Lanka has a sound understanding of the risk associated with the informal MVTS sector, which is assessed in the NRA as the highest-risk sector because of its undocumented nature and associated cases of LTTE financing and ML.** These conclusions are consistent with international

typologies. However, the MVTS sector is not primarily used for criminal purposes; its main purpose is to provide for Sri Lankan workers residing overseas to remit legally acquired and legitimately-earned funds back to their families in Sri Lanka. Nevertheless, despite this understanding, no substantive action has been taken against abuse by criminals and terrorists of informal MVTS providers.

51. **Certain aspects of the assessment on national vulnerabilities are overly positive**. Authorities do not fully appreciate the ML or TF risks resulting from deficiencies in laws and regulations, institutional capacity and resources. For example, suspicious transactions report data analysis is rated quite highly as combatting ML/TF, which is contrary to the conclusions in IO.6. In other areas conclusions are more consistent with the assessment team's findings. However, the NRA does contain recommendations to overcome these deficiencies. Overall, the reasonableness of the NRA's conclusions of national vulnerabilities could have been enhanced if an outsider or external reviewer provided a critique of the self-assessment to moderate the overly positive conclusions in certain areas.

52. **While authorities demonstrate a sound understanding of offshore TF, they have a more limited understanding of the outward flow of funds abroad for ML.** Neither the NRA, nor officials met, articulated clearly the end destination points of proceeds of corruption. The NRA demonstrates Sri Lanka's clearer understanding of illicit flows from drug trafficking, noting that most of the illicit proceeds revert back to their primary source countries in South Asia.

53. **There has not been a comprehensive assessment of the risks posed by legal persons and arrangements**. The NRA contains a brief summary of existing legislative requirements of legal persons and arrangements but does not examine the various forms of legal persons or arrangements to analyse which are more vulnerable and at risk, unlike the methodology used in the NRA for financial institutions (FIs) and DNFBPs. Understanding of the ML/TF vulnerabilities and potential misuse of legal persons and arrangements is significantly lacking with the Registrar-General of Companies, the key agency responsible for the Companies Act and Trust Ordinance under which legal persons and arrangements are registered, but is more developed among justice/security agencies such as the CID, TID and in the Office of the Chief of National Intelligence. Understanding among supervisory authorities is mixed.

54. All relevant competent authorities and officials contributed to the NRA and their understanding, as articulated at face-to-face meetings, is broadly consistent with the findings in the NRA, with a few exceptions, notably among some DNFBP licensing authorities. While the latter could be because the persons met may not have been involved in the NRA, generally there is consistency in officials' written and oral views of ML/TF risks provided to the assessment team, particularly on the major predicate crimes for ML and ongoing LTTE concerns. However, given the absence of AML/CFT supervisory authorities for DNFBPs, understanding of ML/TF risks by government officials working in those sectors is underdeveloped.

(b) National AML/CFT policies and activities to address the ML/TF risks

55. **Sri Lanka's National Security Strategy outlines a coordinated response to terrorism and the TF threats and risks**. The strategy details the threats, and notes the lack of coordination among the intelligence services as the most serious handicap. In response, all intelligence services, including the TID and CID of the police have been brought under the Chief of National Intelligence, who in turn reports directly to the Secretary of Defence. The strategy does not cover ML. During the onsite, relevant authorities advised that weekly meetings are held where agencies are required to share intelligence, including financial information. These activities are reiterated in the recommendations of the NRA.

56. Activities to combat TF are more consistent with evolving policies on and understanding of risk of TF. Previous activities amongst agencies had focused on countering LTTE activities in the critical period of 2006 to 2009. During this time, in combating the LTTE authorities used a range of functions available to them, primarily via the Prevention of Terrorism Act (PTA) No. 48 of 1979 (as amended), that included administrative means of preventing TF. Post 2009, activities focus more on deterring the re-emergence of the LTTE, including preventing funds from abroad entering Sri Lanka in support of potential LTTE

activities, such as those of April 2014. Evidence was provided to the team to this effect. Ongoing activities include monitoring of individuals formerly connected to the LTTE, NGOs operating in the former conflict areas, businesses that might act as conduits for receipt of external funds, and other measures permitted under the PTA and other legislation. Since 2009, Sri Lanka has had greater scope to focus on other national security concerns, including drug trafficking and people smuggling that include some information sharing on financial intelligence. The latter has focused more on predicate offences rather than ML, although ML investigation activities have been discussed during the weekly meetings.

57. **There is no articulated national AML policy or strategy**. Reflecting the absence of an overarching strategy informed by ML risks, the police department has not focused its activities on drug trafficking or corruption.

58. **Sri Lanka's recent NRA contains recommendations for dealing with identified ML risks, which is a positive step, but these are not yet developed into a national strategy or agreed to as an action plan.** The recommendations contained in the NRA to address identified deficiencies are still awaiting formal approval by the FIU Advisory Board. The recommendations include additional resources for AML/CFT. The FIU Advisory Board will meet to undertake a more detailed review of the actions recommended in the NRA. Once approved, authorities plan to disseminate the findings to financial institutions and DNFBPs.

59. As noted in section 2.1 (a) above, with the exception of the FIU, Sri Lanka has not provided the assessment team with any evidence of sector-specific strategies related to AML. The FIU provided their authority's strategy as part of the Central Bank of Sri Lanka's strategy. The strategy includes targets, but is neither risk-based, nor focused on key ML risks identified such as drug trafficking and corruption.

(c) Exemptions, enhanced and simplified measures

60. **Sri Lanka is yet to adopt a risk-based approach for exemption from requirements and the application of enhanced or simplified preventive measures is not based on the NRA or other risk assessments**. The recommendations contained in the NRA, which include implementation of a risk-based approach, are waiting formal approval by the FIU Advisory Board. In the absence of any applied risk-based approach, there is no specific exemption or extension of preventive measures based on risks and their materiality. As covered under c.1.6 in the technical compliance annex, specific AML/CFT obligations and supervision exclude certain institutions (rural banks, cooperative societies) and not all elements of the relevant FATF Recommendations are required to be implemented by FIs and DNFBPs. The basis for these exemptions is not based on any proven low risk of ML/TF. The NRA has assessed cooperative societies as low risk, although the DNFBP sector at large is rated medium-high. Furthermore, there has been no implementation of the findings or recommendations contained in the NRA. For areas of higher risk, the NRA has also identified issues arising from sectoral and national vulnerabilities and threats, including from the informal sector. The NRA has identified a need to progress financial inclusion concerns, including allowing for reduced CDD for certain products, and exemption for certain categories of cooperatives.

61. **Sri Lanka has used the NRA process to comprehensively survey and evaluate available financial inclusion products.** Sri Lanka used the World Bank's *Financial Inclusion Product Risk Assessment Tool* (FIRAT) to undertake a comprehensive evaluation of the ML and TF vulnerabilities and risks arising from both existing and emerging financial inclusion products. Supervisors evaluated the survey results from financial institutions regarding stated financial inclusion products. The supervisors identified a need to develop a more specific regulatory framework and guidance for the providers of financial inclusion products since some products have vulnerabilities that institutions would be precluded from applying simplified CDD measures to, such as those with a high volume of transactions or with high-value transaction limits.

(d) Objectives and activities of competent authorities

62. **Sri Lanka has a clear policy objective in deterring the re-emergence of the LTTE through TF or other activities, and has implemented multi-faceted actions to this end**. There is now a multi-stakeholder approach that is coordinated, as indicated previously, by the Office of the Chief of National Intelligence in the Ministry of Defence. Authorities indicated that activities are multi-faceted and not limited to the investigative activities of the CID and TID in the police. Sri Lanka has a comprehensive network of intelligence services based throughout the country that feeds into discussions at meetings coordinated by the Office of Chief of National Intelligence. There has been a focus on disrupting TF from abroad in support of potential resurgence of the LTTE, which includes intelligence on LTTE funding in April 2014, and other earlier incidents, and then coordinated actions including arresting local operatives and confiscating their assets. The meetings have also been used to identify targets for designations under United Nations Security Council Resolution (UNSCR) 1373, which subsequently led to the designations in March 2014, and the TID and AGD are continuing to develop evidence to prosecute the TF offence.

63. **There is no articulated AML objective(s) to guide the activities of the competent authorities and SRBs.** Authorities have not yet coordinated efforts to produce a national AML strategy, although the recent completed NRA with its proposed actions, once adopted, could form the basis of a national action plan. The consequence of having no national AML strategy is the lack of any AML action plans, including objectives, among key competent authorities. Until recently, this was exacerbated by the absence of an NRA. While competent authorities' activities have attempted to address ML, they have not necessarily focused on key risks identified in the NRA. Despite numerous requests by the assessment team for Sri Lanka to provide AML strategies, both at the national and individual agency level, only the FIU provided a document showing a strategy in place, although it was not targeted at key risks. Nevertheless, authorities have been able to implement various elements required of an AML/CFT regime, including: amending AML/CFT laws to meet the requirements of the FATF concerning the criminalisation of ML, issuing new regulations on preventive measures, and more recently, completion of an NRA.

64. **SRBs have not undertaken any significant independent actions in the absence of a government strategy**. While they are aware of the ML/TF risks, including corruption, drugs trafficking and the LTTE, they are waiting for clearer guidance and directions from the government. The legal profession did not pose any fundamental objections to customer due diligence (CDD) or STR requirements, but neither has it initiated any actions in the absence of regulatory enforcement.

(e) Cooperation and coordination

65. Domestic cooperation amongst agencies that work on combating terrorism and TF is well coordinated. As mentioned, the Chief of National Intelligence oversees all relevant agencies. A working group meets weekly to discuss terrorism and TF threats, both LTTE and non-LTTE, amongst other national security issues. The group consists of the TID, CID, State Intelligence Service, and the Defence Intelligence agencies of Directorate of Military Intelligence, Directorate of Naval Intelligence, and Air Intelligence. The FIU and Customs also attend these meetings as required.

Extract from National Security Strategy

"The foregoing threat assessment makes clear that even in the present post-war situation; national security remains very much a justified concern for the government of Sri Lanka. In addressing the challenges discussed above and in developing a comprehensive national security strategy, it is important for the government to take a holistic view and incorporate many of its elements into a single policy framework.

In the past, the lack of strength and coordination amongst these various intelligence services was a serious handicap. It is essential that they work together under a unified command structure in order to improve coordination and enhance capabilities. Towards this end, the present government has brought these intelligence services under the Chief of National Intelligence, who reports directly to the Secretary to the Ministry of Defence. This has streamlined coordination and improved cooperation amongst the intelligence

agencies."

66. The focus of Chief of National Intelligence chaired meetings has been on monitoring and investigating financing from abroad in support of the attempted re-emergence of the LTTE, and designations under UNSCR 1373. Since the demise of the LTTE, meetings have also focused on other emerging national security threats, including from organised crime, human trafficking and people smuggling.

67. **The Advisory Board to the FIU can be an effective mechanism for AML/CFT coordination, but to date it has not been used to set strategic AML or CFT directions.** It is currently more reactive or administrative in nature, including previously responding to the FATF's International Cooperation Review Group milestone requirements, undertaking the NRA and preparing for the mutual evaluations. The completion of the NRA shows the ability for effective coordination among competent authorities using this mechanism, and between the former and private sector bodies, including SRBs. However, to date it has not produced any policy or strategy for combating ML or TF.

68. **There is a lack of coordination between the FIU Advisory Board and the Office of the Chief of National Intelligence.** The mandates of the two overlap, notably in TF, but there does not appear to be any formal mechanism for coordination. Largely, the same set of operational agencies participates in both, although the FIU is not a regular weekly participant at the meetings chaired by the Chief of National Intelligence.

69. **Formal domestic mechanisms to support national coordination of policy and operational imperatives on ML are not comprehensive.** There are some instances of memorandums of understanding, staff placements and interagency agreements, but they are not the norm. While interagency cooperation generally occurs unhindered, it is mostly based on operational connections born of necessity, and not formal or structured. That said, the arrangements in place between the FIU, CID, TID and the AGD have supported efforts to counter ML activities as demonstrated by the 'secondment' of AGD staff to the FIU and CID. This arrangement has facilitated closer information sharing and cooperation at an operational level, and to build trust between key operational officials. However, there is no systematic coordination between the FIU as the primary AML/CFT supervisor and prudential supervisors, as the latter include AML/CFT supervision at a higher level in their supervisory programmes.

70. **The authorities, particularly supervisory authorities, have worked closely with the three main financial sector industry associations and the relevant professional associations in assessing sectoral vulnerabilities, as part of the NRA process.** This includes the banking, securities, insurance, other financial institutions and DNFBPs. However, given there has been no implementation of AML/CFT in the DNFBPs, input has been limited in that area, although the relevant SRBs for the legal and accountancy professions contributed to the process. The analysis identified deficiencies and actions to address these gaps, but has not yet been approved.

71. **Coordination on proliferation financing criterion is at an early stage.** Authorities advise that law enforcement agencies, in particular the State Intelligence Service, have commenced preliminary cooperation including with the FIU on this matter and that they are working toward implementation. This has been limited to some meetings; no substantive progress has been achieved as yet.

(f) Communicating ML/TF risks

72. **As indicated, the recommendations contained in the NRA are still awaiting formal approval by the FIU Advisory Board, and once approved, authorities plan to disseminate the findings to financial institutions and DNFBPs**. Nevertheless, the three main industry associations for the banking, securities and insurance sectors, had been heavily involved in the development of the NRA and have acquired an enhanced understanding of ML/TF risks through the NRA process. This was confirmed with industry representatives, who demonstrated a sound understanding of the risk environment in Sri Lanka.

73. **While the results of the NRA have not been disseminated, the FIU has conducted a number of awareness raising programs over the last few years to enhance understanding of ML/TF threats, vulnerabilities and risks**. These awareness programmes are focused on general ML/TF risks posed by criminals and terrorists, and on AML/CFT obligations. The programme activities have been conducted on a regular and systematic basis, with an average of 18 events attracting 1500 participants each year since 2008. This has contributed to broader appreciation of ML/TF risks by various constituents of the financial sector, however the DNFBP sector, which is not currently subject to AML/CFT supervision, do not have that same level of appreciation. In general, there is a need for continued outreach to reporting entities, in particular to raise awareness on the ML risks identified in the NRA.

74. **The National Security Strategy has not been distributed to financial institutions or DNFBPs.** Since the national security strategy examines the terrorism threat more broadly than LTTE, such a document would be useful for any risk assessment undertaken by reporting entities.

Overall conclusion on Immediate Outcome 1

75. Sri Lanka is achieving Immediate Outcome 1 to some extent. Sri Lanka has assessed its ML and TF risks. The NRA is generally reasonable, although the self-assessment on national vulnerability appears overly optimistic, some assumptions on DNFBP vulnerability are questionable, and a proper assessment of legal persons and arrangements is lacking. All relevant competent authorities and officials contributed to the NRA and their understanding, as articulated at face-to-face meetings, are broadly consistent with the findings in the NRA. Officials have more of an acute understanding of TF risks shaped by years of war between the Sri Lankan Government and the LTTE and strong grounds for its ongoing strategy for that area. There is also a sound understanding of the major ML threats such as drug trafficking and corruption, and of major sectoral vulnerabilities. The levels of understanding of ML risks are not universal across all competent authorities. There is a sound understanding among the FIU, AGD, and the CID, but mixed among other competent authorities and reporting entities. Authorities do not fully appreciate the ML or TF risks resulting from deficiencies in laws and regulations, capacity and resources. While the results of the NRA have not been disseminated to FIs and DNFBPs, the FIU and Central Bank of Sri Lanka supervisory departments have implemented regular awareness raising programmes on AML/CFT that have focused on general ML risks and requirements under the FTRA and CDD circulars.

76. The Advisory Board to the FIU undertakes AML/CFT coordination. The completion of the NRA shows the ability for effective coordination among competent authorities using this mechanism and between the former and private sector bodies, including SRBs. However, to date it has not been used to set strategic priorities or develop a national AML/CFT action plan, which is reflected in the lack of any promulgated national AML policy or any policy informed by the NRA to guide activities of the competent authorities and SRBs. The NRA's recommendations, which can provide for a national AML/CFT strategy, had still not been adopted at the end of the onsite. Nevertheless, key agencies such as the FIU, police, Office of the Chief of National Intelligence and Central Bank supervisory departments are attempting to implement measures to address ML, in addition to TF. The Chief of National Intelligence undertakes coordination for TF, working with a clear government policy and imprimatur, and overseeing disciplined inter-agency direction. Interagency coordination on proliferation financing is at an early stage. Overall, the deficiencies in risk-based strategies for ML and lack of a systematic coordination mechanism for PF have limited Sri Lanka's effectiveness in addressing problems in both areas.

77. Overall, the team assessed that Sri Lanka's understanding and activities to address TF are tangibly different to its understanding and activities to address ML. The outcomes under IO.1 on ML have had an adverse impact on the rating, while on TF they have had a positive impact. They are therefore important considerations in the assessment team's weighting of the relative importance of TF and ML in arriving at the overall rating for IO.1.

78. Sri Lanka is rated a **moderate level of effectiveness** on Immediate Outcome 1.

2.4 Recommendations on National AML/CFT Policies and Coordination

79. Sri Lanka is **recommended** to undertake the following prioritised actions:

- Adopt a national AML/CFT strategy informed by the risks identified in the NRA, and competent authorities should develop their own action plan or strategy to implement the national AML/CFT strategy.
- Use the findings in the NRA, including any future updates, to apply enhanced measures for higher-risk situations, or to justify exemptions or simplified measures for low or lower-risk situations, particularly given the commendable work in evaluating existing financial inclusion products.
- Undertake a more thorough assessment of national vulnerability and of legal persons and arrangements in any future update of the NRA, and consider subjecting the update to independent and external critique before finalising.
- Institutionalize an ongoing interagency process to update its risk assessment and enhance it over time, and the results are used to inform its AML/CFT strategy.
- Increase coordination and collaboration between the FIU Advisory Board and the Office of the Chief of National Intelligence.
- Undertake enhanced information sharing on ML/TF risks through formalising intelligence sharing arrangements between FIU and police, and regulatory information among supervisors, particularly in the CBSL.
- Distribute the sanitised version or the key findings of the NRA and National Security Strategy to all competent authorities and the private sector, including industry associations, SRBs, financial institutions and DNFBPs, and undertake continued outreach programmes using the findings contained in the NRA.
- Formalise coordination mechanisms for PF and then develop a strategy to implement requirements on targeted financial sanctions for PF.
- Introduce more systematic and coordinated collection of AML/CFT statistics to assist with future updates to its NRA, and in allocating limited AML/CFT resources.

3. LEGAL SYSTEM AND OPERATIONAL ISSUES

Key Findings

- Significant progress has been made in addressing the technical deficiencies identified in the 2006 mutual evaluation report of Sri Lanka. Deficiencies in the ML offence have been rectified through amendments to the Prevention of Money Laundering Act No. 5 of 2006 (PMLA), although there remain gaps in the list of predicate offences. Authorities have been designated for ML and TF investigations.
- Sri Lanka's use of financial intelligence and other information for ML/TF and associated predicate offence investigations does not extend to the full range of potentially relevant information. The financial intelligence unit (FIU) uses limited available and obtainable police information in its operational analysis of suspicious transaction reports (STRs), which has had a negative impact on the quality of intelligence products disseminated to the police.
- There are insufficient resources devoted to operational and strategic analysis and there is a backlog of STR analysis of up to three to four months.
- For TF, there is a more systematic and structured access and use of information. As mentioned in IO.1, the Office of the Chief of National Intelligence coordinates intelligence sharing on a weekly basis. The Terrorist Investigation Division (TID), which is a member of this group, can access information at these meetings, in addition to the usual sources used by the Criminal Investigation Division (CID). The information shared at such meetings has been particularly useful in the TF investigations of an NGO with fund raising branches located globally, in respect to which three indictments have been filed under the Convention of the Suppression of Terrorist Financing Act (CSTFA). Results arising from TF efforts are more prominent in the confiscation of property associated with the Liberation Tigers of Tamil Eelam (LTTE) and affiliated entities.
- Sri Lanka possesses the foundation for an effective AML system, but to date there has been limited demonstration of effectiveness with only one ML conviction. The low prosecution and conviction rates for ML are mostly explainable by the jurisdiction's over-emphasis on investigating and prosecuting the predicate offence. This has resulted in a low level of effectiveness in conducting ML investigations. Sri Lankan authorities prefer to investigate and prosecute the predicate offence, as it is a quicker process and less challenging given existing skills and resources; the same reasoning applies to cases involving foreign nationals.
- Aside from the efforts of the CID and TID (mainly for TF) and Sri Lanka Customs, as facilitated by their respective asset forfeiture legislation, Sri Lanka does not demonstrate characteristics of an effective system for confiscating proceeds and instrumentalities of crime. The low rates of investigation and prosecution of ML offences translate to even lower confiscations of criminal proceeds and results in criminals substantially retaining their profits of crime.
- Sri Lanka should promulgate clear national and agency policy directives and guidelines on following the money trail and confiscating the proceeds of crime. To support implementation, Sri Lanka should allocate additional resources to the FIU and CID to enable both agencies to better implement their analytical and financial investigations mandates respectively. Further training should be provided to law enforcement to develop their forensic and financial investigations capabilities.

3.1 Background and Context

(a) Legal System and Offences

80. Significant progress has been made in addressing the technical deficiencies identified in the 2006 mutual evaluation report of Sri Lanka. Deficiencies in the ML offence have been rectified through amendments to the Prevention of Money Laundering Act No. 5 of 2006 (PMLA), although there remain gaps in the list of predicate offences. The FIU has now been established under the Financial Transactions Reporting Act No.6 of 2006 (FTRA) and operating autonomously within the Central Bank of Sri Lanka.

81. The main legislation containing ML and confiscation provisions are the PMLA, the Code of Criminal Procedure Act, the Exchange Control Act and the FTRA. Subsections 13(1) and (1A) of the PMLA permit confiscation of laundered property, proceeds or instrumentalities used in ML or property of corresponding value owned, possessed or under the control of the person convicted of the ML offence.

82. The two Financial Investigation Units in the CID in the Sri Lanka police have been designated for ML and TF investigations, and the TID designated for TF investigations, although the National Intelligence section of the Ministry of Defence and other intelligence services also have a role in countering terrorist activities. The role of the CID in TF investigations is limited primarily to STRs, while the TID can commence investigations based on other sources. The Attorney-General's Department (AGD) remains responsible for prosecuting ML and TF with four prosecutors assigned to advise CID on its investigations.

3.2 Technical Compliance (R.3, R.4, R.29-32)

83. See the technical compliance annex for the full narrative on these Recommendations.

Money Laundering and Confiscation:

- Recommendation 3 – Money laundering offence is rated largely compliant
- Recommendation 4 – Confiscation and provisional measures is rated partially compliant

Operational and Law Enforcement

- Recommendation 29 – Financial intelligence units is rated partially compliant
- Recommendation 30 – Responsibilities of law enforcement and investigative authorities is rated compliant
- Recommendation 31 – Powers of law enforcement and investigative authorities is rated largely compliant
- Recommendation 32 – Cash Couriers is rated partially compliant

3.3 Effectiveness: Immediate Outcome 6 (Financial intelligence)

(a) Types of reports received and requested

Table 3.1: Suspicious Transaction Reports (STRs) submitted

Year	2009	2010	2011	2012	2013	2014
Licensed Banks	78	77	76	126	267	451
Licensed Finance Companies	-	7	9	9	4	-

Insurance Companies	-	1	4	6	-	1
Stockbroker Firms	-	2	2	3	1	-
LEAs	29	156	90	54	88	246
Exchange Control Department	0	0	0	1	0	1
NBFI (supervisor)	0	0	1	1	0	0
General Public	4	3	3	3	6	19
TOTAL	111	246	185	203	366	718

Table 3.2: CTRs and EFTs submitted

Year	2009	2010	2011	2012	2013
CTRs	1,616,018	2,606,102	2,827,034	3,418,851	3,137,038
EFTs	304,786	491,512	670,063	791,570	1,483,445
Total	1,920,804	3,097,614	3,497,097	4,210,421	4,620,483

Reports Received

84. **The FIU receives STRs, cash transaction reports (CTRs), and electronic funds transfer (EFT) information reported from financial institutions.** Statistics on STRs submitted are provided in Table 3.1, and on CTRs and EFT information at Table 3.2. Financial institutions have submitted STRs based on suspicion of ML/TF, while CTRs and EFT reporting are based on a set threshold of LKR 1 million (USD 7 600[4]) or more.

85. **However, several factors negatively affect the FIU's ability and capacity to produce good intelligence products: the rather low quantity and, in some cases, quality of the STRs received, and the non-uniformity of reporting**. There has been no reporting from DNFBPs and low levels of reporting from the non-banking financial sector. As discussed in IO.4 on preventive measures, even within the banking sector, reporting has not been uniform. Given the risks identified by the assessment team and in Sri Lanka's NRA, this is a significant gap particularly in relation to casinos, the real estate sector and precious gemstones. While information contained in STRs submitted generally includes relevant and accurate information, which has enabled the FIU to analyse the key characteristics of STRs submitted to date, potentially relevant information from outside of the banking sector is not being provided to competent authorities, at least through this reporting mechanism.

86. **The FIU also receives information from Sri Lanka Customs ('Customs'), which files STRs regarding any customs offences that are suspected to be ML/TF related.** Despite the signed memorandum of understanding (MOU) between the FIU and Customs, there are no other mechanisms or systems in place providing for routine or spontaneous sharing of information by Customs with the FIU for intelligence purposes, other than through STRs. At the time of onsite visit there had been 1 424 declarations made by passengers in 2014 in accordance with the provisions under the FTRA. However, Customs only shared those declarations that were related to ML/TF activities. The provision of all declaration information to the FIU would provide wider cross-border financial intelligence to assist authorities to identify potential cross-border ML/TF activities.

[4] Approximate figures based on LKR 1 equalling USD 0.00761, as at the end of the onsite visit, 12 December 2014, www.oanda.com

87. **Customs also, as noted under R.32, do not receive reports on bearer negotiable instruments (BNIs) and all categories of cross-border reports, which further limit the potential scope of financial intelligence available from cross-border movements.** While there is a requirement for foreign currency to be declared above a set threshold, the definition of foreign currency does not cover the full range of BNIs. Financial intelligence from cross-border declarations is essentially limited to foreign cash currency declarations.

88. **Financial intelligence from supervisors is negligible.** Regulators including Exchange Control Department and Department of Supervision of Non-Bank Financial Institution report STRs to FIU when they identify suspected ML/TF transactions during supervision. However, the number of STRs reported by regulators is small with only four from 2009 to 2014. This is not surprising given the findings under IO.3 on the effectiveness of AML/CFT supervision.

Reports Requested

89. **The Financial Investigation Units in the Police CID, TID, Customs and regulators have filed STRs to the FIU for different purposes**. Under section 15(1)(a) of the FTRA and section 5 of the PMLA, law enforcement agencies (LEAs) and regulators can file STRs to the FIU when there is suspicion of an act constituting an unlawful activity and property that has been derived or realised from an unlawful activity. However, LEAs, such as the police Financial Investigation Units and the TID have filed STRs as a practical means in seeking assistance from the FIU to obtain relevant financial information from financial institutions to facilitate their investigations. As indicated in Table 3.1 above, there is increasing use of this STR mechanism by other competent authorities to request information from the FIU.

90. For LEAs, these STR submissions act as an alternative process to court orders and assist in making financial information available to the LEAs more quickly. In addition, based on the STR, the FIU can provide the police Financial Investigation Units with an analysis of financial information to augment the investigation capability of the LEAs. It does facilitate LEAs to identify criminal assets and financial transactions, as indicated in the case example below. LEAs commented during the onsite that the analysis of financial information provided by the FIU is useful and of high standard in facilitating their investigations, but not to a level or volume that impact substantially on the effectiveness of IOs 7, 8 and 9.

On 14 January 2012, the CID initiated investigation on several individuals who was the associates of drug dealer Mr X and his wife Mrs X. Having raided the premises of a packing centre, the tenant of premises – Ms M was arrested with books of accounts of drugs trafficking activities relating to Mr and Mrs X seized. Further investigation revealed that Ms M had frequently deposited cash to Mrs X's bank account. Immediate assistance of FIU was sought from CID to ascertain the fund flow and trace the financial transactions of the individuals concerned. To the credit of FIU, Mr and Mrs X were subsequently arrested and charged under the Prevention of Money Laundering Act, Dangerous Drugs and Emigration Laws. Assets, valuables and cash of around LKR 1.7 billion (USD 12.9 million[4]) were suspended. The case is still pending in court.

(b) Use of financial intelligence and other relevant information

91. **The CID utilises different information sources of financial intelligence to assist in ML, TF and predicate crime investigations including intelligence obtained from weekly meetings coordinated by the Chief of National Intelligence.** The CID uses information provided from other predicate crime investigation units within the police for intelligence on potential ML investigations associated with drug trafficking, human trafficking and in other areas. The weekly meeting is mainly focused on intelligence sharing on terrorism, in particular LTTE, but intelligence concerning other organised crime activities such as drugs trafficking and human trafficking is also shared. While the

intelligence sharing in the weekly coordination meeting has demonstrated its usefulness in TF investigations, it has so far been of limited use to ML investigations. It has been useful for some predicate crime investigations, notably on human smuggling from Sri Lanka to Australia. Notwithstanding the higher-level coordination and information sharing, there are no operational groups or task forces formed within the police to access information on a regular basis, particularly in high threat/risk areas such as drug trafficking and corruption. Information sharing, therefore, between predicate crime investigation units is generally ad hoc. While there have been some ad hoc information exchanges on drug trafficking between the CID and the narcotics bureau, there has been limited use and access of information held by the anti-corruption agency.

92. The CID is not able to access tax information for ML investigations. The police do access information held by the Registrar of Companies and other government agencies, as required, during their investigations. However, no statistics have been provided to the assessment team on how often information has been accessed and used. In the absence of further information, it is hard to conclude such information is used to investigate ML, TF or predicate offences.

93. **For TF, there is a more systematic and structured access and use of information**. As mentioned in IO.1 and above, the Office of the Chief of National Intelligence coordinates intelligence sharing, both financial and non-financial, on a weekly basis. The TID, which is a member of this group, can access information at these meetings, in addition to the usual sources mentioned for the CID. The financial intelligence shared has been useful in identifying LTTE assets for confiscation, movement of funds from abroad and internally, and in specific TF investigation cases (see IO.8 and IO.9).

94. The information shared at such meetings has been particularly useful in the interdiction of attempted resurgence of LTTE activities in April 2014, which involved financial support provided by the LTTE network overseas operating from Europe. Shared intelligence demonstrated that funds were transferred from abroad using hawala and subsequently used to procure safe houses, vehicles and other resources. It has also been useful in the ongoing TF investigations of the Tamil Rehabilitation Organisation (TRO), which is an NGO with fund raising branches located globally. The investigations started in 2006, based on a number of leads, including STRs submitted by a commercial bank. However, as noted under IO.9, the case remains pending in Court.

95. **The designated Financial Investigation Units in the Sri Lanka Police CID do not have a legal basis to request information held by the FIU**, **because there is no provision in the FTRA and there is no MOU between the police and FIU**. The electronic LankaFIN system stores financial intelligence, including STR, CTR and EFT information. Under the FTRA, there is no provision that allows the Financial Investigation Units in the CID, or any other police department, to request financial intelligence from the FIU. Information, however, may be shared once an MOU is finalised, but no MOU has been signed between the FIU and the police. This lack of information gateway has hampered the efficiency and effectiveness of the FIU's ability to contribute to ML, TF and predicate crime investigations.

96. The police Financial Investigation Units have stated that financial intelligence can still be obtained from the FIU, through the submission of an STR, despite the absence of an MOU. Evidence of this was provided to the team during the onsite. One of the given examples is the submission of ML information from Dehiwala Police Station to the CID in respect of Mr X who was found to have significant deposits to his bank accounts, which was incommensurate with his personal background. The CID then filed an STR to the FIU and requested additional information on Mr X's bank accounts. As a result, the FIU provided details of Mr X's banking and financial transaction details to the CID for their further investigation on possible ML activities. Subsequent investigations by the CID revealed that Mr X had been involved in the drugs trading activities. During the onsite meeting, the CID and FIU advised the assessment team that this arrangement has worked well and without any difficulties. Nevertheless, this arrangement cannot be regarded as a formal protocol, and other legal provisions or an MOU should be in place to ensure financial information is obtained directly and swiftly by the CID from the FIU instead of resorting indirectly to the STR channel.

97. **The FIU does not systematically access or use police information (CID, narcotics etc.) on known criminals or terrorists in its analysis**. As stated above, there is no MOU signed between the FIU and police on the sharing of intelligence. It was confirmed during the onsite meeting that the FIU does not have available information on known criminals, or seek input from the police during the STR analysis process. It is not part of the FIU's analysis procedure. In the absence of police information, including but not limited to criminal records, the quality and effectiveness of STR analysis is seriously affected. The implications for ML investigations are discussed under IO.7, whereby ML investigations arising from the CID (containing the known criminal and police information) are more fruitful than those from the STRs (which may not contain information on known criminals and police information).

98. **The FIU can and does access other relevant information for the purpose of STR analysis**. The whole STR analysis process in the FIU can be divided into two stages: namely pre-analysis and full analysis. During the pre-analysis stage, the FIU matches the subject of the STR with the LankaFIN database of CTRs, EFTs and STRs. If necessary, the FIU conducts open source research by means of Google or World Check in the full analysis stage. If additional information is required for further analysis, the FIU seeks information from the reporting institutions and other government agencies such as Sri Lanka Customs, Immigration/Emigration, person registration, and the NGO Secretariat. Overall, the STR analysis is undertaken primarily using STR, CTR and EFT information stored in LankaFIN.

99. **The FIU has suspended financial transactions for a period of 7 days based on STRs received pursuant to its powers under s.15(2) of the FTRA.** Authorities undertake certain actions in circumstance warranting the suspension of bank accounts. The STR will be disseminated immediately to the CID or TID for possible ML or TF investigations, and consultations commenced with the Attorney General's Department (AGD) on processes, including possible next steps to extend the freeze beyond 7 days. Within the FIU, the STR Review Committee decides on whether to freeze or not. The Director of FIU is vested with power of suspension under section 15(2) of FTRA. In urgent case, the Director of FIU will freeze the transaction forthwith and the decision will be endorsed in the next STR Review Committee. Should further extension of suspension period is required; an ex-parte application could be made to High Court of Colombo. The following is the funds suspended for transactions between 2008 and 2012:

Table 3.3: Transactions suspended following to the STRs reported.

	2008	2009	2010	2011	2012
Funds Suspended	LKR 471 Mn	LKR 42 Mn	LKR 181.7 Mn	LKR 107.5 Mn	LKR 1,800 Mn

100. The freezing power allows the FIU to put on hold transactions until cases are referred to LEAs for ML or TF investigations. The following is the total number of accounts and cash have been frozen in respect of the identified predicate offences:

Table 3.4: Accounts frozen based on STRs from 2008-2012

No. of Accounts	Balance of Accounts	Type of Predicate Crime
47	LKR 52.6 Mn	Drug Trafficking
67	LKR 30.8 Mn & USD 149,013[5]	Fraud/Customs Violation
3	LKR 17 Mn	Human Trafficking

101. Example given by the FIU is the freezing of a bank account in connection with a human smuggling case in 2012. A customer of a commercial bank was reported in the newspaper to have been

[5] USD figure provided by Sri Lanka

arrested by Colombo Fraud Bureau of the Sri Lanka Police for organising human trafficking. Simultaneously, the commercial bank and Colombo Fraud Bureau respectively filed STRs against the customer to the FIU. By virtue of the power vested under section 15(2) of the FTRA, the FIU suspended the account transactions pending for the further investigation of Colombo Fraud Bureau.

102. **While the FIU does undertake suspension of accounts, there does not appear to be any real tracing of criminal assets.** The Financial Investigation Units of the CID and the TID both indicated a lack of higher-level forensic accounting or financial investigation expertise to undertake comprehensive tracing of criminal assets or terrorist funds. As indicated in IO.7 and IO.8, freezing and confiscation actions are limited to assets readily identifiable (e.g., used in the commission of an offence) such as property owned or controlled by criminals or terrorists when arrested or convicted. However, the Office of National Intelligence provided example of a comprehensive tracing of TF involving the financial support of overseas LTTE network operating in Europe, which involved attempted resurgence since April 2014 in the Jaffna area in Sri Lanka.

(c) FIU analysis and dissemination

103. **STR analysis is done manually by analysts**. The LankaFIN system functions mainly as a database of reports received from financial institutions (FIs) and other agencies rather than as an analytical tool. STR findings are discussed in the STR Review Committee, normally held at two to three month intervals, unless required for urgent cases. The STR Review Committee is chaired by the Director of the FIU and assisted by the staff from AGD. The Committee decides on the possible next steps with STRs that have been analysed, including dissemination, 'no further action' or putting an account under surveillance. Given the Review Committee includes the AGD and CID, feedback on the quality and potential utility on any STR is provided even before dissemination. This provides for a more efficient process, and ultimately it is aiming to improve the quality of STRs disseminated. However, the issues noted concerning the analysis process and FIU resourcing and capacity will continue to undermine the FIU's product, despite other measures aimed to improve quality. Following is the breakdown of the results of STR analysis and dissemination.

Table 3.5: Breakdown of STR analysis and dissemination

	2010	2011	2012	2013	2014 (as at onsite)
No. of STR received	246	185	203	366	640
No. of STR undergone full analysis	177	143	178	214	176
Disseminated to LEAs	31	60	48	55	151
Prior to Review Committee Meeting	0	29	12	35	135
After Review Committee Meeting	31	31	36	20	16
Disseminated to Regulators	13	5	8	18	6
Prior to Review Committee Meeting	7	5	5	5	3
After Review Committee Meeting	6	0	3	13	3
Total Dissemination (Dissemination rate)	44 (17.9%)	65 (35.1%)	56 (27.6%)	73 (19.9%)	157 (24.5%)
No Further Action/Keep account under surveillance	133	78	122	141	19

Table 3.6: Breakdown of STR dissemination to LEA/Intelligence Services

	2010	2011	2012	2013	2014 (as at onsite examination)
Dissemination to:	31	60	48	55	151
CID (STR reported by Reporting Institutions/STR reported by others including Customs, Police etc.)	14 (8/6)	44 (12/32)	27 (15/12)	35 (25/10)	95 (24/71)
Egmont	0	2	8	7	4
Special Task Force	0	1	1	5	0
State Intelligence Service	0	0	4	3	18
Police Narcotics Bureau	0	0	3	3	3
CIABC	0	0	1	1	0
Other Police	0	0	0	1	0
TID	17	13	4	0	31

Table 3.7: Breakdown of the use of STRs for ML or TF investigations

	2010	2011	2012	2013	2014 (as at onsite examination)
ML investigations	14	47	44	55	120
TF investigations	17	13	4	0	31
Total	31	60	48	55	151

104. **Due to a lack of dedicated intelligence staffing resources at the FIU, there is a backlog of about three to four months of STRs requiring analysis**. The three Assistant Directors of Intelligence Management Division of the FIU are responsible for the STR analysis. Their work experience in the FIU ranges from four to seven years. They have all received some relevant on-the-job training to carry out their tasks. On average, it takes over two and a half months to process a single STR, although multiple STRs are processed simultaneously. This overly long time for analysis, and subsequent backlog of STRs, is caused in part by the three assistant directors having to put on hold their analysis functions when there is a need to conduct onsite examinations of reporting entities. Further, the skill sets required for intelligence staff are fundamentally different from supervisory staff, and the lack of dedicated analytical staff further hinders the quality of the FIU's products. Furthermore, the potential utility of financial intelligence held by the FIU is mitigated by its delayed dissemination

105. **During the past five years, the STR dissemination rate from the FIU to other agencies has been reasonably high, in the range of 18% to 35% of all STRs received. The majority of the cases are referred to LEAs such as the CID and TID.** Between 2010 and 2014, 215 STRs were referred to the CID for investigations but only 157 were investigated for ML/TF (refer to Table 3.8 of IO. 7). For the CID, in 2014, over 50% of the disseminations pertains to responses to STRs (requests for information on financial institutions) initiated originally by LEAs via the STR channel (refer to Table 3.6). Overall, ML or TF investigations resulting from STRs are reasonable as they represent 73% of the STRs disseminated. However, while 31 STRs have been referred to the TID, there is only one case that has led to an ongoing TF investigation – which originated from an STR referred by FIU in May 2014. This low conversion rate may reflect TID's mandate to initiate TF investigations on non-STR financial intelligence, while the CID focuses on STR referrals. Among the 157 investigations by CID on both TF and ML, only five cases have been submitted to AGD for advice with one case pending trial. The low rate of STR disseminations leading to prosecution and conviction is a concern. Nonetheless, the FIU is supporting to a certain extent the

operational needs of competent authorities including liaison with FIs for financial information and provision of financial analysis reports to the CID and TID.

106. While no separate statistics on STRs leading to predicate crime investigations, prosecutions and convictions were provided to the assessment team, based on discussions during the onsite and cases provided, STRs have led to predicate crime investigations, notably on drug trafficking, human trafficking, people smuggling, currency control and customs violations.

107. **During the onsite, the CID and TID commended the FIU for its expertise in the facilitation of obtaining financial intelligence and serving as the primary focal point between the police and FIs in obtaining relevant financial information**. The FIU maintains a good liaison channel between the banks and LEAs to facilitate ML/TF investigations. During the onsite, the CID and TID advised that they have sought the assistance of the FIU to obtain further information from the banks in almost 90% of cases arising from STRs disseminated. The CID and TID advised that banking information obtained via the FIU is only used as intelligence, not as evidence in support of prosecution. They have found it useful that the FIU includes in its intelligence report a fund-flow analysis on transactions, together with their connection to the reported subjects.

108. **The FIU is not using financial intelligence or other available information to undertake strategic analysis, including in identifying emerging ML/TF trends and threats.** The limited FIU staffing resources has negatively affected both operational and strategic analysis. However, there has been some preliminary work on ML/TF typologies, as evidenced in the FIU's 2013 annual report, which includes consideration of relevant areas such as drug trafficking, trade-based ML and payment card fraud.

(d) Cooperation and exchange of information

109. **There is generally sound operational cooperation among the FIU, CID, TID and, AGD, but the lack of formal arrangements has limited information sharing.** Despite the existence of only one MOU, which is between Customs and the FIU, the key competent authorities are working to cooperate and exchange information. However, this is not based on any formal protocol or procedure. The absence of an MOU between the FIU and the police, which includes the CID, TID and Narcotics Bureau, has resulted in a lack of comprehensive and timely available and obtainable information from the police to the FIU. The same is potentially true for intelligence from other government agencies, as there is no formal arrangement between the FIU and the Office of the Chief of National Intelligence, the NGO Secretariat in the Ministry of Defence, or other intelligence services as they are potentially good sources of financial intelligence on TF, and on ML. In the absence of formal protocol, the FIU relies on trust and mutual understanding in sharing financial intelligence, including forensic financial analysis of banking information, to the police upon request. This has helped mitigate the problem, but a more structured approach is needed to improve the effectiveness of information exchange.

Overall conclusion on Immediate Outcome 6:

110. **Sri Lanka's use of financial intelligence and other information for ML and associated predicate offence investigations does not extend to the full range of potentially relevant financial intelligence.** The FIU receives STRs, CTRs and EFTs from FIs and other agencies, which it uses to develop intelligence. It is a solid foundation for financial intelligence building but development of a more comprehensive product is compromised because financial intelligence flow is hampered by incomplete reporting from FIs and no reporting from DNFBPs, and the FIU does not systematically use all available and obtainable police information (on known or suspected criminals in Sri Lanka) in its operational analysis of STRs. It relies primarily on STRs submitted by LEAs for such information. Both have had a negative impact on the quality of intelligence products disseminated to the police, as demonstrated by the low prosecution rate arising from STRs. Nevertheless, the FIU has played a role in supporting investigations by the CID and the TID, and both refer to the FIU as a centre of financial

expertise, and have called upon the FIU to provide forensic accounting support. For TF specifically, authorities access a wider range of information through the Chief of National Intelligence coordination mechanism. Arguably for TF, the use of information gathered from this mechanism is just as important as financial intelligence gained from the FIU. Overall, the lack of complex financial investigation and forensic accounting expertise has hampered the ability of the designated ML/TF investigation units to maximise the use of available financial intelligence.

111. **There are insufficient resources devoted to operational and strategic analysis and a backlog of STR analysis up to three to four months.** The number of STRs received by the FIU has increased exponentially from 246 in 2010, to 640 in 2014 (as at the onsite visit). The 75% increase of STR from 366 in 2013, to 640 in 2014, has reduced the rate of full analysis from 58.5% in 2013, to 27.5% in 2014. The increased workload has maximised use of the resources available for STR analysis. The FIU's resources are insufficient to carry out its operational and strategic analysis functions effectively. Furthermore, analytical resources and staff members are re-directed to the FIU's supervisory function as necessary.

112. Sri Lanka has achieved a **low level of effectiveness** with Immediate Outcome 6.

3.4 Effectiveness: Immediate Outcome 7 (ML investigation and prosecution)

(a) Circumstances in which ML is being identified and investigated

113. **The authorities conduct ML investigations but the results are hampered by a lack of clear policy direction and capacity.** As indicated previously, there is no national AML policy, internal police directive, or guidance on ML investigations. While there is an operational willingness to investigate ML, outcomes are constrained by capacity. The designated ML investigation authorities, which are the two Financial Investigation Units in the CID of the Sri Lanka Police, lack the advanced financial and forensic skills needed to undertake complex financial investigations required for complex ML investigations.

114. The two units were established in 2006 and 2014 respectively with 32 officers under the command of a senior superintendent. The investigators of the Financial Investigations Units have received either basic financial or commercial crime training, before or after joining the units. As noted, the CID has requested and received assistance from the FIU in conducting financial analysis of suspicious bank accounts. While such interagency cooperation is commendable, it indicates that there is insufficient staffing within the police units and, more importantly, that ML investigators in the police units are not adequately trained to conduct complex financial analysis, including forensic accounting. Without a clear policy direction, these capacity constraints remain significant challenges to effective ML investigations.

115. **The Financial Investigation Units initiate their ML investigations from three different sources namely: (i) STRs, (ii) referral from other predicate crime investigation units, and (iii) their own intelligence**. The following are two tables of ML investigations initiated from STRs (Table 3.8) and parallel ML investigation initiated from predicate crime investigations and internally within the financial investigation units (Table 3.9) during the past five years:

Table 3.8: Number and progress of ML/TF Investigations originated from STRs

Year	No. of ML/TF investigation	Total	Under Investigation	Pending with AGD	Pending with Court	Closed Files
2010	16/4	20	11	4	1	4
2011	34/5	39	27	0	0	12
2012	26/4	30	28	1	0	1

2013	25/0	25	25	0	0	0
2014	43/0	43	43	0	0	0
Total		**157**	**134**	**5**	**1**	**17**

Table 3.9: Number and progress of parallel ML investigations originating from other predicate crime investigation units and Financial Investigation Units

Year	No. of ML investigation	Under Investigation	Pending with AGD	Pending with Court	Closed Files
2010	1	0	0	0	1 case convicted only on predicate offence
2011	1	0	0	0	1
2012	15	9	3	1	2 cases convicted only on predicate offence
2013	11	9	1	1	0
2014	24	24	0	0	0
Total	52	42	4	2	4

116. **The CID relies primarily on STRs (including those STRs that originated from LEAs) to initiate ML investigations; intelligence from its own agency is provided on an ad hoc basis and not systematically developed.** There have been 157 ML investigations based on STR intelligence compared to 52 from others sources (refer tables 3.8 and 3.9 above). Intelligence from non-STR sources is less regular and systematic. Authorities informed the assessment team that, for example, the narcotics bureau might on occasion provide relevant information on a predicate crime drug investigation to the CID for potential ML investigation. However, there is no systematic sharing of such intelligence. This is true also for other predicate crime investigation departments in the police. Non-police units share information with the CID for potential ML investigation is more indirect involving the filing of STR report via the FIU.

117. **However, the difference between the numbers provided in the tables above indicate that ML investigations sourced from within the police are marginally more successful than investigations originating from STRs disseminated by the FIU**. Based on these statistics, in the past five years, five cases (3.18%) out of 157 ML investigations that originated from STRs have been submitted to AGD for advice, resulting in one trial. During the same period, four cases (7.69%) out of 52 ML investigations derived directly from CID have been submitted to AGD for advice resulting in two trials. This is in agreement with the finding of IO.6 that the current standard of STR analysis does not contribute appreciably to successful investigations or prosecutions. In total, the number of completed ML investigations is low, just nine out of total 209 cases, or 4.3%, which reflects on the investigation capability of the CID, and the intelligence upon which the investigations have been based. However, the complexity of the cases and the absence of sufficient resources could likely be other reasons for the low rate of completed investigations and prosecutions.

(b) Consistency with Sri Lanka's threat and risk profile and national AML/CFT policies

118. **The targeting, conduct and outcomes of ML investigations are not consistent with the major proceeds-generating predicate crimes, particularly drug trafficking and corruption. In addition, the number of ML investigations is small compared to the potential number of ML offences and associated illicit proceeds generated from the main predicate offences identified in the NRA.** While the statistics on ML investigations as shown in table 3.10 below would suggest a relationship between ML investigations and the major predicates, a more thorough review indicates otherwise. Both the assessment team and Sri Lanka's NRA have identified drug trafficking as posing the greatest ML risk.

Money laundering investigations on drug trafficking increased significantly in 2014, however, the police advised that about 95% of the reported drug trafficking cases are drug *consumption* cases. Therefore the increased focus on drug trafficking does not indicate any shift in focus on the illicit proceeds generated from drug trafficking.

119. Furthermore, although the Commission to Investigate Allegations of Bribery or Corruption (CIABC) has completed investigations for 4206 cases in the past five years and prosecuted over 500 cases, only one case has been referred to the CID for investigation into the ML offence.

120. This is symptomatic of the absence of a national AML strategy to focus on the key risk areas. There is closer correlation between human trafficking and people smuggling, and ML investigations. Both human trafficking and people smuggling are significant crimes facing Sri Lanka. While human trafficking, similar to drug trafficking, is an ongoing challenge, Sri Lanka has had successes in disrupting people smuggling and associated ML, although only in terms of ML investigations (see table 3.10) but not ML convictions.

Table 3.10: Breakdown of parallel ML investigation by predicate offence

Year	No. of parallel ML investigations	Drug Trafficking	Fraud	Human Trafficking/ People Smuggling	Exchange Control Violation & Customs Offence	Corruption	Payment Card Fraud
2010	1	0	0	0	0	0	1
2011	1	0	1	0	0	0	0
2012	15	1	4	6	0	0	4
2013	11	1	3	3	1	0	3
2014	24	17	5	0	1	1	0
Total	52	19	13	9	2	1	8

(c) Different types of ML cases pursued

121. Sri Lanka has pursued both self- and third-party ML investigations but the majority of the cases are connected to predicate offences committed within Sri Lanka only. There have been no standalone ML offences involving professional launderers because of the difficulties in prosecuting the autonomous ML offence, even though there is no requirement in the PMLA for ML offences having to be linked to the predicate offences. Below in table 3.11 is the breakdown of ML investigations, originating from both STRs and parallel investigations, by the type of ML offences and location of predicate offences:

Table 3.11: Breakdown of ML investigations by the types and location of predicate offence

Year	Total no. of ML investigation	Self-Laundering	Third party Laundering	Self- and Third-Party Laundering	Yet to be identified	Predicate Offence in Sri Lanka	Predicate Offence in overseas
2010	21	2	6	2	11	21	0
2011	40	4	4	2	30	40	0
2012	45	13	7	3	22	45	0
2013	36	13	3	0	20	36	0
2014	67	27	0	0	40	66	1
Total	209	59	20	7	123	208	1

122. In all cases, whether self-laundering or third party laundering, there have been no cases of ML prosecutions of legal persons, and all are natural persons. There have been numerous investigations of legal persons including companies and NPOs. Under the PMLA, any person, including a legal person, who commits the offence of ML as defined under section 3(1) of the PMLA can be prosecuted and punished as provided in the same section. Given the issues of capacity, it would be challenging for authorities to prosecute legal persons, given the challenges to date in prosecuting natural persons.

(d) Extent to which sanctions are applied and are effective, proportionate and dissuasive:

123. **There has only been one ML conviction**. Out of the 209 ML investigations conducted between 2010 and 2014, the CID submitted only nine cases to the AGD for advice, with three cases pending High Court trial. The only conviction originated from an STR report, which led to a case that started in 2009 and concluded in 2013 (details refer to paragraph 112). Authorities advised that three other cases proceeded to trial for ML in 2010 and 2012 but ML convictions were not achieved, although predicate crime convictions were obtained. The low conviction rate reflects further on the lack of expertise in this area – from investigations in evidence gathering through to prosecutions and the judiciary.

124. The assessment team met various stakeholders in the criminal justice system to understand the low prosecution and conviction rates for ML. The authorities acknowledge that the two main impediments are a lack of a national AML policy and capacity. In this environment, the authorities consider that the pursuit of predicate offence alone is sufficient to show the gravity of the illegal act without adding the ML offence to the indictment. Authorities stated that they would consider framing charges under the PMLA, however if the accused pleaded guilty or was found guilty for the predicate offence, proceedings on the ML charge were terminated. More importantly, the investigation of ML offences often requires more expertise and a longer time to complete the financial investigation. The difficulties in conducting ML investigations in comparison with predicate offence investigations render the authorities reluctant to proceed with ML prosecutions, in particular if the case also involves foreign nationals. Although there is no policy in place concerning the ML charge, the AGD has realised the importance of asset recovery in respect of the proceeds generating crime such as drugs trafficking. While giving advice on the drugs-related ML offence, the AGD would also advise the application of freezing orders to avoid the dissipation of the proceeds of crime.

125. The accused for the only ML conviction was punished with one-year rigorous imprisonment and order to pay sum of LKR 7 million (USD 53 294[4]), in addition to the punishment of the predicate offences. The punishment does not reflect the gravity of the ML offence and deviates from the applicable penalty of 'imprisonment for a period of not less than five years and not exceeding twenty years'. Further, as the accused pleaded guilty to the charges the effectiveness of the judiciary cannot be tested – although it is not uncommon for a trial in Sri Lanka to be drawn out over a long period because of the overloaded court system.

126. Following are the details of the only ML conviction case in Sri Lanka:

Customer 'A' is the Secretary of a Death Donation Scheme opened a savings account in the Bank 'B' on 26 August 2009. At the time of account opening, Customer A stated that his average monthly income was less than LKR 100 000 (USD 730[4]). After the account was opened, Customer A deposited a cheque in value of LKR 7 million (USD 53 294[4]) to his savings account. Subsequently, the funds were transferred to another bank as several fixed deposit savings accounts. Bank B then filed an STR because a large turnover of funds in the account was inconsistent with the known customer patterns of transacting.

Subsequent investigations revealed that Customer A, in collusion with the President of the Death

Donation Scheme, drew the above cheque from the members' contribution fund and deposited it in his personal account. Based on the STR, the funds in the account of Customer A were suspended by the FIU, initially for a period of 7 days, which was later extended by the High Court. The case was referred to the CID for investigation.

On the completion of investigation, Attorney General Department filed indictments against Customer A for the following charges.

1. Provision 456 Penal Code on forgery of a valuable security or will
2. Provision 459 Penal Code on using as genuine a forged document
3. Provision 386 Penal Code on dishonest misappropriation of property
4. Section 3 (1) (a) of the Prevention of Money Laundering Act

The accused pleaded guilty for all four charges. He was sentenced to one-year rigorous imprisonment for the ML charge and ordered to pay a sum of LKR 7 million (USD 53 294[4]), in addition to two years rigorous imprisonment each for the other charges.

(e) Extent to which other criminal justice measures are applied where conviction is not possible

127. As noted, the authorities have also attempted to disrupt criminals from benefitting from illicit proceeds by prosecuting the predicate offence. Sri Lanka has not provided evidence to demonstrate its effectiveness in using such an approach. In any case, such measures are applied regardless whether it is possible or not to achieve a ML conviction.

Overall conclusion on Immediate Outcome 7:

128. **Sri Lanka possesses the foundation for an effective AML system, but to date there has been limited demonstration of effectiveness with only one ML conviction.** The ML offence in the PMLA is technically sound, although with some missing predicate offences, and there are two designated ML investigation teams within the police. The low prosecution and conviction rates for ML are mostly explainable by the lack of prioritising AML investigations through a national AML policy, and capacity constraints. Sri Lankan authorities find it more expedient to prosecute the predicate offence, as it is quicker and less challenging given existing skills and resources; the same reasoning applies to cases involving foreign nationals. As such, ML investigations relate predominantly to local predicate offences, precluding offences committed overseas. Furthermore, Sri Lanka authorities view the punishment of the predicate offence as sufficient deterrence and sanction without the need to consider the additional ML offence.

129. Sri Lanka has achieved a **low level of effectiveness** with Immediate Outcome 7.

3.5 Effectiveness: Immediate Outcome 8 (Confiscation)

a) Confiscation as a policy objective

130. **Sri Lanka does not have any articulated national or agency-level policy objectives for pursuing the proceeds of crime,** reflecting the lack of an articulated national AML strategy. As mentioned under IO.1, the NRA includes recommended actions and once adopted will form the basis of a national strategy or action plan, including on confiscation.

131. **Law enforcement agencies such as the Police Narcotics Bureau (PNB) and CIABC do not have confiscation policies/strategies in place to counter ML.** This is despite the fact that Sri Lanka acknowledges significant ML threats from narcotics offences and from bribery and corruption. The

National Drug Control Board (NDCB) identifies and drives national policies on drug-related issues and coordinates this amongst relevant agencies such as the PNB and Customs. The NDCB confirmed that it does not collect or review any data or statistics for ML relating to proceeds of drugs offences or use confiscation as a tool to deprive offenders of the incentive to commit drug crimes or ML related to drug crimes. The NDCB indicated that it has no immediate plans to put this on the agenda. There has not been any confiscation under the PMLA for drug offences. Similarly, there is no evidence of any policy objective on the part of the CIABC to pursue confiscation of criminal proceeds, instrumentalities or property of equivalent value for ML relating to corruption and bribery offences. CIABC officials state that they are not accustomed to considering ML or confiscation of proceeds of ML in its investigations. There is no indication that CIABC has any plans to focus on the ML or confiscation of proceeds of ML aspect of corruption and bribery offences in the future.

b) Confiscation of proceeds from domestic and foreign predicates, and proceeds moved to other countries

132. **Generally, Sri Lanka has a sound legal framework for tracing, freezing, and conviction-based confiscation, for proceeds of crime under the PMLA**, other than the technical deficiencies identified in the technical compliance annex under Recommendations 3 and 4.

133. **Statistics provided by the Sri Lankan authorities show that between 2008 and 2013, only seven ML indictments were filed, resulting in one ML-related confiscation under the PMLA.** Consequently, the amount confiscated under the PMLA remains low at LKR 7 million (USD 53 294[4]). As the regime for ML confiscation is primarily conviction-based, the lack of prosecutions and convictions for ML under the PMLA severely limits the ability to use confiscation as a means to deprive criminals of their proceeds of crime.

134. The sole ML conviction is in relation to the fraudulent use of funds belonging to a trust. The offender pleaded guilty to charges of forgery and dishonest misappropriation of property as well as a charge of ML under the PMLA. The bank into which the fraudulently obtained sum was deposited had filed an STR based on transactions inconsistent with the known customer pattern. The FIU suspended the account and referred the matter to CID for investigations. Upon conviction in 2013, the Court ordered the offender to pay the State LKR 7 million (USD 53 294[4]) being the value of the funds laundered.

135. **Difficulties cited by the Sri Lankan authorities in pursuing assets include the complicated nature of confiscation proceedings compounded by the lack of technical expertise.** The confiscation proceedings under the PMLA involve the identification of realisable property and potentially numerous Court applications for freezing and forfeiture orders and dealing with claimants' applications. Institutional problems such as delays in the court process also make it challenging to pursue the money laundering and consequently the confiscation aspects of their cases. Between 2008 and 2013, only nine police officers have participated in training on asset tracing and asset forfeiture. The lack of training opportunities and insufficient staffing resources limit their ability to pursue asset forfeiture investigation. For example, the CID does not have access to a forensic accountant to assist with its investigations, which would be invaluable for complex ML investigations especially where not emanating from the FIU.

136. **The AGD has cited legislation other than the PMLA, being section 425 of the Criminal Procedure Code, where upon conviction forfeiture of seized proceeds of crime from predicate offences is also possible but does not appear to be pursued.** There are no statistics to demonstrate when and how often this provision has been successfully used in forfeiting proceeds of crime, as opposed to routine disposal of items that are not proceeds of crime. As such, it is not possible to gauge the quantum of assets confiscated by the Sri Lankan authorities in order ascertain whether the confiscation framework in relation to ML is an effective one. Statistics relating to this provision are not comprehensively maintained and monitored by the Sri Lankan authorities, further indicating that confiscation is not pursued as a policy objective.

137. The Sri Lankan authorities did provide some case examples where, although the ML charge was not pursued, proceeds of crime were confiscated upon conviction of the predicate offence. Based on the examples provided, there have been two cases involving seven foreigners prosecuted for payment card fraud that resulted in LKR 3 835 000 (USD 29 200[4]) in local and foreign currency being confiscated.

138. In confiscating proceeds of ML relating to narcotics offences, the PMLA would be employed and a confiscation exercise embarked by CID prompted by internal police referral by the PNB. This is done on a case-by-case basis in situations where a suspect involved in a narcotics offence is found to have unexplained wealth. Since 2006, the PNB has referred 20 cases to CID but none of these has resulted in a confiscation under the PMLA. Other laws, such as Customs Ordinance, Excise Ordinance, and the Forest Ordinance, provide for the confiscation of instrumentalities, but not of proceeds.

139. For predicate crimes alone, Sri Lanka has suspended funds and properties for cases pending investigations. In the following tables, Table 3.12 includes properties suspended for drug trafficking cases, which constitutes the total property amounts for 2013 and 2014, and LKR 185 million (USD 1.4 million[4]) of the LKR 245 million (USD 1.9 million[4]) in 2012.

Table 3.12: Funds suspended for cases pending investigation

	2010	2011	2012	2013	2014 (end March)
Funds (LKR Mn)	11.47	-	6.15	3.00	-
Property (LKR Mn)	-	-	245.00	27.50	1580.00

140. Sri Lanka has also suspended funds pursuant to STRs received by the FIU. However, only a fraction of the amount frozen has been confiscated.

Table 3.13: Funds suspended following STRs received

Year	2008	2009	2010	2011	2012	2013	2014
No. of STRs received	89	111	246	185	203	366	
No. of prosecutions (indictments filed)	-	-	2	1	4	-	
Funds frozen/suspended (LKR)	471 Mn.	42 Mn.	181.7 Mn.	107.5 Mn.	1,800 Mn.	-	63 Mn
Assets confiscated/forfeited (LKR)	-	-	-	-	2.9 Mn.	7 Mn	

141. **However, the lack of focus on ML and asset confiscation is particularly stark in relation to bribery and corruption.** Although CIABC has completed investigations for 4206 cases in the past five years and prosecuted over 500 cases, only one case has been referred to the CID for investigation into the ML offence.

142. **Section 26 of the Bribery Act allows for the forfeiture of the value of the gratification received so that the recipient of the bribe is prevented from benefiting from the gratification.** However, no statistics were provided to show how often the provision is invoked or the value of assets related to proceeds of bribery/corruption that have been confiscated under the provision. Statistics of instances where proceeds of bribery and corruption were confiscated pursuant to section 26 of the Bribery Act are not comprehensively being maintained or monitored by the Sri Lankan authorities, further indicating that confiscation is not pursued as a policy objective by the CIABC.

143. **For ML, the Sri Lankan authorities do not have any examples of asset forfeiture pursuant to or arising out of international assistance.** This appears to be not just a result of the Sri Lankan authorities not pursuing asset forfeiture as a policy objective, but also due to deficiencies in the mutual legal assistance regime, in particular, being restricted in its ability to provide assistance for freezing and confiscation assistance to a limited number of prescribed/specified countries rather than on the basis of

reciprocity. The Sri Lankan authorities have also not pursued any confiscation relating to proceeds of crime in Sri Lanka that relate to foreign predicate offences.

144. **However, as CID and AGD gain greater awareness and expertise in the area, there is some indication that greater emphasis is being focused on pursuing parallel ML investigation and consequently this may lead to more prosecution and confiscations of proceeds of crime.** This is reflected in the recent statistics relating to ML investigations that show that CID has identified a several cases involving drug trafficking, fraud and smuggling, where parallel ML investigations are being conducted and assets are being identified for freezing, or have been frozen, with a view to confiscation (refer to table 3.10 above, 'Breakdown of parallel ML investigation by predicate offence').

c) Confiscation of falsely or undeclared cross-border transportation of currency/bearer-negotiable instruments

145. **Sri Lanka Customs confiscates cash and other goods that have moved across Sri Lankan borders without proper declarations under the Customs Ordinance.** Cases that reveal further offences are referred to CID to investigate further, and there appears to be robust enforcement of forfeiture of the falsely declared and undeclared goods. Statistics provided by Customs show that in 2014 alone, more than LKR 85 million (USD 647 000[4]) of undeclared currency and over LKR 5 billion (USD 38 million[4]) in undeclared precious metal were forfeited. Most of these relate to the illegal import and export of gold. Gold, jewellery and gems are restricted items and must be declared. The following statistics in Table 3.14, provided by the Sri Lankan authorities, show cross-border confiscation figures for 2010 to 2013. While the figures reflect the value to the amount recovered, it does not reveal how much of the value refers to confiscated cash assets.

Table 3.14 on cross-border confiscations

	2010	2011	2012	2013
Total No. of Cases	6120	4220	5899	7252
Pending Cases	4389	1650	1889	3997
Finalized Cases	406	1528	1962	1454
Amount Recovered (LKR)	126.0 Mn.	188.8 Mn.	193.4 Mn.	21.6 Mn.

146. As noted in the technical compliance annex, in Recommendation 4, various legislations provide for the ability of authorities to manage confiscated assets, however, there was no indication of any formal structures to effectively facilitate this. **Although the Sri Lankan authorities have identified ML/TF risks, confiscation results fail to reflect the ML risk assessment.** For example, the Sri Lankan authorities have identified fraud as a predicate offence generating over LKR 3 billion (USD 22.8 million[4]) in proceeds of crime. However, between 2008 and 2012, only 11 out of 39 000 cases relating to fraud were investigated for ML, and there is no clear indication as to the extent to which confiscation proceedings were pursued for these. The data and statistics for narcotics as well as bribery and corruption cases suggest the same.

d) Extent to which confiscation results reflect ML/TF risks and national policy and priorities

147. **The low confiscation statistics under the PMLA is a result of the authorities' lack of focus on parallel ML prosecution.** Although the Sri Lankan authorities have identified ML/TF risks, confiscation results fail to reflect the ML risk assessment. For example, the Sri Lankan authorities have identified fraud as a predicate offence generating over LKR 3 billion (USD 22.8 million[4]) in proceeds of crime. However, between 2008 and 2012, only 11 out of 39 000 cases relating to fraud were investigated for ML, and there is no indication that for any of these cases confiscation proceedings were pursued. The data and statistics for narcotics as well as bribery and corruption cases indicate the same trend.

148. **On the other hand, the confiscation of cash and non-cash assets under the PTA to counter the risks relating to terrorism in Sri Lanka is clearly a reflection of the commitment of the Sri Lankan authorities to prioritise asset confiscation in the implementation of its national CFT policies and priorities.**

149. The CSTFA provides for freezing and confiscation but it is rarely used to freeze or confiscate assets (there are three indictments pending in the High Court against the Tamil Rehabilitation Organisation (TRO) in which LKR 89 million (USD 677 000[4]) and two properties worth LKR 70 million (USD 532 944[4]) has been frozen). Instead use has been made of the Financial Transaction Reporting Act paragraph 15(2)(c) in association with section 425 of the Code of Criminal Procedure, the Public Security Ordinance (PSO) No. 25 of 1947 (as amended) and the Prevention of Terrorism Act (PTA) No. 48 of 1979 (as amended). It appears that the last is currently utilised because it permits confiscation/seizure independently of conviction on terrorism charges, and the competent authorities and judiciary are now familiar with the required processes. Emergency regulations under section 5 of the PSO (Gazette 1583/12 of 7 January 2009) that permitted this action lapsed in 2011 and were replaced by equivalent provisions under s27(1) of the PTA (Gazette 1721/02 of 29 August 2011).

150. Whilst there has been a scarcity of cases under the CSTFA on TF, freezing and confiscation of property under the PSO and subsequently the PTA has been significant since 2007 (with the exception of 2010 when there were no cases – see table 3.15 below).

Table 3.15: Sri Lanka Police Terrorism Investigation Division Summary of confiscated property (PSO and PTA)

	Land, building, printing press	Vehicles	Machines & others	Money	Total per year
2007			12,209,500		**12,209,500**
2008		10 000	4,447,700		**4,457,700**
2009	96,700 000	28,034 000	35,952,703	5,127,979	**165,814,682**
2010					**0**
2011	40 000 000	26,150 000	9,550 000	39,880,654	**115,580,654**
2012	312,100 000	10,650 000	16,123,225	78,949,322	**417,822,547**
2013	28,760 000	160 000	100 000	22,775,127	**51,795,127**
2014	30 000 000	12,450 000	7,950 000	25,677,581	**76,077,581**
Total per property type	**507,560 000**	**77,454 000**	**86,333,128**	**172,410,663**	**843,757,791** (USD 6.4 million[2])

Overall conclusion on Immediate Outcome 8

151. Overall, despite some confiscation by the TID and CID (mainly for TF) and Sri Lanka Customs, Sri Lanka does not demonstrate the characteristics of an effective system for confiscating proceeds and instrumentalities of crime. The low rate of investigation and prosecution of ML offences, coupled with a lack of pursuit of proceeds of crime through predicate investigations, results in low levels confiscation of criminal proceeds and in criminals substantially retaining their profits of crime.

152. Sri Lanka has achieved a **low level of effectiveness** with Immediate Outcome 8.

3.6 Recommendations on legal system and operational issues

Recommendations:

153. Sri Lanka is **recommended** to undertake the following prioritised actions:

Financial Intelligence (IO.6)

- The FTRA should be amended to allow CID or police to have a legal basis to request all relevant information held by the FIU to facilitate ML and predicate offence investigations.
- The FIU should enhance its operational analysis procedures to ensure that essential and critical information, beyond what is provided in STRs/CTRs/EFTs, is included in the initial analysis stage.
- A written information exchange instrument should be established so that the FIU can, and should, access available and obtainable information from the police to augment the standard of operational analysis.
- The FIU should use cross-border declaration information from Customs to enhance operational analysis.
- Comprehensive strategic analysis should be conducted by using available financial intelligence to identify emerging ML/TF trends and threats and be shared with relevant stakeholders.
- The current FIU electronic database should be upgraded to allow an interface with different databases, such as police and customs information, and to function as an analytical tool.
- Staff resources should be increased to allow the FIU to cope with the increasing workloads and upgrade the IT system.

ML investigations and prosecutions (IO.7)

- There should be a clear national AML policy and police directive to focus efforts on combating ML, informed by the NRA. ML prosecutions should be encouraged and facilitated instead of relying on the prosecution of predicate crimes as deterrence.
- More training and resources should be provided to the CID to enhance their ML investigation capabilities, and staff should be recruited with appropriate financial investigation skills, particularly in anti-corruption, counter drug trafficking and other areas identified as top-tier risks in the NRA.
- Better coordination should be made between the CID, and other police and non-police units, to facilitate parallel ML investigations, particularly on drug trafficking and corruption.
- More training and resources should be provided to the Prosecutors to enhance their abilities and confidences in the prosecution of ML offence.

Confiscation (IO.8)

- Promulgate and implement policies and strategies at the national and operational levels to pursue confiscation, including repatriation, sharing and restitution, of criminal proceeds, instrumentalities, and property of equivalent value, in particular for areas identified to by high risk such as drug trafficking, corruption and fraud.
- Develop and increase authorities' technical expertise to pursue asset recovery.
- Aside from CID and TID, other law enforcement agencies such as PNB and CIABC should also be sensitised to the benefits of pursing asset forfeiture in order to be able to support CID and TID's efforts to deprive criminals of their proceeds.
- The relevant authorities should maintain and monitor statistics relating to confiscation of proceeds of crime under all asset forfeiture legislation to better assess the effectiveness of asset forfeiture efforts in Sri Lanka and to identify the areas where confiscation is not being effectively pursued.

4. TERRORIST FINANCING AND FINANCING OF PROLIFERATION

Key Findings

- Sri Lanka's counter-terrorism regime reflects high-level governmental commitment as well as multi-pronged and well-coordinated efforts, with a clear and high national-level policy focus on deterring terrorist activities especially through confiscating the assets of terrorists. This has been effective in countering the Liberation Tigers of Tamil Eelam's (LTTE) operations in Sri Lanka. However, it has been less effective in prosecuting TF cases with foreign elements given the challenges with international cooperation to obtain evidence to prosecute terrorist financiers. The Public Security Ordinance (PSO) and Prevention of Terrorism Act (PTA) have provided an efficient avenue for the authorities to pursue terrorists and their assets and it is evident from the statistics that this avenue has been broadly and effectively used. Notwithstanding, there have been only three TF convictions under the PTA as well as three indictments for the TF offence under the Convention on the Suppression of Terrorist Financing Act (CSTFA), with no convictions yet.
- High-level governmental coordination has ensured that intelligence sharing, investigation and other action is taken against re-emerging terrorist and TF threats. This reflects the dedication and professionalism of the Criminal Investigations Division (CID) and the Terrorist Investigation Division (TID), which work effectively with the FIU and other government authorities. Sri Lanka has implemented targeted financial sanctions on UNSCR 1267, such as UN Regulation No. 2, gazettal of the Taliban and Al-Qaida Lists, and 14 subsequent amendments to December 2014. To date there has been no positive matches against the Lists. This is consistent with the relatively lower TF risk profile for Al-Qaida and the Taliban in Sri Lanka.
- For UNSCR 1373, Sri Lanka has designated entities and persons, principally those associated with the LTTE. There are some issues with the implementation of 'freezing without delay' to date, but UN Regulations No.1 allow for freezing to be implemented forthwith upon designation and ex parte. More significantly, all those designated are based in other jurisdictions and the authorities have approached those jurisdictions for support but with very limited positive outcomes to date. Eight domestic bank accounts have been frozen based on matches against the designated lists.
- However, the lack of implementation of customer due diligence (CDD) beneficial ownership and preventive measures undermines the implementation of targeted financial sanctions for United Nations Security Council Resolutions (UNSCRs) 1373 and 1267. Compounding this challenge for UNSCR 1373, is that until the amendments were made to UN Regulations No.1 on 11 December 2014, the previous freezing requirements did not cover persons or entities acting on behalf of, or at the direction of, designated persons or entities.
- Sri Lanka has taken effective measures under the PSO and the PTA to confiscate assets related to terrorism. In the seven year period from 2007-2014 Sri Lanka has confiscated LKR 507.6 million (USD 3.86 million[4]) in land and buildings; LKR 77.5 million (USD 590 000[4]) in vehicles; LKR 86.3 million (USD 657 000[4]) in equipment; and LKR 172.4 million (USD 1.3 million[4]) in money. A total of LKR 843.8 million (USD 6.4 million[4]) of LTTE assets was confiscated.
- Sri Lanka displays awareness of the risk of non-profit organisations (NPOs) being used for TF, although no outreach or other targeted activities have been conducted on TF to protect the sector in this regard. Officials advised of plans for such outreach but details were not provided. The Non-Government Organisations (NGOs) Secretariat exercises oversight of the sector and inasmuch as they receive information from those organisations seeking registration, they are able to conduct adequate background checks. However, the secretariat is not able to effectively monitor and support the sector.
- No material steps have been taken to implement the requirements for targeted financial sanctions

concerning UNSCRs 1718 and 1737 (and successor resolutions) aimed at the Democratic People's Republic of Korea (DPRK) and Iran respectively. Key agencies are aware of Sri Lanka's obligation under those UNSCRs. There is also some awareness amongst the more sophisticated financial institutions.

4.1 Background and Context

154. Significant progress has been made in addressing the technical deficiencies identified in the 2006 mutual evaluation report of Sri Lanka. Sri Lanka has developed a strong legal framework for countering TF that is provided by the CSTFA No. 25 of 2005 (as amended) and that criminalises TF in accordance with the FATF standards. There is also other relevant legislation such as the Prevention of Terrorism Act (PTA) No. 48 of 1979 (as amended) and the Public Security Ordinance (PSO) No. 25 of 1947 (as amended). UN Regulations Nos. 1 and 2 provide the basis for designation and freezing without delay mechanisms for UNSCR 1373 and 1267 respectively.

155. Due to the civil war with the LTTE, authorities have mostly relied on the expeditious provisions in the PSO and the PTA, and the wide ranging powers it gives to military and law enforcement authorities, to pursue and seize property of terrorists and their affiliates.

156. Sri Lanka's policies in promoting transparency, integrity, and public confidence in NPOs are provided for in the Voluntary Social Service Organisations (VSSO) Act 1980 (as amended), VSSO Regulations No. 1101/4 of 1999, and circular issued by the President in 1999. Implementation of the requirements is overseen by the National Secretariat for NGOs in the Ministry for Defence.

157. Sri Lanka has taken no material steps towards complying with the requirements of the UNSCRs on proliferation financing, which is a new Recommendation not required during the 2006 assessment.

4.2 Technical Compliance (R.5-8)

158. See the technical compliance annex for the full narrative on these Recommendations.

- Recommendation 5 – Terrorist financing offence is rated compliant
- Recommendation 6 – Targeted financial sanctions related to terrorism and terrorist financing is rated largely compliant
- Recommendation 7 – Targeted financial sanctions related to proliferation is rated non-compliant
- Recommendation 8 – Non-profit organisations is rated partially compliant

4.3 Effectiveness: Immediate Outcome 9 (TF investigation and prosecution)

(a) Prosecution/conviction for TF activity consistent with Sri Lanka's risk profile

159. **As indicated under IO.1, Sri Lanka has an acute understanding of its risks relating to terrorism and TF, particularly the TF threats relating to the possible re-emergence of the LTTE, but also other TF threats**. Two key documents, the National Security Strategy and the non-sanitised version of the NRA, identify Sri Lanka's TF risk largely in reference to the movement and use of funds within Sri Lanka, funnelled in from funds raised abroad in support of potential LTTE activities. Authorities confirmed to the team during the onsite this understanding of Sri Lanka's risk, including at discussions with the Chief of National Intelligence.

160. **There is a clear and high-level focus on national policy to deter terrorist activities, especially through confiscating the assets of terrorists**. The focus of Sri Lanka's security and law enforcement agencies in relation to TF has traditionally been the threat from LTTE activities but Sri Lankan authorities are also cognisant of possible TF threats arising from such non-LTTE activities as are prevalent in other parts of the world.

161. **Sri Lanka has a legal framework for the investigation of terrorist financing that can impose effective sanctions, which is the CSTFA**. The CSTFA is consistent with Sri Lanka's obligations under the International Convention for the Suppression of the Financing of Terrorism, and was enacted to disable and punish terrorist financiers and to trace, freeze and confiscate their assets.

162. To date, there has been no conviction under the CSTFA because Sri Lankan authorities have found it more expedient to pursue prosecutions and other actions under the PTA, and in limited cases, emergency provisions of the PSO. Authorities indicated that they are more familiar with the PTA, and that the CSTFA initially had significant technical deficiencies, prior to the two amendments in 2011 and 2013 respectively. The PTA remains the preferred legislative tool because authorities remain less familiar with the CSTFA, which is more challenging to implement. The PTA, with its non-conviction based, administrative mechanisms, is particularly useful in instances where access to evidence is challenging, such as where the evidence or the offender lies abroad and there are challenges in obtaining international cooperation to obtain the evidence or the offender.

163. **The Sri Lankan authorities have observed that a significant number of TF offences have a foreign connection in view of the involvement of the Sri Lankan diaspora**. However, as noted under IO.2, both technical and structural deficiencies in the mutual legal assistance regime limit Sri Lanka's ability to obtain assistance and evidence to support and pursue TF prosecutions and confiscations with significant foreign elements. While the Sri Lankan authorities like the Central Bank of Sri Lanka (CBSL) and Ministry of Defence have indicated requests for assistance could be affected by foreign jurisdictions not having designated the LTTE, none of the authorities showed any examples of mutual legal assistance requests, extradition requests or such that had been rejected by foreign countries on the basis of the status of the LTTE.

164. **There have been efforts by the Sri Lankan authorities to obtain evidence through international cooperation resulting in a handful of successful cases.** The Sri Lankan authorities cited a case involving a European citizen based in an Asia/Pacific jurisdiction who was arrested in Sri Lanka for his involvement in TF offences relating to the LTTE. Evidence against the offender was sought through a mutual legal assistance request to the Asia/Pacific jurisdiction and the offender since convicted in Sri Lanka under the PTA. Another mutual legal assistance request, to a European country, resulted in five LTTE operators being convicted in that jurisdiction. Several other mutual legal assistance and extradition requests and requests for international assistance relating to the participation and financing of LTTE activities remain in progress and reflect the TID's ongoing counter-terrorist financing engagement on several fronts. The Sri Lankan authorities also cited several cases where mutual legal assistance requests were made but assistance is yet to be forthcoming or has been rejected. In one case relating to TF, the foreign authority did not pursue the matter as there was no prospect of conviction.

(b) TF identification and investigation

165. There are two designated agencies for TF. Both the TID and the CID in the Sri Lanka Police have a role in TF investigations and work closely together. To assist in TF investigations, the Attorney General's Department (AGD) has assigned four senior prosecutors to work with the FIU and CID on TF (and ML) cases. TID investigates both terrorism and TF offences relating to the LTTE, while CID only investigates TF offences that arise from STRs and information provided by national security agencies. The TID is an offshoot of the CID that was established to investigate LTTE terrorist and TF activities.

166. While the division appears to be due to past events rather than of a functional nature, CID's focus on using STRs to uncover TF activity has resulted in 14 TF investigations. The STRs related to 289 bank accounts and other transactions. Four of these cases were referred to the AGD. Of these, one has led to three indictments under the CSTFA for TF and is pending in court. In addition, in May 2014, TID received a referral from the Sri Lankan FIU relating to a TF suspect with foreign bank accounts. TID sought and received further information domestically from the FIU with respect to the accounts and the Sri Lankan authorities are now considering seeking further evidence from foreign authorities.

167. **TID investigates both TF and other terrorism cases related to the LTTE, and has identified 59 cases for potential TF-related investigations since 2006.** TID provided the assessors with a list containing a description of confiscated items (that includes cash assets as well as vehicles, land and equipment for use of LTTE activities). The investigations resulted in three TF convictions under the PTA that all attracted prison sentences. The Sri Lankan authorities provided the following details of these cases:

Table 4.1: Convictions of TF Cases under the PTA

	Offence	Sentence
Case 1: KR	Providing weapons to the LTTE	10 years imprisonment
Case 2: VB	Providing vehicles to the LTTE	5 years imprisonment
Case 3: GJ	Attempting to procure communication equipment for the LTTE	1 month imprisonment on 15 counts to run concurrently

168. **The most significant case arising out of CID's and TID's coordinated investigations is the TRO case, which disrupted LTTE fund raising flowing into Sri Lanka from abroad.** The TRO is a large transnational NGO established in 2002 that states its purpose as being rehabilitation, resettlement and reconstruction for Tamil refugees. Investigations revealed that the TRO in Sri Lanka, under the guise of a charitable organisation, directed funds to the LTTE by systematically setting up bank accounts in Sri Lanka to channel in funds on the pretext of implementing development projects. The TRO headquarters in Sri Lanka, now closed, operated branch offices throughout Sri Lanka. The TRO is known to have, or have had, a presence in 17 countries worldwide, namely Belgium, Denmark, Finland, France, Germany, Italy, the Netherlands, Norway, Sweden, Switzerland, South Africa, the UK, the US, Australia, Canada, New Zealand and Malaysia. STR information used by CID and other evidence uncovered by TID in 2006 resulted in 9 arrests out of which arose 3 indictments. LKR 90 million (USD 685 200[4]) in 177 bank accounts in 6 local banks were restrained and subsequently confiscated under the PSO. This investigation remains ongoing as TRO affiliated organisations are still operating offshore.

169. More broadly, Sri Lankan authorities have been investigating LTTE fundraising activities pre- and post-2009. Based on evidence provided to the team, from these investigations Sri Lanka has developed a comprehensive schematic of LTTE financing in the years before and after the civil war. These investigations extended beyond activities linked to specific terrorist acts. Previously they were aimed at disrupting and defeating the LTTE as an entity, and now at deterring its re-emergence post 2009. The international financing network and operatives have been identified, including how funds have been channelled through major international financial centres, cash couriers, hawalas and NPOs. The past fundraising activities of the LTTE have also been profiled, including front organisations managing legitimate businesses, criminal activities, and fundraising events from LTTE supporters based overseas. These investigations note that while LTTE financing activities have been significantly reduced in the post-2009 environment, they nevertheless still continue, largely overseas.

170. **TID's investigations in tracing assets relating to terrorist financing include investigating legal arrangements to uncover beneficial ownership and links of companies to terrorists and terrorist financiers where these companies are used to move funds.** TID is able to and has shared relevant

beneficial ownership information obtained through its investigations with other domestic law enforcement agencies (noting the limitations on beneficial ownership as detailed in IO.5). TID has also shared such information with foreign authorities through mutual legal assistance mechanisms as well as through intelligence sharing. TID cited two cases where such information was shared with foreign authorities that contributed to one accused being indicted for his role in facilitating the transfer of funds for the LTTE using his company, and another accused being convicted for TF offences in their respective jurisdictions (refer IO.2).

(c) TF investigation integrated with and supporting national counter-terrorism strategies and investigations

171. There are frequent and regular meetings amongst the relevant security and law enforcement agencies, led by the Chief of National Intelligence, to assess current terrorism and TF threats, discuss significant investigations, develop strategies and share intelligence and information. Terrorism trends are also studied, in particular the threat relating to the LTTE. This enables Sri Lanka to prioritise its national counter-terrorism strategies and build strong inter-agency coordination for counter terrorism efforts in Sri Lanka. The Sri Lankan authorities noted that information provided at such meetings has revealed critical information such as attempts by the LTTE to regroup using its foreign network. The meetings are then used to discuss and coordinate strategies to counter such threats. For example, the Sri Lankan authorities received intelligence that funds were flowing from a European country into Sri Lanka for TF purposes, legally through NGOs but diverted for military purpose. This intelligence was shared and discussed at one of these meetings and resulted in investigations, including a request by Sri Lanka for legal assistance from that European country.

172. Aside from its investigative functions in relation to the PTA, TID also coordinates UNSCR 1373 investigations and intelligence gathering, and advises that the regular meetings are useful to coordinate and disseminate information to support the 1373 list as well as for outreach efforts with foreign counterparts in relation to the list. The FIU has also used the information to freeze bank accounts and assets where appropriate.

(d) Effective, proportionate, and dissuasive sanctions

173. TID cited three cases where convictions were obtained under the PTA for offences relating to terrorism and TF activities. The prison sentences imposed are reflected in Table 4.1 above.

174. Authorities advised the assessment team during the onsite visit that the PTA is less complicated, more efficient, and more familiar than the relatively new CSTFA. The PTA criminalises both terrorism and TF activities. However, authorities did not assert or provide evidence to the assessment team that TF cases were prosecuted under the PTA beyond the three cases provided. This small number of cases is not proportionate to the terrorism activity that has occurred in Sri Lanka in the past, particularly given the statistics provided that show significant confiscation of property and assets using the PTA as well as cases revealing TF funds flowing into Sri Lanka from abroad. As such, it is not clear that the PTA is being used widely for prosecution of TF offenders. However, to some degree the low conviction rate for TF is a reflection of how the PTA is utilised as a relatively efficient non-conviction based and administrative confiscation mechanism made to deter terrorist and TF activities by depriving them of their assets. This is compared to the more onerous process required by the CSTFA, whereby the TF offence must be prosecuted through the judicial system.

175. Under the PTA, where it can be shown that funds that are being used for, or are intended to be used for, the purpose of a prescribed organisation such as the LTTE, these funds can be forfeited. TID and AGD have advised that as of December 2014, the PTA has been invoked to confiscate LKR 843 757 793 (USD 6.4 million[4]) (provided in Table 3.15 in IO8 above), which were found to have been used or intended to be used for the purpose of the LTTE.

176. The effectiveness of the CSTFA is not optimal since authorities do not readily use it. However, TID has advised that it is investigating a TF case that it is looking to indict under the CSTFA, and CID has indicted three cases under the CSTFA. TID has also advised that although the CSTFA takes longer to and requires more resources to prosecute and confiscate assets, they are shifting their focus to employ the CSTFA for future TF investigations. By doing this, the Sri Lankan authorities hope to move away from the temporary legislation and employ more permanent laws with respect to these offences.

(e) Other criminal justice and other measures to disrupt TF activities

177. **As explained in detail above, Sri Lankan authorities regularly apply measures to restrain and confiscate assets under the PTA as the preferred method to disrupt TF and terrorist activities relating to the LTTE.** Cases under the PTA are heard by two special courts located in Colombo and Anuradhapura. These cases are fast-tracked and thus do not suffer from the delays faced under the usual court system. The PTA also contains 10 distinct offences under sections 2 and 3 of the legislation. Forfeiture of "all property movable and immovable" of the offender is available upon conviction. In addition, the PTA provides for confiscation of assets and property used or intended to be used for the LTTE without conviction. Thus, the legislation is wide enough to cover a broad range of terrorist activities and property, beyond TF and proceeds, instruments or profits of crime, in order to disrupt terrorist activity.

Overall conclusion on Immediate Outcome 9:

178. Sri Lanka's counter-terrorism regime reflects high-level governmental commitment as well as multi-pronged and well-coordinated efforts, which has been effective in countering the LTTE's operations in Sri Lanka before and post 2009. It has been less effective in prosecution of terrorist financiers although has had successes in disrupting the financing itself. The PTA and the PSO have provided an efficient avenue for the authorities to pursue terrorists and their assets, and it is evident from the statistics that this avenue has been broadly and effectively used. Significant sums of funds and assets (USD 6.4 million[4]) have been confiscated under the PTA and the PSO. This reflects the focus and dedication of the CID as well as the TID, and coordination of the various Sri Lankan authorities. Notwithstanding, there has been no conviction for the TF offence under the CSTFA and only three indictments and three TF convictions under the PTA. There remains broad room for improvement, such as greater focus on prosecution by increasing the use of the CSTFA through improving infrastructure and expertise. The team considered all those issues in arriving at the rating and balanced the deficiency relating to the low number of prosecutions and convictions (core issue 9.1) against the successful efforts of the Sri Lankan authorities in relation to the remaining core issues, in particular core issues 9.3 and 9.5 on sanctions and other disruptive measures respectively.

179. Sri Lanka has achieved a **substantial level of effectiveness** for Immediate Outcome 9.

4.4 Effectiveness: Immediate Outcome 10 (TF preventive measures and financial sanctions)

(a) Implementation: UNSCR 1267 and UNSCR 1373

180. Sri Lanka has appointed competent authorities for UNSCR 1267, being the Chief of National Intelligence, and UNSCR 1373, the Secretary to the Ministry of Defence and Urban Development. Both are appointed by the Minister of External Affairs. The offices of the competent authorities are supported by the Ministry of Defence, as approved by the Cabinet of Ministers of Sri Lanka, including the coordination with relevant departments, such as the FIU.

181. **Sri Lanka has implemented UNSCR 1267 (and its successor resolutions) with changes to the UN Taliban and Al-Qaida Lists coming into effect domestically at the same time as the lists are changed by the UN**. This is consistent with best practice as the obligation is automatic. Further, for public information changes to UN Taliban and Al-Qaida Lists are published in the Government Gazette. The

Taliban and Al-Qaida Lists were first published on 11 June 2013, and an amendment published on 16 August 2013, after UN Regulations No. 2 of 2012 was made on 31 May 2012. Since June 2013, there have been 14 amendments published by way of Gazette up to the end of 2014. The gazettal is public and accessible to all financial institutions (FIs) and designated non-financial businesses and professions (DNFBPs). Further, a directive was issued by the competent authority under sub-regulation 16(3) of UN Regulations No. 2 on 13 October 2013. This directive deals primarily with electronic communication of updates of the Taliban and Al-Qaida Lists to relevant government agencies and reporting entities. Circular 02/13 of 29 October 2013 was issued by the FIU to licensed banks and licensed finance companies. Circular 02/13 states that freezing is effective as soon as the UN Security Council announces the names of designated persons and entities. This deals with how reporting institutions are provided with timely information about updates to the Taliban and Al-Qaida Lists. The FIU also provides monthly updates on any amendments to the Taliban and Al-Qaida Lists to financial institutions.

182. Sri Lanka authorities have identified and documented the funding network of the LTTE from 1987 to 2014, including the key actors based overseas. They have identified three funding sources: front organisations conducting legal businesses; profit-driven criminal activities such as drugs and human smuggling; and donations. Further, authorities have identified the channels for remitting funds from jurisdictions where they have been raised, including through the banking sector in major international financial centres, and then to the LTTE. The subsequent designations under UNSCR 1373 (see below) are based on evidence gathered from investigations over a substantial period of time, including financial investigations and intelligence sharing to lift the veil of secrecy surrounding LTTE financing.

183. **For UNSCR 1373, on 21 March 2014 Sri Lanka designated 16 entities and 424 natural persons through Gazette No 1854/41, pursuant to regulation 4(2) of the UN Regulations No.1**. The designated entities were identified by a working group chaired by the Chief of National Intelligence that meets weekly to consider this issue among others on counter terrorism, ensuring that designation involves coordinated input from relevant law enforcement and national security agencies. The designated names include the LTTE and affiliated organisations based overseas. The list includes a substantial number of names of natural persons residing overseas – none are resident in Sri Lanka – including those previously involved with the LTTE. From the perspective of addressing Sri Lanka's ongoing TF risk, the list is targeted at persons providing ongoing financing support to the LTTE.

184. While the designations were made pursuant to regulation 4(2) of UN Regulations No.1, this regulation does not impose a freezing obligation; the freeze obligation is under regulation 5. Nevertheless, the freeze order is required to be gazetted "forthwith" and ex parte upon designation under regulation 4(2). While UN Regulations No.1 allows for designation and freezing to be gazetted at the same time, thereby avoiding any transposition delay, implementation did not occur simultaneously because the freeze order was not issued until 22 May 2014 via Gazette No. 1863/25. Given the press coverage of the initial designations issued in March 2014, there was a window of opportunity for designated persons and entities to move their funds. The mitigating factor for this is the fact that all designated persons are based overseas, and, except in those few jurisdictions that have designated the LTTE, the affiliated organisations and natural persons are operating legally and would not have been subject to targeted financial sanctions in any event.

185. Furthermore, FIs (banks, securities and finance businesses) were only advised on 24 June 2014 via a directive (Circular No. 02/14) issued by the FIU to implement UN Regulations No.1 and Gazette Notifications No. 1854/41 dated 21 March 2014 and No. 1863/25 dated 22 May 2014. This was issued to facilitate implementation as the freezing obligation came into effect upon the gazettal of the freeze order on 22 May 2014, as noted previously. The directive instructed FIs that in the case of a match of a customer(s) with the particulars of the designated list, the FIs must prevent designated persons from conducting any transactions and freeze all funds, other financial assets, and economic resources without delay.

186. **Despite these issues, the banking sector displayed general awareness of its obligations with regard to targeted financial sanctions**. This is not true for other financial sectors and DNFBPs, which

have not implemented any systematic screening systems. In the banking sector, for persons and entities designated under UNSCR 1267, they have been incorporated into the banks' monitoring systems. In many cases, banks use externally provided software applications to screen records against the sanctions lists. For designations under UNSCR 1373, designated names have also been added to the banks' monitoring systems. There have been no positive matches against the UNSCR 1267 Taliban and Al-Qaida lists but eight individuals have had their bank accounts frozen based on the UNSCR 1373 designations. Authorities advised of ongoing investigations but no details were provided to the assessment team. While it is a positive development that bank accounts have been frozen, the other channel that has been used for TF, that is, the informal remittance sector, remains vulnerable.

187. **For UNSCR 1373, Sri Lanka has approached jurisdictions in which designated persons or entities are located for them to consider designating the persons and entities designated by Sri Lanka**. The designated list includes the LTTE and individuals, persons and entities associated with the LTTE; the former of which some jurisdictions have already designated. These approaches have been through formal diplomatic channels, principally through contacting foreign diplomatic missions based in Sri Lanka. Authorities advised that some responses were received seeking further information, or providing explanations of those other jurisdictions' designation processes. The lack of sufficient evidence to satisfy the requirements of other jurisdictions was mentioned as a hindrance to receiving fruitful responses. At completion of the onsite, no jurisdiction has designated in response to Sri Lanka's request. Sri Lanka subsequently made amendments in Gazette Extraordinary No 1892/37 of 11 December 2014 to UN Regulation No.2, under regulation 4(B), that will provide comprehensive requirements for the competent authority to include more information and particulars in support of any request to a foreign State to designate any natural or legal person, group or entity designated by the Minister under the regulations. Sri Lanka views the 1373 designations as also having a deterrent effect within Sri Lanka.

188. More importantly, while banks have implemented screening against the UNSCRs 1267 and 1373 lists, the lack of CDD beneficial ownership implementation and significant gaps in the implementation of preventive measures (refer IO.3 & 4) fundamentally undermines the implementation of targeted financial sanctions. As discussed under IOs 3 and 4, implementation in non-bank FIs has been limited, and there has been no implementation of preventive measures in the DNFBP sectors. Even for the banking sector, it would be very challenging to delve further into a customer's identity to check whether the ultimate beneficial owner is a designated person/entity. Compounding this challenge is that until the amendments were made to UN Regulations No.1 on 11 December 2014 the previous freezing requirements did not cover persons or entities acting on behalf of, or at the direction of, designated persons or entities.

189. Sri Lanka has not proposed any designations to the UN Sanctions Committee in respect to UNSCR 1267 (and its successor resolutions) because it has not identified thus far any natural person or entities that could have been linked with Al-Qaida or the Taliban. Sri Lanka has mechanisms in place for identifying targets for designation based on the process used recently for the UNSCR 1373 designations.

(b) Not-for-Profit Organisations

190. **Sri Lanka has not implemented a uniformly strategic approach to monitoring the NPO sector, conducted meaningful outreach or exercised material oversight in dealing with NPOs that are at risk from the threat of terrorist abuse.** Although Sri Lanka applies an intelligence-based monitoring system to NPOs (see Recommendation 8 in the technical compliance annex), it is undermined by regulatory deficiencies in the legal framework, including insufficient empowerment for the authorities to compel registration of NPOs or to apply sanctions for lack of administrative compliance.

191. **The Non-Government Organisation Secretariat, which is responsible for registering NGOs and monitoring their activity, has a good level of understanding of the risks associated with NPOs and TF,** in part as a result of NPOs such as the Tamil Rehabilitation Organisation (TRO) raising funds for the LTTE. Sri Lanka acknowledged the risk posed by NGOs in its NRA and has identified certain categories within the sector as posing higher risk because of their affiliations and operational locations in

Sri Lanka. As identified at Recommendation 8 in the TC Annex, Sri Lanka has not yet undertaken a comprehensive review to understand the NPO sector, including of its risks. While Sri Lanka is especially sensitised because of the conflict with the LTTE, it has not addressed this risk through any measured or substantive approach.

192. Sri Lanka's understanding of the risk TF poses to NPOs is reflected by the decision to move the NGO Secretariat from within the Ministry for Social Security to within the Ministry of Defence, in 2010. This decision was taken due to the case of the TRO, which arose in 2006.

193. The oversight of NPOs, their registration and monitoring, is assisted by the secretariat's placement in the Ministry of Defence where it is able to have substantial checks conducted on individuals through vetting by the office of the Chief of National Intelligence (via the TID), including against UNSCR 1267 and 1373 lists. Whilst it is not mandatory to register with the secretariat, banks will not open accounts unless the NPO is registered, being an incidental effect arising from individual bank policy, not from legislative requirements. Banks do not appear to apply this policy to NPOs registered as companies. While there is incentive to register and to lodge annual returns in order to gain and retain tax concessions, the nature of voluntary registration results in an incomplete understanding of the size of the sector and the size and dynamics of the sector's finances, both international and domestic. Furthermore, those NPOs registered as limited liability companies under the Corporations Act, that are performing NPO activities through which there is significant money passing, are not subject to those checks ordinarily being performed on NPOs. Amendments are proposed to the Voluntary Social Services Organizations (Registration) Act No. 31 of 1980 to make registration compulsory and extend the coverage of NGO regulation.

194. The sector is aware of the administrative role of the NGO Secretariat but not of its role in protecting the sector from abuse by terrorism financiers. The secretariat advises that it has not undertaken any outreach regarding TF but in light of the new TF requirements in the draft amendments to the VSSO, it will likely do so in the future. Practically, the ongoing military presence in the north and east of Sri Lanka, coupled with ongoing monitoring processes, provides for a high level of scrutiny of any new NPOs and all NPO activities as the authorities seek information on who is working there and why, alert to any association with LTTE or other terrorism activities.

(c) Deprivation of assets and instrumentalities related to TF activities

195. Effectiveness of freezing and confiscating in the context of criminal investigations and prosecutions of TF are considered at IO.8.

(d) Consistency with overall TF risk profile

196. **Implementation of targeted financial sanctions for UNSCR 1373 is consistent with Sri Lanka's TF risk profile.** The major TF risk is from funds raised abroad for potential LTTE activities and as such the UNSCR 1373 designations are targeted at individuals and organisations all based offshore that the Sri Lankan authorities believe have known links to the LTTE.

197. Sri Lanka's sensitivity to the NPO sector, its ability to conduct thorough background checks of those NGOs that register with the NGO Secretariat, and its targeted approach in investigating TF are in keeping with the overall TF risk profile. However, the deficiencies outlined above are at odds with the risks identified by authorities, who in turn, in place of policies to govern and protect NPOs and of a more comprehensive appreciation of the dynamics and dimensions of the sector, rely on military and other intelligence to guard against TF in the NPO sector.

198. Deprivation of assets and instrumentalities related to terrorism cases demonstrates more outputs, and these are in keeping with the risk profile.

Overall conclusion on Immediate Outcome 10:

199. Sri Lankan authorities have taken tangible actions to implement targeted financial sanctions to prevent terrorists from raising, moving and using funds. The freezing obligation under UN Regulations No.2 occurs immediately upon designation by the UN Sanctions Committee and inclusion on the Taliban and Al-Qaida Lists. Amongst FIs, only the banks, have implemented screening as required based on commercially provided sanctions list screening programs, and effectiveness is undermined by gaps in implementation of CDD beneficial ownership obligations. Moreover, as discussed under IOs 3 and 4, implementation in non-bank FIs has been limited, and there has been no implementation of preventive measures in the DNFBP sectors. To date there has been no positive matches against the Taliban and Al-Qaida Lists, which is consistent with Sri Lanka's relatively lower TF risk profile for Al-Qaida and the Taliban.

200. For UNSCR 1373, Sri Lanka has designated entities and persons, principally those associated with the LTTE. The lack of screening beyond the banking sector and poor implementation of CDD beneficial ownership and preventive measures also undermines the implementation of targeted financial sanctions for UNSCR 1373. More so, because until recent amendments made to UN Regulations No.2 on 11 December 2014, the freezing requirements had not covered persons or entities acting on behalf of, or at the direction of, designated persons or entities. Nevertheless, eight bank accounts have been frozen based on matches against the designated lists. Sri Lanka displays awareness of the risk of NPOs being used for TF, although no outreach or other targeted activities have been conducted on TF to protect the sector in this regard. The NGO Secretariat exercises oversight of the sector, however, the secretariat is not able to effectively monitor and support the sector.

201. Sri Lanka has a **low level of effectiveness** for Immediate Outcome 10.

4.5 Effectiveness: Immediate Outcome 11 (PF financial sanctions)

(a) Implementation - UNSCRs combating of financing of proliferation

202. There are no formal sanctions against the financing of the proliferation of weapons of mass destruction. An advisory committee is to be established under the United Nations Act No. 45 of 1968 to undertake work in this area comprising the Ministry of External Affairs, AGD, Customs, Atomic Energy Commission, Legal Draughtsman and Ministry of Justice. The FIU, with its familiarity with the international standards has also advised the MEA of Sri Lanka's obligations in this regard. As noted in IO.2, there is generally good coordination amongst relevant Sri Lankan agencies but no coordinated action on proliferation financing (PF) sanctions has been taken yet.

(b) Designated persons and entities

203. **Sri Lanka has not yet taken any steps to identify funds or other assets of designated persons and entities under UNSCRs 1718 and 1737 (and those acting on their behalf or at their direction) to prevent such persons and entities from operating or executing financial transactions related to proliferation**.

(c) Understanding and compliance by financial institutions and DNFBPs

204. The larger FIs in Sri Lanka demonstrated awareness of the international obligations regarding PF and are utilising standard internal processes to comply with these, in particular the international institutions. The smaller domestic institutions and DNFBPs did not have exposure to the requirements and were less confident about the compliance requirements for targeted financial sanctions relating to financing of proliferation.

(d) Monitoring the compliance of financial institutions and DNFBPs

205. Sri Lanka is not monitoring compliance by FIs and DNFBPs in regards to PF, as there is currently no requirement to apply targeted financial sanctions in this regard.

Overall conclusion on Immediate Outcome 11

206. Key agencies are aware of Sri Lanka's obligation under the relevant UNSCRs to implement those requirements. There is also some awareness amongst the more sophisticated FIs. However, no material steps have been taken to implement the requirements for targeted financial sanctions concerning the UNSCRs relating to the combating of financing of proliferation.

207. Sri Lanka has a **low level of effectiveness** for Immediate Outcome 11.

4.6 Recommendations on Terrorist Financing and Financing of Proliferation

208. Sri Lanka is **recommended** to undertake the following prioritised actions:

- Authorities should use the CSTFA to prosecute the financiers of terrorism.
- Invest in technical expertise to be able to pursue more TF prosecutions and asset confiscation proceedings under the CSTFA.
- Maintain data and statistics in relation to assets restrained and confiscated that relate specifically to the financing of terrorism.
- Support effective implementation of targeted financial sanctions for TF by:
  - implementing all aspects of targeted financial sanctions pursuant to UNSCR 1267 and 1373 as required by Recommendation 6, and
  - establishing effective supervision of FIs and DNFBPs for targeted financial sanctions.
- Implement measures to address the requirements of Recommendation 8, particularly build a solid framework of preventive measures to apply to those NPOs that account for a significant portion of the financial resources under control of the sector, and a substantial share of the sector's international activities, and deliver outreach to NPOs regarding TF risk and requirements for NPOs per the new legislative amendments.
- Take material steps to implement targeted financial sanctions concerning UNSCRs 1718 and 1737 relating to the combating of financing of proliferation. These steps should include effective supervision and monitoring of compliance.

5. PREVENTIVE MEASURES

Key Findings

- Since the last mutual evaluation report in 2006, Sri Lanka has made progress in promulgating enforceable rules under the Financial Transactions Reporting Act (FTRA) to enhance the level of compliance across financial sector. Efforts made by authorities to increase the level of understanding and awareness among financial institutions (FIs) are also commendable. However, significant gaps still exist in prescribed requirements on a number of key areas such as customer due diligence (CDD), politically exposed persons (PEPs), high-risk countries, internal controls, correspondent banking, wire transfer and money or value transfer service (MVTS), among others. These gaps inhibit the effective implementation of preventive measures across all financial sectors.
- Based on onsite meetings, financial institutions' (FIs') level of understanding of ML/TF risks and obligations is variable across sectors and within a sector, across institutions. In general, while FIs exhibited some understanding of such risks and obligations, there is lack of a comprehensive risk-based approach in understanding, addressing and taking mitigating measures, which is a significant gap. Capacity issues (both technical capability and human resources) also remain a challenge especially in the context of FIs having a large number of branches and a widely dispersed geographical reach and client base.
- While there are some basic requirements in the FTRA for designated non-financial businesses and professions (DNFBPs), there is neither implementation nor supervision of any AML/CFT preventive measures, and this is a significant and fundamental gap. There is no, or very minimal, understanding and appreciation of ML/TF risks in the sector as well as lack of any kind of implementation efforts. This should be a priority area for Sri Lanka, going forward.

5.1 Background and Context

(a) Financial Sector and Designated Non-Financial Businesses and Professions (DNFBPs)

209. The financial sector in Sri Lanka consists of banks, insurance companies and intermediaries, stock exchange, stockbrokers and dealers, and other FIs such as licensed finance companies, authorized moneychangers, MVTS providers.

i. ***Banking Sector:*** The banking sector, regulated and supervised by the Central Bank of Sri Lanka (CBSL) comprises of licensed commercial banks (LCBs) and licensed specialized banks (LSBs) which accounted for 56.7 per cent of the financial sector's assets as at end 2013. The level of banking sector assets relative to GDP was 68.5 per cent as at end 2013. At the end of 2013, there were 33 licensed banks including 24 LCBs and 9 LSBs. Of the total LCBs, twelve were foreign bank branches. Out of all banks, 21 were domestic banks comprising of 12 LCBs and nine LSBs as at end 2013. The Sri Lankan banking sector remains concentrated on a few major banks and the six largest local LCBs are identified as being systemically important by the CBSL. Just over half of the assets of the banking sector are accounted by the two largest LCBs, which are state owned. Foreign representation of the banking sector is relatively low in market share. As is the case with most other jurisdictions, the banking sector is important from an ML/TF risk perspective.

ii. ***Securities Sector:*** The securities sector is regulated by the Securities and Exchange Commission of Sri Lanka (SEC). The Colombo Stock Exchange (CSE) is the only licensed stock exchange operating in the country. As at end of March 2014, there were 15 member firms and 15 trading members (commonly referred to as 'broker firms') operating in the CSE. In addition, 16 custodian

banks providing custody services to clients were operating on the CSE. As at end of March 2014, 293 companies covering 20 sectors with a market capitalization of approximately LKR 2500 billion (USD 19 billion[4]) were listed on CSE. The CSE's market capitalization was equivalent to 32.4% of GDP according to the 2013 data. The number of approved units trusts as at December 31, 2013 stands at 62 with net asset value at LKR 54 billion (USD 411 million[4]).

iii. ***Insurance Sector:*** The insurance industry is governed by the Insurance Board of Sri Lanka (IBSL) established under the Regulation of Insurance Industry Act No. 43 of 2000. There were 21 companies operating as insurers under the Act as at the end of the year 2013. Total assets held by insurance companies were only 3.5 per cent of the total assets of financial sector in 2013. Total gross written premium generated by companies amounted to LKR 94.4 billion (USD 719 million[4]) and industry grew by 8.39 per cent in 2013 compared with the previous year.

iv. ***Other Financial Institutions:*** Other financial sector institutions comprise both regulated and informal sector. Regulated sector comprises of licensed finance companies, specialized leasing companies, authorized moneychangers, non-bank primary dealers, authorized money brokers, e-money services providers, rural banks, thrift and co-operative societies, while informal sector comprises informal MVTS providers, informal money lenders, informal pawn brokers and informal microfinance institutions. Regulated institutions are considered less vulnerable to ML/TF risks compared to informal sector institutions. Within the sector, Sri Lanka considers informal MVTS as having highest vulnerability in ML/TF framework with high structural risks and low control measures.

210. A snapshot of relative size of the financial sector constituents is as follows in Table 5.1.

Table 5.1: Financial sector – size by organisational grouping

Financial Institution	% of Total Assets	% of Total Deposits	Regulator/SRB	AML/CFT Supervisor
Licensed Banks	55.8	91.9	CBSL	FIU and CBSL
Licensed Finance Companies	4.9	6.2	CBSL	FIU and CBSL
Primary Dealers	1.5	n/a	CBSL	FIU
Specialized Leasing Companies	1.5	n/a	CBSL	FIU and CBSL
Rural Banks	0.9	1.8	DCD	FIU and DCD
Thrift and Credit cooperative Societies	0.0	0.2	DCD	FIU and DCD
Insurance Comp.	3.3	n/a	IBSL	FIU and IBSL
Stockbrokers/Dealers	0.2	n/a	SEC/CSE	FIU and SEC
Unit Trusts	0.3	n/a		
Mkt. Intermediaries	0.3	n/a		
Credit Rating Agency.	0.0	n/a		
Central Bank	15.4	n/a	n/a	n/a
Contractual Savings Institutions	15.9	n/a	CBSL, Department of Labour	FIU
	100	100		

211. DNFBPs that operate in Sri Lanka are casinos, real estate agents, dealers in precious metals and stones, lawyers and notaries public, accountants and trust and company service providers. The lack of relevant statistics (such as on the size and number of institutions, intensity and value of cash transactions, key products, services and clients served, number and value of predicate or ML/TF offences involving DNFBPs) hampers meaningful assessment on the materiality and specific ML/TF risks posed by DNFBPs within Sri Lanka's financial system.

i. **Casinos:** The Department of Inland Revenue confirms that there are five casinos operating in Colombo. These casinos pay the relevant taxes to the Department of Inland Revenue based on self-declared profit submissions. The casinos continue to operate on an unlicensed basis, as the Casino Business Regulations Act 2010 has not been brought into effect, neither has a competent Ministry been appointed to administer the Act. The Sri Lankan authorities are not able to provide any reliable estimates on the turnover or volume of transactions of the gaming industry as the casino operators are not subject to any form of regulatory reporting, but confirm that casinos are frequented mainly by foreigners. The assessment team visited a casino during the onsite and confirmed operations are relatively small scale. The NRA considers casinos to be of higher risk to ML given the high use of cash for purchase of chips, high exposure to high-risk clients, which are identified as PEPs and tourists and absence of regulations and implementation of AML/CFT measures.

ii. **Real estate agents**: There are no available estimates on the number of real estate agents as there is no authority or self-regulatory body (SRB) responsible for regulating the real estate sector. The Registrar General's Department acts as the supervisor of land registries. Based on increasing volume of transfer of ownership transactions that are registered in 45 Land Registries across Sri Lanka, the country's real estate sector is vibrant and growing. In 2009, 748 086 deeds were registered with the Land Registries, increasing to over 1.3 million deeds in 2011, while a total of 951 746 deeds were registered in 2013. The Sri Lankan authorities assert that the sale and purchase of land and property is negotiated by many parties including real estate agents and property developers, through finance companies or through direct negotiations between buyer and seller. The government has introduced measures to prohibit the sale of land to foreigners effective from 1 January 2013[6], but it is unclear what mechanisms have been established to monitor and enforce this. Similar to casinos, the NRA considers the real estate sector to be of higher risk to money laundering given the absence of a prudential regulator and AML/CFT supervision, and incidents of ML investigations relating to the real estate industry in the last five years.

iii. **Dealers in precious metals and stones:** Dealers in precious metals and stones are regulated under the National Gem and Jewellery Authority Act no. 50 of 1993, with the National Gem and Jewellery Authority (NGJA) serving as the industry's regulator. In 2013, 6 565 and 4 429 licences were issued by the NGJA for gem mining and gem dealing respectively. The Sri Lanka Gem and Jewellery Association was established in 2012 to act as the industry association for the sector. The export value of gem, jewellery and diamonds is LKR 55 billion (USD 418.7 million[4]), representing 4.3% of exports and equivalent to 7 015 export invoices as reported to the NGJA. The NRA reports that most of the transactions within the country are cash-based and that majority of the clients are foreigners, with no ML investigations reported in relation to dealers in precious metals and stones.

iv. **Lawyers and Notaries**: The Sri Lankan authorities estimate the number of lawyers at 12 000. Legal professionals in Sri Lanka are regulated by the Supreme Court, which determine the eligibility criteria for issue, renewal (and revocation) of practising certificates and imposes rules on conduct through Gazettes. The Bar Association of Sri Lanka acts as the SRB for the profession. Notaries are governed by the Notaries Ordinance, which is administered by the Registrar General's Department (RGD). Notaries provide conveyancing services, with a total of 10 352 practising notaries registered with the RGD in 2013. Of these, 9 988 are lawyers, while 364 notaries are not lawyers. The NRA considers notaries to have low exposure to foreign and high-risk customers, but does not elaborate on the basis for this assessment beyond professional judgment. There have been

[6] http://www.reuters.com/article/2014/10/21/sri-lanka-land-foreigners-idUSL3N0SG5NB20141021

cases of ML investigations reported in relation to the legal profession and notaries in the last five years.

v. **Accountants**: There are a total of 10 254 professionally qualified accountants in Sri Lanka, and the relevant professional bodies inform that there are other non-professional members who are degree holders, higher national diploma holders and part qualified students who also serve as accountants. It is unclear how many of these accountants fall within the scope of DNFBPs as defined by FATF. There are several professional bodies that offer professional accounting qualifications and serve as SRBs for their respective members – Institute of Chartered Accountants of Sri Lanka (ICASL), Chartered Institute of Management Accountants of the United Kingdom (CIMA), Association of Chartered Certified Accountants (ACCA), Association of Accounting Technicians of Sri Lanka (AAT) and Certified Management Accountants of Sri Lanka (CMA). ICASL members account for the highest percentage of qualified accountants (45%), followed by CIMA (29%) and CMA (23%). The members are governed by the Acts, regulations, by-laws, and code of ethics of their respective body. The Sri Lanka Accounting and Auditing Standards Act No. 15 1995 restricts the conduct of external audits of specified businesses only to members of ICASL. The authorities assert that most of the clients of accountants are low risk and comprise mainly of local residents, but it is unclear whether this is the case on the ground as no AML/CFT supervisory activities have been conducted to validate this assumption.

vi. **Trust and company service providers (TCSPs)**: TCSPs are required to be registered with the Registrar of Companies (ROC). As at 30 November 2014, there were a total of 4 485 TCSPs registered with the ROC, that is, 4 123 company secretaries and 362 auditors. The NRA asserts that exposure to foreign clients is low but no data is available to validate this assumption, rather, it was based on professional judgement. There have been ML investigations involving companies and business structures over the last five years.

(b) Preventive Measures

212. Sri Lanka's legal framework for preventive measures is laid down in the FTRA. The AML/CFT measures applicable to Sri Lanka's FIs are contained in the FTRA for thirteen categories of FIs designated by the FATF. Obligations under the FTRA are applicable to 'institutions', a term that includes persons and entities engaged in finance business and designated non-finance businesses and professions. The FTRA requirements include basic know-your-customer (KYC) and CDD measures, record keeping, suspicious transaction reporting (STR), including tipping off and safe harbour, and the requirement to appoint a compliance officer.

213. Sector-specific rules as provided under the FTRA have been issued for different constituents of the financial sectors separately. Thus, detailed requirements and obligations are set out in KYC/CDD rules issued to licensed banks and finance companies, stockbrokers, insurance companies, and authorised moneychangers (though these requirements do not fully meet the standards in a number of areas as set out in the technical compliance annex). These KYC/CDD rules are enforceable means because they have been issued by competent authorities pursuant to the FTRA, with mandatory language and sanctions for non-compliance as contained in the FTRA, and sanctions have been applied for violations. These Rules are:

- Know Your Customer (KYC) and Customer Due Diligence (CDD) Rule No. 1 of 2011 and Amendment in 2012 for Licensed Banks and Registered Finance Companies ('Financial Institutions')
- Rules on Know Your Customer (KYC) & Customer Due Diligence (CDD) for the Securities Industry of 28 December, 2007
- Rules on KYC and CDD for the Insurance Industry of 11 September 2008

- Rules of 31 January 2013 for all Authorized Money Changing Companies

214. While the FTRA contains broad CDD requirements, record keeping and reporting obligations and internal control procedures for both FIs and DNFBPs, to date no specific rules have been issued for the DNFBP sector, which remains outside the implementation of AML/CFT preventive measures and supervision. Non-bank MVTS providers (such as the Post Office and other permitted entities) that serve as inward remittance agents of foreign MVTS providers (such as Western Union) are also not subject to detailed CDD or other preventive obligations.

215. The FIU has drafted Financial Institutions (Customer Due Diligence) Rules 2014, addressed to FIs. These rules are expected to substantially improve the technical compliance requirements relating to customer identification, ongoing due diligence, enhanced and ongoing customer risk assessments, measures for identifying and managing PEPs consistent with the new FATF Standards, correspondent banking, wire transfer rules and new technology, among others, as applicable to such institutions. These rules, however, are yet to be issued, as the internal consultation process is still ongoing as stated by authorities.

(c) Risk-based exemptions or extensions of preventive measures

216. Sri Lanka is yet to adopt a risk-based approach for exemption or extension of preventive measures. The recommendations contained in the NRA were still awaiting formal approval by the FIU Advisory Board, including the proposed actions to address the identified deficiencies as on the date of onsite visit. As covered under Recommendation 1 in the technical compliance annex, specific AML/CFT obligations exclude certain institutions (rural banks, cooperative societies) and not all elements of the relevant FATF Recommendations are required to be implemented by FIs and DNFBPs. The basis for these exemptions is not based on proven low risk of ML/TF or their materiality.

5.2 Technical Compliance (R.9-23)

217. See the technical compliance annex for the full narrative on these Recommendations.

- Recommendation 9 – Financial institution secrecy laws is rated largely compliant

Customer due diligence and record keeping

- Recommendation 10 – Customer due diligence is rated non-compliant
- Recommendation 11 – Record-keeping is rated largely compliant

Additional measures for specific customers and activities

- Recommendation 12 – Politically exposed persons is rated non-compliant
- Recommendation 13 – Correspondent banking is rated non-compliant
- Recommendation 14 – Money or value transfer services is rated non-compliant
- Recommendation 15 – New technologies is rated partially compliant
- Recommendation 16 – Wire transfers is rated non-compliant

Reliance, controls and financial groups

- Recommendation 17 – Reliance on third parties is rated non-compliant
- Recommendation 18 – Internal controls and foreign branches and subsidiaries is rated partially compliant
- Recommendation 19 – Higher-risk countries is rated non-compliant

Reporting of suspicious transactions

- Recommendation 20 – Reporting of suspicious transactions is rated compliant
- Recommendation 21 – Tipping-off and confidentiality is rated compliant

Designated non-financial businesses and professions (DNFBPs)

- Recommendation 22 – DNFBPs Customer due diligence is rated non-compliant
- Recommendation 23 – DNFBPs Other measures is rated partially compliant

5.3 Effectiveness: Immediate Outcome 4 (Preventive Measures)

218. Since the adoption of the last MER in 2006, Sri Lanka has taken steps to implement the FTRA (which came into effect during onsite visit of the last assessment team) and the applicable rules issued subsequently. However, the FTRA and the rules are still inadequate to require FIs and DNFBPs to fully implement preventive measures effectively. This is a result of a combination of factors and challenges, including those resulting from inconsistent or lack of enforceable obligations in a number of key areas and for constituents as further elaborated in subsequent paragraphs. Sound and effective implementation efforts on the basis of ML/TF risks across sectors are also at a preliminary stage, as the NRA has recently been completed and is yet to be formally approved as at the time of the onsite and its recommendations are therefore work in progress.

219. Furthermore, rules issued for FIs do not fully address the key technical requirements relating to enhanced CDD, beneficial owners, PEPs, correspondent banking, wire transfer, internal controls and procedures, and higher-risk jurisdictions among others. This has had a cascading impact on implementation and effectiveness.

(a) Understanding ML/TF risks and AML/CFT obligations and applying mitigating measures

220. **Since its inception, the FIU has conducted a number of awareness raising programs and one-on-one meetings with constituents across sectors to enhance their levels of understanding of the AML/CFT requirements as contained in FTRA and sectoral rules**. The awareness raising is not based on the results of any formal risk assessments, but on the general risk of ML/TF occurring through criminals or terrorists abusing vulnerabilities in the financial sector. This certainly has contributed to a broad appreciation of ML/TF obligations by various constituents of the financial sector and to building their capacity, though market participants underscored the need of further guidance and engagement. Understanding of broad ML/TF risks and measures needed to mitigate them vary across sectors and within a sector, across institutions. Financial institutions as a whole did exhibit some understanding of ML/TF risks, especially the risk posed by drug traffickers and the Liberation Tigers of Tamil Eelam (LTTE), and mitigating measures (though varying across sectors) , even in the absence of the NRA results being made available to FIs.

221. **DNFBP Sector: The absence of comprehensive, enforceable AML/CFT obligations for the DNFBP sector and the absence of any implementation is a major concern.** As mentioned, there are

STR reporting, recording keeping, basic CDD and internal control requirements in the FTRA for DNFBPs. However, despite the presence of such obligations since 2006, there has been no implementation of those requirements. No detailed AML/CFT rules have been issued for any of the DNFBP sectors. Casinos and real estate agents lack a market entry regulator and have not yet been subject to any AML/CFT supervision and enforcement of requirements by the FIU. Dealers in precious stones and metals, lawyers, notaries, accountants, and TCSPs, have not been subject to either offsite or onsite AML/CFT supervision or enforcement by the FIU as the designated supervisor. There is a low level of awareness, understanding and appreciation of ML/TF risks, even at a general level, within the DNFBP sector as a whole. The sector as a whole expressed an earnest need to initiate efforts for building capacity and awareness programs.

(b) Requirements on CDD and PEPs

222. **Requirements stated under FTRA and rules do not fully address the standards and hence it results in major technical deficiencies,** particularly in areas such as identification and verification of beneficial ownership, of person purporting to act for the customer, keeping CDD information up to date and relevant, application of CDD on existing customers on the basis of materiality and risk, enhanced CDD measures across all sectors in case where ML/TF risks are higher, risk profiling of clients, among others result in uneven implementation and is often subject to the discretion and level of understanding of market participants. This has had a cascading impact on effective implementation of CDD measures across sectors.

223. **Lack of consistency and uniform application is another area of concern as requirements vary across sectors. Rules containing detailed CDD elements have not been issued to all sectors** (on issues such as beneficial owner definition, measures to identify customers that are legal persons or legal arrangements, timing of verification, simplified CDD measures among others). Therefore, the significant technical deficiencies coupled with inconsistent requirements across sectors have led to regulatory uncertainty and challenges as regards expectations from market participants.

224. FIs interviewed by the assessment team demonstrated implementation of basic CDD using the documents prescribed by the FTRA and rules, and some implementation of beneficial ownership checks, irrespective of the lack of specific enforceable requirements. Such implementation varies across sectors and within sectors, across institutions, depending upon the level of sophistication and internal norms. Onsite inspection reports made available to the assessment team confirmed the implementation of basic CDD practices, although there have been certain deficiencies especially relating to enhanced CDD, beneficial ownership, full CDD documentation etc. across financial sector.

225. Banks met during the onsite displayed a more sophisticated approach to CDD. Within the banking sector, foreign banks and domestic private banks are implementing measures beyond mandated obligations, with international banks implementing higher, home supervisor and group requirements. Foreign market share in the banking sector, however, is relatively low. Two state-owned banks account for over half of the assets of the banking sector. These two banks also have the most branches throughout Sri Lanka. Based on a comparative review of onsite inspection reports, implementation of preventive measures in non-bank FIs is generally lower than required under the FTRA and CDD directives.

226. Both authorities and FIs reported that rejection of business with customers due to incompleteness of CDD happens in accordance with the risk appetite and the risk tolerance of the particular institution, though it is unclear if such decision is informed by specific ML/TF risks in the absence of consistent understanding across institutions. Generally, account opening or conduct of business with customer is refused if the institutions are not satisfied with the data provided by them.

227. Significant technical compliance shortcomings undermine effectiveness of implementation of requirements relating to PEPs. Even without existence of essential requirements across sectors, FIs generally consider PEPs as significantly high-risk customers from their perspective. While there is general understanding and appreciation of PEPs and corresponding risks, implementation of requirements relating to PEPs is uneven across sectors. The general findings on CDD are also applicable to PEPs. At a broader

level, written AML/CFT policy documents of most of the FIs contain reference to PEPs, risks posed by them and requirement to involve senior management in establishing business relationship with PEPs. However, implementation efforts to proactively identify PEPs, fully understand, address and mitigate risks posed by such business relationships and to conduct enhanced CDD were not found to be adequate commensurate to the risks. Lack of guidance and clarification from authorities on PEPs is also an inhibiting factor for effective implementation.

228. Overall, authorities seem to be aware of these issues and in response the draft Financial Institutions (Customer Due Diligence) Rules, 2014 have been formulated by FIU. These rules are expected to substantially improve, at least, the technical compliance requirements relating to customer identification, ongoing due diligence, enhanced and ongoing customer risk assessments, measures for identifying and managing PEPs consistent with the new FATF Standards. The draft rules in their existing form provide further direction on the risk-based approach that is to be followed by FIs. The rules intend to prescribe obligations for FIs regarding implementation of internal policies and controls for determination of a customer as PEP, approval of senior management to establish or continue business relations, identifying source of funds and wealth and conduct of enhanced ongoing monitoring of business relationships. These rules, however, are yet to be issued, as the internal consultation is ongoing.

(c) Record Keeping

229. Generally, the FIs seem to have strong record keeping practices in Sri Lanka. CDD, transactions and other records are kept by FIs for a period longer than that required under the standards. The onsite examinations conducted by the FIU did not reveal any significant compliance failures and generally, FIs seem to have strong systems, processes and procedures in place to comply with record keeping obligations. Many of the larger institutions also have automated systems to keep CDD information in electronic format for easy retrieval. In case of the DNFBP sector, in the absence of any specific enforceable obligations and supervision, no indicators exist to demonstrate effective implementation of record keeping measures.

(d) Correspondent banking

230. As set out in the technical compliance annex, significant technical deficiencies exist on the issue of correspondent banking. These relate to the absence of any explicit requirements for banks and finance companies to understand the AML/CFT responsibilities of each FI, or to obtain approval from senior management before establishing new correspondent relationships. Requirements relating to 'payable-through accounts' are also missing and rules do not specifically prohibit dealing with shell banks. While FIs seem to exercise some diligence in establishing such relationships, the effectiveness of implementation is, inhibited due to lack of specific enforceable obligations. Interviews with private sector and industry associations indicated that even without clear obligations, to some extent implementation is achieved, as foreign banks tend to follow their own global risk practices. Secondly, establishment of correspondent banking relationships by domestic banks with international banks results into AML/CFT assessment by such global banks, which even without domestic obligations, seeks to enhance the level of implementation to some extent. That said, such indirect efforts for enhancing the level of compliance do not fully address implementation challenges.

(e) New technologies

231. Sectoral rules have identified certain scenarios (electronic cards, preloading of credit cards, internet banking and online sale of insurance policies) for which banks, finance companies and insurers should apply enhanced measures. While different sector constituents seem to put processes and structures (including approval through senior level committees) in place before the launch of a new product, no specific ML/TF risk assessment is carried out in all such cases. This is reflective of the absence of specific obligations to assess the ML/TF risks associated with new products, technologies, delivery channels and

practices across the financial sector. The draft rules addressed to FIs prescribe more detailed requirements, though as stated earlier these are yet to be issued.

(f) Wire transfers rules

232. While KYC/CDD rules impose very limited obligations to incorporate information pertaining to originator, in the absence of a specific requirement, it is unclear to what extent FIs verify it for accuracy. Other technical deficiencies identified with respect of wire transfer rules such as, inclusion of beneficiary information in cross-border wire transfer, verification of information pertaining to customer where there is a suspicion of ML/TF, among others have also had a cascading effect on effectiveness of implementation. Financial institutions tend to follow their own business practices and policies in accordance with their own risk management systems and procedures. Interviews with private sector indicated that the business practices, procedures and risk monitoring mechanisms of global entities with which domestic banks/non-bank MVTS providers have a tie up, indirectly lead to enhanced compliance at the ground level domestically. However, this does not seem to fully meet the implementation requirements owing to absence of direct obligations.

(g) Targeted financial sanctions relating to TF

233. **Competent authorities and FIs (notably banks) are generally aware of their obligations with regard to targeted financial sanctions.** Systems and procedures are in place for prompt electronic dissemination of UNSCR 1267 Taliban and Al-Qaida Lists to authorities and FIs, and there seems to be a comparatively better understanding and appreciation of obligations amongst the banking sector, as compared to other FIs and DNFBPs. However, there have been problems with implementation of UNSCR 1373 as the designations and freezing via the gazette were done separately with a gap of a few months, and not forthwith and ex parte as required under UN Regulations No.1. Despite these challenges, representative from the banking sector met during the onsite advised of positive matches and freezing actions taken against recent 1373 designations (LTTE-related persons and entities) but no matches against the 1267 lists. Given the gaps in CDD implementation among all FIs (and no implementation by DNFBPs), particularly on beneficial ownership, it is not clear how well FIs are identifying customers that may be acting on behalf or under the direction of those on the UNSCRs 1267 and 1373 designated lists. Onsite inspection reports have not delved into this level of implementation of targeted financial sanctions.

(h) Higher-risk countries identified by the FATF

234. **The absence of any clear requirements or guidance by authorities is an inhibiting factor with regard to steps to be taken by FIs while dealing with such situations.** Financial institutions, especially the foreign ones having their own risk management systems and policies have some procedures to carry out such risk assessments while on-boarding clients or extending business relationships. However, the same cannot be said to be a practice across board.

(i) Suspicious Transaction Reporting Obligations and Tipping Off

235. **Overall, FIs are generally aware of their obligations to file suspicious transactions reports with the FIU.** The FIU has also made significant efforts to generate necessary awareness and build capacity with the financial sector to make STR filings, which indicates an increasing trend, at least in the banking sector as a whole. However, there is under-reporting across sectors that affect the quantity and quality of information acquired through reporting obligations. There has been no reporting from DNFBPs and very low levels of reporting from the non-banking financial sector. Given the risks identified by the assessment team and in Sri Lanka's own NRA, this is a significant gap, particularly in relation to casinos, the real estate sector and precious gemstones dealers. While information contained in STRs submitted generally includes relevant and accurate information, potentially relevant information from outside of the banking sector is not being provided to competent authorities, at least through this reporting mechanism.

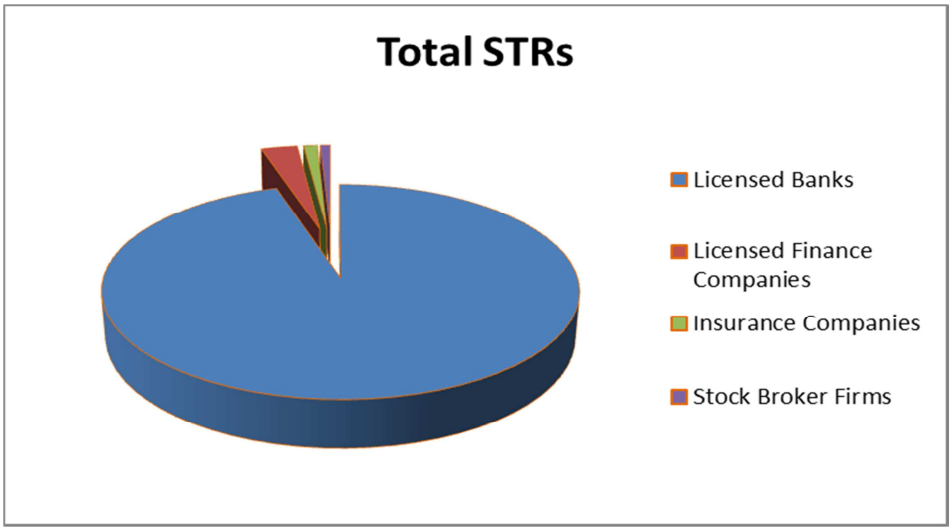
236. The following table, 5.2, reflects the STRs filings made by different constituents of the financial sector:

Table 5.2: STRs filed per financial sector

Year	2010	2011	2012	2013	2014
Licensed Banks	77	76	126	267	451
Licensed Finance Companies	7	9	9	4	-
Insurance Companies	1	4	6	-	1
Stockbroker Firms	2	2	3	1	-

237. Data captured in the above table can also be depicted by the following chart:

Chart of table 5.2: Total STRs received 2010 to 2014



238. There seems to be a greater appreciation of STR obligations in the banking sector vis-á-vis other sectors, as reflected by the above chart. For example, during 2010-14, banks have filed 950 STRs, while STR number for finance companies, insurance companies and stockbroking firms stands at 29, 11 and 8, respectively for the same period (with no STRs during 2014 from any other FIs). No other financial sector or DNFBP institution has submitted an STR during last 5 years. The relative greater share of banks as the predominant contributor to STR filing can be well understood and appreciated in the context of the banking sector's share in the overall economic activity of Sri Lanka. Nevertheless, it is also clear from discussions with market participants during the onsite that the absence of adequate and effective transaction monitoring systems across institutions may be contributing factors to less than the adequate reporting from all segments. Likewise, with too much emphasis or reliance on personal relationships in certain cases especially in the securities sector where comfort seems to be drawn from the fact that clients are known to financial advisors personally. This is despite the fact that PEPs are considered as a significant source of ML/TF risks by FIs and DNFBPs.

239. The inconsistency of reporting is further amplified by an analysis of reporting within sectors. While in the case of 25 commercial banks, 19 have made least one STR during the last five years (which is still

comparatively low), out of 48 licensed finance companies, only three have made any STR filings during last five years. The filings for insurance (3 out of 21) and stockbrokers (3 out of 29) for the same period also reflect an uneven level of reporting obligations within sectors.

240. Authorities are making efforts to enhance the level of awareness and understanding of obligations by the FIs and a general need expressed across the board was for more guidance and typologies of generation of red flags for reporting STRs. Further efforts are needed to improve the feedback and guidance to FIs across sectors and to individual institutions as regards their STR filing obligations and measures to improve the quality of STRs made.

241. Reporting institutions generally seem to be aware of their obligations with regard to tipping off and authorities have indicated no specific concern in this regard.

(j) Internal AML/CFT Controls

242. Authorities have put in place some requirements with regard to internal controls and foreign branches and subsidiaries. However technical gaps remain, which have had a cascading impact on effectiveness of implementation. For example, there are no explicit requirements to have independent audit function to test the AML/CFT systems across financial sector. Financial groups are not required to have group-wide programmes and measures against AML/CFT and there are no specific requirements for FIs across financial sector to apply additional measures to manage ML/TF risks in case host country does not permit implementation of home country AML/CFT measures. Banks and other FIs in certain cases exercise their own discretion and judgement based on their own assessment to deal with such issues but that cannot be said to be full effective across all segments of the market.

Overall Conclusions on Immediate Outcome 4

243. Since the last MER, Sri Lanka has taken a number of steps to put in place preventive measures in the financial sector, but significant gaps remain in implementation primarily because of ongoing technical deficiencies in a number of key areas such as CDD, PEPs, correspondent banking and wire transfers, internal controls and high-risk countries etc., among others. Implementation is relatively more mature in the banking sector than other parts of the financial sector. There has been no implementation in the DNFBP sector of even the basic preventive requirements in the FTRA. The sector seems to be vibrant and sizeable and hence lack of implementation efforts has a serious impact on overall level of compliance.

244. Furthermore, FIs' level of understanding of ML/TF risks and obligations is variable across sectors and within a sector, across institutions. In general, while FIs exhibit some understanding of risks and obligations, there is lack of a comprehensive risk-based approach to understanding, addressing and taking mitigating measures, which is a significant gap.

245. Authorities seem to be aware of these concerns and have formulated draft CDD rules to help address them. Apart from this, capacity issues (technical know-how, human resources and systems) across institutions are also a challenge and would need to be further augmented to ensure effective implementation. This will include a mechanism for implementation of risk-based approach, transaction-monitoring systems, risk-profiling procedures etc.

246. Sri Lanka has achieved a **low level of effectiveness** with Immediate Outcome 4.

5.4 Recommendations on Preventive Measures

247. The following recommendations are made on preventive measures (IO 4):

- Ensure that all the constituents of the DNFBP sector (casinos, real estate agents, dealers in precious stones and metals, lawyers, notaries, accountants and trust and company service providers) are brought within the ambit of the AML/CFT regulatory framework in terms of the

FATF standards. Undertake steps to ensure that the sector is aware of ML/TF risks, implements effective AML/CFT obligations and takes a risk-based approach to mitigating these risks effectively.

- Issue the necessary rules to FIs under the FTRA with a view to address fully the existing gaps in applicable obligations on preventive measures. Ensure consistent understanding and application of key requirements across financial sector on issues such as CDD, PEPs, beneficial ownership, high-risk countries, wire transfers requirements etc.

- Ensure that all the constituents of the financial sector (including non-bank MVTS providers and authorized money changing companies) are subject to full set of obligations with regard to preventive measures.

- Ensure issuance of necessary guidance to FIs on risk-based approach to be followed by them for identifying, addressing and mitigating ML/TF risks faced by them.

- Improve the feedback and guidance to FIs across sectors and to individual institutions within a sector as regards their STR filing obligations.

6. SUPERVISION

Key Findings

- The FIU is significantly under-resourced in its role as the primary AML/CFT supervisor of financial institutions (FIs) and designated non-financial businesses and professions (DNFBPs). Consequently, the FIU has not implemented nor supervised the Financial Transactions Reporting Act's (FTRA's) AML/CFT requirements for DNFBPs.
- There is a distinct lack of clarity on the functions and accountabilities between the FIU and the other prudential supervisory authorities, which also have a role in AML/CFT supervision of FIs under their respective purview. No mechanisms for coordination or collaboration between the FIU and the relevant supervisory authorities with respect to monitoring of FIs' compliance to AML/CFT requirements, be it on a on a risk-informed basis or otherwise, has been established.
- There is no risk-based approach to AML/CFT supervision. Supervision conducted by the FIU and supervisory authorities on FIs is mainly rule-based, with no specific focus on products, clients, channels, or institutions that have been identified as posing higher ML/TF risk.
- The formulation of the national risk assessment (NRA) in 2014 was timely in addressing gaps in supervisors' understanding of ML/TF threats and vulnerabilities in the financial sector but significant gaps remain with respect to DNFBPs. Sectoral risk assessments in the NRA have not manifest into the application of a risk-based approach to supervision of FIs by the FIU or supervisory authorities.
- Supervisory authorities lack clear powers to prevent criminals and their associates from holding, or being the beneficial owner of, a significant or controlling interest in some FIs and all DNFBPs. In addition, certain high-risk sectors are not subject to any fit-and-proper assessments of key responsible persons.
- None of the casinos in operation has been licensed under the Casino Business Regulations Act 2010, and no competent ministry has been appointed to administer the Act. Not all DNFBPs are subject to adequate fit-and-proper requirements in accordance with FATF Recommendations.
- The absence of detailed know your customer/customer due diligence (KYC/CDD) rules and AML/CFT monitoring mechanisms in relation to DNFBPs further constrains effectiveness of the overarching framework for AML/CFT supervision in Sri Lanka.
- A range of remedial and enforcement actions are imposed by the FIU but sanctions for breaches of FTRA provisions do not appear to commensurate with the level of non-compliances observed and is focused primarily on breaches by the banking sector. The sanctions imposed have not been very effective in improving the level of compliance to the AML/CFT requirements in FIs across all sectors, while no efforts have been taken to enforce FTRA requirements on DNFBP sectors.
- The FIU should be commended on driving and facilitating the conduct of AML/CFT awareness activities for FIs and other supervisory authorities, but significant gaps remain with respect to DNFBPs. No written guidance has been issued by the FIU to improve understanding on supervisory expectations and sectoral ML/TF risks.
- There are certain areas of the AML/CFT supervisory regime that require early attention. On market entry, the relevant supervisory authorities should enhance assessment of fitness-and-propriety of licensed FIs in banking, insurance and securities sectors to the level of the ultimate beneficial owner or natural persons with material controlling interest. On compliance monitoring, Sri Lanka should develop a risk-based approach to AML/CFT supervision to assist the FIU and sectoral supervisors in

better allocating their scarce supervisory resources to reporting institutions, products, services or delivery channels that have been identified as posing higher ML/TF risks. This includes extending supervisory coverage to higher-risk DNFBPs and then to all DNFBPs. The lack of clarity in the functions and accountabilities between the FIU and other supervisory authorities should also be addressed for more optimal use of scarce supervisory resources.

6.1 Background and Context

248. Sri Lanka's FIs are regulated through sector-specific legislations such as the Banking Act 1988, Finance Business Act 2011, Securities and Exchange Commission of Sri Lanka Act 1987, Insurance Industry Act 2000 and the Exchange Control Act 1953. The Central Bank of Sri Lanka (CBSL) is responsible for the prudential supervision of licensed banks, licensed finance companies, specialised leasing companies and authorized moneychangers. The Insurance Board of Sri Lanka (IBSL) serves as the prudential supervisor for insurers and insurance intermediaries while the Securities and Exchange Commission of Sri Lanka (SEC) is responsible for the prudential supervision of stockbrokers and capital market intermediaries.

249. Section 15(1)(e) of the FTRA empowers the FIU to function as the AML/CFT supervisor for all reporting institutions in Sri Lanka. In relation to this, s.18(1) of the FTRA provides the FIU, or any person authorised by the FIU, with the mandate to examine the books, records and affairs of any reporting institution to ensure compliance with the Act. In addition, s.23 of the FTRA also requires relevant supervisory authorities to regularly monitor compliance to the Act by reporting institutions under their respective purview and to report any non-compliance to the FIU. With respect to the financial sector, both the FIU and the sectoral supervisory authorities conduct AML/CFT supervision, with the FIU serving as the primary AML/CFT supervisor for FIs and DNFBPs. While rural banks and cooperative societies are broadly scoped in as designated Institutions under the Prevention of Money Laundering Act (PMLA) , and are regulated by the Department of Cooperative Development, they are outside the scope of specific AML/CFT obligations and supervision by the FIU. The Department of Cooperative Development has issued a Circular on know your customer/customer due diligence (KYC/CDD) on 8 August 2014. Rural banks and cooperative societies were instructed to complete a Client Identification Form using a two-page template attached to the Circular, including a checklist for requesting and recording basic information on the purpose of account opening, the source of funds, expected volume of monthly deposits, occupation, and documents used to verify identity and address of the client. However, the circular is not legally enforceable, and serves more as guidance.

250. While the FIU is empowered to function as the AML/CFT supervisor for DNFBPs, there has been no progress in extending more prescriptive KYC/CDD rules on the sector, beyond the provision in the FTRA, since Sri Lanka's mutual evaluation in 2006. There are licensing authorities or self-regulatory bodies (SRBs) for dealers in precious metals and stones, the accounting profession, lawyers, notaries public, and to some extent, trust, and company service providers. Of concern, the casino and real estate sectors remain unregulated.

251. Table 6.1 below lists the relevant regulator and SRBs, and corresponding AML/CFT supervisory authorities for FIs and DNFBPs in Sri Lanka:

Table 6.1 Institutions, regulators & AML/CFT supervisors for reporting institutions in Sri Lanka

Sector	No. of RIs (2013)	Regulator/SRB	Subject to KYC/CDD Rules	AML/CFT Supervisor
Licensed Banks	33	Bank Supervision	Yes	FIU (and

Sector	No. of RIs (2013)	Regulator/SRB	Subject to KYC/CDD Rules	AML/CFT Supervisor
		Department (BSD), CBSL		BSD)
Licensed Finance Companies	48	Department of Supervision of Non-Bank Financial Institutions (DNSBFI), CBSL	Yes	FIU (and DNSBFI)
Specialized Leasing Companies	10		No	
Non-Bank Primary Dealers	7	Public Debt Department (PDD), CBSL	No	FIU
Authorized Moneychangers	68	Exchange Control Department (ECD), CBSL	Yes	FIU (and ECD)
Rural Banks	36	Department of Cooperative Development (DCD)	No	FIU (and DCD)
Thrift and Credit Cooperative Societies	9,571	DCD	No	FIU (and DCD)
Insurance Company	21	IBSL	Yes	FIU (and IBSL)
Stockbrokers/ Dealers	37	SEC/CSE	Yes	FIU (and SEC)
Unit Trusts	15	SEC/CSE	Yes	FIU (and SEC)
Market Intermediaries (includes Margin Providers, Investment Managers, Underwriters, Clearing Houses and Credit Rating Agencies)	74	SEC/CSE	Yes	FIU (and SEC)
Contractual Savings Institutions[7]	174	CBSL, Department of Labour	No	FIU
E-Money Service Providers	2	Payment and Settlement Department (PSD), CBSL	Yes	FIU
Casinos	5	None	No	FIU
Real Estate	*Not available*	None	No	FIU

[7] Contractual savings institutions sector, or the superannuation funds sector, consists of the Employees' Provident Fund (EPF), which is the largest systemically important superannuation fund in Sri Lanka, the Employees' Trust Fund (ETF), the Public Services Provident Fund (PSPF) and the 171 Approved Private Provident Funds (APPFs).

Sector	No. of RIs (2013)	Regulator/SRB	Subject to KYC/CDD Rules	AML/CFT Supervisor
Agents				
Dealers in Precious Metals and Stones	6,565 gem mining 4,429 gem dealing	National Gem and Jewellery Authority	No	FIU
Lawyers	12 000 (estimate)	Supreme Court/Bar Association of Sri Lanka	No	FIU
Notary Public	10,352	Registrar General's Department	No	FIU
Accountants	14,254, of which: – 4,608 (ICASL) – 000 (CIMA) – 2,330 (CMA) – 316 (ACCA) – 4,000 (AAT)	Various professional accounting bodies – ICASL, CIMA, ACCA, CMA, AAT(Association of Accounting Technicians of Sri Lanka)	No	FIU
Trust and Company Service Providers	4,485 of which: – 362 auditors – 4,123 company secretaries	Registrar of Companies	No	FIU

252. The FIU is the primary AML/CFT supervisor for all FIs and DNFBPs, and is authorized to designate other authorities to oversee AML/CFT supervision for their respective sectors. The sectoral supervisors (CBSL, SEC and IBSL) are also responsible for ensuring that FIs under their purview comply with the FTRA and KYC/CDD rules. Table 6.2 below summarizes the supervisory resources available in the FIU and other supervisory authorities for purpose of monitoring compliance with AML/CFT requirements:

Table 6.2: Summary of Supervisory Resources for AML/CFT Supervision of FIs and DNFBPs in Sri Lanka

Authority	Sector	Number of Supervisors as at end-2013
Financial Intelligence Unit, CBSL	All FIs (and DNFBPs)	1 Deputy Director, 8 officers from Intelligence Management and Data Analysis Sections in FIU
Bank Supervision Dept., CBSL	Licensed Banks	28 staff – Statutory Examination 24 staff – Continuous Supervision
Dept. of Supervision of Non-Bank FIs, CBSL	Licensed Finance Companies and Specialised Leasing Companies	20 staff – Onsite 22 staff – Off-site
Exchange Control Dept., CBSL	Authorized Moneychangers	9 staff
Securities and Exchange Commission of Sri Lanka	Stockbrokers, Unit Trusts, Capital Market Intermediaries	10 staff

Insurance Board of Sri Lanka	Licensed insurers and insurance intermediaries	12 staff

6.2 Technical Compliance (R.26-28, R.34, R.35)

253. See the technical compliance annex for the full narrative on these Recommendations.

- Recommendation 26 – Regulation and supervision of financial institutions is rated partially compliant
- Recommendation 27 – Powers of supervisors is rated compliant
- Recommendation 28 – Regulation and supervision of DNFBPs is rated non-compliant
- Recommendation 34 – Guidance and feedback is rated partially-compliant
- Recommendation 35 – Sanctions is rated partially compliant

6.3 Effectiveness: Immediate Outcome 3 (Supervision)

(a) Measures to prevent criminals and their associates from entering the market

254. **Supervisory authorities lack clear powers to prevent criminals from holding, or being the beneficial owner of, a significant or controlling interest in some FIs and all DNFBPs.** These include finance companies and specialised leasing companies, authorized moneychangers, non-bank money value transfer services (MVTS) providers and their agents, stockbrokers, capital market intermediaries, rural banks, cooperative societies, casinos and real estate agents. This is a material concern as all these sectors have been assessed as higher risk in Sri Lanka's NRA. Fit-and-proper requirements apply to shareholders with material shareholdings in banks and CBSL conducts checks on the financial standing of shareholders of legal persons with material shareholdings in banks. However, it is unclear how far CBSL goes to identify and assess fitness-and-propriety of ultimate beneficial owners of banks in Sri Lanka as no evidence was provided in support of this.

255. **Compliance with fit-and-proper rules by directors and senior management of FIs is not uniformly assessed by supervisory authorities, with certain high-risk sectors not being subject to any fit-and-proper assessments.** The assessment of fitness-and-propriety appears to be reasonably effective with respect to banks, finance companies and insurers but no requirements are in place for authorized moneychangers, casinos and other DNFBPs. Despite the NRA identifying informal MVTS providers as having high ML/TF vulnerabilities, there appears to be no efforts or action plans in place to identify and encourage the formalization or shutting down of these illegal entities.

256. **None of the casinos in operation has been licensed under the Casino Business Regulations Act 2010, and no competent Ministry has been appointed to administer the Act.** No fit-and-proper requirements have been imposed on owners and key responsible persons of casinos, which continue to operate with little regulation of any sort. The Department of Inland Revenue informed that five casinos are registered and pay levies of LKR 100 million (USD 761 000[4]) per annum. The authorities do not appear to maintain any formal records on the owners and operators of casinos. The casinos submit self-assessments of their annual takings to the Department of Inland Revenue for tax purposes. From the NRA and through discussions with the authorities, there appears to be a significant gap in understanding of the nature, size and extent of operations of the five casinos that operate in Colombo.

257. **While some DNFBP sectors are subject to fit-and-proper (F&P) rules to qualify as professionals within their chosen profession, these are not to the extent required by the FATF standards.** Furthermore, it is unclear how effectively these rules are enforced by the licensing authorities and SRBs. Agents, brokers and firms that operate in the real estate sector are not regulated or subject to any F&P requirements. While dealers in precious metals and stones are subject to licensing conditions imposed by the National Gem and Jewellery Authority, these do not extend to F&P considerations, and no applications for gem dealerships have been rejected over the last three years. The Registrars' of notaries and trust and company service providers impose very basic F&P requirements in relation to minimum professional qualifications and record of good behaviour. These are submitted as self or statutory declarations at the point of application. It is unclear what level of independent verification is conducted on these declarations by the Registrars' before such applications are approved. The Registrar of Companies is empowered to list trust and company service providers (TCSPs), and can delist TCSPs that commit professional negligence. However, no clarification is provided on what qualifies as 'professional negligence' and no applications have been rejected over the last three years for failure to meet or comply with fit and proper requirements. **These deficiencies significantly reduce the barriers to entry by criminals and their associates into key professions that are central to the formation of legal entities, creation and management of trusts and foundations and facilitation of real estate transactions in Sri Lanka.**

258. With respect to the legal profession, Section 40 of the Judicature Act, No. 2 of 1978 provides for the Supreme Court to admit and enrol as Attorneys-at-Law, persons of good repute and of competent knowledge and ability, in accordance with Part VII of the Rules of the Supreme Court, Gazette Extraordinary no 535/7 of 1988. In addition to overseeing the issuance of practising certificates to suitably qualified individuals in Sri Lanka, the Supreme Court also gazettes rules on conduct, such as the Supreme Court (Conduct of and Etiquette for Attorneys-At-Law) Rules 1988. The Bar Council's Disciplinary Committee receives and investigates complaints on misconduct by its members, and submits recommendations for the consideration and appropriate action by the Supreme Court. Disciplinary measures for breach of the code of conduct by lawyers include reprimands, suspensions, fines or disbarment, with the Supreme Court determining the period of disbarment on a case-to-case basis, based on the severity of misconduct. From 2010 to 2014, a total of 91 cases of misconduct have been referred to the Supreme Court, although it is unclear what the nature of offences were in relation to these cases, nor is it clear what disciplinary measures have been taken. To-date, 69 cases are still pending decision by the Supreme Court to determine whether the lawyers in question should be disbarred.

259. Similarly, the various professional accounting bodies in Sri Lanka have established a code of ethics and professional conduct to which its members are expected to adhere and have set-up disciplinary committees to receive and investigate complaints of misconduct by their members. For example, sections 16 and 18 of the Act of Incorporation of the Institute of Chartered Accountants of Sri Lanka (ICASL) specify provisions on disenrollment or revocation of registration for professional misconduct by its members. Over the last three years, ICASL confirms that none of its members have been removed from professional practice, although two warning letters have been issued due to professional misconduct. Section 19(1) provides that any person aggrieved by a decision of the council under sections 16 or 18 may appeal against that decision to the Supreme Court.

(b) Supervision for compliance with AML/CFT requirements and identification of ML/TF risks

260. **There is no risk-based approach to AML/CFT supervision**. Supervision conducted by the FIU and supervisory authorities of FIs is mainly rule-based, with no specific focus on products, clients, channels, or institutions that have been identified as posing higher ML/TF risk.

261. **The formulation of the NRA in 2014 was timely in addressing gaps in supervisors' understanding of ML/TF threats and vulnerabilities to which the financial sector and institutions are exposed. Nevertheless, significant gaps remain with respect to DNFBPs.** The licensing bodies and

SRBs of DNFBPs do not appear to have been sufficiently engaged in the NRA formulation process. This was apparent from the lack of understanding of ML/TF risk exposures and the outcome of the NRA by the representatives of these organisations. In some cases, the assessment of ML/TF risk by the private sector representatives contradicted the findings in the sanitized NRA. For example, the NRA claims that TCSPs have low exposure to foreign clients. However, the Registrar of Companies has observed an increasing trend in foreign ownership, shareholdings and directorships in companies registered in Sri Lanka, and has inferred a rise in foreign clientele for TCSPs based on this observation. In any case, authorities were unable to substantiate these observations with any data or statistics.

262. **Sectoral risk assessments in the NRA have not resulted in the application of a risk-based approach to supervision of FIs across all sectors.** From 2008 to 2011, the FIU conducted 22 onsite examinations of FIs, while 46 onsite examinations were conducted from 2012 to 2014, mainly to assess compliance with KYC/CDD rules and the FTRA (see Table 6.3 below). The FIU is committed to conducting at least ten onsite examinations annually for 2015 to 2020. This arbitrary target is not commensurate with, nor does it appear to relate to, the higher-risk sectors identified in the NRA. The Bank Supervision Department (BSD), CBSL conducts statutory examinations of all 33 licensed banks annually during which supervisors assess the existence of internal policies, procedures and controls in line with the KYC/CDD rules issued by the FIU. The Department of Supervision of Non-Bank Financial Institutions (DSNBFI), CBSL conducts similar checks on the finance companies under its supervisory purview. The Exchange Control Department (ECD), CBSL conducts annual onsite examinations of moneychangers under its purview but the scope and frequency of supervisory activities conducted is not informed by risk. No evidence was provided to suggest that a risk-based approach is applied by CBSL supervisors in any sector under its purview. The SEC appears to conduct strictly rule-based checks of compliance with KYC/CDD rules during its routine onsite examinations of stockbrokers, (unit trusts and fund managers), and its overall supervisory approach is not informed by risks. The Insurance Board of Sri Lanka (IBSL) conducts onsite examinations on a selected basis and off-site inspections on a quarterly basis, but such supervisory activities do not appear to be guided by a risk-based approach. Furthermore, the actual number of onsite supervisory activities conducted by IBSL does not appear to be sufficient to ensure robust compliance to the AML/CFT requirements by insurance companies operating in Sri Lanka.

Table 6.3 AML/CFT Onsite Examinations Conducted by the FIU and Supervisory Authorities on Financial Institutions from 2012 to 2014

Sector	2012				2013				2014			
	FIU	CBSL	IBSL	SEC	FIU	CBSL	IBSL	SEC	FIU	CBSL	IBSL	SEC
Banks	10	23			26	33			2	33		
Finance Co.	3	23			-	42			2	43		
Money changers	-	54			-	56			-	37		
Insurers	2		-		-		3		-		5	
Stock broking Companies	1			38	-			28	-			23
Stock dealers				8				7				-
Unit Trust Managing Companies				2				13				14
Market Intermediaries				31				57				55
Total	**16**	**100**	**-**	**79**	**26**	**131**	**3**	**105**	**4**	**113**	**5**	**92**

263. **AML/CFT supervision conducted by the FIU and other supervisory authorities on FIs is mainly rule based, with no specific focus on products, clients, channels, or institutions that have been identified as posing higher ML/TF risk.** The scope of supervisory activities by the FIU and relevant

supervisory authorities is limited to assessments of compliance with sectoral KYC/CDD rules and FTRA requirements. These supervisory efforts do not extend to assessments of financial institutions' effectiveness in identifying and addressing specific ML/TF vulnerabilities arising from their operations and clients, nor is there sufficient assessment on effectiveness of AML/CFT preventive measures in higher-risk institutions. Non-bank MVTS providers (such as the Post Office and other permitted entities) that serve as inward remittance agents of foreign MVTS providers (such as Western Union) remain outside the supervisory purview of the FIU and CBSL. This has resulted in an overall low level of effectiveness with respect to the implementation of AML/CFT obligations by FIs, as elaborated in Chapter 5 above.

264. **Sri Lanka has used the NRA process to comprehensively evaluate the ML risks arising from financial inclusion products. The development of a specific regulatory framework on financial inclusion and the implementation of simplified KYC/CDD rules have been identified as key measures to further enhance access to basic financial services by lower income communities.** Based on the World Bank's Findex database, the number of adults with accounts in FIs has increased from 68.5% in 2011 to 82.7% of all adults over the age of 15 years in 2014[8]. In the assessment of ML vulnerabilities within the banking sector, the NRA has identified the existing clients of micro-deposit and micro-loan facilities within the banking sector to be of low risk. While access to FIs is considered to be adequate, the lack of clear guidance from the regulators on specific features of a financial inclusion product and absence of simplified KYC/CDD requirements for low-risk customer segments and products has resulted in some FIs' preference not to offer such products. Only 25% of all FIs in Sri Lanka claim to provide financial inclusion related products and services.

265. **There is a lack of effective coordination between the FIU and the relevant supervisory authorities with respect to monitoring of FIs' compliance with AML/CFT requirements.** Annual supervision planning is conducted independently, with no coordination or sharing of annual AML/CFT supervision plans between the supervisory authorities and the FIU. Similarly, the FIU does not consult with the relevant supervisory authorities before conducting AML/CFT onsite examinations on FIs under their respective supervisory purview and vice versa. Prior to the completion of the NRA, the FIU had formulated Institutional Risk Ratings for four key financial sectors in 2013. However, the AML/CFT supervisory activities conducted by FIU and the relevant supervisory authorities in 2013 and 2014 do not appear to be informed by this institutional risk assessment. Similarly, CBSL does not share the institutional risk rating for banking institutions under their supervisory purview with the FIU.

266. **The FIU is significantly under-resourced in its role as the primary AML/CFT supervisor**. **Of greater concern, and as the preceding paragraph suggests, there is a distinct lack of clarity on the specific functions and accountabilities between the FIU and the sectoral supervisors, which are also empowered to oversee AML/CFT compliance of FIs under their purview.** The supervisory areas in the CBSL, SEC and IBSL appear relatively better resourced and more familiar with the operations and culture of compliance in FIs under their respective purview, and have the prerequisite supervisory skills. Based on discussions with representatives from BSD, DSNBFI, ECD, SEC and IBSL, they view it as the FIU's sole responsibility to conduct more in-depth AML/CFT supervision and checks of effectiveness. With only nine officers in the FIU overseeing the intelligence management and data analysis function having to double-up as AML/CFT supervisors, this is clearly not commensurate with the number of FIs the FIU is expected to monitor. There appears to be no clear action plans or urgency at the national or strategic level to address this deficiency.

267. **The absence of detailed KYC/CDD rules and AML/CFT monitoring mechanisms in relation to all DNFBPs and other FIs further constrains effectiveness of the overarching framework for AML/CFT supervision in Sri Lanka.** While the FIU is the primary AML/CFT supervisor for contractual savings institutions, no enforceable KYC/CDD rules have been issued, nor have any AML/CFT supervisory activities been conducted. Similarly, while the Department of Cooperative Development (DCD)

[8] Source: http://datatopics.worldbank.org/financialinclusion/country/sri-lanka

and the FIU are empowered to function as the AML/CFT supervisory authority for rural banks, thrift and credit cooperative societies by virtue of s.18 and s.23 of the FTRA, no enforceable KYC/CDD rules have been issued, and there is no monitoring for compliance to FTRA requirements by DCD or FIU.

(c) Remedial actions and sanctions for non-compliance with AML/CFT requirements

268. **The FIU imposes a range of remedial and enforcement actions upon discovery of breaches of FTRA provisions resulting from its AML/CFT onsite examinations or through referrals from other supervisory authorities[9].** However, sanctions for breaches of FTRA provisions appear to have been focused on the banking sector. Following the completion of onsite supervision by sectoral supervisors, any non-compliance with the KYC/CDD rules by FIs are addressed through the issuance of supervisory letters, and FIs are required to submit an action plan to address deficiencies identified within a specified time frame. The sectoral supervisors are responsible for monitoring the effective implementation of agreed remedial measures based on action plans submitted by FIs under their respective supervisory purview. While the law also requires sectoral supervisors to report any non-compliance to the FIU, it is unclear whether all sectoral supervisors comply with this requirement. Nor is it clear what efforts the FIU makes to ensure such information is provided on a regular basis to facilitate prompt and dissuasive sanctions on breaches of the FTRA and AML/CFT requirements by financial institutions. Based on the documents cited, only the BSD and DSNBFI of CBSL have been providing such referrals to the FIU. However, there appears to be significant lag time (eight months to over one year) between the completion of onsite supervision and submission of referrals on non-compliances observed to the FIU by BSD and DNSBFI.

269. To monitor implementation of remedial measures, the FIU also conducts one-on-one meetings with the CEOs and Compliance Officers to discuss action plans and timelines to rectify the deficiencies identified (see Table 6.4 below). Administrative sanctions are imposed by the FIU based on the nature and gravity of the breach observed. An institution that fails to comply with the requirements pursuant to Parts I and II of the FTRA is liable to a penalty under section 19 of the FTRA, while all other offences are penalized under section 28 of the FTRA. According to the FIU, if a person who has been subjected to an administrative penalty commits a repeated offence, the penalty imposed on such a person will be double the amount imposed on the first breach. Since 2006, a total of LKR 8.87 million (USD 67 531[4]) of administrative monetary penalties have been imposed by the FIU, mainly for breaches of FTRA requirements by banking institutions (see Table 6.5 below). The amounts imposed do not appear to be proportionate or dissuasive in relation to the breaches committed.

270. The SEC had sent 23, 32 and 21 supervisory letters to stockbroking firms and market intermediaries in 2012, 2013 and 2014 respectively. One stockbroking firm was fined by the FIU for non-compliance with the statutory requirement to appoint a compliance officer. The SEC had co-ordinated with the FIU in this respect to ensure that the stockbroking firm concerned complies with the aforesaid requirement.

Table 6.4: One-On-One Meetings between FIs and FIU from 2012 to 2014

Sector	2012	2013	2014
Banks	11	13	4
Finance Companies	5	2	-
Insurers	1	1	-
Stockbrokers	3	-	1
TOTAL	**20**	**16**	**5**

Note: Statistics above includes meetings requested by FIs

[9] Section 23 of the FTRA requires the relevant sectoral supervisors to regularly monitor compliance to the Act by reporting institutions' under their respective purview and to report any non-compliance to the FIU.

Table 6.5: Penalties Imposed on FIs by FIU for Breaches of FTRA from 2006 to 2014

Year	Sector	Violation	Penalty (LKR)
2006	Bank	Violation of s.15(2) FTRA	25 000
2009	Bank	Non-submission of STR, Non-compliance with KYC	1,803,770
	Bank	Maintaining Certificate of Deposits (CDs)	4,100 000
2010	Finance Co.	Non-compliance with KYC	*Court order to rectify*
2012	Bank	Non-compliance with KYC – Maintaining multiple accounts without valid reason	50 000
2013	Stockbroker	Failure to appoint CO, breach of s.6 FTRA (CTR)	10 000
	Bank	Maintaining CDs and breach of s.5 FTRA (CDD)	50 000
	Bank	Maintaining CDs and breach of s.5 FTRA (CDD)	187,900
	Bank	Maintaining CDs and breach of s.5 FTRA (CDD)	766,400
	Bank	Maintaining CDs and breach of s.5 FTRA (CDD)	1,867,900

(d) Impact of supervisory actions on compliance

271. **The sanctions imposed by the FIU and supervisory authorities have not been very effective in promoting greater understanding and compliance with the AML/CFT requirements.** There is no information to conclude that it has been very effective. Nevertheless, the sanctions imposed have resulted in the discontinuation of a prohibited high-risk product (transferable Certificate of Deposits) by banking institutions in 2013, and the larger banking institutions appear to be putting in place more integrated AML/CFT systems to support CDD, transaction monitoring and risk profiling of their clients. However, such efforts to enhance AML/CFT internal controls and systems appear to be isolated to the banking sector. There have been no efforts by the FIU to enforce the FTRA on reporting institutions in the DNFBP sectors.

(e) Promoting a clear understanding of AML/CFT obligations and ML/TF risks

272. **The FIU should be commended on driving and facilitating the conduct of AML/CFT awareness activities for market participants and other supervisory authorities.** Nevertheless, the level of understanding on AML/CFT obligations, and the need to identify and mitigate ML/TF risks in the context of the clients, channels and jurisdictions they deal with, remains low among most FIs. The efforts of the FIU have contributed to improved awareness on AML/CFT reporting obligations among FIs as well as among regulatory, supervisory and law enforcement authorities (see Table 6.6 below).

273. The FIU also conducts one-on-one meetings with FIs upon request to clarify its supervisory expectations in relation to sectoral KYC/CDD rules, and a dedicated website, www.fiusrilanka.gov.lk, has been launched to provide wider public access to AML/CFT measures, updates and alerts. In addition, the FIU also publishes typology analysis and case studies in its annual report commencing 2011.

Table 6.6: AML/CFT Awareness Programmes Conducted by FIU from 2011 to 2014

Year	2011	2012	2013	2014
No. of Programmes	28	28	37	17
No. of Participants	2,300	1,825	2,582	554

274. Significant gaps remain with respect to DNFBPs and other FIs (in particular, rural banks, thrift and credit cooperative societies, and contractual savings institutions), with no efforts or action plans in place to improve awareness of and compliance with AML/CFT reporting obligations by these institutions. The licensing bodies and SRBs of DNFBPs have not been empowered or approached by the FIU to take on a

greater role in promoting awareness or to assist in monitoring compliance to AML/CFT requirements by DNFBPs under their purview.

275. **No written guidance has been issued by the FIU to facilitate understanding of supervisory expectations with respect to sectoral KYC/CDD rules imposed on FIs.** The FIU appears to focus more on monitoring FIs' operational compliance with CTR and STR reporting obligations. Furthermore, with the recent completion of the NRA, most FIs and DNFBPs remain unaware of the findings in the report. This has resulted in poor understanding of national and sectoral ML/TF threats and vulnerabilities among FIs and DNFBPs met by the evaluation team. Once formally adopted, the FIU plans to disseminate the sanitised version of the NRA to FIs and DNFBPs.

Overall conclusion on Immediate Outcome 3

276. Significant deficiencies have been identified in relation to supervision of FIs and DNFBPs in Sri Lanka, with fundamental improvements required to improve effectiveness across all core issues. Apart from banks, the institutional framework for preventing criminals from owning or operating a FI or DNFBP is subject to significant legal deficiencies, while it is unclear what mechanisms are in place to identify the ultimate beneficial owners of banks.

277. The supervisory authorities' understanding of ML/TF risks is better with respect to the financial sector but materially lacking with respect to DNFBPs. AML/CFT supervisory activities are not commensurate with the risks identified in the NRA, and are not being conducted on a risk-informed basis. Supervisory authorities have adequate powers to supervise FIs and DNFBPs, but resource constraints and poor coordination between supervisory authorities have resulted in ineffective monitoring of AML/CFT compliance in the financial sector, while DNFBPs remain unsupervised for compliance to AML/CFT reporting obligations. The absence of a regulatory framework on financial inclusion and simplified KYC/CDD requirements for low-risk clients and products has prevented wider access to basic financial services by lower income communities.

278. A range of remedial and enforcement actions have been imposed, but these do not appear to be sufficiently dissuasive and have not translated into improved AML/CFT compliance among FIs. No efforts are in place to enforce FTRA requirements on the DNFBP sector. The FIU's awareness activities have been focused mainly on enhancing general awareness on AML/CFT reporting obligations among FIs, with insufficient guidance provided in the form of written guidance to provide clarity on supervisory expectations, verbal or written feedback on STRs received from FIs or through publication of typology reports.

279. Sri Lanka has a **low level of effectiveness** for Immediate Outcome 3.

6.4 Recommendations on Supervision

280. The following recommendations are proposed towards enhancing Sri Lanka's effectiveness in the supervision of FIs and DNFBPs for AML/CFT compliance:

- The relevant supervisory authorities should enhance assessment of fitness-and-propriety of licensed FIs in banking, insurance and securities sectors to the level of the ultimate beneficial owner or natural persons with a material controlling interest.
- The FIU and relevant sector supervisors should consider extending enforceable fit-and-proper requirements on owners, beneficial owners and key responsible persons of FIs and DNFBPs:
  - Gaps in sectors identified as being more vulnerable to ML/TF risks should be prioritized, such as non-bank MVTS providers, authorized moneychangers, finance companies, cooperatives and rural banks, stockbrokers, casinos and real estate agents.

– For other DNFBPs, the FIU should consider enhancing collaboration with the existing licensing authorities and SRBs towards enhancing fit-and-proper criteria at point of entry or qualification, such as the National Gem and Jewellery Authority for dealers in precious metals and stones, Registrar of Companies for trust and company service providers, Supreme Court/Bar Council for legal profession, Institute of Chartered Accountants Sri Lanka and key professional bodies for the accounting profession, Registrar-General's Department for notaries.

- There are potential synergies to be reaped from improved clarity on accountabilities, better coordination and sharing of supervisory resources between the FIU and relevant supervisory authorities (CBSL, SEC, IBSL, DCD), to provide for more effective use of scarce supervisory resources:

  a. Firstly, the FIU and sectoral supervisors need to come to a clear agreement on their respective functions and accountabilities in relation to the monitoring of AML/CFT compliance by FIs under each authority's purview.

  b. The FIU should also consider signing MOUs with the sector supervisors to clarify the terms of collaboration, roles and responsibilities of each authority, procedures for sharing of information arising from on-going supervision or surveillance activities, and enforcement procedures following reports of FIs' non-compliance by sector supervisors to the FIU. Areas of collaboration could include the development of joint supervision procedures, joint issuance of guidance notes for FIs, conduct of joint awareness activities for Senior Management and Compliance Officers of FIs, planning and conduct of joint thematic on-site examinations for wider coverage of higher-risk sectors, institutions or products within the financial sector.

  c. The development of a risk-based approach to AML/CFT supervision should also be expedited, to assist the FIU and sectoral supervisors in better allocating their scarce supervisory resources to reporting institutions, products, services or delivery channels that have been identified as posing higher ML/TF risks. The immediate priority should be in developing and operationalizing the AML/CFT risk-based supervision framework for the banking sector.

- Notwithstanding the above, the FIU remains significantly under-resourced in its role as the primary AML/CFT supervisor for FIs and DNFBPs. An immediate review of the adequacy of FIU's staffing and other resources to serve this role effectively should be conducted to determine the quantum of increase required.

- While the need to develop KYC/CDD rules and to increase resources for AML/CFT supervision of DNFBPs has been acknowledged in the NRA, it is unclear when these deficiencies will be addressed. This fundamental deficiency had been highlighted as a gap in the MER 2006, and needs to be addressed on an immediate basis.

- There is an urgent need to commence AML/CFT awareness and training activities for the DNFBP sector as a whole. As a starting point, the FIU should initiate engagement sessions with the relevant licensing bodies and SRBs of DNFBPs to secure their commitment to collaborate in efforts to improve AML/CFT awareness and compliance by DNFBPs. These awareness sessions must be accompanied by appropriate supervisory and enforcement activities within the DNFBP sector to provide strong incentive for DNFBPs to implement effective preventive measures to deter ML/TF.

- The assessment of sectoral ML/TF vulnerabilities in the NRA can be further enhanced with the inclusion of more relevant indicators – such as, value of criminal proceeds and supervisors' assessment of the level of AML/CFT compliance of supervised FIs. This would provide a more objective assessment of the pervasiveness and impact of crimes, and serve as guidance that is more useful to supervisory authorities and reporting institutions in developing their own sectoral and institutional ML/TF risk assessments. The need to enrich datasets and indicators used in the

formulation of the NRA has been acknowledged in the sanitized NRA, but it is unclear which agencies will be responsible for driving and contributing to this effort, nor have clear milestones or timelines been drawn.

- The FIU should ensure prompt and dissuasive enforcement of remedial actions and sanctions for non-compliances with FTRA and KYC/CDD rules by all FIs, and not just the banking system, as a means of instilling a stronger culture of AML/CFT compliance in the financial system as a whole. In addition, the FIU should consider increasing the quantum of penalties for non-compliance to FTRA obligations to ensure such penalties are sufficiently dissuasive.

- The FIU should issue guidance notes on sectoral KYC/CDD rules to improve clarity on policy interpretation and supervisory expectations and to educate and improve awareness of the AML/CFT reporting obligations by reporting institutions. Upon approval by the FIU Advisory Board, the findings of the NRA should be widely circulated to support the development of institutional ML/TF risk assessments by FIs. Moving forward, the FIU should facilitate greater engagement between the LEAs, supervisory authorities and FIs to support the production of typology reports as an additional source of reference on key and emerging ML/TF threats and vulnerabilities within the financial system.

- In line with the findings of the NRA, the financial sector regulators should consider the development of a clear framework to define and clarify the features of financial products and services that support financial inclusion, to ensure wider access to basic financial services by lower income and rural communities. The framework should include clear guidance on specific features (e.g. limits on number and size of transactions) to mitigate the ML/TF risk arising from the offering of such facilities. In addition, the FIU should work with the relevant sectoral supervisors in developing simplified KYC/CDD rules for client and product segments that have been identified as posing low ML/TF risk.

7. LEGAL PERSONS AND ARRANGEMENTS

Key Findings

- Sri Lanka has not conducted a comprehensive assessment of the risks relating to the misuse of legal persons and arrangements. There is no separate risk assessment on legal persons and arrangements in the national risk assessment (NRA). However, there are documented cases of criminals and terrorists using legal persons to conduct ML and TF, and law enforcement and intelligence agencies are aware of the TF risk, and to a lesser extent the ML risk.
- Given the lack of risk assessment, there is no formal strategy to prevent legal persons and arrangements for being used for criminal purposes. There have been no specific measures undertaken to mitigate the risks posed by share warrants.
- Sri Lanka's reliance on using existing information, including preventive measures, to mitigate the abuse of legal persons and arrangements is not an effective mechanism. There are significant gaps in preventive measures on customer due diligence (CDD) and beneficial ownership (refer IO.4 & 5).
- There is publicly available information on the types of legal persons and arrangements in Sri Lanka. The majority of legal persons are companies registered with the Registrar-General of Companies. However, limited verification is undertaken at registration.
- Information on beneficial ownership is not maintained so that it is accessible to authorities in a timely manner. There is no effective mechanism to record beneficial ownership of legal persons. There is also no effective mechanism to record beneficiaries of legal arrangements including trusts. Information on shareholders is available where those shareholders may be other legal persons and not the beneficial owner as defined by the FATF.
- There is no requirement for trustees to disclose their status to financial institutions (FIs) and designated non-financial businesses and professions (DNFBPs) when forming a business relationship or carrying out an occasional transaction above the threshold.
- The company registration system is manually based with limited monitoring and application of sanctions. The Trusts Ordinance, by Sri Lanka's own admission, is outdated.

7.1 Background and Context

(a) Overview of legal persons

281. The types of legal persons that can be established or created in Sri Lanka are companies, associations and societies. Companies may be limited in liability (by shares or guarantee) or unlimited. They may be public or private. They are created and registered under the Companies Act No. 7 of 2007, and are administered by the Registrar-General of Companies. Foreign companies are also permitted to register and operate in Sri Lanka. Offshore companies are permitted to register but must operate outside Sri Lanka. As at the end of November 2014, their numbers were as follows:

a. Private limited liability – 42642
b. Public limited liability – 2238
c. Foreign companies – 1363
d. Off-shore companies – 94
e. Unlimited companies – 2

f. Guarantee companies – 313

g. Associations – 989

282. Societies consist of cooperative societies and mutual provident societies.

283. Cooperative societies are regulated under the Cooperative Societies Law No. 05 of 1972, under which they are required to register with the Registrar of Cooperative Societies. These societies are involved in distribution of consumer goods, supply of essential inputs, agricultural, fisheries and industry promotion and marketing activities and mobilisation and allocation of savings in the rural areas through the cooperative rural banks.

284. There were 14 749 cooperative societies registered at the end of 2011, of which 9 751 were active. Membership was 7 833 775 with 40 380 employees. In 2013 total assets were LKR 85 billion (USD 647 million[4]) while turnover was LKR 636.61 million (USD 4.85 million[4]). The majority of customers were public servant members whose membership fees and loan repayments are recovered through their salaries.

285. Mutual provident societies (and societies created for a purpose authorised by the Minister) are created under the Societies Ordinance No. 16 of 1891 and are registered and supervised by the Registrar-General of Companies. As at 30 November 2014 there were 12 190 so registered. The nature of such societies is that they are established primarily for non-profit social welfare purposes: "established for the object of promoting thrift, of giving relief to members in times of sickness or distress, of aiding them when in pecuniary difficulties, and for making provision for their widows and orphans" (paragraph 3(a) Societies Ordinance).

286. In all cases, the characteristics of these companies, associations and societies is that they are body corporates that may sue and be sued in their own name and have perpetual succession.

287. The recent national risk assessment identified the vulnerability for ML and TF in general terms as medium. However, this assessment did not consider in any detail the various types of legal persons described above, and the risk that might be presented by each. There is no separate section in the NRA devoted to the risks relating to the misuse of legal persons.

(b) Overview of legal arrangements

288. Discretionary or express trusts can be established in Sri Lanka under the general common law. The basic characteristic of a trust is that it separates the legal and beneficial ownership of the assets of the trust, and for those assets to be administered by the legal owner (trustee) for the benefit of the beneficiaries. Beneficiaries may range from individuals to public groups. There are no provisions in law to obligate trustees of those trusts to collect beneficial ownership information, where beneficiaries are known.

289. The role of the Registrar-General's Department is to maintain a register of trustees appointed to a charitable trust, or trust for a public or private association. Of the 1 446 trusts currently registered, 94.5 % (1367) of them are in Colombo. Only about 10% of those registered in Colombo have objectives related to financial profit. Most of the trusts registered in Sri Lanka are providing non-profit social welfare facilities such as operating religious centres or orphanages. There is no requirement to register discretionary or express trusts.

290. The national risk assessment identified the risk of ML through trusts as medium. TF risks in relation to legal arrangements, including discretionary/express trusts and charitable trusts, have not been fully assessed, nor do authorities understand those TF risks.

(c) International context for legal persons and arrangements

291. **Sri Lanka does not appear to be an international centre for the creation or administration of legal persons or arrangements**. There are only 94 off shore companies registered in Sri Lanka. Offshore

companies are not permitted to operate in Sri Lanka but are granted certain concessions from the Banking Act & Exchange Control Laws. Within the terms of the Companies Act Part XVIII, foreign companies are overseas companies that operate in Sri Lanka and are permitted to own land (s.490 Companies Act), but the extent to which such assets are held is unknown. This and related risks have not been analysed in the recent national risk assessment.

7.2 Technical Compliance (R.24, R.25)

292. See the technical compliance annex for the full narrative on these Recommendations

- Recommendation 24 – Transparency and beneficial ownership of legal persons is rated as non-compliant
- Recommendation 25 – Transparency and beneficial ownership of legal arrangements is rated as non-compliant

7.3 Effectiveness: Immediate Outcome 5 (Legal Persons and Arrangements)

a) Identification, assessment, and understanding of the vulnerabilities and misuse of legal persons created in the country

293. **The relevant competent authorities have not yet fully identified, assessed and understood the vulnerabilities and the extent to which legal persons created in the country can be, or are being misused for ML/TF**. This is based on the fact that the recent NRA only undertook a cursory analysis of this issue. There is no separate section in the NRA devoted to legal persons and arrangements. It concluded that corporate and trust transparency needs to be improved.

294. However, law enforcement authorities are fully cognisant of the potential for terrorists to abuse non-profit organisations and to a lesser extent companies to channel funds for terrorist activities given LTTE activities in the past and recent attempts at resurgence. There is also an appreciation of criminals using companies to launder proceeds of crime and cases were provided to the assessment team. However, this level of awareness is not universal and is lacking in the authorities responsible for registering legal persons and arrangements, except for the Non-Government Organisation Secretariat, which has a good level of understanding of the risks associated with non-profit organisations (NPOs) and TF (refer IO.10 for NPOs).

b) Implementation of measures to prevent the misuse of legal persons and arrangements for ML/TF purposes

295. **Sri Lanka has not implemented any specific measures to prevent the misuse of legal persons and arrangements for ML/TF purposes**. There is a lack of beneficial ownership information requirements in respect to legal persons and trusts. There is no explicit prohibition in the Companies Act on bearer shares, but the Act does state under section 79 that a share certificate shall be prima facie evidence of the title of the shareholder to the shares. 'Shareholder' is defined as a person whose name is entered in the share register as the holder for the time being of one or more shares in the company. The Registrar-General advised that on this basis bearer shares did not exist in Sri Lanka, although the team was not able to verify the accuracy of this statement.

296. There is a lack of controls over the use of bearer share warrants.

297. Shareholders may nominate directors and the nomination is required to be filed with the Registrar-General, and thereby become publicly available.

298. The Registrar-General of Companies informed the assessment team that before registering a company it would check: (i) whether the company has provided the required documents, including the

declaration by the applicant that the name of the proposed company is not identical or similar to that of any existing company; and, (ii) against the Registrar's data base to verify the declaration made is correct. No other due diligence is undertaken.

299. There are vulnerabilities as shown by Terrorist Investigation Division (TID) cases relating to the Liberation Tigers of Tamil Eelam (LTTE) but there are limited mitigating measures in place. The know-your-customer/customer due diligence rules issued to banks and FIs do reflect an attempt to mitigate abuse through the application of preventive measures. However, such measures are not fully in compliance with the FATF standards and implementation is not consistent across FIs or DNFBPs (see IO.4/5). The CID advised that there is equal use of legal and natural persons for ML activity, and less so the use of NGOs.

c) Public availability of information on the creation and types of legal persons and arrangements in the country

Basic information

300. When registering, companies are required to provide information as detailed in sections 4 and 5 (Incorporation of Companies) of the Companies Act 2007, which include the company's name, proof of incorporation, legal form and status, the address of the registered office, and a list of directors. If the shareholders are natural persons, their names, national identification numbers or passport numbers, and signatures are required to be provided. Sections 120 and 123 of the Companies Act include the requirement to maintain the information set provided at registration and on shareholders in respect to companies with a share register. A company is required under ss. 9 (1) to give public notice of the name of the company and address of the company's registered office. The website of the Registrar-General of Companies includes the names of all registered companies, delisted companies and companies pending approval. However, the information is limited to the name of the company - no other information is available on the website.

301. **There are two avenues available for public access to more detailed information on companies.** Section 120 of the Companies Act requires the company to make available specified records for public inspection. These include Certificate of Incorporation, Article of Association and share register. Section 480 of the Companies Act provides for information held by the Registrar-General of Companies to be made available for inspection to any person upon payment of a fee of LKR 500 (USD 3.8[4]), which is not prohibitive. No details were provided to the assessment team although the Registrar-General noted such requests amount to the 'thousands' in the last few years.

302. **In terms of available information on trusts, information is available to a limited extent from the Registrar-General's Department in respect to trustees appointed to a charitable trust, or trust for a public or private association**. However, as detailed in R.25, the Trusts Ordinance No. 9 of 1917, specifically ss.6, 7, 9, 10, 11, 100 and ss.113(4), do not require:

a) trustees of express trusts to obtain and hold adequate, accurate and current information on the identity of settlors, trustees, protectors (if any) and beneficiaries of trusts, including any natural person who exercises ultimate effective control over a trust;

b) trustees of any trust to hold basic information on other regulated agents of, and service providers to, the trust, including investment advisors or managers, accountants, and tax advisors; or

c) professional trustees to maintain this information for at least five years after their involvement with the trust ceases.

303. Subsection 113(4) of the Trusts Ordinance requires the Registrar-General to prepare and maintain a register of trustees appointed to a charitable trust, or trust for a public or private association. There is no reference to registers of other types of trusts. There is no requirement to keep the information up to date and or for it to be available on a timely basis.

d) Obtaining beneficial ownership information on all types of legal persons created in the country

304. **As indicated, section 123 of the Companies Act requires companies to maintain information on immediate shareholders in respect of companies with a share register. However, the information relates to legal and not beneficial ownership**, although it may include aspects of beneficial ownership information in some cases. This requirement does not provide for beneficial ownership information to be maintained and accessible to competent authorities in a timely manner, except in those circumstances mentioned where legal and beneficial ownership are identical.

305. The Registrar-General of Companies advised of numerous requests from police and to a lesser extent from the FIU and Inland Revenue for information on companies, but was not able to provide detailed statistics due its manual system. The Registrar-General indicated that more requests were made by the Criminal Investigation Division (CID) than the TID. The requests were for certified copies of information regarding incorporation status, directors, shareholders and articles of association. Given that only basic information is held, the information provided in most cases relate to legal ownership, and further investigations are required by law enforcement to identify the natural person or persons. The same challenges apply when authorities access share registries for information on ownership. Records held by societies may contain more information on beneficial ownership.

306. As indicated under IO.9, the Sri Lanka Police TID's investigations in tracing assets relating to terrorist financing include investigating legal arrangements to uncover beneficial ownership and links of companies to terrorists and terrorist financiers where these companies are used to move funds. TID cited two cases where such information was shared with foreign authorities that contributed to one accused being indicted for his role in facilitating the transfer of funds for the LTTE using his company, and another accused being convicted for TF offences in their respective jurisdictions

307. For other legal persons such as mutual provident societies, they must have a registered office and the society's books (including the names of the members) must be available for public inspection. The register of members must contain names, addresses and occupations of members (ss.9(10)). Cooperative Societies must also have a registered office (s.18) and allow its rules, by-laws and list of members to be available for inspection at the registered office (s.19). However, its members may also be other registered societies.

308. Law enforcement also access records held by FIs. However, given the gaps in beneficial ownership requirements and implementation highlighted under IO.4, it is not clear that recourse to records held by FIs would yield significantly more information. The CID and TID have, as indicated under IO.7 and IO.9, accessed records held by FIs for ML, TF and predicate crime investigations, including in an attempt to identify the beneficial owner(s). This approach could be reasonably effective when the accounts are in the names of natural persons, but challenging when owned by legal persons, or multiple layers of legal persons. Nevertheless, in terms of LTTE financing concerns, there have been some successes in tracing the controlling natural persons of legal persons in Sri Lanka.

309. The role of gatekeepers in forming legal persons is relatively minor, as most legal persons are created directly with the Registrar-General of Companies by natural persons, for either themselves or acting on behalf of the beneficial owners. Authorities advised during the onsite that there is a growing use of gatekeepers by foreigners to form legal persons. However, at the time of the onsite, due to this being a recent phenomenon, such company formation providers would yield little in the way of beneficial ownership information.

e) Obtaining beneficial ownership information on all types of legal arrangements created in the country

310. **Relevant competent authorities can obtain limited basic information on trustees of charitable trusts, or trusts for a private or public purpose, in a timely way by consulting the register maintained by the Registrar-General's Department**. The accuracy of this information is not verified and it may contain limited beneficial ownership information, thus impairing its adequacy. As there is no

requirement to register discretionary or express trusts, neither basic nor beneficial ownership is available on those trusts.

311. **There is no requirement for trustees to disclose their status to FIs and DNFBPs when forming a business relationship or carrying out an occasional transaction above the threshold.**

f) Sanctions for non-compliance: effective, proportionate, and dissuasive

312. **There are sanctions available under the Companies Act against those who do not comply with the information requirements in respect to companies (see c.24.13 in the Technical Compliance Annex). However, these are not dissuasive and have not been applied with any regularity.** For example, the obligation to maintain a share register in section 123 of the Companies Act carries a penalty for breach of a fine of up to LKR 200 000 (USD 1 520[4]) for the company and a fine of up to LKR 100 000 (USD 760[4]) for each officer in default. Further, section 514 of the Companies Act prescribes that court proceedings may be instituted and monetary sanctions imposed where any company has made default in complying with any provision of the Act that requires it to file with or deliver or send to the Registrar any account, document or return or to give notice to him of any matter, and has by reason of such default committed an offence under the Act. This is not the case in respect to trustees (see c.25.7 and 25.8 in Technical Compliance Annex). In any case, the lack of obligations to provide beneficial ownership information reduces the utility of such sanctions in respect to ML/TF.

313. Sri Lanka provided the following statistics for compounding charges imposed during the period February–June 2014 on late submission of Forms 3, 6, 15, 20 and 39 (see below at Table 7.1). However, authorities did not provide the assessment team with statistics on other sanctions, including the deregistration of companies.

Table 7.1: Charges paid by companies submitting late reports to the Companies Registrar

Form No.	Description	Compounding Charges Paid LKR	No. of Instances of late submission
F 3	Notice of Change of Name	2 000.00	4
F 6	Notice of Issue of Shares	99 750.00	61
F 15	Notice of Location of Accounting Records	118 000.00	14
F 20	Notice of Change of Directors/Secretary and Particulars of Directors/ Secretary	232 000.00	70
F 39	Notice of a Special Resolution	34 500.00	10

Overall conclusion on Immediate Outcome 5

314. Sri Lanka's NRA does not include a proper assessment of the risks relating to the misuse of legal persons and arrangements, nor has any other assessment been undertaken. Legal persons have been shown to be vulnerable to TF and ML, particularly in the past with LTTE activities. The majority of legal persons are companies registered by the Registrar-General of Companies. Limited information is publicly available even in respect to basic information. The existing measures and mechanisms are not sufficient to ensure that information is available on beneficial ownership of legal persons and arrangements on a timely basis. There is no requirement for trustees to disclose their status to FIs and DNFBPs when forming a business relationship or carrying out an occasional transaction above the threshold.

315. The company registration system is manual, with limited monitoring and limited application of sanctions. The Trusts Ordinance, by Sri Lanka's own admission, is outdated.

316. Sri Lanka has a **low level of effectiveness** for Immediate Outcome 5.

7.4 Recommendations on Legal Persons and Arrangements

317. The following recommendations are made on preventive measures (IO.5):

- Complete an assessment of the risks relating to the misuse of legal persons and arrangements, and then undertake measures to mitigate the identified risks.
- Introduce mechanisms to ensure information on the beneficial owner of legal persons is maintained and accessible to competent authorities in a timely manner and made publicly available.
- Undertake verification of the information on the companies register. This could be undertaken by the Registrar-General of Companies.
- Revise the Trusts Ordinance to require trustees to obtain and hold adequate, accurate and current information on the identity of settlors, trustees, protectors (if any), and beneficiaries of trusts, including natural persons who exercise ultimate effective control over a trust, and make that information available to competent authorities

8. INTERNATIONAL COOPERATION

Key Findings

- There are significant legal and structural limitations to Sri Lanka's effective ability in relation to its formal international cooperation mechanisms. The central authority does not adequately maintain and monitor the status and timeliness of requests made and obtained. This, in combination with varying levels of inter-agency coordination, leads to a cumbersome system where the progress of requests is not always apparent.
- Given the acknowledged risk of Liberation Tigers of Tamil Eelam (LTTE) funding from abroad, the limited statistics provided to the team on outgoing MLA requests and other requests are not consistent with the identified risks. However, there is evidence of more international cooperation amongst the law enforcement agencies where assistance is initiated and monitored at an informal level. The Sri Lankan authorities have cited over 70 requests made and 90 requests received between 2008 and 2014 that resulted in information shared through the Egmont Group. The FIU has signed memorandums of understanding (MOUs) with over 25 FIUs from other countries. Four of these are MOUs with FIUs from South Asian Association for Regional Cooperation (SAARC) states.

8.1 Background and Context

318. **As noted under IO.1, there is a significant element in Sri Lanka's ML/TF risks of cross-border illicit flows.** Some key ML threats originate from neighbouring jurisdictions in South Asia and Indian Ocean, and funds are laundered to those jurisdictions. For TF, the key offshore risks originate outside of South Asia and the Indian Ocean.

319. **Formal cooperation between Sri Lanka and foreign authorities is achieved under the Mutual Assistance in Criminal Matters Act (MACMA) No. 25 of 2002, and the Ministry of Justice is the 'central authority' for dealing with formal mutual legal assistance requests under the MACMA.** More than 40 requests have been channelled through the central authority over the last five years.

8.2 Technical Compliance (R.36-40)

320. See the technical compliance annex for the full narrative on these Recommendations.

- Recommendation 36 – International instruments is rated as largely compliant
- Recommendation 37 - Mutual legal assistance is rated as partially compliant
- Recommendation 38 – Mutual legal assistance: freezing and confiscation is rated as partially compliant
- Recommendation 39 – Extradition is rated as largely compliant
- Recommendation 40 – Other forms of international cooperation is rated as partially compliant.

8.3 Effectiveness: Immediate Outcome 2 (International Cooperation)

a) Responding with constructive and timely mutual legal assistance and extradition upon request

321. **The MACMA does not operate on the basis of reciprocity but requires a mutual legal assistance arrangement between Sri Lanka and the state requesting assistance**, except in regard to specified Commonwealth states[10] deemed to be covered by the provisions of the Act. Aside from those, Sri Lanka has mutual legal assistance arrangements with a small range of states[11]. This means that outside that limited range of states, there is no certainty that Sri Lanka can provide coercive assistance, including assistance where a court order is required, assistance for freezing of funds, or in confiscating assets. There have been no instances of such coercive assistance being provided to foreign states on the basis of reciprocity where they are not specified states or where there is no treaty arrangement. The Sri Lankan authorities have indicated that there is currently no proposal to amend the MACMA to include the provision of assistance on the basis of reciprocity. The Sri Lankan authorities informed the team that they have sought to negotiate bilateral mutual legal agreements with more countries but do not always receive a favourable response.

322. **It is recognised that Sri Lanka accepts some requests pertaining to non-coercive assistance from states that *do not* have a mutual legal assistance arrangement.** The Ministry of Justice (the central authority) provided some instances where voluntary statements were recorded from witnesses in Sri Lanka pursuant to mutual legal assistance requests from such jurisdictions. Nevertheless, the requirement for formal agreements appears to create a restriction in the framework that affects Sri Lanka's ability to cooperate internationally and there have been several cases where assistance was not forthcoming in relation to countries where there is no mutual legal arrangement.

323. The Ministry of Justice provided some information relating to 70 mutual legal assistance cases received since 2010, of which about eight related to the LTTE and some related to ML. **However, based on their statistics, assistance was only provided in five cases related to ML and eight cases related to TF between 2008 and 2012. A large number of cases remain pending without any explanation as to why there has been no progress.** The Attorney General's Department (AGD) provided statistics of 31 cases between 2008-2011 and 15 cases in 2012 of mutual legal assistance provide directly by the AGD in responses to requests made. No other information relating to the types of offences or assistance provided was available.

324. **The provision of timely and constructive assistance for formal requests made under the MACMA is hampered by the absence of an effective case management system, inadequate maintenance of data and poor coordination between the central authority and the operational agencies.** The central authority advised that several pending requests had been channelled to the AGD or law enforcement agencies and as such, the central authority was not able to provide further information on the progress of the request. Although the authority sends periodic reminders it is reliant on other agencies to act on the requests. The central authority has a registration process for incoming requests, is able to liaise with the requesting authority and relegates the request to the appropriate law enforcement authority. Using this rudimentary system, the central authority continues to monitor the progress of the request,

[10] Per the *Gazette of the Democratic Socialist Republic of Sri Lanka – Extraordinary*, 14 July 2013 on the 'Mutual Assistance in Criminal Matters Act No. 25 of 2002, Sri Lanka has MLA arrangements with Commonwealth members per the following schedule: Antigua and Barbuda, Australia, The Bahamas, Bangladesh, Barbados, Belize, Botswana, Brunei Darussalam, Cameroon, Canada, Cyprus, Dominica, Fiji Islands, The Gambia, Ghana, Grenada, Guyana, India, Jamaica, Kenya, Kiribati, Lesotho, Malawi, Malaysia, Maldives, Malta, Mauritius, Mozambique, Namibia, Nauru, New Zealand, Nigeria, Pakistan, Papua New Guinea, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Samoa, Seychelles, Sierra Leone, Singapore, Solomon Islands, South Africa, Swaziland, United Republic of Tanzania, Tonga, Trinidad and Tobago, Tuvalu, Uganda, United Kingdom, Vanuatu, Zambia, and Zimbabwe

[11] Authorities advise that Sri Lanka has bilateral MLA agreements with Belarus, United Arab Emirates, Pakistan, Thailand, Hong Kong and India. Sri Lanka cited two other countries with which agreements have been finalised but have not yet entered into force.

although there was no evidence that requests or follow-ups were prioritised for efficiency or by the urgency of the request. The central authority was not able to provide thorough and comprehensive statistics of mutual legal assistance received and requested by Sri Lanka. There were no statistics provided by the central authority on mutual legal assistance requests that resulted in freezing of funds or confiscation of assets, and the assessors were referred to the FIU to obtain such information.

325. **The Sri Lankan authorities agree that one of the causes of delays is that there are too many agencies involved with the processing of mutual legal assistance requests.** The inability of the central authority to provide a one-stop response hampers the ability of the requesting state to communicate with the appropriate Sri Lankan authority on progress of the case. This also affects Sri Lanka's ability to keep comprehensive and up-to-date data and statistics of mutual legal assistance requests, including information on its timeliness. A sampling of requests, conducted with the central authority, revealed a number of requests from over a few years that were still outstanding, with no detail available as to what was preventing execution of those cases. The central authority had referred many of these cases to another agency, with no subsequent update from that other agency, even after follow up by the central authority.

326. **Sri Lanka's extradition efforts appear to be similar to its mutual legal assistance regime, that is, there is no evidence of an effective case management system, adequate maintenance or monitoring of data, or effective coordination between the central authority and the operational agencies.** Cooperation relating to extradition is achieved under the Extradition Act No. 48 of 1999 (as amended) that officially comes within the purview of the Ministry of Defence. However, in practice, extradition requests are channelled through the Ministry of External Affairs, Ministry of Justice, or the Attorney-General's Department. The extradition statistics provided were basic and did not provide sufficient information to demonstrate that extradition requests were being dealt with in a constructive and timely manner.

327. Neither the Ministry of Defence nor the Ministry of External Affairs was clear about its role in terms of extradition from Sri Lanka. Neither agency was able to provide workable statistics, significant case studies, or information on the extradition process, to demonstrate Sri Lanka's effectiveness in terms of extradition. The information provided showed that between 2010 and 2014 there were 18 extradition matters. No information was provided as to whether the requests were incoming or outgoing, the offences for which extradition was sought, or the status/end result. It appears that although some amount of exchange of information and extradition does take place, these matters are handled by the relevant law enforcement authorities with minimal oversight by the relevant central authority.

b) Seeking in a constructive and timely way mutual legal assistance and extradition

328. Discussions with Sri Lankan law enforcement authorities revealed that mutual legal assistance and extradition requests are made to pursue evidence or criminals, although the statistics provided did not provide this level of detail. As indicated under IO.9, Sri Lankan authorities have observed that a significant number of TF offences have a foreign connection in view of the involvement of the Sri Lankan diaspora, which include countries in Europe and North America. As such, the importance of having an effective international cooperation regime is critical for Sri Lanka. Sri Lankan authorities have stated that they have made ongoing efforts through mutual legal assistance and extradition to pursue foreign-based offenders and to obtain evidence located in foreign countries for domestic investigation in terrorism and terrorist-financing related cases. However, the very limited statistics provided (see table 8.1 below) do not validate this claim, as only one mutual legal assistance request on TF was made through the Ministry of Justice by Sri Lanka in the last 4 years.

329. The authorities advised of cases that involved mutual legal assistance for TF. The Terrorist Investigation Division (TID) cited the case previously mentioned under IO.9, involving a European citizen based in an Asia/Pacific jurisdiction who was arrested in Sri Lanka for his involvement in TF offences relating to the LTTE. Evidence against the offender was sought through a mutual legal assistance request to the Asia/Pacific jurisdiction and the offender has since been convicted in Sri Lanka. Similarly, there was an outgoing mutual legal assistance request in the case relating to the European country that resulted in five

LTTE operators being convicted in that jurisdiction. Several other mutual legal assistance and extradition requests remain in progress and reflect the TID's ongoing counter-terrorist financing engagement on several fronts.

Table 8.1: Mutual Legal Assistance through Ministry of Justice

	2008	2009	2010	2011	2012
MLA requested by Sri Lanka - outgoing					
MLA on TF	-	-	-	1	-
MLA on ML	-	-	-	-	-

330. However, the list of cases provided by the central authority did not provide sufficient information to make an assessment as to the quality of the outgoing requests. Sri Lanka's inability to provide a reciprocity undertaking limits its ability to seek formal cooperation for coercive assistance, including for asset information, seizure and confiscation from states that are not specified or with which there is no treaty arrangement. There was at least one outgoing request in a fraud case in which the requested jurisdiction was not able to provide the bank account details pursuant to Sri Lanka's request because of Sri Lanka not being able to provide an undertaking for reciprocity. The Sri Lankan authorities also cited several cases where mutual legal assistance requests were made but assistance is yet to be forthcoming or has been rejected. In one case relating to TF, the foreign authority reported that it did not pursue the matter as there was no prospect of conviction. Sri Lankan authorities' efforts with formal international cooperation do not appear to be achieving significant successful outcomes in the prosecution of ML, TF or depriving criminals of their assets. The lack of data and statistics made it difficult to ascertain further as to why this is the case.

c) Other forms of cooperation

331. **Sri Lanka maintains a variety of bilateral and multilateral channels for international cooperation.** These include membership of regional and international organisation such as Interpol, the Egmont Group, World Customs Organisation, International Organisation of Securities Commissions and International Association of Insurance Supervisors. Sri Lankan law enforcement and supervisory agencies have also signed bilateral and multilateral MOUs to facilitate international cooperation for the prevention of AML/CFT in relation to their respective scope of duty. Authorities from the Securities and Exchange Commission advised that since 2010, there have been 2 occasions where Sri Lanka obtained useful information from 4 jurisdictions through the IOSCO MMOU platform.

Table 8.2: Police-to-Police Assistance though Interpol	**2010**	**2011**	**2012**	**2013**	**2014**
Provided by Sri Lanka					
Cases on TF.	7	4	0	0	01
Cases on ML	4	8	7	4	8
Predicate offence	156	151	171	199	169
Requested by Sri Lanka					
Cases on TF.	10	3	3	1	1
Cases on ML	0	2	4	8	5
Predicate offence	226	240	246	227	276

332. The Sri Lankan authorities cited a joint investigation among CID, Police Narcotics Bureau and the authorities of a SAARC country in an ML investigation involving proceeds of drug trafficking. Cooperation between the authorities of the two countries resulted in tracing of funds that had allegedly been laundered through overseas companies, factories and houses. The Sri Lankan authorities informed that the offender has been deported to Sri Lanka to face ML charges and that the information shared will form the basis of a mutual legal assistance request to the SAARC country to obtain the evidence for the purpose of prosecution.

333. Sri Lanka recognises that it faces significant AML/CFT risks from jurisdictions in the region; it has entered into regional conventions and arrangements with SAARC members to facilitate exchange of intelligence and information. These include the Additional Protocol SAARC Regional Convention on Suppression of Terrorism, SAARC Convention on Narcotic Drugs and Psychotropic Substance, SAARC Convention on Mutual Assistance in Criminal Matters and the SAARC Regional Intelligence Liaison Office under the World Customs Organisation. The SAARC Terrorist Offence Monitoring Desk (STOMD) was established in Colombo in 1995 to collate, analyse and disseminate information on terrorist offences, tactics, strategies and methods through a database and secure email network. However, due to delays between the relevant SAARC counterparts on matters such as common software and expert contact points, the desk is not fully operational, functioning only as a data exchange via email, and therefore appears to attract limited use.

334. **The Sri Lankan FIU has signed MOUs with over 25 FIUs from other countries.** Four of these are MOUs with FIUs from SAARC states. As an Egmont member, the Sri Lankan FIU shares information mostly through the Egmont Secure Web even without a MOU. In the case of non-Egmont members, Sri Lanka uses formal letters to share information. The Sri Lankan authorities have provided statistics with regards to requests received and made between their counterparts that have been reproduced in table 8.3 below, and indicated that they responded to all requests received from their counterparts.

Table 8.3: Sharing information with foreign counterparts (FIU to FIU)

	2009	2010	2011	2012	2013	2014
Requests received from other FIUs	6	9	25	11	18	10
Requests made by Sri Lankan FIU	47	13	4	12	2	8

335. In particular, STR information has led to investigations. The Sri Lankan authorities cited the Tamil Rehabilitation Organisation investigations for TF (See IO.9) as an example where STRs received from FIU counterparts were channelled to CID and which eventually led to TF investigations and prosecutions, some of which are ongoing.

336. The Sri Lankan authorities provided the following case examples of effective international cooperation that resulted in action taken against offenders:

Case 1

The Sri Lankan FIU received an STR in relation to a bank account that was used by a suspect who fraudulently collected over LKR 85 million (USD 1.4 million[4]) by arranging places in educational institutes in a regional country for medical courses even though these institutes were not appropriately registered. The FIU sought assistance directly from the AML Department of the regional country's FIU to obtain evidence relating to the educational institutes and medical courses that was used in the investigations by Sri Lankan CID. This resulted in sufficient evidence to obtain a domestic order to have the bank account of the suspect frozen and the case has been submitted to the AGD for prosecution.

Case 2

A European citizen was arrested for drug trafficking in Europe. Prior to the arrest, the offender was observed to have made a transaction to the bank account of a Sri Lankan resident. The European FIU requested assistance from the Sri Lankan FIU to identify if there was any relation between the offender and the Sri Lankan recipient of the transaction. The Sri Lankan FIU sought assistance from local authorities to trace border control movements of the offender to Sri Lanka and identify further financial transactions. It was found that the offender maintained a current account in Sri Lanka and held hotel property in Sri Lanka that had been leased to the Sri Lankan resident. The information gathered was provided to European FIU through Egmont Secure Web.

d) Identifying and exchanging basic and beneficial ownership information of legal persons and arrangements.

337. The deficiencies concerning beneficial ownership are noted under IO.5; the Registrar of Companies is able to provide certified copies of publically available company registration documents to domestic law enforcement agencies as well as to foreign authorities through diplomatic channels. Authorities did not provide statistics on the sharing of basic information.

338. To the extent that the information is available, the Sri Lankan FIU also endeavours to share beneficial ownership information where this can be obtained through interviews with company secretaries as well as through minutes of board meetings and other documents. However, a court order may be required to obtain such information and in such cases, a foreign authority may have to make a formal request under the MACMA. Sri Lanka provided an example of where investigations conducted by its authorities allowed foreign authorities to unveil the real managers of a company and share this information with its foreign counterparts. In the example provided, pursuant to one European country's mutual legal assistance request to obtain information of a company based in Sri Lanka that was used to set up a scam website seeking investors to participate in a fraudulent transnational business, Sri Lankan investigations uncovered information showing that although the company was registered to a Sri Lankan family, and had established an office in Colombo, the affairs of the company were being run by a foreign national in order to conduct the criminal activities without being identified.

339. **TID has also formally and informally shared information relating to links between companies and terrorists activities that they have uncovered through their investigations.** TID advised that it does use bank account details and reports from the Registry of Companies and information obtained from the FIU in its investigations in order to find out the beneficial ownership of suspicious legal arrangements. However, there is no indication that cooperation is similarly being provided by other law enforcement agencies, e.g., CID for ML and other non-TF offences.

Overall conclusion on Immediate Outcome 2:

340. There are significant legal and structural limitations to Sri Lanka's ability to be effective in relation to its formal international cooperation mechanisms. The central authority does not adequately maintain or monitor the status and timeliness of requests made and obtained. This, in combination with varying levels of inter-agency coordination, leads to a cumbersome system where the progress of requests is not always apparent. There does appear to be more effective international cooperation amongst the law enforcement agencies and their respective foreign counterparts, wherein assistance is initiated and monitored at an informal level. However, as Sri Lankan authorities have observed that a significant number of TF offences have a foreign connection in view of the involvement of the Sri Lankan diaspora, the importance of having an effective formal international cooperation regime is critical in the case of Sri Lanka.

341. Sri Lanka has achieved a **low level of effectiveness** for Immediate Outcome 2.

8.4 Recommendations on International Cooperation

342. The following recommendations are made on preventive measures (IO 2):

- Ensure that its MACMA framework allows Sri Lanka to be able to provide/obtain a wide range of mutual legal assistance regime (including coercive assistance) from a broader range of jurisdictions.

- Central authorities need to implement a much more robust and efficient case management framework to ensure better coordination and monitoring of mutual legal assistance and extradition requests.

- Maintain more comprehensive statistics on mutual legal assistance and extradition requests in order to better monitor the efficacy of its international cooperation framework.

- Establish a mechanism to better able to provide beneficial ownership information for foreign requests beyond the basic information it is currently able to provide.

TECHNICAL COMPLIANCE ANNEX

1. INTRODUCTION

1. This annex provides detailed analysis of the level of compliance for Sri Lanka with the Financial Action Task Force (FATF) 40 Recommendations. It does not include descriptive text on the country situation or risks, and is limited to the analysis of technical criteria for each Recommendation. It should be read in conjunction with the mutual evaluation report.

2. Where both the FATF requirements and national laws or regulations remain the same, this report refers to analysis conducted as part of the previous mutual evaluation in 2006. This report is available from www.apgml.org[12].

2. NATIONAL AML/CFT POLICIES AND COORDINATION

Recommendation 1 – Assessing risks and applying a risk-based approach

3. These requirements were added to the *FATF Recommendations 2012*, and were not therefore assessed in APG's 2nd round mutual evaluation report of Sri Lanka in 2006.

4. *Criterion 1.1*. Sri Lanka completed its first national risk assessment (NRA) of money laundering (ML) and terrorist financing (TF) in October 2014 two months before the onsite. The NRA was completed using the World Bank's *National Money Laundering and Terrorist Financing Risk Assessment Tool*. Prior to the NRA, there had not been any ML national or sectoral risk assessments. There is also the National Security Strategy, which was issued in 2014 and published in the Ministry of Defence's website. The strategy shows that Sri Lanka has assessed and identified TF risks, not only LTTE but also other TF risks such as Islamic State of Iraq and the Levant (ISIL). This strategy focuses primarily on terrorism, including its financing, but also examines maritime security issues (including organised trafficking of persons, human smuggling and drug trafficking) and organised crime. The document covered three areas:

- Sri Lanka's overall national security context;
- The primary threats to Sri Lanka's national security; and
- The strategies being formulated in response to these threats.

5. In the NRA, the overall conclusions of ML/TF risks are based on assessments done using seven modules and seven respective sub-teams involving 60 expert participants. These include ML and TF threat analysis, national vulnerability (including legal and regulatory framework, institutional capacity, and other factors), banking sector vulnerability, securities sector vulnerability, insurance sector vulnerability, other financial sector vulnerability and designated non-financial businesses and professions (DNFBPs) sector vulnerability. ML and TF risks on financial inclusion products were also assessed. Information sources used were quite broad and included both quantitative data and qualitative information, such as databases in government agencies; feedback obtained through questionnaire circulated among participants of banking, securities and insurance sectors; open source information; and qualitative input from sectoral experts from competent authorities and private sector. Further, the NRA contains comprehensive proposed actions to address the identified deficiencies and provide the basis of a national AML/CFT strategy.

[12] http://www.apgml.org/includes/handlers/get-document.ashx?d=866e80e0-42b2-484a-990b-0d61b3dfb19b

6. The NRA's assessment of ML/TF risks, overall, is reasonable and is not inconsistent with the assessment team's findings. The NRA is relatively broad and recognizes all the major ML/TF risks identified by the assessment team. It is lacking the assessment of the ML/TF risks of legal persons and arrangements. However, the NRA is primarily a self-assessment, and would have benefited from an independent review to moderate some of the conclusions on sectoral and national vulnerabilities.

7. *Criterion 1.2*. Sri Lanka has established the National Risk Assessment Working Group (NRAWG) with the FIU as the designated lead agency for preparing the NRA. The NRAWG represents all AML/CFT-related stakeholders in Sri Lanka, including private sector representatives (from the three major financial industry associations covering the banking, securities and insurance sectors) and comprises of senior officials of 23 institutions.

8. The NRAWG has been divided into eight sub-groups based on members' professions, specialisations, and backgrounds. The eight groups include one group for each thematic area of threat analysis, national vulnerability assessment, banking sector vulnerability assessment, securities sector vulnerability assessment, insurance sector vulnerability assessment, other financial institutions (FIs) vulnerability assessment, designated non-financial businesses and professions (DNFBPs vulnerability assessment, and financial inclusion product risk assessment.

9. *Criterion 1.3*. There has been no updating of the NRA because the NRA was completed just before the onsite. During the onsite, authorities advised that future updates will be discussed once the recommendations contained in the NRA have been adopted.

10. *Criterion 1.4*. The NRA has been disseminated to competent authorities and the three main financial sector industry associations have received the sanitised version of the report. At the time of the onsite, the FIU has not disseminated directly the sanitised version to FIs or DNFBPs. The FIU plans to disseminate the results of its NRA to all FIs and DNFBPs after the FIU Advisory Board has endorsed the NRA in early 2015.

11. *Criterion 1.5*. Sri Lanka has not yet applied a comprehensive risk-based approach to applying resources and implementing measures to prevent or mitigate ML/TF because it has just finalised the NRA and no other ML risk-based approach had previously been implemented. It has developed a security strategy that focuses on TF risks. The strategy includes implementation of a national coordination mechanism chaired by the Chief of National Intelligence.

12. *Criterion 1.6*. Not all elements of the relevant FATF Recommendations are required to be implemented by FIs or DNFBPs (see section on preventive measures). These exemptions are not based on proven low risk of ML/TF.

13. *Criterion 1.7*. The NRA has identified higher-risk areas arising from threats and sectoral and national vulnerabilities, including the informal sector. Because the recommendations contained in the NRA have not been approved, there is no national or sectoral strategy yet developed to address these NRA identified risks. However, supervisors have identified certain categories of customers e.g., politically exposed persons (PEPs) as higher risk and mandated that FIs undertake enhanced customer due diligence (CDD), issuing know your customer (KYC)/CDD rules to licensed banks and finance companies, stockbrokers, insurance companies, but not yet to DNFBPs. There is also no requirement for FIs and DNFBPs to ensure that such information is incorporated into their risk assessments.

14. *Criterion 1.8*. There has been no implementation of simplified AML/CFT measures based on proven lower risks for financial inclusion or otherwise. Further, the Financial Transactions Reporting Act (FTRA) does not explicitly provide for simplified measures to be adopted.

15. *Criterion 1.9*. Sri Lanka's supervisory authorities do not have a formal risk-based approach to supervision for the financial sector and there are no designated supervisors for DNFBPs. Sri Lanka has just completed its NRA and therefore has not adopted a risk-based approach to supervision. Financial supervisors have made some efforts in implementing a risk-sensitive approach, but this has not been systematically adopted or reflected in supervisory policies, practices and systems.

16. *Criterion 1.10*. Sri Lanka has not introduced a national requirement for all FIs and DNFBPs to identify, assess and understand their ML/TF risks. Only the CDD rules for the securities industry and insurance require a risk-based approach to those processes, and those are limited. However, the obligations do not appear to cover other types of risks such as products, services, transactions or delivery channels, or require institutions to document their risk assessment, or have appropriate mechanisms to provide such information to supervisors.

17. *Criterion 1.11*. Since Sri Lanka has not required FIs and DNFBPs to have comprehensive policies, controls and procedures in place to mitigate risks or take simplified measures.

18. *Criterion 1.12*. No regulatory instruction has been promulgated that would permit financial institutions and DNFBPs to take simplified measures to manage and mitigate risks, if lower risks have been identified.

19. *Weighting and conclusion*: Sri Lanka completed is first NRA in October 2014 and has not yet adopted a risk-based approach informed by the NRA to prevent or mitigate ML/TF, nor has there been any other systematic risk-based approach adopted prior to the NRA except for TF. **Recommendation 1 is rated partially compliant.**

Recommendation 2 – National cooperation and coordination

20. In the 2006 MER, Sri Lanka was rated partially compliant with the former R.31. It was found that Sri Lanka needed to enhance domestic coordination on AML/CFT across agencies with the primary deficiency considered to be the lack of a functioning FIU and of provision for its potential role in national coordination. Follow-up reports found that this has improved due to the establishment of the FIU, its subsequent interaction with other agencies, and the formation of a national coordination body, being the Advisory Board to the FIU.

21. *Criterion 2.1*. The National Security Strategy, which was made public in 2014, provides for a coordinated response to terrorism, including TF. Sri Lanka does not yet have national AML/CFT policies informed by an NRA, or from other forms of comprehensive ML risk assessments. Sri Lanka's national AML/CFT body, the Advisory Board for the FIU, serves as the reviewing body for national AML/CFT policies. However, there is no national AML policy or strategy. Authorities indicate that they will use the NRA to inform future reviews of national AML/CFT policies, primarily through the advisory board.

22. *Criterion 2.2*. The Advisory Board for the FIU is also the designated authority responsible for national AML/CFT policies. The cabinet memorandum forming the advisory board provides the board's terms of reference, including responsibility for national AML/CFT policies, and not just FIU matters. Authorities advised that the TORs are, and therefore the mandate of the board is, ongoing. Further, the Office of the Chief of National Intelligence performs a coordination role on matters relating to national security, including terrorism and TF, and certain categories of predicate offences but not ML.

23. *Criterion 2.3*. At the national level, the Governor of the Central Bank of Sri Lanka (CBSL) chairs the Advisory Board for the FIU. The board is tasked with deciding on AML/CFT policy matters and consists of heads of key ministries and institutions:

- Governor of Central Bank of Sri Lanka as the Chairman
- Secretary of Ministry of Finance and Planning
- Secretary of Ministry of Justice
- Secretary to Ministry of External Affairs
- Attorney General
- Legal Draftsman
- Controller General of Department of Import and Export Control
- Controller General of Department of Immigration and Emigration
- Inspector General of Police
- Chairman of Board of Investment of Sri Lanka
- Director General of Securities and Exchange Commission of Sri Lanka
- Director General of Sri Lanka Customs
- Registrar General of Companies
- Director General of Accounting and Auditing Standard Board
- Director General of NGO Secretariat
- Chairman of National Dangerous Drug Control Board
- Controller of Exchange

24. The Chief of National Intelligence oversees all agencies relevant to countering terrorism and meets weekly to discuss threats, including TF, from both LTTE and non-LTTE. The group consists of the Sri Lanka Police Terrorist Investigation Division (TID) and Criminal Investigation Division (TID), the State Intelligence Service, and the Defence Intelligence agencies: Directorate of Military Intelligence, Directorate of Naval Intelligence, and Air Intelligence. Other agencies such as Customs and the FIU attend as required. There is also information sharing on predicate offences such as drug trafficking, people smuggling and human trafficking.

25. In addition to the advisory board, there are several other coordination mechanisms/arrangements between domestic authorities providing for cooperation between agencies on policy development and implementation. Examples provided by Sri Lanka include:

- As noted previously, up to 60 officials from all relevant competent authorities were involved in preparing the NRA, including recommendations to address identified deficiencies.
- Two senior officials of the Attorney General's Department (AGD)) are appointed as consultants to the FIU to facilitate coordination with the AGD (the prosecutor).
- Some members of the CID are housed at the central bank, providing for close coordination between CID and the FIU.
- FIU has entered in to memorandum of understanding (MOU) with the Sri Lanka Customs to share information and initiatives. Formal arrangements have been made with Department of Immigration and Emigration, and Department of Persons Registration, to share information without MOUs. An officer has been designated in each department and the FIU and respective department to share information by emails using a specified document format.

26. Despite such examples, there is no formal information sharing agreement between the FIU and the police, or between the FIU, as the primary AML/CFT supervisor, and other financial sector supervisors.

27. *Criterion 2.4*. Authorities indicate that coordination on proliferation financing (PF) criterion is at an early stage, but that law enforcement agencies, in particular the State Intelligence Service, interact closely with the FIU on this matter and that they are working toward implementation. The FIU, through the Central Bank Deputy Governor, provided advice to the Ministry of External Affairs as to Sri Lanka's

obligations under the FATF Recommendations, in particular Recommendation 7, via letter on 29 August 2013 and again 2 July 2014.

28. *Weighting and conclusion*: Sri Lanka has the Advisory Board for the FIU that has the mandate to work on national-level AML/CFT policies, although it has yet incorporated the findings of the NRA in its work. There are regular meetings on terrorism, including TF, under the auspices of the Chief of National Intelligence. Coordination on PF is as yet only preliminary. **Recommendation 2 is rated partially compliant.**

Recommendation 33 – Statistics

29. In the 2006 MER, Sri Lanka was rated partially compliant with former R.32. The 2006 MER concluded that statistics for this part of the Recommendation were available to a varying extent across agencies.

30. Different competent authorities provided statistics for their mandated areas.

31. *Criterion 33.1 (a).* The FIU keeps reasonably detailed statistics of suspicious transaction reports (STRs) received and disseminated. Statistics provided included details of STRs reported individually by FIs, reasons for suspicion, a break-up of STRs analysed, details of STRs disseminated to law enforcement and supervisors including the NGO Secretariat, and some information on international dissemination. Information on STRs are sufficiently detailed to track whether ML/TF investigations, or prosecutions originated or not from STRs. The FIU classifies some intelligence reports provided by other competent authorities as also STRs, however, the statistics distinguish STRs received from financial institutions from those received from competent authorities.

32. *Criterion 33.1 (b).* The CID maintains a comprehensive spreadsheet of all ML cases under investigations and prosecutions. Further, the CID provided detailed statistics to the assessment team during the onsite on ML cases referred to the CID for investigations, ML cases under investigations, ML cases pending in High Court of Sri Lanka and ML cases concluded after trial. Information held was sufficient to indicate related predicate offences, whether from domestic or foreign proceeds, and whether 3rd party or self-laundering. There were less detailed statistics provided on TF investigations.

33. *Criterion 33.1 (c).* The FIU and AGD provided details on accounts temporarily frozen for both ML/TF under the FTRA. The AGD provided statistics on forfeiture under the Prevention of Money Laundering Act (PMLA) for the one ML conviction. The TID provided summary statistics of confiscated properties under various legislations, including the Prevention of Terrorism Act (PTA) and Public Security Ordinance (PSO), but not on the Convention on the Suppression of Terrorist Financing Act (CSTFA) as it has been rarely used. Customs provided details on 207 cases of cross-border confiscations but for 2014 only. Statistics were also provided on assets frozen under UN Regulations No.1 (1373).

34. *Criterion 33.1 (d).* The Central Authorities for mutual legal assistance and extradition do not keep comprehensive statistics regarding mutual legal assistance or other international requests for cooperation made and received. Although Sri Lanka provided the assessment team with a list of mutual legal assistance requests, the list did not provide clarity on the requests received/made, the type of assistance provided/obtained, the offences and whether the requests were dealt with in a timely manner.

35. *Weighting and conclusion*: There are legal provision under the FTRA requiring Sri Lanka to maintain or compile statistics on the types of reports that are mandated under section 15(i),(k),(o) and (p) of the FTRA. Statistics are available for STRs received and disseminated; ML/TF investigations, prosecutions and convictions; property frozen, seized, and confiscated; mutual legal assistance or other international requests for cooperation made and received. However, the information provided is not all

sufficiently detailed and comprehensive to demonstrate that it meets the scope of R.33. **Recommendation 33 is rated partially compliant**.

3. LEGAL SYSTEM AND OPERATIONAL ISSUES

Recommendation 3 – Money laundering offence

36. Sri Lanka was rated partially compliant with the former R.1. The report concluded that Sri Lanka had some technical deficiencies, preventing compliance with the international standards. Namely, that it had not yet ratified the Palermo Convention and that, at the time of the assessment: not all FATF designated offences were included as predicate offences to money laundering; third-party predicate offenders may require prosecution prior to money laundering prosecutions; only domestic offences were considered predicate offences – not foreign offences; and, ancillary offences did not include all requirements of the Palermo Convention.

37. Sri Lanka was rated partially compliant with the former R.2. The report concluded that the then newly enacted PMLA served to address many of the requirements of R.2 but not all, that the penalty framework was not dissuasive, and that the offences were not yet fully implemented.

38. The 2013 ME progress report on Sri Lanka found that it had made sufficient progress, primarily through amendments to the PMLA.

39. *Criterion 3.1*. ML is criminalised on the basis of the Vienna and Palermo Conventions by s.3 of the PMLA No. 5 of 2006 as amended.

40. *Criterion 3.2*. Predicate offences are defined by reference to 'unlawful activity'. Section 35 of the PMLA defines 'unlawful activity' which covers a range of requisite predicate offences as informed by offences detailed in other relevant legislation. The predicate offences of counterfeiting and piracy of products and non-habitual illicit trafficking in stolen and other goods are not covered as they are not criminalised, and tax crimes do not fall within the definition of 'unlawful activity' in the PMLA.

41. As paragraph (o) of the definition of 'unlawful activity' requires imprisonment of five years or more, clarification was sought from the AGD on how this sat with Penal Code provisions that expressed 'imprisonment may extend to five years'. As the theoretical maximum is 5 years, it falls within paragraph (o) regardless of the sentence that might be handed down in any particular case. On the same basis, if the punishment for the offence has a range of imprisonment that starts lower than five years but goes beyond five years then it falls within the definition.

42. *Criterion 3.3*. The amended PMLA contains a mixture of listed offences and a set threshold of five years imprisonment or more for other predicate offences. However, not all predicate offences are listed and some are below the five-year threshold as noted in the analysis for c.3.2.

43. *Criterion 3.4*. The definition of 'property' in section 35 of the PMLA is wide enough to cover any type of property that directly or indirectly represents the proceeds of crime, and is not expressly limited as to value.

44. *Criterion 3.5*. Subsection 3(3) of the PMLA provides that an accused need not be convicted of a predicate offence to be convicted of a ML offence as a conviction for the commission of the 'unlawful activity' is not necessary for proof of the ML offence.

45. *Criterion 3.6*. Paragraph (p) of the definition of 'unlawful activity' in section 35 of the PMLA satisfies this requirement. The amendments to the PMLA in 2011 extended unlawful activity to include an

act committed in any jurisdiction outside of Sri Lanka, which would constitute an offence in that jurisdiction or which would, if committed in Sri Lanka, amount to an unlawful activity.

46. *Criterion 3.7*. Though it is not expressly stated, ss. 3(1) of the PMLA is broad enough to cover the requirement that the ML offence should apply to persons who commit the predicate offence.

47. *Criterion 3.8*. Sri Lanka has advised that its criminal jurisprudence permits the mental element for the ML offence to be inferred from the objective factual circumstances. This appears to be consistent with general legislation such as the Penal Code, and is supported by case law, e.g., *Prasad Perera v AG* 2004 (1) Sri Lanka Law Reports 417 at p 420 and *King v Eddin* 41 New Law Reports 345 at p 346.

48. *Criterion 3.9*. Under ss.3(1) of the PMLA, upon conviction for the ML offence a natural person may be subject to a fine of up to three times the value of the relevant property, or to imprisonment for up to 20 years, or both. By comparison to the criminal sanctions for the predicate offences, this provides sufficient flexibility to be proportionate and dissuasive.

49. *Criterion 3.10*. Any person, including a legal person, who commits the offence of ML as defined under section 3(1) of the PMLA can be prosecuted and punished as provided in the same section. The definition of 'person' in s.35 of the PMLA to include a 'body of persons' applies the ML offence in ss.3(1) to some legal persons. Section 18 of the PMLA appears to clarify that this means a body corporate, a partnership and an unincorporated body. Section 18 extends liability for the ML offence to natural persons that lie behind such legal persons, subject to certain defences. According to section 10 of the Penal code a 'person includes any company or association or body of persons, whether incorporated or not'. Section 2 of the Code of Criminal Procedure Act No 15 of 1979 (CPC) also contains a similar interpretation to the term 'person'. Section 2(s) of the Interpretation Ordinance provides that a 'person includes any body of persons corporate or unincorporated'.

50. The sentence that can be imposed on a legal person convicted under this section is confined to a fine not less than the value and not more than three times the value of the property relating to which the offence was committed. In addition assets of the 'legal person' will be liable to be forfeited under the PMLA (ss. 3(1A)). In the event that the legal person fails to pay the fine imposed by the court, the court has the jurisdiction to issue a warrant for the levy of the amount by distress and sale of any movable property belonging to the offender (ss. 291(2) of the CPC). In addition to the fine imposed on the legal person, every director, other officer, partner, individual of an unincorporated body who is responsible for the management and control of such body by operation of section 18, is deemed to be guilty of the offence of money laundering and is liable to be punished with a term of imprisonment and a fine or with both as provided under section 3.

51. *Criterion 3.11*. Subsection 3(2) of the PMLA contains appropriate ancillary offences.

52. *Weighting and conclusion*: Sri Lanka's remaining deficiency is the incomplete coverage of predicate offences as described in c.3.2. **Recommendation 3 is rated largely compliant.**

Recommendation 4 – Confiscation and provisional measures

53. Sri Lanka was rated partially compliant with the former R.3. The report concluded that the proceeds of crime regime in Sri Lanka was too restrictive in terms of the offences it covered.

54. *Criterion 4.1*. Subsections 13(1) and (1A) of the PMLA permit confiscation of laundered property, proceeds or instrumentalities used in ML or property of corresponding value owned, possessed or under the control of the person convicted of the ML offence. Gaps in predicate offences identified under c.3.2 limits the scope, though it is noted that general provisions under the Inland Revenue Act No. 10 of

2006 to collect default tax can be utilised even though tax crime is not a predicate offence. There do not appear to be confiscation measures relating to third parties.

55. Subsections 4F(1) and (2) of the CSTFA, as amended, permits confiscation of funds or property provided or collected in contravention of the TF offence in section 3, and any instrumentalities used in the commission of the TF offence. The confiscation measures do not relate specifically to the person convicted of the TF offence and therefore they may also apply to third parties.

56. Sri Lankan authorities confirmed that there is no provision for confiscation in the absence of conviction where the offender has absconded or died.

57. Regulation 7 of regulations made under section 27(1) of the PTA (Gazette 1721/02 of 29 August 2011) permits the President, after satisfactory inquiry, to declare that money, securities, credits and any movable or immovable property in the custody of any person which are being used or intended to be used for the purposes of the LTTE, as a proscribed organisation, (whether at the time of the declaration or later) to be forfeited to the State. Such a decision is final and conclusive. Similar provisions existed under regulations made under section 5 of the PSO by the President giving the Minster for Defence the power to make the declaration (regulation 7, Gazette 1583/12 of 7 January 209, which lapsed in 2011 prior to commencement of the regulations under the PTA). Such provisions have the capacity to deal with laundered property, proceeds and instrumentalities relating to predicate offences, ML, TF and terrorist acts provided they relate to the LTTE.

58. *Criterion 4.2*. In respect to ML, sections 7, 9 and 12 of the PMLA permit freezing of property prior to confiscation and to identify, trace and evaluate such property. Part V of the Code of Criminal Procedure Act 1979 provides general powers for investigation of offences. A freezing order is only in force for seven days and the Sri Lanka Police must apply ex parte to the High Court within that time (or any extension granted by the High Court) for confirmation of the order. The High Court may permit essential and legitimate transactions despite confirming a freezing order.

59. In respect to TF, sections 4, 4A, 4B and 4E of the CSTFA, together with Part V of the Code of Criminal Procedure Act 1979, provide a similar regime.

60. The regulations under the PTA are implemented largely by the TID using general police investigative methods.

61. *Criterion 4.3*. Section 14 of the PMLA and section 4G of the CSTFA allow bona fide claimants, that is, those not the subject of the freezing order, to seek an order of the Court to have their property, etcetera, excluded from the scope of the order. Authorities advised that there is an ability for people affected by confiscation under the PTA regulations to seek an order restoring their property but this seems to be left to the general law as there are no specific provisions to cover it.

62. *Criterion 4.4*. Sections 11 and 15 of the PMLA and sections 4D and 4H of the CSTFA provide for a court appointed receiver to manage property the subject of a freezing order and subsequently a forfeiture order. However, no further details are provided on procedures or processes that a receiver needs to follow, or whether the court appointed receiver is another government agency or outsourced. There are no relevant provisions relating to action under the PTA.

63. *Weighting and conclusion*: Sri Lanka meets most of the requirements of this Recommendation with the remaining deficiencies being gaps in predicate offences, the lack of confiscation measures relating to third parties under the PMLA and lack of mechanisms or processes for managing or disposing of property frozen, seized and confiscated. **Recommendation 4 is rated partially compliant.**

Operational and Law Enforcement

Recommendation 29 – Financial intelligence units

64. In the 2006 MER, Sri Lanka was rated non-compliant with the former R.26. The Sri Lanka FIU was formally established in March 2006 but it was not in operation at the date of the 2006 MER. The powers and functions of the FIU are clearly stated in the FTRA 2006. The 2012 ME progress report noted that considerable progress had been made in addressing the deficiencies of the FIU. As a result, progress was considered to be equivalent to largely compliant in 2012.

65. *Criterion 29.1*. The Sri Lanka FIU was established as a national centre under the Central Bank of Sri Lanka (CBSL) in March 2006 through an Extraordinary Gazette notification dated 23rd March 2006 issued by the President of Sri Lanka. The legal basis for the FIU functions are provided in section 15 of FTRA, which empowers the FIU to receive reports, conduct analysis and disseminate to either the relevant law enforcement or supervisory authority.

66. *Criterion 29.2*. The FTRA provides for a wide range of reports to be received by the FIU, including for ML, TF and any unlawful activity. The FIU is the central agency mandated to receive STRs under Part I: Section 7 of the FTRA relating to ML, TF, or other related crimes notwithstanding the amount. Under Part I: Section 6 of the FTRA, the FIU is mandated to receive cash transaction reports (CTRs) and electronic fund transfer reports (EFTs). The current threshold for both threshold and wire transfer reports is LKR 1 million or above (USD 7 610[13]).

67. *Criterion 29.3*. The FIU under Section 7(3) of FTRA is empowered to require a person who has made a report to provide additional information upon request by the FIU. This criterion, however, requires the FIU to be able to obtain and use additional information from reporting entities, irrespective whether the reporting entity has made a report or not.

68. The FIU can make requests for information to any government agency, including law enforcement authorities (LEAs) and supervisory agencies for the purpose of FTRA as per Section 15(1)(c) of FTRA. Currently, information requests are ad hoc; other than an MOU with Customs, no other MOU or mechanisms have been established.

69. *Criterion 29.4*. The Intelligence Management Division of the FIU is responsible for conducting operational analysis from information received from reporting entities and other information (as described in c.29.2 -3). Under Section 15(1)(d), the FIU may analyse and assess all reports and information. The analysis procedure is detailed in the FIU Operational Manual. The analytical process for conducting operational analysis on an STR, including the use of additional information and intelligence, is outlined in paragraph 9 of Part 9(c) of the Manual. However, the FIU uses limited available and obtainable police information in conducting operational analysis. Similarly, the FIU does not make use of cross-border declaration information from Customs to assist in operational analysis. Customs provides only suspected ML/TF cases to FIU by means of STR reporting. The FIU does not access cross-border declaration information during the STR analysis stage.

70. The Strategic, Policy Development and International Relations Division of the FIU is responsible for conducting strategic analysis. However, only preliminary strategic analysis has been conducted on the typologies on certain areas, which was published in the 2013 FIU Annual Report. The analysis was found to be basic without conducting structured and comprehensive analysis based on the information from the

[13] Approximate figures based on LKR 1 equalling USD 0.00761, as at the end of the onsite visit, 12 December 2014, www.oanda.com

STRs over a period to systematically identify the trend and emerging ML/TF threat. Trend and strategic analysis entails the analysis with data covering a certain period of time. The typology provided is only a case study based on one or several cases.

71. *Criterion 29.5*. Section 15(f) of FTRA allows the FIU to refer any matter or any information derived from its operational analysis to LEAs, and a copy be sent to the relevant supervisory authority. The referrals, which are addressed to the Head of Disseminating Parties, are classified as confidential and delivered in person. The FIU can only disseminate the information spontaneously to LEAs or other competent authorities, but not upon the request from them.

72. *Criterion 29.6*. Under section 20(2) of FTRA, FIU staff members are required by law not to disclose any information/matters relating to their duties except in a few prescribed situations. FIU staff members are screened for their personal, career, and behavioural background, including a requirement to produce a Police Clearance Report before appointment. The FIU Operational Manual stipulates that the personal information under its control is protected from unauthorised disclosure. The FIU occupies one floor in one building of the Central Bank of Sri Lanka complex, and is physically secured by restricted access, CCTV monitoring, etcetera. Compartmentalisation is made in different divisions within the FIU in which the files/documents of the respective divisions are only accessible by authorised staff.

73. *Criterion 29.7*. The FIU is housed within the Central Bank of Sri Lanka.

74. For c.29.7 (a), according to paragraph 10 of Part 9(c): STR Review Committee in the Operational Manual of the FIU dated 1 July 2014, the Director of the FIU chairs the STR Review Committee that reviews STRs prior to dissemination and has full autonomy in deciding dissemination. For c.29.7 (b), once approval of the Minister under section 17(1) of the FTRA is given, the FIU can enter agreement and arrangement with any domestic or overseas agencies regarding information exchange as provided in sections 16 and 17 of the FTRA. For c.29.7 (c), the FIU is a department within the Central Bank of Sri Lanka, and while its responsibilities are clearly provided for in the FTRA and in the Operational Manual of the FIU, the Director of the FIU is accountable to the Assistant Governor of the Central Bank. It was confirmed during the face-to-face meeting that such reporting arrangement has had no impact on the FIU's operational independence. For c.29.7 (d), the FIU, with the exception of the Director of the FIU, employees are appointed by the Central Bank under the Monetary Act. However, this arrangement has not compromised its operational independence.

75. *Criterion 29.8*. The FIU has been a member of Egmont Group since 2009.

76. *Weighting and conclusion*: The FIU has made significant progress since the 2006 MER. Nevertheless, there are significant deficiencies concerning c.29.4 on operational and strategic analysis, which are the essential elements for the functioning of the FIU. The FIU's operational analysis uses limited available and obtainable police information on known criminals which impacts negatively on the quality of the STR analysis and financial intelligence product. In addition, Customs' information, such as cross-border declaration information, is not used by the FIU to augment the result of STR analysis. The absence of comprehensive strategic analysis also affects the jurisdiction's understanding of emerging ML/TF trends and risks. The gaps in operational and strategic analysis are given greater weighting in determining the rating. **Recommendation 29 is rated partially compliant.**

Recommendation 30 – Responsibilities of law enforcement and investigative authorities

77. Sri Lanka was rated PC in the 2006 MER for the former Recommendation 27. The major deficiency identified was the absence of designated law enforcement agency in conducting ML investigations.

78. *Criterion 30.1*. The CID in the Sri Lanka Police is responsible for ML/TF investigations while the TID also has a role in TF investigations. Two designated units, that is Financial Investigation Units 1 and 2 are formed under the CID and headed by a Senior Superintendent of Police to specialise on ML/TF investigations. The Director of CID has overall responsibility for ML/TF investigations. To assist in ML/TF investigations, the AGD has assigned four senior prosecutors to work with the FIU and CID on ML and TF cases. The Office of the Chief of National Intelligence in the Ministry of Defence also has a role in investigating terrorist activities.

79. *Criterion 30.2*. Sri Lanka's authorities report that all other authorities conducting predicate crime Investigations, while they are not authorised to conduct ML investigations, can refer cases to the Financial Investigation Units for ML investigations directly or indirectly through the FIU. The investigation units of predicate crimes within the police can refer cases directly to the Financial Investigation Units. For other non-police investigation units, cases would be referred indirectly to the Financial Investigation Units by means of STRs via the FIU. TID can do both Terrorism and TF investigations while CID can only do TF but not terrorism investigation.

80. *Criterion 30.3*. The Financial Investigation Units are the de facto designated competent authorities to expeditiously identify, trace and initiate freezing and seizing of property that is subject to confiscation, or is suspected of being proceeds of crime in Sri Lanka. Under Part II of the PMLA, a police officer, not below the rank of Assistant Superintendent of Police, can decide to take such actions. In addition, the FIU can exercise its power under s. 15(2) of FTRA to suspend a transaction for a period of seven days to avoid the dissipation of proceeds of crime before the investigation is taken over by the Financial Investigation Units.

81. *Criterion 30.4*. There is no non-law enforcement competent authority in Sri Lanka vested with the powers to undertake financial investigations of predicate offences.

82. *Criterion 30.5*. The Commission to Investigate Allegations of Corruption or Bribery (CIABC) in Sri Lanka is not designated as a LEA for corruption-related ML investigations. It can only investigate the predicate offence of corruption while Financial Investigation Units are responsible for corruption related ML investigations.

83. *Weighting and conclusion*: Sri Lanka meets all the essential criteria for Recommendation 30. **Recommendation 30 is rated compliant.**

Recommendation 31 – Powers of law enforcement and investigative authorities

84. Sri Lanka was rated largely compliant for the former Recommendation R.28 in the 2006 MER. The major deficiency identified was the various powers attached to relevant legislations including that the PMLA had not been tested and further powers should be made available.

85. *Criterion 31.1*. Chapter XI – Information to Police Officers and Inquirers and their Powers to Investigate in the Code of Criminal Procedure contains the necessary general powers for the Sri Lanka Police to take witness statements, to compel the production of documents, to search persons or premises, and to seize documents and records held by financial institutions and other businesses or agencies. The relevant provisions in PMLA and CSTFA also empower the police with the rank of Assistant Superintendent to seize and freeze the property relating to ML/TF for a period of 7 days before a court order is required for further extension of the detention period.

86. *Criterion 31.2*. There is no specific provision in any legislation in Sri Lanka empowering the Sri Lanka Police to conduct special investigations using techniques such as undercover operations, intercepting communications, accessing computer systems and controlled delivery. However, while there is no specific provision, it appears that police are able to use such powers as they are frequently used by them as part of their investigation techniques.

87. *Criterion 31.3*. There are a number of mechanisms, including under Section 124 of the Code of Criminal Procedure Act, that allow investigative authorities to seek assistance from a magistrate in making orders including an order to obtain information on bank accounts. However, there is no specification in the Act of identifying accounts and assets in a timely manner without notification to the owners. There are mechanisms or processes in place for securing and executing the court order to allow the police to identify assets without prior notification to the owner.

88. *Criterion 31.4*. There is no provision in the FTRA that allows competent authorities to ask for information held by the FIU in assisting their ML/TF investigations. However, section 15(1)(r) stipulates that the FIU can enter into agreements or arrangements with domestic government agencies for information exchange, but no such agreement or arrangement has yet to be made between the FIU and the Sri Lanka Police.

89. *Weighting and conclusion*: The Sri Lanka Police has sufficient power to conduct ML/TF investigations but the use of special investigation techniques are not contained in any legislation. In practice, the police appear to be able to use such special investigation techniques and have processes or mechanisms to identify assets without prior notification. In addition, there is no provision in the FTRA allows competent authority to obtain information from the FIU for ML/TF investigations but permits the FIU to enter agreement or arrangement with other agencies for information exchange. However, no such agreement or arrangement has been made between the FIU and the Sri Lanka Police. **Recommendation 31 is rated largely compliant.**

Recommendation 32 – Cash Couriers

90. Sri Lanka was rated as non-compliant for the former SR.IX in the 2006 MER. The MER noted that despite the FTRA requirements in place regarding cross-border transportation of currency and bearer negotiable instruments (BNI), there were major deficiencies identified. Deficiencies included the absence of a mechanism to ascertain the origin of currency and its intended use in relation to ML/TF, and the absence of a mechanism to maintain comprehensive statistics and share the information of declaration with the FIU, once established.

91. While there are no written declaration requirements for the Sri Lankan currency, there are strict controls for the export and import of Sri Lanka currency, which are only allowed in limited circumstances such as 'employment or for education or on a temporary visit on holiday, business or medical treatment, or for any other similar reasons and only authorised persons'. The limit to be exported or imported in such circumstance is very low at LKR 20 000 per person (USD 152[13]).

92. Further, the above requirements for foreign currency do not cover the full BNIs. The Exchange Control Act defines foreign currency to mean currency other than Sri Lankan currency and includes any currency payable by a foreign government or institution to a person in, or resident in, Sri Lanka in respect of his pension or other gratuities due to him. The definition of currency does include a broader set of BNIs, but the requirements in both the Foreign Exchange Act and Gazette Notice refer to foreign currency only, and not to the definition of currency. The Gazette Notice, while defining foreign currency as exactly the same as in the Foreign Exchange Act, also includes money orders and postal orders for the import of foreign currency.

93. *Criterion 32.2*. Under the Gazette Notice, it is mandatory for incoming passengers to make a declaration on arrival in Sri Lanka to Sri Lanka Customs in the 'Passenger Baggage Declaration: Inward' form if the value of currency exceeds USD 15 000, or its equivalent in other foreign currencies. Regarding outgoing passengers, they are required to make declaration to Sri Lanka Customs in the 'Passenger Baggage Declaration: Outward' form if the value of foreign currency taken or sent out of Sri Lanka exceeds USD 10 000, or its equivalent in other foreign currencies. However, as stated above, there is no written declaration requirement for the local currency and the full range of BNIs is not covered.

94. *Criterion 32.3*. Sri Lanka has adopted a declaration system and not a disclosure system.

95. *Criterion 32.4*. Section 119 of Customs Ordinance provides powers to Sri Lanka Customs when dealing with false declaration, untruly answering questions, and counterfeiting and using false documents. It provides penalties against persons making false declarations and not providing truthful answers to questions asked by customs officers. Under s.9(1), customs officers should have the general authority to request and obtain further information relating to the currency or BNIs, and their intended use.

96. *Criterion 32.5*. Any person who makes a false declaration commits an offence under Section 51(4) of Exchange Control Act are subject to penalties under that section. The punishments are in the range of imprisonment not exceeding 18 months, or both such imprisonment and a fine to imprisonment not exceeding five years, or both such imprisonment and a fine. Further, the court may, if it thinks fit, order the forfeiture of gold, currency, security, goods or other property. The maximum fine for a natural person (non-body corporate) is LKR 15 000 (USD 114[13]). However, where the offence does not consist only of a failure to give information or produce documents as required in section 39, but is also concerned with gold, currency, security, payment, goods or other property, a larger fine may be imposed not exceeding three times the amount or value of the gold, currency, security, payment, goods or property. There are also criminal and monetary sanctions under section 27 of the FTRA for failure to declare cash or BNIs.

97. *Criterion 32.6*. Under section 15(1)(r) of FTRA, the FIU may enter into any agreement or arrangement with any domestic government institution or agency regarding the exchange of information. A MOU has been signed between the FIU and Customs in 2010. However, there is no mechanism in place to make the cross-border declaration information available to the FIU. The Customs only selectively passes the information to the FIU for investigation on those declaration violations with suspicion of ML/TF activities.

98. *Criterion 32.7*. Sri Lanka Customs has only signed an MOU with the FIU but not Immigration and other related authorities to implement this Recommendation. There is an arrangement of information sharing with Inland Revenue Department and Department of Motor Traffic. However, there is no indication of how this arrangement contributes to addressing the physical cross-border transportation of currency and BNIs in relation to AML/CFT. There is also no elaboration of the established procedures between Sri Lanka Customs and these domestic departments to ensure the best use of the information from both ends.

99. *Criterion 32.8*. Under sections 24 and 25 of the FTRA, an authorised officer, that is, an Assistant Superintendent of Police or above, or a Superintendent of Customs or above, can examine and seize cash or BNIs in order to ascertain whether there is evidence as to the commission of unlawful activity and TF (section 25), or failure to report upon arrival or departure with cash or BNIs exceeding the prescribed sum (section 27). The seizure of cash and BNIs shall occur within 24 hours after an authorised officer believes based on reasonable grounds that there is evidence of unlawful activity, but should not be restrained for more than five working days unless a court order has been issued for further restraint.

100. *Criterion 32.*9. The FIU allows the exchange of information with foreign FIUs using an agreement or arrangement under section 16 and 17 of FTRA. Technically, cross-border declaration information can be shared with the foreign FIUs under this protocol. However, the full set of cross-border declaration information is not available to the FIU. Nevertheless, Sri Lanka Customs is able to share the information, including cross-border declaration information, with other customs counterparts through the Regional Intelligence Liaison Office, WCO or through MOU arrangements but it is unlikely for the purpose of declaration violation.

101. *Criterion 32.10*. Under the Code of Conduct and Customs Ordinance, it is an offence to disclose information contained in a declaration to a third party without legitimate reasons. In addition, section 50A of the Exchange Control Act stipulates that staff in the Department of Exchange Control of the Central Bank shall ensure confidentiality of information arising from their official functions. The same confidentiality clause is also applied to FIU staff under Section 20 of FTRA.

102. *Criterion 32.11*. Any act, which constitutes an offence, including the declaration offence under Exchange Control Act, is an unlawful activity under the definition of PMLA. It is caught by the ML/TF offence that is subject to punishment and forfeiture under Section 3 of the PMLA, and sanctions are as described in R.3 and R.5.

103. *Weighting and conclusion*: Sri Lanka has adopted a written declaration system for incoming and outgoing cross-border transportation of currency above a threshold. It is only applied to foreign currency but not Sri Lankan currency. However, the declaration requirement of foreign currency does not cover the full range of BNI as restricted by the definition of foreign currency under the Exchange Control Act. There are available powers and mechanisms in place to implement and enforce these requirements, although there are gaps including the lack of information sharing mechanisms by Customs with other relevant competent authorities such as immigration, and no mechanism in place for sharing the declaration information with the FIU. **Recommendation 32 is rated as partially compliant.**

4. TERRORIST FINANCING AND FINANCING OF PROLIFERATION

104. Sri Lanka was rated partially compliant with the former SR.II. The report concluded that the offence did not include: funding a single terrorist; the definition of 'funds' in the Act and in the UN Regulation, which did not extend to what is required by the Terrorist Financing Convention; proper extra-territorial jurisdiction of offences, as under the UN Regulation it was restricted to Sri Lankan citizens only; and, proper domestic jurisdiction over the UN Regulation offences as it was severely restricted to Sri Lankan citizens and residents only.

105. The 2013 follow-up report on Sri Lanka concluded that it had achieved full technical compliance with SR.II and Sri Lanka had brought the level of compliance with SR. II up to a level equivalent to largely compliant. The report noted that previously, while Sri Lanka had enacted the CSTFA (Amendment) Act, No. 41 of 2011 , which came into effect on 6 October 2011, the CSTFA had introduced a new subsection 3(2A), which allowed assistance on humanitarian grounds to be exempted. This technical deficiency has been rectified with the Sri Lankan Parliament passing amending legislation in February 2013, which is now in force.

Recommendation 5 – Terrorist financing offence

106. *Criterion 5.1.* The TF offence in section 3 of the CSTFA is consistent with article 2 of the TF Convention. Further, regulations made by the President under section 27 of the PTA on 29 August 2011 (Extraordinary Gazette No. 1721/12) also creates offences in respect to TF (Regulations 3(i) and (l)) with respect to the LTTE, or any organisation representing or acting on behalf of the LTTE (PTA Regulations).

Similar regulations under section 27 of the PTA could also be made in respect to other proscribed organisations.

107. This criterion is satisfied by s.3 of the CSTFA that stipulates any person who unlawfully and wilfully by any direct or indirect means provides or conspires to provide, material support or resources with the unlawful intention that they should be used, or in the knowledge that they are to be used, in full or in part to carry out a terrorist act (s), or by an individual terrorist, or a terrorist organisation, shall be guilty of an offence under the Act, even in the absence of a link to a specific terrorist act or acts. The offence under the PTA Regulations referred to above is not expressed in such detailed terms as it simply refers to people within or outside Sri Lanka engaging in specified activities connected with the LTTE.

108. *Criterion 5.3*. This criterion is satisfied by s.3 of the CSTFA and the definition of 'funds or property' as used in that section and defined in s.16A of the CSTFA extends to any funds whether from a legitimate or illegitimate source. The PTA Regulations refer to money and material and are not qualified as to their legitimacy.

109. *Criterion 5.4*. This criterion is satisfied by s.3 of the CSTFA because TF offences under the CSTFA do not require that the funds were actually used to carry out or attempt a terrorist act, or be linked to a specific terrorist act. The PTA Regulations do not require such a connection as they are simply based on a connection with a proscribed organisation, currently the LTTE.

110. *Criterion 5.5*. Sri Lanka's criminal jurisprudence permits the mental element for the offence to be inferred from the objective factual circumstances. This appears to be consistent with general legislation such as the Penal Code, and is supported by case law (such as *Prasad Perera v AG* 2004 (1) Sri Lanka Law Reports 417 at p 420, and *King v Eddin* 41 New Law Reports 345 at p 346). This jurisprudence should also apply to the PTA Regulations.

111. *Criterion 5.6*. Subsection 3(4) of the CSTFA provides for a penalty of imprisonment for 15 to 20 years, and also a fine. It is not clear what the maximum fine might be. This is similar to the penalty for the ML offence, and is comparable to the sanctions for the predicate offences, though it provides less flexibility on the minimum term of imprisonment than the ML offence. The penalty under the PTA Regulations is up to 20 years imprisonment. The criminal sanctions appear to be proportionate and dissuasive.

112. *Criterion 5.7*. The definition of 'person' in s.16A of the CSTFA to include a 'body of persons' appears to apply the TF offence in ss.3(1) to some legal persons. Unlike section 18 of the PMLA, there is no clarification of what 'body of persons' means. According to section 10 of the Penal Code, a 'person includes any company or association or body of persons, whether incorporated or not'. This definition applies for the purposes of the Penal Code. Section 2 of Code of Criminal Procedure Act No 15 of 1979 also contains a similar interpretation of the term 'person' for the purposes of that Act. However, section 2(s) of the Interpretation Ordinance provides that a 'person includes any body of persons corporate or unincorporate'. This definition applies generally to all Sri Lankan legislation. Given that s.16A CSTFA is an open definition, it incorporates individuals via s. 2(s) of the Interpretation Ordinance, therefore the terrorism financing offence applies to both individuals and legal persons. Regulation 6 of the PTA Regulations also applies the provisions in those regulations to a body of persons. The sanctions appear to be proportionate and dissuasive as per the commentary on c. 5.6 above.

113. *Criterion 5.8. Subsection* 3(2) of the CSTFA provides for a range of ancillary offences, as does regulation 5 of the PTA Regulations.

114. *Criterion 5.9*. The TF offence in ss.3(1) of the PMLA is designated as a predicate offence as it falls within the definition of 'unlawful activity' in s.35 of the PMLA either as a law relating to the prevention and suppression of terrorism (paragraph b), or an offence punishable by imprisonment for five years or more (paragraph o). The TF offence created by regulation 4 of the PTA Regulations would also fall within the definition of predicate offence in the PMLA for the same reason.

115. *Criterion 5.10*. This criterion is satisfied by s. 2A of the CSTFA. TF offences should apply regardless of the geographic location. The TF offence in the PTA Regulations is similarly not dependent on the geographic location of the offender.

116. *Weighting and conclusion*: Sri Lanka meets all the essential criteria. **Recommendation 5 is rated compliant**.

Recommendation 6 – Targeted financial sanctions related to terrorism and terrorist financing

117. Sri Lanka was rated partially compliant with the former SR.III. The 2006 MER concluded that Sri Lanka had not implemented an effective mechanism to freeze terrorist funds or other assets pursuant to Resolutions 1267 and 1373; and did not have an effective and publicly known procedure for considering de-listing and unfreezing requests in a timely manner.

118. The 2013 follow-up report on Sri Lanka found that it had not made sufficient progress. The follow-up report concluded that the making of the regulations to implement UNSCRs 1373 and 1267 was an important development, and the subsequent gazetting of the UNSCR 1267 lists. However, it was not clear how freezing without delay would be achieved without detailed procedures or mechanisms in place.

119. *Criterion 6.1 (a)-(e)*. Amendments made on 11 December 2014 to UN Regulations No.2 of 2012 allow the Minister for External Affairs, in consultation with the Minister for Defence and on the recommendation of the competent authority, to propose names to the 1267/1989 and the 1988 Committees for designation. The Competent Authority, the Chief of National Intelligence, chairs a working group of intelligence and police agencies that meets regularly for the purpose, amongst other things, of identifying targets for designation. The group consists of the TID, CID, State Intelligence Service and the Defence Intelligence agencies: Directorate of Military Intelligence, Directorate of Naval Intelligence, and Air Intelligence. Whilst it is not explicit that the designation criteria followed is that set out in the relevant UNSCRs, the amendments require the Minister to follow the procedure and standard forms adopted by the relevant UN Sanctions Committees. The evidentiary standard of proof for proposing a designation is on reasonable grounds and is not conditional on the existence of a criminal investigation or proceeding. A proposal must be based on precise information or material from any relevant source and the Competent Authority shall take all reasonable steps to ensure that names of persons, groups or entities that are proposed for designation have sufficient particulars appended to permit effective and accurate identification (see regulation 15A).

120. *Criterion 6.2 (a)*. For UNSCR 1373, the competent authority (the Secretary to the Ministry of Defence) is appointed by the External Affairs Minister in consultation with the Defence Minister. The competent authority can provide recommendations for designation to the Minister, but the Minister can act on his own initiative, or upon the request of a foreign state (UN Regulations No.1 of 2012, regulations 3 and 4).

121. *Criterion 6.2(b)*. Further to the comment in c.6.1, a working group meets weekly under the chair of the Chief of National Intelligence to discuss TF threats, both LTTE and non-LTTE, and identify targets for designation. This is the same working group that considers targets for UNSCR 1267 designation (see c.6.1 above).

122. *Criterion 6.2(c)*. Regulation 4 of UN Regulations No.1 of 2012 allows the Minister, upon the recommendation of the competent authority, to designate pursuant to a foreign state request. Amendments made on 11 December 2014 in Extraordinary Gazette 1892/37 clarify the procedure for a foreign state request placing the emphasis on a prompt determination of the request. The competent authority must consider whether there are sufficient grounds for making the designation and make a recommendation to the Minister for External Affairs, who promptly communicates the outcome to the foreign state.

123. *Criterion 6.2 (d)*. This is satisfied in regulation 4(1) by applying a reasonable grounds test for the belief. Regulation 4(1) allows a designation to be made irrespective of the existence of a criminal investigation or proceedings.

124. *Criterion 6.2 (e)*. A new Regulation 4B introduced into UN Regulation No.1 of 2012 on 11 December 2014 requires the Minister, on the recommendation of the Competent Authority, to request a foreign state to make a designation of a person, group or entity designated in Sri Lanka. The request is to be accompanied by information that enables effective and accurate identification, particulars that support the designation, and any other information that may justify the designation in the foreign state.

125. *Criterion 6.3 (a)-(b)*. For UNSCR 1373, Sri Lanka has referred to the designation being made upon precise information or material from any relevant source (regulation 4(4) of UN Regulations No.1 of 2012), and the competent authority's obligation to ensure the accuracy of the identification of those designated. For UNSCR 1267, amendments made on 11 December 2014 to UN Regulations No.2 of 2012 (Regulation 15B) allow the Minister to propose designations to the UN Sanctions Committee based on precise information or material from any relevant source. The assumption for both UNSCR 1373 and 1267 implementation is that designation is done *ex parte* with a subsequent right of review.

126. *Criterion 6.4*. In respect to UNSCR 1373, a list of those designated was published in the Gazette No 1854/41 on 21 March 2014 pursuant to regulation 4(2) of UN Regulations No.1 of 2012. However, regulation 4(2) does not impose a freezing obligation. The freeze obligation is under regulation 5. Nevertheless, the freeze order is required to be gazetted 'forthwith' upon designation under 4(2). While UN Regulations No.1 allow for designation and freezing to be gazetted at the same time, thereby avoiding any transposition delay, implementation did not occur simultaneously because the freeze order was not issued until 12 May 2014 via Gazette No. 1863/25.

127. In respect to UNSCR 1267, the consolidated list was first published on 11 June 2013, and an amendment published on 16 August 2013, after UN Regulations No.2 of 2012 was made on 31 May 2012. There have been 14 amendments published by way of Gazette Extraordinary up to end of 2014. Monthly updates are by way of a Gazette. Email notifications are sent to licenced banks and finance companies as, and when amendments to the 1267 list are issued by the UN Security Council.

128. For UNSCR 1267 (UN Regulations No.2 of 2012), regulations 5 and 6 prohibit dealing with or making available funds, other financial assets or economic resources in respect to designated persons. Designated persons are defined in regulation 2 of UN Regulations No.2 as those designated as such by the UN Sanctions Committee for the purpose of UNSCR 1267, and whose name appears on the Consolidated List adopted by the Sanctions Committee. Regulation 4(2) of UN Regulations No.2 requires the Competent Authority to publish in the Gazette the original list and any subsequent amendments immediately they are made. This is for the purpose of notifying the public rather than legal effect as under regulation 5 of UN Regulations No.2 of 2012 freezing occurs immediately upon designation by the UN Sanctions Committee and inclusion on the Consolidated List.

129. A directive was issued by the competent authority under regulation 16(3) of UN Regulations No.2 on 13 October 2013. This directive deals primarily with electronic communication of updates of the

consolidated list to relevant government agencies and reporting entities. Circular 02/13 of 29 October 2013 was issued by the FIU to licensed banks and licensed finance companies. Circular 02/13 states that freezing is effective as soon as the UN Security Council announces the names of designated persons and entities. This deals with how reporting institutions are provided with timely information about updates to the Consolidated List.

130. *Criterion 6.5 (a)*. For UNSCR 1267, regulations 5 and 6 of UN Regulations No.2 of 2012 satisfy the requirement on freezing without delay. As noted previously, for UNSCR 1373, regulations 4(2) and 5 of UN Regulations No.1 of 2012 do meet the requirement to freeze without delay. Regulation 4(2) states: 'Upon the designation of natural persons, legal persons, groups or entities, the Competent Authority shall compile a List of all Designated Persons (hereinafter referred to as the 'List'). The Competent Authority shall cause the List to be published forthwith in the Gazette.' As noted above, under regulation 5, it clearly states that upon designation, the Competent Authority shall also forthwith freeze by an Order.

131. For UNSCR 1373, under regulation 4(8) of UN Regulations 1, no person shall at any time prior to the designation provide notice to the person, group or entity that such person, group or entity is being considered for or is being designated. Further, regulation 5(3) states that no person shall at any stage prior to the designation or to the making of an Order of Freezing in terms of paragraph (1) notify or permit or cause notice to be given to the person, group or entity that an order of freezing may be imposed.

132. For UNSCR 1267 there are similar provisions in regulation 8, as amended on11 December 2014, of UN Regulations No.2, that no person shall at any time prior to the making of a proposal for designation, provide notice to the person, group or entity that such person, group or entity is being proposed or is being considered for such proposal.

133. *Criterion 6.5 (b)-(c).* For UNSCR 1267, regulations 5 and 6 (together with the definition of 'funds' in regulation 17) in UN Regulations No.2 of 2012 satisfy the obligation to freeze funds or other assets. For UNSCR 1373, regulation 5 (together with the definition of 'funds' in regulation 13) in UN Regulations No.1 of 2012, was amended via Gazette Extraordinary No. 1892/37 on 11 December 2014 to satisfy this sub-criterion. The same analysis applies to c.6.5(c), that is, the prohibition of funds, assets, economic resources, and services for designated entities, which is covered under regulation 5(1)(a) as amended on 11 December 2014.

134. *Sub-criterion c.6.5 (d).* For UNSCR 1267, the mechanism to communicate designations to the financial sector and DNFBPs is by publication of a consolidated list and via procedures described in the directive and circular referred to in the analysis of c.6.4. For UNSCR 1373, this is done by gazette publication of a list. A directive (FIU/UNSCR-1373/Directives No. 01) has also been issued under paragraph 12(3) of UN Regulations No.1 of 2012 all licensed banks and licensed finance companies under cover of Circular No. 02/14 of 25 June 2014 setting out a procedure to be followed to implement UNSCR 1373.

135. *Sub-criterion c.6.5 (e) For* UNSCR 1267, regulation 12 of UN Regulations No.2 of 2012 and the directive of 13 October 2013 (referred to in the analysis of c.6.4) satisfy the requirement on reporting by financial institutions and DNFBPs. For UNSCR 1373, regulation 9 of UN Regulations No.1 of 2012 satisfies this reporting requirement.

136. *Sub-criterion c.6.5 (f)* On rights of bona fide third parties, in relation to UNSCR 1267, reference is made to regulations 10 and 11 of UN Regulations No.2 of 2012, but this only deals with rights of persons claiming not to be the designated person, or any person aggrieved by a decision of the competent authority – they do not deal specifically with rights of bona fide third parties. The provisions of regulation 15A introduced by Gazette 1892/37 of 11 December 2014 do not rectify this. For UNSCR 1373, reference is

made to sub-regulation 8(3) of UN Regulations No.1 of 2012, which is a right of appeal if designated. Regulation 8(4) provides a more general right to seek judicial relief if a person is affected by a freezing order. Regulation 8A introduced by Gazette 1892/37 of 11 December 2014 allows a person claiming not to be a designated person to apply to the competent authority for a certificate to this effect, but this is similar to the provisions under UN Regulations No.2 of 2012 referred to above.

137. *Criterion 6.6 (a) – (g)*. For UNSCR 1373, regulation 8 of UN Regulations No.1 of 2012 provides a general right to seek revocation of designation by applying to the competent authority. For UNSCR 1267, reliance is placed on publication of amendments to the consolidated list (UN Regulations No.2 of 2012, -regulation 4(2)), which may give rise to delay. An alternative, more direct, means appears to be via electronic communication of amendments under the directive referred to in the analysis of c.6.4. UN Regulations No. 2 of 2012, s. 9 provides a way of releasing frozen funds and assets upon notification to the UN Sanctions Committee and compliance with the Committee's requirements. For UNSCR 1373, reliance is placed on regular review and amendment of the published list in the Gazette, though this may be as infrequently as once a year (UN Regulations No.1 of 2012, regulations 4(6) and (7)).

138. *Criterion 6.7*. Regulation 6 in the UN Regulations No.1, and regulation 9 in UN Regulations No.2, allow authorised access to frozen funds or other assets that have been determined as necessary for basic living expenses such as food, medicine and rent, and other fees, expenses and service charges such as taxes, utilities and compulsory insurance premiums.

139. *Weighting and conclusion*: Sri Lanka has established measures for the implementation of UNSCRs 1267 and 1373. There are minor deficiencies with the rights of bona fide third parties. **Recommendation 6 is rated largely compliant.**

Recommendation 7 – Targeted financial sanctions related to proliferation

140. The financing of proliferation is a new Recommendation added in 2012.

141. *Criteria 7.1-5*. Authorities advise that while there has been some discussion regarding Sri Lanka's responsibilities in the area of targeted financial sanctions related to proliferation financing, there have been limited steps taken towards implementation to date. On 20 November 2014, a preliminary inter-Ministerial Advisory meeting was held between officers of the Ministry of External Affairs, Ministry of Defence, Attorney General's Department, Legal Draftsman's Department and the FIU to discuss implementation issues. Political clearance has been obtained from the Minister of External Affairs to make regulations under the United Nations Act No. 45 of 1968 to implement relevant UNSCRs.

142. *Weighting and conclusion*: Sri Lanka has taken no material formal steps towards implementation. **Recommendation 7 is rated non-compliant.**

Recommendation 8 – Non-profit organisations

143. Sri Lanka was rated PC in the 2006 MER. At that stage, Sri Lanka had commenced a review of its NGO legislative framework but not focused on TF. Overall, there was limited compliance of the former SR.VIII requirements.

144. *Criterion 8.1*. Authorities advise that a three-year review of the NPO legislation is in its final stages with the Legal Draftsman's Department at Ministry of Justice with anticipated completion in the next twelve months. The review included legal experts and other personnel from Ministry of Social Services, the FIU, the Chief of National Intelligence, and other relevant agencies. There is no indication as to the regularity of such reviews or their outcomes.

145. *Criterion 8.2*. While the National Secretariat for NGOs conducts outreach and provides general awareness raising at annual progress meetings with Non-profit organisations (NPOs) and at other forums, at this stage such events do not cover TF risks and issues.

146. *Criterion 8.3*. Sri Lanka's policies in promoting transparency, integrity, and public confidence in NPOs are provided for in the Voluntary Social Service Organisations (VSSO) Act 1980 (as amended in 1998), VSSO Regulations No. 1101/4 of 1999, and Circular issued by the President 1999.

147. Implementation of the requirements is overseen by the National Secretariat for NGOs in the Ministry for Defence. The secretariat has a website devoted to providing information to NPOs and to the public about the NPO sector in Sri Lanka. The website provides a list of registered and de-registered NPOs and some basic information on each NPO.

148. *Criterion 8.4*. Given the scope of the VSSO Act, it is not clear that the secretariat oversees non-profit organisations (as defined by the FATF) that account for a significant portion of the financial resources or a substantial share of the sector's international activities. This criterion is partially met by Sri Lanka's requirements for registration and reporting by NPOs. NPOs are required to keep an updated list of members and details of appointees, and to provide those to authorities, but there is no requirement to authenticate the identity and background of beneficiaries/associated NPOs.

149. Article 3 of the VSSO Regulations requires NPOs to maintain financial records of all transactions including ledgers and cashbooks, and for them to be made available to the National Secretariat for NGOs. However, it is silent on the period for which the records must be maintained.

150. *Criterion 8.5*. There is limited monitoring of NPOs for compliance with registration. In terms of those aspects of c.8.4 that are met by Sri Lanka, the VSSO 1980, section 16.1 provides for the registrar to apply fines for non-compliance. The fine is listed as 'not exceeding two hundred and fifty rupee.' which is equivalent to USD 1.9[13]. This alone does not appear to be either proportionate or dissuasive.

151. *Criterion 8.6*. Section 11 of the VSSO enables the Minister to form a 'board of inquiry'. Under Section 12, the board of inquiry has significant investigation powers including summoning and compelling the attendance of witness, compelling the production of documents, and administering oath or affirmation. Under Section 14, the Minister can then refer the matter to the appropriate authority for further investigation or prosecution. General investigative powers of police under Part V of the Code of Criminal Procedure Act provide for police to investigate criminal acts as discussed at Recommendation 30 & 31.

152. The National Secretariat for NGOs works closely with key AML/CFT agencies in Sri Lanka, most notably the CID and TID (TF investigation) in the Police, FIU, AGD and Office of the Chief of National Intelligence in the Ministry of Defence. The co-location of the NGO Secretariat and the National Intelligence Office (terrorist investigation) in the Ministry of Defence helps facilitate information sharing on terrorism-related investigations.

153. Sec 15 (1) (c) FTRA also provides for the FIU to receive, analyse, and disseminate 'any information that the (FIU) considers relevant to an act constituting and unlawful activity or an offence' etc. This section also provides for request of information from other competent authorities.

154. *Criterion 8.7*. The ability of authorities to respond to international requests is provided for by the Mutual Assistance on Criminal Matters Act (MACMA) No 25 of 2002, and the NGO Secretariat has indicated its willingness to cooperate utilising available laws. However, no information was provided as to contacts or procedures for NPO/TF matters in terms of exchange of information outside of MLA, for example, bilateral exchange with foreign charities regulators.

155. *Weighting and conclusion:* The NPO sector is not yet subject to adequate outreach and oversight for AML/CFT purposes. The NGO Secretariat in the Ministry of Defence regulates NGOs, however registration is not mandatory and similar activity is conducted by NPOs registered as limited liability companies. Vetting does occur against the UNSCRs 1267 and 1373 lists. The relevant legislation is being amended to make registration compulsory and extend its coverage. **Recommendation 8 is rated partially compliant.**

5. PREVENTIVE MEASURES

Preamble: Scope of Financial institutions

156. The AML/CFT measures applicable to Sri Lanka's FIs are contained in the FTRA for thirteen categories of financial institutions designated by the FATF. Obligations under the FTRA are applicable to 'institutions', a term that includes persons and entities engaged in finance business and designated non-finance businesses. Designated Non Businesses and Professions (DNFBPs) as defined by the FATF are captured under the FTRA's definitions of designated non-finance business.

157. More detailed requirements are specified in KYC and CDD rules issued to licensed banks and finance companies, stockbrokers, insurance companies, and authorised moneychangers. These are enforceable means because they have been issued by competent authorities pursuant to the FTRA, with mandatory language and sanctions for non-compliance as contained in the FTRA, and sanctions have been applied for violations. However, no sector-specific rules have been issued to non-bank legal remitters or their agents (or for DNFBPs).

Recommendation 9 – Financial institution secrecy laws

158. *Criterion 9.1*. Section 31 of the FTRA provides that an institution shall comply with the requirements of the Act notwithstanding any obligation as to secrecy or other restriction on the disclosure of information imposed by any written law or otherwise.

159. The PMLA also contains overriding provisions with regard to secrecy obligations. Section 16 of the PMLA provides that the provisions of this Part of this Act (Part II: which provides for freezing and forfeiture of assets in relation to the offence of money laundering) shall have effect notwithstanding any obligation as to secrecy or other restriction upon the disclosure of information imposed by any written law or otherwise and accordingly any disclosure of information by any person in compliance with the provisions of this Part of this Act shall be deemed not to be a contravention of such obligation or restriction. Competent authorities in the banking, insurance, and security sector are also empowered to collect information, whenever required.

160. The FTRA (Section 15 (1)) contains provisions for sharing of information between FIU and other Government, law enforcement and supervisory agencies. While Section 16 of FTRA empowers FIU to share information with foreign institutions and agencies, it is uncertain if all the competent authorities can share information with their foreign counterparts. For example, position with regard to CBSL's ability to share information with foreign counterparts is not clear. It is also unclear, in the absence of specific provisions, whether financial institutions can share CDD information between themselves, where this is required under Recommendations 13 (correspondent banking), 16 (wire transfers) or 17 (reliance on third parties).

161. *Weighting and conclusion*: There is lack of clarity concerning the ability of sharing information, in particular, by CBSL and within financial institutions. **Recommendation 9 is rated largely compliant.**

Recommendation 10 – Customer due diligence

162. Sri Lanka was rated non-compliant with the former R.5 in its 2006 MER. Since its 2006 MER, Sri Lanka has prescribed detailed KYC and CDD rules for different sectors. These rules are:

i. Know Your Customer (KYC) and Customer Due Diligence (CDD) Rule No. 1 of 2011 and Amendment in 2012 for Licensed Banks and Registered Finance Companies ('Financial Institutions')
ii. Rules on Know Your Customer (KYC) & Customer Due Diligence (CDD) for the Securities Industry of 28 December, 2007
iii. Rules on KYC and CDD for the Insurance Industry of 11 September 2008
iv. Rules of 31 January 2013 for all Authorized Money Changing Companies

163. The 2013 follow-up report of Sri Lanka concluded that Sri Lanka had not brought the level of compliance with R.5 up to a level equivalent to largely compliant. The report observed that while Sri Lanka had made good progress over the last year in addressing a number of deficiencies, non-bank money remitters were still not subject to AML/CFT requirements and not all AML/CFT requirements were applicable to all FIs. The latter include verifying any person purporting to act on behalf of the customer is so authorised, ownership and control structure of the customer, beneficial ownership, and purpose and intended nature of the business regulations.

Detailed CDD requirements

164. *Criterion 10.1*. As noted in 2006 MER (paragraph 218, page 58), Section 2(1) of the FTRA prohibits institutions (including persons and entities engaged in finance business and designated non-finance businesses) from opening or maintaining an account where the account holder cannot be identified, including an anonymous account or a numbered account. This prohibition also applies to accounts that the financial institution knows are under false or fictitious names.

165. *Criterion 10.2*. Section 2, Subsection 2(a), (b), (c) and (d) of FTRA contains provisions with regard to conduct of customer identity verification by institutions in keeping with the FATF requirements.

166. *Criterion 10.3*. Requirements prescribed for banks and registered finance companies, securities industry, and insurance sector are quite detailed and prescriptive. However, for authorized money changing companies, requirements are less elaborate. Rule (8) of 31 January 2013 applicable to money changing companies states that every authorized money changing company shall maintain information of every customer as stipulated in s.(j) of the permit (which simply states that a register should have record of the name of customer, passport number, nationality and amount) issued by the Controller of Exchange. In addition, authorised money changing company shall obtain address and source of foreign currency and retain copies of all reference documents used to verify the identity of the customer. No rules have been prescribed for non-bank money value transfer service (MVTS) providers.

167. These rules, however, do not further prescribe source documents that may be used for conducting independent customer identification process.

168. *Criterion 10.4*. There are no explicit obligations in the rules for banks, finance companies, insurance companies and the securities sector to verify a person purporting to act for the customer is so authorised, and identify and verify the identity of that person. No such obligations exist for authorised moneychangers and non-bank money MVTS providers.

169. *Criterion 10.5*. The requirements to identify and verify the identity of beneficial owner have been stipulated in rules applicable to different constituents (other than non-bank MVTS providers and money changing services) of the financial sector with varying degrees of obligations. Rules for banks and registered financial companies simply state that every FI shall be able to justify the reasonableness of the measures taken to identify the beneficial owners (but with no definition or explicit reference to the natural person), having regard to the circumstances of each case, and that the financial institution may also consider obtaining an undertaking or declaration from the customer, on the identity of, and the information relating to, the beneficial owner. There are also some general requirements on beneficial owners in the rules for the securities sector. They, however, do not cast any direct obligations upon banks, registered finance companies, and securities companies to proactively identify and verify the identity of beneficial owner. Rules applicable for the insurance sector are closer to the requirements of the FATF Standards, but there is no explicit reference to the natural person behind a customer. No further clarity, definition or consistent interpretation or application of term 'beneficial owner' exists across the entire financial sector.

170. *Criterion 10.6*. The rules for licensed banks and registered finance companies provide for the former to obtain details of the customer's business, profession, level of income, economic profile, business associates and other connections, source of funds, in order to understand the customer. There is a mandatory obligation in the insurance sector to obtain information on the purpose and intended nature of the business relationship and other relevant factors. In the securities sector, there is an obligation to obtain information, such as financial background and business objectives, in order to develop a business and risk profile and to ensure that transactions being conducted are consistent with that profile (including, where necessary, the client's source of funds). Rules for money changing do not deal with this aspect, and no rules exist for non-bank MVTS providers.

171. *Criterion 10.7*. Section 5 of FTRA requires institutions to conduct ongoing due diligence of the business relationship with its customer, and ongoing scrutiny of any transaction undertaken throughout the course of the business relationship to ensure that any transaction that is being conducted is consistent with the institution's knowledge of the customer, the customer's business and risk profile, including, where necessary, the source of funds. Similar such requirements have also been prescribed separately under rules for securities and insurance sector. However, no obligations exist to ensure that document, data or information collected under CDD process is kept up-to-date and relevant.

172. *Criterion 10.8*. Specific rules have been prescribed for licensed banks and registered finance companies (Article 13, 14 and 34 of 2011 Rules), insurance industry (Article 7 of Rules) and securities industry (Part I B, paragraph 3 of 2007 Rules) to understand the nature of business of customers that are legal persons and legal arrangements and their ownership and control structure. However, such requirements are absent for money changing services and MVTS providers.

173. *Criterion 10.9*. Detailed obligations, including documentary requirements, have been prescribed for banks and registered finance companies to identify the customers that are legal persons or legal arrangements. Such measures are applicable for corporate entities, trusts, nominee and fiduciary accounts, charities, clubs and associations, societies and cooperatives among others. Similar rules are applicable for insurance industry. Rules applicable in securities markets are quite detailed in respect of corporate bodies but do not address other legal arrangements such as trusts. No such requirements have been prescribed for money changing and non-bank MVTS providers.

174. *Criterion 10.10*. As noted under c.10.5, there are significant gaps in the requirements for beneficial ownership. While there are references to the term 'beneficial ownership' in the various rules, there is no definition of such provided, or, where it is provided it is not consistent with the FATF Standards. Furthermore there is no detail provided on what constitutes reasonable steps that should be taken to identify the beneficial owner for any segment of the financial sector.

175. *Criterion 10.11*. Similar to c.10.10, while there are references to beneficial owners, and for banks and finance companies to identify and verify the trustee, settler, and protector beneficiary, and whether the customer is taking the name of another customer, there are no explicit obligations to identify and verify the beneficial owner, and as stated, there is no definition of beneficial ownership provided. The rules for the insurance sector are closer to the requirements of c.10.11, but lacking a definition of beneficial ownership consistent with the FATF Standards.

176. *Criterion 10.12*. The rules for the insurance sector lay down detailed requirements to identify and verify the identity of beneficiary (as distinct from the beneficial owner) of a contract. These rules provide that identification and verification of the beneficiary may take place after the insurance contract has been concluded with the policyholder, provided the ML and TF risks are effectively managed. Rules also require that identification and verification should occur at, or before the time of pay out, or the time when the beneficiary intends to exercise vested rights under the policy.

177. *Criterion 10.13*. The rules for the insurance sector provide that customer due diligence measures that should be taken by insurers include identifying the (ultimate) beneficial owner, and taking reasonable measures to verify the identity of the beneficial owner such that the insurer is satisfied that it knows who the beneficial owner is. For legal persons and arrangements, insurers should take reasonable measures to understand the ownership and control structure of the customer. These rules provide that the extent and specific form of these measures may be determined following risk analysis based upon relevant factors with enhanced due diligence called for in case of higher-risk customers. These rules indicate that the expression 'beneficial owner' applies to the owner/controller of the policyholder as well as to the 'beneficiary' to the contract. However, as noted earlier, the definition of beneficial owner does not include explicit reference to the natural person.

178. *Criterion 10.14*. The rules for banks and registered finance companies stipulate that no financial institution shall open an account unless and until adequate identity of the prospective customer is obtained. However, timing of verification of beneficial owner is not prescribed. Rules prescribed for insurance sector are more specific and granular and require that, in principle, identification and verification of customers and beneficial owners should take place when the business relationship with that person is established, subject to certain exceptions provided that ML and TF risks are effectively managed. Securities market participants are required to identify and verify the identity of investors before or during the opening of account, though for beneficial owner, timing of verification is not prescribed. Rules for moneychangers are not precise in this respect and such obligations do not exist for money changing services. As noted earlier, while there are references to beneficial owner, there are gaps in terms of its definition.

179. *Criterion 10.15*. For banks and finance companies, there is an explicit requirement in the rules for financial institution not to open an account unless and until adequate identity of the prospective customer is obtained. The rules further provide for financial institution to make an initial assessment of customer's risk profile and make additional enquiries and obtain additional information for high-risk profile customers. Rules for insurance and securities industry contain provisions that require financial institutions to adopt risk management procedures concerning the conditions under which a customer/beneficiary may utilize business relationship prior to verification. However, moneychangers and non-bank money MVTS providers are not subject to any such requirements.

180. *Criterion 10.16*. Section 2(5)(c) of the FTRA provides a phase-in period not exceeding 3 years for application of customer identification and verification procedures in respect of existing customers. Furthermore, rules for licensed banks and registered finance companies provide for updating of existing accounts with relevant information within a timeframe. Rules for the insurance sector also provide for application of CDD requirements to existing customers and/or beneficial owners based on materiality and risk, such explicit obligations are not there for other sectors.

181. *Criterion 10.17*. There is no requirement for enhanced due diligence when the ML/TF risks are higher.

182. *Criterion 10.18*. The basis for simplified CDD measures have been prescribed for insurance and securities industry and are broadly in line with requirements of the criterion. No simplified KYC/CDD measures have been prescribed for banks and registered finance companies. Requirements for moneychangers and MVTS providers are also absent.

183. *Criterion 10.19*. Section 3 of FTRA stipulates that if satisfactory evidence of identity is not submitted to an institution, the institution shall not proceed any further with the transaction unless directed to do so by the FIU and shall report the attempted transaction to the FIU as a suspicious transaction.

184. *Criterion 10.20*. While Section 3 of FTRA requires a specific direction from FIU for an institution to proceed with a transaction where it is not able to satisfactorily identify the client, there is no enabling provision that generally allows an institution *not* to pursue CDD process where it is reasonably believed that the customer will be tipped off if CDD process is performed.

185. *Weighting and conclusion*: FTRA contains broad obligations for FIs with regard to conduct of customer identity verification. Detailed requirements have been separately prescribed in rules for banks and registered finance companies, securities sector, insurance industry and authorized money changing companies. These requirements, however, have significant deficiencies, particularly in areas such as identification and verification of beneficial ownership, of person purporting to act for the customer, keeping CDD information up to date and relevant, application of CDD on existing customers on the basis of materiality and risk, enhanced CDD in case where ML/TF risks are higher etc. **Recommendation 10 is rated non-compliant.**

Recommendation 11 – Record-keeping

186. Sri Lanka was rated partially compliant with the former R.10 in the 2006 MER. The report concluded (paragraph 3.5.3, page 70) that maintenance of records was not a requirement because the FTRA was not yet in effect. The 2011 follow-up report concluded that Sri Lanka had made sufficient progress equivalent to largely compliant with the former R.10. The follow-up report also noted that there was still a lack of coverage of the non-bank MVTS and foreign exchange sectors.

187. *Criterion 11.1*. In terms of Section 4(1) (a) of FTRA, every institution (term 'institution' as defined in FTRA includes both finance business and designated non-finance business) shall be required to maintain records of transactions and of correspondence relating to transactions and records of all reports furnished to the FIU for a period of six years from the date of the transaction, correspondence or the furnishing of the report, as the case may be.

188. *Criterion 11.2*. Section 4(1) (b) of FTRA requires every institution to maintain records of identity obtained in terms of section 2 for a period of six years from the date of closure of the account or cessation of the business relationship, as the case may be. Record retention requirements for business correspondence (as stipulated in Section 4(1)(a) of FTRA) is for a period of six years from the date of transaction/correspondence and not from the date of termination of business relationship. While Section 4(1) does provide for the FIU to issue directions for longer retention period in specific cases, the same is not applicable in all cases. This may potentially lead to lower retention period for correspondence records than as required under the criterion. Furthermore, no specific obligations exist for institutions for maintaining account files.

189. *Criterion 11.3*. Section 4(2) of FTRA requires details of records to be maintained by institutions. Such details include name, address and occupation (or where appropriate business or principal activity) of

each person conducting the transaction and where applicable, on whose behalf the transaction is being conducted, nature and date of the transaction, type and amount of currency involved, parties to the transaction, the name and address of the employee who prepares the record and such other information as may be specified in rules issued by the FIU. These details are quite granular in nature and seem to be sufficient to permit reconstruction of individual transactions.

190. *Criterion 11.4*. Section 4(3) of FTRA states that where any record is required to be maintained under this Act, it shall be maintained in a manner and form that will enable an institution to comply immediately with requests for information from the FIU or a law enforcement agency (though relevant supervisory authority is not mentioned as possible recipient of such information).

191. *Weighting and conclusion*: Sri Lanka has put most of the record keeping requirements in place. The only remaining concerns are that there are no specific obligations for FIs to maintain account files and time period (six years) for maintaining business correspondence records is linked to the date of transaction/correspondence and not from termination of business relationship. **Recommendation 11 is rated largely compliant.**

Additional measures for specific customers and activities

Recommendation 12 – Politically exposed persons

192. Sri Lanka was rated non-compliant with the former R.6. The report concluded that there was no legislative, regulatory, or other enforceable requirement in respect of politically exposed persons. During the review process, the 2011 follow-up report observed that the KYC-CDD rules issued to banks and insurers provide for requirements relating to domestic and foreign politically exposed persons (PEPs), but only the insurance rules appear to cover the full range of requirements under R.6.

193. *Criterion 12.1*. The KYC/CDD rules for banks and registered finance companies provide limited obligations in dealing with PEPs. Paragraph 12 of the rules requires authorisation of senior management for opening of accounts for PEPs. While the paragraph subsequently explains the term PEPs, the definition of PEPs in paragraph 12 of the rules do not distinguish between foreign and domestic PEPs. Moreover, no obligations exist: for putting in place a risk management system to determine whether a customer or the beneficial owner is a foreign PEP; for obtaining senior management approval for continuing business relationship for existing customers and beneficial owners identified as foreign PEPs; for taking reasonable measures to establish the source of wealth and the source of funds of customers and beneficial owners identified as foreign PEPs; and, for conducting enhanced ongoing monitoring of that relationship.

194. The KYC-CDD rules for the securities industry, Part B, s.2, do not provide any specific obligations other than the general requirement to apply more stringent client identification measures in cases where the risk is higher that an institution will not know the ‘true identity’ of an investor, such as a PEP.

195. The requirements relating to foreign PEPs in the insurance sector are more elaborate (though still falling short of standards). As per paragraph 48 of KYC/CDD rules for the insurance industry, insurers should have appropriate risk management systems to determine whether the customer is a PEP. These requirements, however, do not extend to identification of beneficial owner. The paragraph further provides that the board of directors of the insurer must establish a client acceptance policy with regard to foreign PEPs, taking account of the reputational and other relevant risks involved. Insurers are also required to obtain senior management approval for establishing (though not necessarily for continuing business relationships) with such customers. Requirements exist for taking reasonable measures to establish the

source of wealth and source of funds (though not of beneficial owner), and for conducting enhanced ongoing monitoring of the business relationship.

196. *Criterion 12.2*. As noted, the rules do not distinguish between foreign and domestic PEPs. However, it is deficient in that officials of international organisations are excluded in the definition. Further, while there is a requirement to identify PEPs, there is no requirement to identify whether a beneficial owner is a domestic PEP, and the enhanced measures required for foreign PEPs are not available in higher-risk cases, given the gaps identified under c.12.1.

197. *Criterion 12.3*. The requirements applicable for different sectors as discussed in criteria 12.1 and 12.2 extend to family members and close associates of PEPs.

198. *Criterion 12.4*. There are no requirements to determine whether the beneficiaries and/or, where required, the beneficial owner of the beneficiary, are PEPs.

199. *Weighting and conclusion*: There are significant gaps in obligations with regard to PEPs across financial sector. **Recommendation 12 is rated non-compliant.**

Recommendation 13 – Correspondent banking

200. Sri Lanka was rated non-compliant with the former R.7. The report concluded that there was no legislative, regulatory, or other enforceable requirement in respect of correspondent banking relationships.

201. *Criterion 13.1*. General requirements are in place for licensed banks and registered finance companies to gather sufficient information about a respondent institution, and to assess its AML/CFT controls. However, there are no explicit requirements for banks and finance companies to understand fully the AML/CFT responsibilities of each financial institution, or to obtain approval from senior management before establishing new correspondent relationships.

202. *Criterion 13.2*. There is an absence of any requirements in the KYC/CDD rules pertaining to 'payable-through accounts' for all FIs.

203. *Criterion 13.3*. The rules do not explicitly prohibit dealings with shell banks, instead the KYC/CDD rules for banks and finance companies state that, 'No accounts for shell FIs should be opened without prior approval of the Controller of Exchange, being obtained'.

204. *Weighting and conclusion:* While general requirements have been established, the KYC/CDD rules do not include specific requirements for FIs to fully understand AML/CFT responsibilities of each institution, nor is there any requirement for FIs to obtain approval from senior management, before establishing new correspondent relationships. There is also an absence of requirements pertaining to payable-through accounts and specific prohibitions from dealing with shell banks in KYC/CDD rules for all FIs. **Sri Lanka is rated non-compliant with Recommendation 13.**

Recommendation 14 – Money or value transfer services

205. Sri Lanka was rated non-compliant with former SR.VI. The 2006 MER concluded that there was no licensing or registration requirement for legal non-bank MVTS providers.

206. *Criterion 14.1*. The Exchange Control Act prohibits any person in Sri Lanka from transferring funds outside the country, or from) paying funds to a resident that is the beneficiary of an inbound funds transfer, except with the permission of the CBSL. The CBSL is responsible for licensed commercial banks, which are authorised to provide MVTS under the banking license. The CBSL is also responsible for

approving any payment, which would therefore apply to all MVTS providers, including non-bank providers. However, in practice, there does not appear to be a licensing or registration regime in place to implement the basic requirements of the Exchange Control Act for legal non-bank MVTS providers that are permitted to act as inward remittance agents for other MVTS providers such as Western Union and Money Gram.

207. *Criterion 14.2.* Unauthorised or unlicensed MVTS are subject to sanctions as provided for under sections 51-52 of the Exchange Control Act. Penalties include fines (ranging from LKR 15 000 (USD 114[13]) to three times the value of the payment), forfeiture of assets, and up to five years imprisonment upon conviction. Sri Lanka's NRA assesses the informal money remittance sector as being highly vulnerable to ML/TF. However, efforts by Sri Lankan authorities to identify and curb such illegal activities and to apply appropriate sanctions are lacking.

208. *Criterion 14.3.* MVTS providers are classified as 'finance business' in the FTRA and supervision is broadly provided for in the FTRA. The FIU has issued KYC/CDD rules for authorized moneychangers and these entities come under the AML/CFT supervision of the Exchange Control Department of CBSL (ECD). However, the FIU has not issued specific KYC/CDD rules for other authorized non-bank MVTS providers and neither the FIU nor ECD conduct AML/CFT supervision on these entities. From interviews conducted during the on-site, ECD are of the view that foreign MVTS providers provide sufficient oversight on compliance to AML/CFT requirements by their locally appointed, inward remittance agents. However, interviews with a permitted non-bank MVTS provider, which has over 2 000 agents nationwide, confirmed that the foreign MVTS provider has only conducted two audits on their operations over the last two years. The Postal Department, which has over 4 000 branches nationwide, informed that about 3 to 4 meetings are held annually with the foreign MVTS provider to discuss operational matters which could include compliance issues, but these meetings are conducted at headquarters, with no further site visits to the branches.

209. *Criterion 14.4.* There is no explicit requirement for agents of MVTS providers to be licensed or registered, or for MVTS providers to maintain a current list of its agents.

210. *New Criterion 14.5.* There is no requirement for MVTS providers to include agents in their AML/CFT programmes and monitor them for compliance.

211. Weighting and conclusion: There are major shortcomings against all five essential criteria. There remains an absence of a proper licensing/registration regime for legal non-bank MVTS providers. Efforts by authorities to identify illegal MVTS providers and to apply appropriate sanctions are not commensurate with the high risk posed by the sector. There is also inadequate monitoring of MVTS providers for AML/CFT compliance, with over-reliance on foreign MVTS providers to ensure AML/CFT compliance by local MVTS providers, and an absence of specific requirements in relation to agents of MVTS providers. **Recommendation 14 is rated non-compliant.**

Recommendation 15 – New technologies

212. Sri Lanka was rated as non-compliant with the former R.8. The report concluded that there was no requirement for measures in respect of technological development or non-face-to-face business relationships.

213. *Criterion 15.1.* The NRA is the first coordinated attempt by supervisors to assess the ML/TF risks associated with new products, technologies, delivery channels and practices across the financial sector and institutions. However, no similar ML/TF risk assessment had been conducted for the financial sector prior to this. The KYC/CDD rules do broadly require banks and finance companies to take measures

to prevent the abuse of new technologies in money laundering schemes. While electronic cards, pre-loading of credit cards, internet banking and online sale of insurance policies have been listed as facilities for which enhanced measures should be taken, there is no specific requirement for FIs to identify and assess the ML/TF risks that may arise in relation to the development of new products and business practices. There are no specific requirements for the securities sector.

214. *Criterion 15.2*. While FIs are required to be extra vigilant when dealing with clients or transactions sourced through new or developing technologies, and to supplement identity verification procedures with specific and adequate measures to mitigate the higher risks from dealing with non-face-to-face clients, there are no specific requirements for FIs to undertake ML/TF risk assessments prior to the launch or use of new products, practices, and technologies.

215. *Weighting and conclusion*: Sri Lanka has not met the essential criteria as it has not adequately assessed risks associated with new technologies and there are no clear requirements on FIs to mitigate these risks. **Recommendation 15 is rated as partially complaint.**

Recommendation 16 – Wire transfers

216. Sri Lanka was rated non-compliant with former SR.VII. The report concluded that no specific laws or enforceable regulations existed in respect of inclusion of originator information in wire transfers.

217. *Criterion 16.1*. There is no *de minimis* threshold prescribed, but some requirements relating to cross-border wire transfers have been imposed. For outward remittances/wire transfers made out of Foreign Currency accounts, the KYC/CDD rules require banks and finance companies to forward a complete application to the financial institution incorporating important and meaningful originator information such as name, address, account number, identification number, together with a brief account of the purpose for such transfers. This is applicable to domestic wire transfers as well. However, there is no specific requirement for originator information to be verified for accuracy. There is also no requirement for the ordering financial institution to forward important and meaningful information on the beneficiary to the receiving financial institution.

218. *Criterion 16.2*. No enforceable requirements have been issued with respect to batch transfers.

219. *Criterion 16.3*. See c.16.1 above.

220. *Criterion 16.4*. The KYC/CDD rules do not specifically require the ordering financial institution to verify the information pertaining to its customer where there is a suspicion of ML/TF.

221. *Criterion 16.5*. See c.16.1 above.

222. *Criterion 16.6*. The Code of Criminal Procedure Act and FTRA empower the FIU and Police to obtain any information deemed necessary for investigations or prosecution. While the FTRA broadly imposes a six-year record keeping requirement, it is unclear if such is imposed on originator and beneficiary information in relation to wire transfers, be it cross-border or domestic.

223. *Criterion 16.7*. While Section 4 of the FTRA requires reporting institutions to maintain and retain records of relevant transactions and correspondences, and records of identity obtained, for a period of six years, no specific rules have been issued by the FIU with respect to wire transfers.

224. *Criterion 16.8*. Section 3 of the FTRA broadly prescribes that Institutions shall not proceed any further with any transaction if satisfactory evidence of identity is not submitted, but no specific rules have been issued with respect to wire transfers.

225. *Criteria 16.9-12*. There are no enforceable wire transfer requirements for intermediary FIs.

226. *Criteria 16.13-15*. There are no enforceable wire transfer requirements for beneficiary FIs.

227. *Criteria 16.16-17*. There are no enforceable wire transfer requirements for MVTS providers.

228. *Criterion 16.18*. The Ministry of External Affairs has issued regulations to effect freezes on funds, other financial assets and economic resources of designated persons that have been sanctioned under UNSCR 1373 (2001) and 1267 (1999) which apply equally to wire transfer transactions.

229. *Weighting and conclusion*: There is no *de minimis* threshold prescribed in KYC/CDD rules, nor are there any requirements for all cross-border wire transfers to be accompanied by the necessary beneficiary information. . **Recommendation 16 is rated non-compliant.**

Recommendation 17 – Reliance on third parties

230. Sri Lanka was rated non-compliant with former R.9. The report concluded that the FTRA was silent on the application of the CDD requirements when business relationships are initiated through third parties and introducers, or the responsibility for meeting the requirements.

231. *Criterion 17.1*. The KYC/CDD rules for banks and finance companies, paragraphs 31 – 33 on introduced business, establish the minimum criteria for selection of introducers. These requirements will help ensure that selected introducers will be in a position to provide the necessary CDD information. However, the rules for banks and finance companies do not state that upon selecting the introducer, ultimate responsibility should remain with the financial institution, or that (a) it should obtain the necessary CDD information, (b) copies of CDD information will be made available upon request, and (c) the introducer is regulated and supervised for AML/CFT. The KYC/CDD rules for insurance companies are explicit and directed at the insurance company as detailed in paragraphs 56-60 (Reliance on intermediaries and third parties). Similar rules have not been established for institutions in the securities sector.

232. *Criterion 17.2*. The KYC/CDD rules for banks and finance companies prohibits reliance on introducers who are subject to weaker standards than those governing its own KYC procedures, or those who are unwilling to furnish copies of their own due diligence documentation. However, this should be further clarified to require them to have regard to information available on jurisdiction risk. There is no specific requirement for insurance and securities sectors.

233. *Criterion 17.3*. There are no specific rules in place concerning when a third party is part of the same financial group

234. Weighting and conclusion: There are significant deficiencies because: there are no requirements in relation to introducers for securities sector; KYC/CDD rules do not explicitly require banks and finance companies to be ultimately responsible for CDD information of business relationships obtained through introducers, and to have regard to information available on country risk when dealing with non-residents; and, there are no requirements in relation to financial group for all FIs. **Recommendation 17 is rated non-compliant.**

Recommendation 18 – Internal controls and foreign branches and subsidiaries

235. Sri Lanka was rated partially compliant with former R.15 on internal controls, compliance and audits (paragraph 3.8.3, page 78). The 2006 MER concluded that the new FTRA law had not provided for the requirements but the efficacy can be assessed only after the financial sector supervisors ensure that FIs integrate the AML/CFT requirements in their internal control procedures. Sri Lanka was rated largely

compliant with former R.22 on foreign branches and subsidiaries. The 2006 MER noted (paragraphs 3.8.3, page 79) that the home/host country standard issues had been clearly covered in the FTRA. However, the provisions were yet to be tested.

236. C*riterion 18.1*. Section 14 of FTRA provides that every institution be required to establish and maintain procedures and systems to implement the following requirements: customer identification; record-keeping and retention; monitoring and reporting; training and screening of employees; and internal awareness relating to ML/TF. The section also provides for requirements relating to establishment of an audit function (though not necessarily 'an independent audit function') to test procedures and systems for compliance.

237. *Criterion 18.2*. No enforceable requirements have been prescribed by authorities to implement group wide programmes against ML/TF, applicable to branches and majority owned subsidiaries of the financial group. Policies and procedures for sharing information required for the purpose of CDD and ML/TF risk management are also yet to be prescribed. Not addressed in the existing provisions are requirements relating to group level compliance, audit and AML/CFT functions of customer, account, transaction information from branches and subsidiaries, necessary for AML/CFT purposes, and necessary safeguards for ensuring confidentiality and use of information exchanged.

238. *Criterion 18.3*. Section 14(3) of the FTRA provides that an institution shall ensure that its foreign branches and subsidiaries adopt and observe measure consistent with the Act to the extent that local laws and regulations permit, and where the foreign branch or subsidiary is unable to adopt and observe such measures, to report the matter to the relevant supervisory authority or in the absence of a supervisory authority to the FIU. Additionally in case of banks and registered finance companies, such matters are required to be reported to their Compliance Officer for appropriate action. However, the existing provisions do not require institutions to apply appropriate additional measures to manage the ML/TF risks in cases where the host country does not permit the proper implementation of AML/CFT measures consistent with the home country requirements, as required under this criterion.

239. *Weighting and conclusion*: Sri Lanka has put in place some requirements with regard to internal controls and foreign branches and subsidiaries. However significant gaps remain. There are no explicit requirements to have independent audit function to test the AML/CFT systems across financial sector. Financial groups are not required to have group-wide programmes and measures against AML/CFT and there are no specific requirements for FIs across financial sector to apply additional measures to manage ML/TF risks in case host country does not permit implementation of home country AML/CFT measures. **Recommendation 18 is rated partially compliant.**

Recommendation 19 – Higher-risk countries

240. Sri Lanka was rated as non-compliant with the former R.21. The 2006 MER (paragraph 3.6.3, page 73) concluded that there were no instructions, guidance notes or advisories to the FIs in respect of dealings with countries that did not apply or insufficiently apply the FATF Recommendations. The 2006 MER (paragraph 298, page 71) noted that the FTRA did not require effective measures be in place to ensure that FIs were advised of concerns about weaknesses in the AML/CFT systems of other countries.

241. *Criterion 19.1*. There are no enforceable requirements to apply enhanced CDD proportionate to the risks, when called upon to do so by the FATF.

242. *Criterion 19.2*. There are no enforceable requirements to apply countermeasures proportionate to the risks, when called upon to do so by the FATF or independently of any call by the FATF to do so. While Part B, s.6, of the FIU Operational Manual deals with internal processes of FIU to monitor FATF updates

relating to the high-risk and non-cooperative jurisdictions and publish them on the FIU website, there are no specific instructions issued by FIU or other supervisor authorities to apply countermeasures in appropriate cases.

243. *Criterion 19.3*. There are no measures in place to proactively identify countries having weaknesses in their AML/CFT systems and advise FIs of such concerns. No FIU advisory has been issued in the last few years to advise FIs of concerns of weaknesses in the AML/CFT systems of other countries.

244. *Weighting and conclusion*: There are no enforceable requirements in respect of dealing with higher-risk countries. **Recommendation 19 is rated non-complaint.**

Reporting of Suspicious Transactions

Recommendation 20 – Reporting of suspicious transaction

245. Sri Lanka was rated non-compliant with former R.13 on suspicious transaction reporting on ML. The 2006 MER concluded (paragraph 3.7.3, page 76) that though the FTRA provided for suspicious transaction reporting, in practice the system was not in effect because the FIU had not been established. Sri Lanka was also rated non-compliant with the former SR.IV on suspicious transaction reporting on terrorist financing.

246. The 2013 follow-up report on Sri Lanka found that for former core recommendations, R.13 and SR.IV, Sri Lanka had brought the overall level of compliance with R.13 and SR.IV up to a level equivalent to largely compliant.

247. The construction of the STR reporting obligation in section 7 of the FTRA is broader than the definition in the PMLA, and therefore the gaps in predicate offences under R.3 do not cascade onto R.20. For TF, R.5 is rated compliant.

248. *Criterion 20.1*. Section 7 of the FTRA outlines the conditions for submission of an STR. Firstly, it requires that where a financial institution has reasonable grounds to suspect that any transaction or attempted transaction may be related to the commission of any unlawful activity, or any other criminal offence, it shall report within two days of forming such suspicion to the FIU. Secondly, the same procedure should be adopted if the financial institution has information that it suspects may be relevant to (a) an act preparatory to an offence under the provision of the CSTFA or to an investigation or prosecution of a person for an act constituting an unlawful activity, or (b) may otherwise be of assistance in the enforcement of the PMLA and CSTFA.

249. Operational instructions, including format of reporting have been issued in rules applicable for banks, registered finance companies, securities and insurance industry and authorized money changing services.

250. *Criterion 20.2*. Section 7 requires institutions carrying out finance business and non-finance business (which includes categories of FATF's designated 13 financial sectors and DNFBPs) to report any suspicious transactions, including attempted transactions to the FIU, irrespective of the amount of transaction.

251. *Weighting and conclusion*: **Recommendation 20 is rated compliant.**

Recommendation 21 – Tipping-off and confidentiality

252. Sri Lanka was rated compliant in the 2006 MER for the former R.14 (paragraph 313-314, page 74). The MER noted that the PMLA and FTRA contain sufficient provisions to deal with tipping-off, confidentiality, and protection from civil and criminal liability.

253. *Criterion 21.1*. Section 12 of FTRA and Section 19 (1) (b) and 19 (2) of PMLA provide necessary protection to institutions (reporting entity and supervisory authority) and natural persons (auditor, director, partner, officer, employee or agent) from criminal and civil liability in this respect. These provisions, however, would be void if the filing of an STR was not carried out in good faith or in compliance with regulations made under the Act or rules or directions.

254. *Criterion 21.2*. Section 9 of FTRA provides for necessary obligation for institutions and other persons not to divulge information relating to STR and other related matters. There are exceptions to these prohibitions as outlined in s.9 (3), including the performance of the mentioned person's duties, or obtaining legal advice or representation in relation to the matter.

255. *Weighting and conclusion*: **Recommendation 21 is rated compliant.**

Designated non-financial businesses and professions

Preamble: Scope of DNFBPs

256. The AML/CFT requirements under the FTRA apply to all DNFBPs in Sri Lanka, namely casinos, real estate agents, dealers in precious metals & stones, lawyers, notaries, other independent legal professionals and accountants; and trust or company service providers. They are captured under section 33 of the FTRA as non-financial businesses. The FTRA requirements include STR reporting, tipping off, record-keeping, basic CDD and internal control requirements for DNFBPs. Similar for FIs, more detailed preventive requirements consistent with the FATF standards are absent. Unlike, however, for FIs, Sri Lanka has not issued detailed KYC/CDD rules for DNFBPs to cover other required preventive measures under the FATF standards.

Recommendation 22 – DNFBPs: Customer due diligence

257. Sri Lanka was rated non-compliant with the former R.12. The 2006 MER concluded that the CDD requirements under the FTRA covered all DNFBPs activities listed under R.12, but those requirements were not in force.

258. *Criterion 22.1*. The basic CDD obligations mandated in the FTRA 2006 apply to all DNFBPs, but unlike FIs, the obligations for DNFBPs are not supplemented by sector-specific rules or regulations. The requirements in the FTRA do not cover the scope of CDD mandated under Recommendation 10, nor does it set thresholds for CDD for casinos and dealers in precious stones and metals.

259. *Criterion 22.2*. The record-keeping obligations prescribed in the FTRA 2006, and deficiency identified under R.11 applies to all DNFBPs.

260. *Criterion 22.3*. There are no enforceable requirements in relation to PEPs or specific rules imposed on DNFBPs in relation to PEPs.

261. *Criterion 22.4*. There are no enforceable requirements or specific rules imposed on DNFBPs in relation to new technologies.

262. *Criterion 22.5*. There are no enforceable requirements or specific rules imposed on DNFBPs in relation to reliance on third parties.

263. *Weighting and conclusion*: The requirements in the FTRA do not cover the scope of CDD mandated under R.10, nor does it set thresholds for CDD by casinos and dealers in precious stones and metals. No detailed KYC/CDD rules have been issued for all DNFBPs, and no enforceable requirements are in place with respect to PEPs, new technologies or reliance on third parties. **Recommendation 22 is rated non-complaint.**

Recommendation 23 – DNFBPs: Other measures

264. *Criterion 23.1*. The legal obligation as provided in the FTRA 2006 to submit reports of suspicious transactions apply to all DNFBPs. The reporting obligation under section 7 of the FTRA requires all 'institutions' to submit STRs. An institution is defined under section 33 of the FTRA to mean any person or body of persons engaged in or carrying out any finance business or designated non-finance business within the meaning of this Act. This includes DNFBPs as defined by the FATF.

265. However, no specific rules have been issued, including for (a) lawyers, notaries, other independent legal professionals and accountants – when, on behalf of, or for, a client, they engage in a financial transaction in relation to the activities described in criterion c.22.1(d); dealers in precious metals or stones when they engage in a cash transaction with a customer equal to or above USD/EUR 15 000; and (c) trust and company service providers – when, on behalf or for a client, they engage in a transaction in relation to the activities described in c.22.1(e).

266. *Criterion 23.2*. Section 14 of the FTRA 2006 imposes legal obligations on all DNFBPs to appoint a compliance officer, and to establish and maintain prescribed controls, procedures, and systems to ensure compliance with the Act. However, no specific rules have been issued.

267. *Criterion 23.3*. As noted under R.19, the FTRA contains no enforceable requirements in place in relation to higher risk countries. To-date, no other enforceable measures have been issued by the FIU, and no advisory has been issued on higher-risk jurisdictions to DNFBPs.

268. *Criterion 23.4*. Legal obligations relating to tipping-off and confidentiality are applicable to DNFBPs.

269. *Weighting and conclusion*: While the FTRA provides for general requirements in relation to reporting of STRs, establishment of internal controls and tipping-off and confidentiality, the gaps in relation to R.18 and R.19 for FIs also apply to DNFBPs. **Recommendation 23 is rated partially compliant.**

6. SUPERVISION

Recommendation 26 – Regulation and supervision of financial institutions

270. Sri Lanka was rated non-compliant in the 2006 MER for the former R.23 because of the absence of a designated and functional AML/CFT supervisor. The MER noted that, in reference to AML/CFT regulation and supervision, only the enactment of the PMLA and FTRA would provide effective powers to implement R.23 via the FIU as a supervisor. Other factors listed contributing to the non-compliant rating were the absence of AML/CFT oversight of foreign exchange dealers and money remitters and the lack of 'fit and proper' requirements for directors and significant shareholders of institutions other than banks.

271. The 2013 ME progress report of Sri Lanka concluded that Sri Lanka had not brought the level of compliance with the former R.23 up to a level equivalent to largely compliant. This was because Sri Lanka had not established an effective AML/CFT supervisory capacity for MVTS businesses and exchange dealers. While Sri Lanka has made progress in complying with the former R.23 since the MER was adopted, issues remain concerning the scope of regulation.

272. *Criterion 26.1*. The FIU is the primary supervisor responsible for regulating and supervising compliance with the AML/CFT requirements. Under Section 18 of the FTRA, relevant supervisory authority for each sector also under undertakes general AML/CFT supervision of FIs being regulated by them. However, such supervision by sectoral regulators is more general in nature and FIU is the main agency for verifying compliance with AML/CFT obligations. . In addition, Section 23 of the FTRA requires the relevant supervisory authority of an institution to verify through regular examinations whether that institution is complying with provisions of the Act and to report any non-compliance to the FIU. The following table indicates the matrix of AML/CFT regulators for those financial sectors subject to supervision:

Institutions	**Regulator**
Licensed Banks	FIU/Bank Supervision Department of CBSL
Licensed Finance Companies	FIU/Department of Supervision of Non-Bank Financial Institution of CBSL
Stockbrokers	FIU/Securities and Exchange Commission of Sri Lanka
Insurance Companies	FIU/Insurance Board of Sri Lanka
Authorised Moneychangers	FIU/Exchange Control Department of CBSL
Rural Banks	FIU/Department of Cooperative Development
Thrift and Credit Cooperative Societies	FIU/Department of Cooperative Development

273. *Criterion 26.2*. Under Section 2 of the Banking Act 1988, commercial banks are subject to licensing conditions. Specialised banks are also licensed under Section 76B of the Banking Act. For registered finance companies (RFCs), licensing requirements are prescribed under Section 4 of the Finance Business Act 2011. In the securities sector, licensing requirements for stockbrokers, managing companies operating unit trusts, and market intermediaries are prescribed under the Securities and Exchange Commission of Sri Lanka Act 1987. Insurers and insurance brokers are subject to licensing requirements under the Insurance Industry Act 2000. The Exchange Control Act contains licensing requirements for authorised moneychangers. There is a basic requirement for non-bank MVTS providers to be approved by the CBSL under the Exchange Control Act. While the banking licence process effectively precludes the establishment and operation of shell banks in Sri Lanka (refer 2006 MER, p79, paragraphs 335-336), there is no express legislative prohibition on the establishment or continued operation of a shell bank.

274. *Criterion 26.3*. For the banking sector, fit and proper criteria for directors, chief executive officers, other executive officers, and substantive shareholders of banks have been prescribed in the Banking Act 1988, s.42 and ss.44A. For registered finance companies, the Finance Business Act includes criteria for directors, CEO, executive officers, secretaries and key management personnel. However, the criteria do not relate to criminal background due diligence and are not applicable for those holding (or being the beneficial owner of) significant or controlling interest of such finance companies. Rules for the insurance sector contain some requirements in relation to fit and proper tests for board members, senior management, and key staff, to be carried out by insurers, however these requirements are not specific and do not extend to significant shareholders or their beneficial owners. In the securities sector, Colombo Stock Exchange (CSE) Rules (Rule 2.19 in particular), contain requirements relating to fit and propriety. These rules are approved by SEC before issuance and are enforceable in case of violation. Other intermediaries of

the securities sector are governed by fit and proper criteria as contained in the respective rules issued by the SEC. However, these requirements do not extend to persons holding (or being the beneficial owner) of a significant or controlling interest in such intermediaries.

275. *Criterion 26.4*. The CBSL, SEC and IBSL undertake prudential supervision of the banking, securities and insurance sectors respectively, in accordance with Basel, International Organisation of Securities Commissions and International Association of Insurance Supervisors core principles. Regulatory and supervisory measures relevant from AML/CFT perspective include examination, monitoring and reporting of transactions, sanctions, and enforcement, and are covered under the FTRA, s.18, s.22 and s.23. All three supervisors conduct prudential supervision concurrently with broader AML/CFT supervision. The FIU role is focused on AML/CFT only, and supervision is conducted in parallel with AML/CFT supervision conducted by prudential supervisors,

276. There is no application of consolidated group supervision from an AML/CFT perspective, although the powers are available for consolidated group supervision. Section 41(1) of the Banking Act and Section 29B of the Monetary Law Act further empower CBSL to conduct examination of books of accounts of any subsidiary and agency of any commercial bank. Finance Business Act of 2011 (Section 24 (1) (d), provides for inspection of books and other records of holding company, associate companies and subsidiary companies of a finance company, or of any subsidiary or associate company of the holding company of finance company or of any company that has substantial financial interest or significant management interest in any finance company

277. The FIU is designated as the primary supervisor for all other FIs. However, similar for core principles institutions, the Department of Supervision of Non-Bank Financial Institution and the Exchange Control Department of CBSL are responsible for supervising registered finance companies and authorised moneychangers respectively. However, supervision is based on prudential considerations rather than ML/TF risks. Non-bank MVTS providers are not supervised by the Exchange Control Department.

278. *Criterion 26.5*. The frequency and intensity of supervision is not clearly informed by ML/TF risks. The Sri Lankan FIU's AML/CFT Examination Manual recommends that examiners study the AML/CFT risk assessment undertaken for the relevant sectors. In the selection of financial institution to be examined, priority must be given to the institutions with 'high' or 'extreme' risk rating. FIU, through its circular dated June 26, 2013 sought data from banks, licensed finance companies, insurance companies and stockbroking companies for assessment of business risks and effectiveness of control parameters. This is designed to enable FIU to undertake AML/CFT supervision on the level of ML/FT risk associated with each institution (with the exception of moneychangers, insurance brokers and non-bank money transmitters). While the FIU Examination Manual provides some structure to the onsite and offsite supervision process on risk-based assessment, it is unclear if and to what extent, this risk-based assessment feeds into the supervisory plan of sectoral regulators. There is also no formal consideration given to ML/TF risks within Sri Lanka. However, authorities have indicated that risk-based supervision will be further strengthened with implementation of the action plan contained in the NRA.

279. *Criterion 26.6*. There are no specific requirements to review the assessment of ML/TF risk profile of all FIs periodically and when there are major events and developments in the management and operations of FIs.

280. The FIU AML/CFT Examination Manual requires periodic review of the ML/FT risk-assessment process to be conducted by FIs. However, it is not clear whether the FIU and respective supervisors are periodically reviewing the risk profiles of FIs or groups.

281. *Weighting and conclusion:* There is absence of consistent obligations for fit and proper criteria across financial sector (other than securities sector). Criteria does not extend to significant shareholders and beneficial owners in case of finance companies, insurance companies, securities sector, authorized moneychangers and non-bank MVTS. AML/CFT supervision of financial institutions is not explicitly informed by AML/CFT risks, which is a significant deficiency. Application of risk-based supervision and consolidated group supervision is also absent. There is no specific requirement to review the AML/CFT risk profile of FIs/group periodically or events based. **Recommendation 26 is rated partially compliant.**

Recommendation 27 – Powers of supervisors

282. Sri Lanka was rated partially compliant with the former R.29. The 2006 MER concluded (p89, paragraph 3.10.3) that the then newly enacted FTRA and other relevant Acts contain generally adequate powers and sanctions; however there had been a lack of effective implementation in relation to AML/CFT supervision.

283. *Criterion 27.1*. The FTRA, s.18, provides sufficient powers to the FIU or delegated authority to examine books and records, and inquire into the business and affairs of an institution in order to ensure compliance with the Act or any other directions, orders, rules or regulations issued under the Act. FTRA s.22(2) also requires supervisory authorities to, at the request of FIU, carry out any examination into any transaction or other matter relating to the institution and report on such examination to the FIU. FTRA s.23 also requires a supervisory authority to verify compliance with provisions of the Act by an institution through regular examinations and to report instances of non-compliance to the FIU.

284. *Criterion 27.2*. The FTRA, s.18, s.22 and s.23, contains provisions to conduct inspections of FIs and access information held. There is no explicit provision in the FTRA to enable the FIU or any other supervisor to compel production of any information relevant to monitoring compliance with the AML/CFT requirements. There is under section 18 (2) of the FTRA, provision for, 'The owner or person responsible for the premises referred to in subsection (1) and every person found thereon shall give the Financial Intelligence Unit or any authorized person all reasonable assistance to enable them to carry out their responsibilities and shall furnish them with any information that they may reasonably require.'

285. Further, all supervisors have the authority under relevant legislations, that is, the Banking Act, Finance Business Act, Foreign Exchange Act, Securities and Exchange Commission Act, and Regulation and Insurance Industry Act. Supervisors have stronger powers under their enabling legislations to compel actions by licensees, including production of records, without recourse to a court order.

286. *Criterion 27.3*. FTRA ss.18 (2) provides sufficient powers to the FIU or delegated authority to obtain any information that it might reasonably require to administer the provisions of the Act or the regulations made thereunder. Supervisory authorities are also empowered to have access to information for their supervisory processes.

287. *Criterion 27.4*. Power to impose monetary penalty rests with the FIU under the FTRA ss.19(1). Ss.19(4) further provides that the imposition of such penalty shall not preclude a supervisory authority or a regulatory authority from taking any regulatory or disciplinary measures, including, but not limited to, suspension or cancellation of licence of the institution. As a whole, these powers to impose sanctions seem sufficient to deal with failures to comply with requirements, though there seems to be some overlap between FIU and supervisory authorities as far as sanctioning power is concerned. **Recommendation 27 is rated compliant.**

Recommendation 28 – Regulation and supervision of DNFBPs

288. Sri Lanka was rated as non-compliant with former R.24. The report concluded that there was no AML/CFT supervision for casinos or other DNFBPs.

289. *Criterion 28.1*. Section 2 of the Casino Business (Regulation) Act, No. 17 of 2010 (CBA) stipulates that *'No person shall, from and after January 1, 2012 engage in the business of a Casino other than under the authority of a valid license issued in that behalf by the Minister'*, but to-date, none of the five casinos in operation in Colombo have been licensed under this Act. Sections 3 and 4 of the CBA empower the Ministry to issue Regulations to set terms and conditions for applying for a casino licence and to give effect to the provisions of the Act. However, Sri Lankan authorities confirm that no Regulations have been issued since the passing of the Act, and no Ministry has been assigned as the competent Ministry to administer the Act. The Act does not provide any measures to prevent criminals or their associates from holding (or being the beneficial owner of) a significant or controlling interest, or holding a management function, or being an operator of a casino. Of concern, Sri Lankan authorities are unable to confirm when a competent Ministry will be identified, or when the existing casino operators will be subject to licensing requirements.

290. There has been no other progress since the MER 2006, with existing casinos still not subject to AML/CFT supervision to ensure compliance with at least STR reporting, basic CDD and record-keeping obligations (under the FTRA). While there is an FIU AML/CFT Examination Manual, its scope does not extend to casinos, and to-date, no AML/CFT supervision of casinos has been conducted by the FIU.

291. *Criterion 28.2*. There has been no progress since the 2006 MER (pp96-98). There appears to be no designated supervisor or enforcement of AML/CFT requirements for DNFBPs. The FIU's AML/CFT Examination scope does not extend to DNFBPs and no AML/CFT supervision of DNFBPs has been conducted by the FIU. While there are self-regulatory bodies (SRBs) and licensing authorities for various DNFBPs, they do not have a role in AML/CFT supervision. There is no SRB for the real estate sector, although the Registrar Generals Department supervises the transfer of real property ownership titles. For dealers in precious stones, the National Gem and Jewelry Authority manages the licensing regime under the National Gem and Jewelry Authority Act 1991. The Bar Association of Sri Lanka is the SRB for the legal profession, and the Institute of Chartered Accountants of Sri Lanka and some other accountancy bodies are the SRBs for the accountancy profession. For notary public, they must be licensed by the Registrar General Department.

292. *Criterion 28.3*. There is an absence of any system to monitor AML/CFT compliance by all categories of DNFBPs.

293. *Criterion 28.4*. While there are powers and sanctions available under the FTRA once an authority has been designated to monitor compliance as explained under R.27, but no competent authority has been designated as the AML/CFT supervisor for DNFBPs. Furthermore, the existing SRBs and licensing/registration authorities do not have any functions with respect to AML/CFT supervision and do not appear to have adequate powers to take necessary measures to prevent criminals or their associates from being professionally associated (or being the beneficial owner of) a significant or controlling interest, or holding a management function in a DNFBP.

294. *Criterion 28.5*. There is no designated DNFBP supervisor, and therefore there is no AML/CFT supervision of DNFBPs being conducted, be it on a risk-sensitive or any other basis.

295. Weighting and conclusion: Casinos remain unlicensed and are not subject to AML/CFT supervision. There is no designated competent authority or SRB responsible for ensuring AML/CFT

compliance by other DNFBPs, and therefore no system is in place for monitoring compliance by DNFBPs to AML/CFT requirements, be it on a risk-sensitive basis or otherwise. **Recommendation 28 is rated non-compliant.**

Recommendation 34 – Guidance and feedback

296. Sri Lanka was rated non-compliant with former R.25. The 2006 MER concluded that supervisory institutions in Sri Lanka had yet to issue comprehensive AML/CFT supervisory guidance to the financial sector and DNFBPs. Apart from the non-mandatory guidance note on KYC issued to banks in 2001 by CBSL, there were no other relevant supervisory instructions.

297. *Criterion 34.1*. The FIU has issued numerous guidelines in the area of AML/CFT that are maintained in the FIU's website. These guidelines includes notification, guidance notes, information circulars, guidelines and FAQs, which are limited to banks, licensed finance companies, stockbrokers and insurance companies. The FIU also conducted various seminars and workshops for FIs on the importance of submitting STRs, including on red flags and reporting procedures. Given there has been enforcement of FTRA requirements for DNFBPs, no guidance has been provided in the area of AML/CFT, including on STR reporting, to the DNFBP sector.

298. On feedback, the last substantive general feedback was provided in 2011 that was in relation to poor compliance with STR reporting obligation. Feedback on CDD deficiencies was last undertaken in 2009. The FIU does provide on a regular basis feedback to reporting entities on compliance with reporting structure via the LankaFIN system. The feedback pertains to data integrity issues such as incorrectly completed or missing fields. Through this feedback exchange, errors in STRs have been rectified.

299. *Weighting and conclusion*: The FIU has issued various guidance notes and feedback on STR data integrity for FIs, most pertaining to the banking sector. No guidance has been issued to the DNFBP sector to mobilise implementation of FTRA requirements. **Recommendation 34 is rated partially compliant.**

Recommendation 35 – Sanctions

300. Sri Lanka was rated partially compliant with former R.17. The 2006 MER concluded that while the provisions of the FTRA provide for effective, proportionate, and dissuasive criminal, civil or administrative sanctions to deal with natural or legal persons covered by the FATF Recommendations, those sanctions were not considered to be in effect at the time of the onsite.

301. *Criterion 35.1*. The FTRA provides for a range of administrative, civil and criminal sanctions in the event of any breaches of the AML/CFT obligations by FIs and DNFBPs. These sanctions extend to both natural and legal persons. Sanctions in Section 19 and Part VI of the FTRA are specific and limited to preventive measures referenced in Parts I and II of the FTRA, namely on basic CDD measures, financial reporting obligations, tipping off, access to information and record keeping. These sanctions are also applicable for breaches of additional enforceable means as contained in the KYC/CDD Rules issued to banks and finance companies, stockbrokers, insurance companies and moneychangers. However, this is not the case for DNFBPs given that no KYC/CDD rules have been issued for the sector. Section 19 provides for regulatory or supervisory measures, administrative monetary penalties or issuance of directive orders to enforce compliance. However, the maximum administrative monetary penalty that can be imposed shall not exceed a sum of LKR 1 million (USD 7 610[13]), which does not seem sufficiently dissuasive. Sections 27 and 28 provides for criminal penalties on more serious violations, such as giving false information. The maximum penalty of a fine not exceeding LKR 100 000 (USD 761[13]) or imprisonment for a term not exceeding one year or both, does not appear sufficiently dissuasive.

302. The UN Regulations No. 1 and No. 2 2012 that were issued by the Minister of External Affairs in May 2012 provides additional sanctions on any persons who fail to comply with Orders issued under UNSCR 1267 and 1373. The criminal penalties imposed for non-compliance with these regulations appear to be more dissuasive compared to the FTRA, such as the maximum penalty of LKR 500 000 to LKR 1 000 000 (USD 3 800 – USD 7 610[13]) and/or imprisonment for a period not exceeding 1 – 2 years. However, given the deficiencies in R.8, the NPO sector is also not subject to adequate sanctions.

303. *Criterion 35.2*. The available sanctions in the FTRA are applicable, not only to FIs and to DNFBPs, but also to their directors and senior management.

304. *Weighting and conclusion*: While a range of sanctions is in place for FIs and DNFBPs, the available sanctions are not sufficiently dissuasive. There is an absence of proportionate and dissuasive sanctions for DNFBPs with respect to KYC/CDD rules, and in relation to NGOs given the deficiencies regarding sanctioning powers available to NPO regulators observed in R.8. **Recommendation 35 is rated partially compliant.**

7. LEGAL PERSONS AND ARRANGEMENTS

Recommendation 24 – Transparency and beneficial ownership of legal persons

305. Sri Lanka was rated partially compliant with the former R.33. The report concluded that Sri Lanka trust and company service providers were not required to obtain, verify, and retain records of the beneficial ownership and control of legal persons. This remains the case.

306. *Criterion 24.1*. In respect to companies, the Companies Act No.7 of 2007 describes the legal status and capacity of a company (s.2), the different types of companies (s.3, ss.4(2), s.260, Parts II and III), and the process for the creation of a company (s.4, s.5, Parts II, III and XI). Shareholder information is publicly available, including notification of any trusts (in the particular circumstances of ss.129(2)). While the name of a person in the share register shall be regarded as prima facie evidence of legal ownership, (Part VII and specifically s. 130), this does not equate to the identification of a natural person when the person is another legal person or arrangement.

307. Mutual provident societies and societies for a purpose authorised by the Minister can be registered under the Societies Ordinance No.16 of 1891. Registration permits the society to become a body corporate (ss. 9(1)). A registered society must have a registered office, have its books audited annually and provide an annual certificate to the Registrar. The society's books (including the names of the members) must be available for public inspection. The register of members must contain names, addresses and occupations of members (ss.9(10)). It seems to be implied that members are to be individuals but this is not expressly stated in the Societies Ordinance.

308. Cooperative Societies are registered under the Cooperative Societies Law No.05 of 1972. Registration permits the society to be a body corporate (s. 20). Every registered society is required to have a registered office (s. 18) and allow its rules, by-laws and list of members to be available for inspection at the registered office (s. 19). Members may be other registered societies as well as individuals (s. 4). The Registrar must audit the accounts at least once a year (s. 44).

309. *Criterion 24.2*. Sri Lanka has not conducted a comprehensive assessment of the risks relating to the misuse of legal persons and arrangements. Sri Lanka has recently concluded a national risk assessment (subject to approval by the FIU Advisory Board) in which it has considered the vulnerability of legal persons and arrangements. The report identified deficiencies in obtaining beneficial ownership and recommended that corporate and trust transparency needs to be improved. The report did not separately consider all the types of legal persons that can be created in the country: limited companies, unlimited

companies, companies limited by guarantee, private companies, offshore companies, cooperative societies, and mutual provident societies.

310. *Criterion 24.3*. Sections 4 and 5 (Incorporation of Companies) of the Companies Act 2007 satisfies this criterion as it requires information on the company's name, proof of incorporation, legal form and status, the address of the registered office, and a list of directors. A company is required under ss. 9 (1) to give public notice of the name of the company and address of the company's registered office. Further, the website of the Registrar of Companies contains basic information on all companies. In addition to information contained in the website, there are two avenues available for public access to more detailed information on companies. Section 120 of the CA requires the company to make available specified records for public inspection. These include Certificate of Incorporation, Article of Association and Share register. Section 480 of the Companies Act provides for information held by the Registrar-General of Companies to be made available for inspection to any person upon payment of a fee.

311. *Criterion 24.4*. Sections 120 and 123 of the Companies Act satisfy the requirement to maintain the information set out in c.24.3 and on shareholders in respect to companies with a share register. There is a similar requirement to maintain a register of members of a company limited by guarantee due to paragraphs 35 (2) (b) and (d) of the Companies Act No. 7 of 2007 which provide that:

> *' b. reference to shareholders were reference to members of the company*
> *d. reference to the share register were reference to the register of members'*

312. *Criterion 24.5*. The mechanism utilised in the Companies Act 2007 is that both the company and every officer of the company commits an offence for breaching the relevant provisions and is subject to a fine. This includes the requirement to file an annual return at least once a year (sections 130-132). Penalties are provided for in ss.130 (4) for violations. The information required to be updated in the Annual Return of a Company form, issued pursuant to ss.131(1), includes share registers, description of records not kept at the company's premises, shares, details of directors and company secretary or secretaries, auditors, existing shareholders, persons who have ceased to hold shares, etc. The form is required to be certified by a director and company secretary or secretaries. There are variations to this form depending on the type of company.

313. *Criterion 24.6*. There is no requirement for companies or company registries to obtain or hold up-to-date information on the companies' beneficial ownership or for companies to take reasonable measures to obtain and hold up-to-date information on the companies' beneficial ownership. Sri Lanka has approach is to use existing mechanisms, including information held by FIs and DNFBPs, information held by other competent authorities such as those held by the Registrar-General of Companies, Inland Revenue and so forth.

314. While there are mechanisms in place to identify a legal owner, there is no mechanism to ensure that beneficial ownership can be determined in a timely manner by a competent authority. As covered under R.10 and R.22, the CDD beneficial ownership requirements fall short of the FATF standards. Further, while the information collected and maintained by companies may include aspects of beneficial ownership information in some cases, in cases where the information is not, identifying beneficial ownership in a timely manner could be very challenging. There is only a requirement for a company share register to record and maintain legal ownership information. Sri Lanka has confirmed that the concept of beneficial ownership is not included in the Companies Act.

315. *Criterion 24.7*. Section 123 of the Companies Act 2007 contains the obligation to maintain the share register but given the deficiencies identified above, the information collected is deficient against such requirements.

316. *Criterion 24.8*. The directors are responsible for the management of the company (s.184 Companies Act 2007) and must act in accordance with the Companies Act 2007. There are significant investigation powers given to competent authorities (s.180 on powers of inspectors) that would oblige a director under s.188 (Director's Duties) to comply, for example, not contravene any provision of the Companies Act, but the latter is deficient on beneficial ownership requirements. Sri Lanka has confirmed that there is a residency requirement for directors that is implemented via the Articles of Association.

317. Given there is no implementation of CDD requirements for DNFBPs, c.28.8 (b) is not used in Sri Lanka. There is no requirement for a DNFBP to be authorised by the company, and accountable to a competent authority, for providing basic and available beneficial ownership information and assistance to the authorities.

318. *Criterion 24.9*. Section 389 Companies Act 2007 provides for the company or liquidator to maintain for at least five years the books and papers of the company from the date of the dissolution of the company. However, the information may not contain the necessary beneficial ownership information.

319. *Criterion 24.10*. A magistrate may, on application, order production and inspection of the books/papers of a company where there is reasonable cause to believe an officer of the company has committed an offence in connection with the management of the company (s.483 Companies Act 2007). The Registrar has a similar general power (s.484). However, the deficiencies noted under c.24.6-8 would limit the ability of competent authorities to obtain beneficial ownership information.

320. *Criterion 24.11* The Companies Act does not expressly include the concept of bearer shares although there is a reference to 'securities to bearer' in section 110 of the Companies Act. The Act requires a company to include the name of each shareholder in the share register (ss. 123(1)). Subsection 130(1) further states that the entry of the name of a person in the share register as holder of a share shall be prima facie evidence that title to the share is vested in that person. Further, the Securities and Exchange Act No.36 of 1987 as amended and the rules formulated by the Colombo Stock Exchange and the Companies Act No.7 of 2007 do not refer to bearer shares.

321. Share warrants are regulated under the Securities and Exchange Commission Act No.36 of 1987 (as amended) and by the listing rules of the Colombo Stock Exchange (Rule 5.10). There do not appear to be any mechanisms for ensuring that they are not misused for ML or TF. Sri Lanka has stated that bearer share warrants cannot be issued in Sri Lanka as share warrants are always required to be issued to the persons in the share register. However, no specific reference to any law or enforceable means was provided to the assessment team.

322. *Criterion 24.12*. There do not appear to be any specific mechanisms requiring nominee directors and shareholders to disclose the identity of their nominator to the company, or to be licensed, or mechanisms to ensure they are not misused. According to the paragraph 544(1)(b) of the Civil Procedure Code, the shareholders can appoint nominees who can acquire the ownership of shares after the death of the shareholder. However, information about nominee directors is required to be submitted to the Registrar-General of Companies, and thus becomes publicly available by other means.

323. *Criterion 24.13*. There are offences related to the relevant provisions culminating in a potential fine for breach, which appear to be proportionate and dissuasive. For example, the obligation to maintain a share register in s. 123 of the Companies Act carries a penalty for breach of a fine of up to LKR 200 000 (USD 1 520[13]) for the company and a fine of up to LKR 100 000 (USD 760[13]) for each officer in default. Further, section 514 of the Companies Act prescribes that court proceedings may be instituted and monetary sanctions imposed where any company has made default in complying with any provision of the

Act requiring it to file with or deliver or send to the Registrar any account, document or return or to give notice to him of any matter, and has by reason of such default committed an offence under the Act.

324. *Criterion 24.14*. The FIU has power to provide information to foreign counterparts, law enforcement, and supervisory authorities (ss.16 and ss.17 of the FTRA). There are also procedures in the MACMA for evidence to be taken and documents to be produced in Sri Lanka, proceeds of crime to be traced and foreign orders to be enforced. However, as beneficial ownership information is not fully captured such information may not be readily available to foreign counterparts on request and in a timely manner.

325. *Criterion 24.15*. Sri Lanka has not provided evidence that it monitors the quality of assistance it receives from other jurisdictions in response to requests for basic and beneficial ownership information, or requests for assistance in locating beneficial owners based overseas.

326. *Weighting and conclusion*: There are no measures in place to identify beneficial owners of legal persons, or make such information available. **Recommendation 24 is rated non-compliant.**

Recommendation 25 – Transparency and beneficial ownership of legal arrangements

327. Sri Lanka was rated partially compliant with former R.34. The report concluded that competent authorities have some powers to obtain access to information on the beneficial ownership and control of certain legal arrangements. Overall, the mechanisms in place were insufficient. This remains the case.

328. *Criterion 25.1*. The Trusts Ordinance No.9 of 1917, specifically ss.6, 7, 9, 10, 11, 100 and ss.113(4) which are of relevance, do not create the required obligations, namely they do not require:

d) trustees of express trusts to obtain and hold adequate, accurate and current information on the identity of settlors, trustees, protectors (if any) and beneficiaries of trusts, including any natural person who exercises ultimate effective control over a trust;

e) trustees of any trust to hold basic information on other regulated agents of, and service providers to, the trust, including investment advisors or managers, accountants, and tax advisors; or

f) professional trustees to maintain this information for at least five years after their involvement with the trust ceases.

329. *Criterion 25.2*. Subsection 113(4) of the Trusts Ordinance requires the Registrar-General to prepare and maintain a register of trustees appointed to a charitable trust, or trust for a public or private association. There is no reference to registers of other types of trusts. The criterion is not otherwise satisfied, as there is no requirement to keep the information up to date and be available on a timely basis.

330. *Criterion 25.3*. There are no measures to ensure that trustees disclose their status to FIs and DNFBPs when forming a business relationship or carrying out an occasional transaction above the threshold. The Licensed Banks and Registered Finance Companies KYC and CDD Rules No. 1 of 2011 (made under ss.2(3) of the Financial Transactions Reporting Act 2006), the rules on KYC and CDD for the Insurance Industry (made under ss.2(3) of the FTRA 2006), and the rules on KYC and CDD for the Securities Industry (made under ss.2(3) of the FTRA 2006) place obligations on reporting entities and not trustees.

331. *Criterion 25.4*. Sri Lanka concluded in the recent national risk assessment that the provision of information relating to a trust by trustees to competent authorities is not prevented by law or enforceable

means. Though Sri Lanka could not provide any case law to support this there was no evidence to suggest it is not an accurate statement, as it is consistent with the general legal system in the country.

332. *Criterion 25.5*. The general investigative powers of the Sri Lanka Police under the Code of Criminal Procedure Act are available to access information held by trustees, FIs and DNFBPs, although information on beneficial ownership may be lacking.

333. *Criterion 25.6*. The FIU has power to provide information to foreign counterparts, law enforcement, and supervisory authorities (ss.16 and 17 of the Financial Transactions Reporting Act No.6 of 2006). There are also procedures in the MACMA for evidence to be taken and documents to be produced in Sri Lanka, proceeds of crime to be traced and foreign orders to be enforced. However, gaps identified under c.25.1 may undermine the information available for exchange.

334. However, there is no evidence that Sri Lanka rapidly provides international cooperation in relation to information, including beneficial ownership information, on trusts or other legal arrangements, on the basis set out in Recs 37 and 40. Foreign competent authorities would have access to public registry information but this has the gaps in respect to beneficial ownership (see c.24.6-8) and as described at c.25.1. The general investigative powers of the police are available as described in c.25.5 to seek to obtain beneficial ownership information on behalf of foreign counterparts.

335. *Criterion 25.7*. Trustees are liable for a breach of trust (ss.23, 27) but only for a loss occasioned by a breach of trust, and not for other more extensive duties on trustees relevant to the particular trust (maintaining information on trust property, information on beneficiaries etc.). Moreover, there are no proportionate and dissuasive sanctions (criminal, civil or administrative) for failing to perform duties. There may be criminal penalties for fraud on beneficiaries, etc., but not in relation to the performance of duties 'as trustees' - only in relation to the general criminal law. Section 101 of the Trust Ordinance relates to legal remedies available through the Attorney General, but only in relation to charitable trusts.

336. *Criterion 25.8*. There are no proportionate and dissuasive sanctions (criminal, civil or administrative) available to enforce the requirement to exchange information with competent authorities in a timely manner in accordance with c. 25.1.

Weighting and conclusion: There is no obligation that trustees obtain and hold adequate, accurate and current information on the identity of settlors, trustees, protectors (if any), and beneficiaries of trusts, including natural persons who exercise ultimate effective control over a trust. **Recommendation 25 is rated non-compliant**.

8. INTERNATIONAL COOPERATION

Recommendation 36 – International instruments

337. Sri Lanka was rated partially compliant with former R.35 and partially compliant with former SR.I. At the time of the 2006 MER, it was reported that Sri Lanka had acceded to the Vienna Convention, and had ratified the UN International Convention on the Suppression of Terrorist Financing (8 September 2000), but had not ratified the Palermo Convention. However, there were deficiencies in the implementing legislation and framework.

338. *Criterion 36.1*. Sri Lanka has ratified all the relevant conventions. The Vienna Convention was ratified on 6 June 1991, Palermo Convention on 22 September 2006, Merida Convention on 31 March 2004, and the Terrorism Financing Convention on 8 September 2000.

339. *Criterion 36.2*. Deficiencies in R.3 (ML Offence) affect the implementation of the Palermo and Merida Conventions. Deficiencies in R.4 (Confiscations) affect the implementation of the Vienna Convention. Deficiencies in R. 38 (MLA: Freezing and Confiscation) affect the implementation of the international cooperation obligations the Vienna, Palermo and Merida Conventions.

340. *Weighting and conclusion*: There are deficiencies with implementation of the Vienna, Palermo and Merida Conventions. **Recommendation 36 is rated largely compliant**.

Recommendation 37 – Mutual legal assistance

341. Sri Lanka was rated as partially compliant with former R.36 on mutual legal assistance on ML, and partially compliant with former SR.V on mutual legal assistance on TF. The 2006 MER concluded that the MACMA, the PMLA, and the CSTFA allowed Sri Lanka to provide a wide range of legal assistance. However, the MER noted that it was not clear whether Sri Lanka provided assistance in timely manner and other deficiencies were also noted.

342. Sri Lanka was rated as largely compliant on dual criminality. The Sri Lankan authorities asserted that where the MACMA provided for limited mutual assistance that acts or omission of a 'serious nature' could be designated as such by the Secretary of Justice, allowing MLA to occur. However, there have been no cases where this channel has been employed for coercive assistance.

343. *Criterion 37.1*. The PMLA and the CSTFA permit recourse to the procedures in the MACMA for the purposes of providing a wide range of mutual legal assistance in respect to investigations and prosecutions of relevant offences.

344. However, the MACMA only operates in reference to prescribed Commonwealth countries that are gazetted in the subsidiary legislation[14] or to specified countries with which Sri Lanka has entered into an agreement with[15]. For countries that are neither prescribed nor specified, the Sri Lankan authorities assert that the Minister has discretion whether to provide assistance. However, Sri Lankan authorities have clarified that for these countries, Sri Lanka has only provided non-coercive assistance based on reciprocity.

345. *Criterion 37.2*. The Central Authority for the purpose of mutual legal assistance is the Secretary to the Minister for Justice. However, other agencies such as the Attorney-General's Department and law enforcement agencies are also involved in the processing of requests and there is no clarity as to how these agencies coordinate with each other. The Central Authority has a rudimentary case management system that does not provide clear timelines, processes for prioritisation and accountability.

346. *Criterion 37.3*. The grounds for refusal listed under the MACMA are not unreasonable or unduly restrictive.

[14] Per the *Gazette of the Democratic Socialist Republic of Sri Lanka – Extraordinary*, 14 July 2013 on the 'Mutual Assistance in Criminal Matters Act No. 25 of 2002, Sri Lanka has MLA arrangements with Commonwealth members per the following schedule: Antigua and Barbuda, Australia, The Bahamas, Bangladesh, Barbados, Belize, Botswana, Brunei Darussalam, Cameroon, Canada, Cyprus, Dominica, Fiji Islands, The Gambia, Ghana, Grenada, Guyana, India, Jamaica, Kenya, Kiribati, Lesotho, Malawi, Malaysia, Maldives, Malta, Mauritius, Mozambique, Namibia, Nauru, New Zealand, Nigeria, Pakistan, Papua New Guinea, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Samoa, Seychelles, Sierra Leone, Singapore, Solomon Islands, South Africa, Swaziland, United Republic of Tanzania, Tonga, Trinidad and Tobago, Tuvalu, Uganda, United Kingdom, Vanuatu, Zambia, and Zimbabwe

[15] Authorities advise that Sri Lanka has bilateral MLA agreements with Belarus, United Arab Emirates, Pakistan, Thailand, Hong Kong and India. Sri Lanka cited 2 other countries with which agreements have been finalised but have not yet entered into force.

347. *Criterion 37.4*. Section 6(1) of the MACMA lists circumstances in which a mutual legal assistance request will be refused, but does not include the fact that the request pertains to an offence involving fiscal matters, or to confidentiality or to financial secrecy requirements.

348. *Criterion 37.5*. Sri Lanka has no specific legislative provisions requiring confidentiality of a mutual legal assistance request to be maintained. Instead, confidentiality is covered in bilateral agreements and in practice.

349. *Criteria 37.6-7*. There is a prohibition in section 6(1)(a) MACMA on providing mutual legal assistance where the offence does not exist under Sri Lankan law. However, there is nothing to prevent non-coercive assistance on the basis of reciprocity. Sri Lankan authorities have informed that non-coercive international cooperation does take place outside the scope of the MACMA.

350. *Criterion 37.8*. Investigative powers under R.31 are available for use in response to requests for mutual legal assistance as provided by the MACMA and the Criminal Procedure Code.

351. Weighting and conclusion: The MACMA does not provide for the application of its provisions on the basis of reciprocity. For this reason, the range of assistance that requires coercive use of powers appears only to be available under the MACMA to prescribed Commonwealth countries and specified countries with which Sri Lanka has an agreement with. However, there is nothing to prevent non-coercive assistance on the basis of reciprocity. Sri Lankan authorities have advised that non-coercive international cooperation does take place outside the scope of the MACMA. Sri Lanka does not have a comprehensive case management system that puts in place standard procedures, accountability and clear time lines for handling MLA cases. **Recommendation 37 is rated partially compliant**.

Recommendation 38 – Mutual legal assistance: freezing and confiscation

352. Sri Lanka was rated partially compliant with the former R.38. The 2006 MER concluded that Sri Lanka's MACMA provided for identification and seizure of assets used for criminal purposes but did not provide for adequate freezing requirements. Although the MACMA identified ML as a 'criminal matter', the mechanisms for freezing, seizing, and confiscation held in the PMLA did not apply, as the PMLA deferred to the MACMA in the instances of mutual assistance.

353. Other deficiencies noted relate to the inability to confiscate property of corresponding value; although there was some ability to share assets either under agreement or ad hoc; and the lack of civil forfeiture or the ability to enforce foreign civil forfeiture orders.

354. *Criterion 38.1*. In relation to assistance in identifying, locating or assessing the value of property, there is no the definition of property in the MACMA and it is not clear whether sections 17, 18 and 19 extend to instrumentalities intended for use and property of corresponding value. However, Sri Lanka has advised that the PMLA and the FTRA define 'property' to include 'proceeds' and 'instrumentalities' and the definition under these legislation apply to the MACMA. There is, however, no explicit provision under the MACMA that makes reference to the PMLA or the FTRA for the definition of property.

355. *Criterion 38.2*. As the provisions make reference to 'criminal matter' and commission of 'serious offence', it is unclear whether sections 17 to 19 of the MACMA allow Sri Lanka to provide assistance for cooperation on the basis of non-conviction based confiscation proceedings. There is no specific provision in the PMLA or the MACMA that provides for confiscation in circumstances when the perpetrator is unavailable by reason of death, flight, absence or the perpetrator is unknown. As such, it is unclear whether requests for cooperation under these circumstances can be provided.

356. *Criterion 38.3*. Section 15 of the PMLA is cited by Sri Lanka in relation to seizure. However, section 19 that relates to confiscation is more generally drafted and does not establish any arrangement or mechanism for coordinating or managing assets for confiscation. No other written procedures or documented mechanisms were provided by Sri Lankan authorities.

357. *Criterion 38.4*. There appears to be no mechanism, nor any legal restriction in relation to sharing of proceeds of crime when confiscation is a result of coordinated law enforcement actions. Sri Lanka has not provided any instances where this has taken place.

358. Since freezing and confiscation necessarily involves the use of coercive power on the part of the state, it appears that the range of assistance under the MACMA cannot be extended to non-prescribed/specified countries. While the Sri Lankan authorities have cited a catch all provision in the PMLA that may provide the Minister of Finance, the discretion to provide coercive assistance to non-prescribed/specified countries, this provision has not ever been used to do so. The exception to this is assistance relating to offences under the CSTFA where the full range of assistance under the MACMA can be provided on the basis of the Terrorist Financing Convention.

359. *Weighting and conclusion*: There are significant deficiencies with the MACMA concerning Sri Lanka's ability to take action in response to requests by other jurisdictions to identify, freeze, seize or confiscate property. **Recommendation 38 is rated partially compliant**.

Recommendation 39 – Extradition

360. Sri Lanka was rated as compliant with former R.39 on extradition. The 2006 MER concluded that the recommendation was fully observed.

361. *Criterion 39.1*. Under section 2 of the Extradition Act 48 of 1999 (as amended), 'an offence within the scope of an international convention relating to the suppression of international crime to which Sri Lanka and the requesting designated Commonwealth country or treaty state are contracting parties and which obliges contracting parties to prosecute or grant extradition for such offence.' Sri Lanka would thus be able to extradite for ML offences to state parties of the Vienna, Palermo and Merida Conventions. The CSTFA specifically provides for the Terrorism Financing Convention to be used as a basis for providing extradition in respect of the terrorist financing offences in the Act.

362. There are no unduly restrictive conditions on the execution of extradition requests. However, there does not appear to be any case management system with clear timelines, processes for prioritisation and accountability. Although the Central Authority for extradition is the Ministry of Defence, several other agencies such as the Ministry of External Affairs, Ministry of Justice, Attorney-General's Department and the investigative agencies are also involved and there is no clarity as to how these agencies coordinate the processing of requests.

363. *Criterion 39.2*. Extradition does not appear to be prohibited on the grounds of nationality.

364. *Criterion 39.3*. Dual criminality is not a pre-requisite for extradition as long as the offence falls within the 'Description of Extraditable Offences' in the schedule or is described in the extradition arrangement with a treaty state, or in the case of a designated Commonwealth country, is punishable in that country by imprisonment of not less than 12 months.

365. *Criterion 39.4.* Sri Lanka does not have simplified extradition arrangements with other jurisdictions such as fellow members of the South Asian Association for Regional Cooperation (SAARC), or a simplified extradition mechanism for consenting persons who waive formal extradition proceedings.

366. *Weighting and conclusion:* Sri Lanka meets most of the four essential criteria. Its deficiencies are mainly in two areas. It does not have a comprehensive case management system, and it does not have simplified extradition arrangements with other jurisdictions such as fellow members of SAARC, or a simplified extradition mechanism for consenting persons who waive formal extradition proceedings. **Recommendation 39 is rated largely compliant**.

Recommendation 40 – Other forms of international cooperation

367. In its 2nd MER, Sri Lanka was found partially compliant with the requirements of Recommendation 40. The primary deficiency at the time was the lack of an FIU and therefore associated mechanisms for FIU international cooperation. It was also noted that at the time of the evaluation the recent enactment of AML/CFT legislation meant supervisors had not had opportunity to be involved in international efforts to combat ML or TF.

368. *Criterion 40.1*. Sri Lanka appears to have the capability to provide a wide range of international cooperation at an agency-to-agency level. Based on the examples provided by the Sri Lankan authorities, this is appears to be taking place both spontaneously and on request.

369. *Criterion 40.2*. Banking information and information relating to securities and exchange have statutory provisions in their governing legislation that restricts sharing of information without a court order. The FTRA provides the legal basis and authority to the FIU to share information internationally through MOUs and the Insurance Act provides the same to the Insurance Board of Sri Lanka.

370. Whilst there appears to be no statutory restriction over international cooperation in relation to law enforcement agencies such as the CID, TID, Narcotics Bureau, Commission to Investigate Allegations of Bribery or Corruption, Department of Immigration and Emigration, Customs and the NGO Secretariat, there are no clear documented mechanisms and processes as required by c.40.2 (c), (d) and (e).

371. *Criterion 40.3*. Various agencies have entered into MOUs with other countries to facilitate sharing of information. The Sri Lankan FIU is a member of the Egmont Secure Web and has signed 24 MOUs with various countries. The Securities and Exchange Commission is a member of the International Organisation of Securities Commissions (IOSCO) and is a party to the multilateral MOU under it. In addition, seven[16] bilateral MOUs have been concluded with countries in the region under which clause 9, which deals with the execution of requests for assistance states that information and documents held in the files of the requested authority, will be provided to the requesting authority upon request. The Insurance Board of Sri Lanka is a member of the International Association of Insurance Supervisors and has an MOU with the Maldives. However, it is not a party to the MMOU platform. The Sri Lankan authorities have also provided data on information shared under these platforms. These have been reflected in IO2.

372. The CID and the Narcotics Bureau use Interpol as a platform to exchange information and have concluded MOUs. CID has also concluded MOUs with Australia and the Maldives. Sri Lanka is a member of the SAARC Convention on Narcotic Drugs and Psychotropic Substance 1993 and information exchange between the Narcotics Bureau and its counterparts can take place via the SAARC Monitoring Desk. Sri Lanka is also a member of the Additional Protocol to the SAARC Regional Convention on Suppression of Terrorism where intelligence and information is exchanged regionally. Sri Lanka Customs is a member of the Regional Intelligence Liaison Office under the World Customs Organisation and has enhanced

[16] These include bi-lateral MOUs signed with the Securities and Exchange Commission of Thailand in 2000, the Securities Commission of Malaysia in 2002, the Capital Market Supervisory Agency of Indonesia in 2002, the Australian Securities and Investment Commission in 2002, the Securities and Exchange Board of India in 2003, the Securities and Exchange Commission of Pakistan in 2003 and with the Letter of Intent between the Securities and Futures Commission of Hong Kong Special Administrative Region of the Republic of China in 2005.

information exchange MOUs with India, China and Japan. Customs also holds regular operational dialogues with its Indian counterparts. The Immigration Department shares information with its international counterparts through diplomatic channels.

373. Sri Lanka has entered, where needed, into a wide range of international cooperation agreements across the competent authorities, barring that of the NGO Secretariat, which whilst expressing its willingness to cooperate with foreign counterparts does not have any formal process to do so.

374. Based on the FIU Manual, where assistance was obtained through the FIU, the Intelligence Management Unit of the FIU does provide feedback. Copies of examples of feedback received were provided.

375. *Criterion 40.5*. No instance of request being rejected on unreasonable or unduly restrictive grounds was cited. Where information cannot be shared through legislative restrictions, requesting states will be required to put in a mutual legal assistance request in order for the relevant agencies to seek a court order. Instances of examples were provided, in particular for international cooperation in relation to terrorism investigations, where channels for international cooperation remained open despite the fact that domestic investigations were also being conducted. There is no indication that requests were rejected on grounds that the nature of the authority's request was different.

376. *Criteria 40.6* – 7. Where information is exchanged via MOUs, the MOUs contain confidentiality obligations and restrictions on the use of the information provided. For example, the standard format of the FIU MOU provides for control and safeguard of information exchanged. The various SAARC platforms of exchange are also secure platforms. No cases were highlighted either by the Sri Lankan authorities or by countries that provided feedback on international cooperation with Sri Lanka, that information provided to Sri Lanka for a particular purpose was used for some other purpose.

377. *Criterion 40.8*. Based on the examples provided by the Sri Lankan authorities, Sri Lanka appears to have the capability to provide a wide range of international cooperation at an agency-to-agency level and this appears to be taking place. The FIU is able to provide spontaneously information derived from a report by an institution to a foreign counterpart if it has reasonable grounds to suspect the information as relevant to an investigation/prosecution of an offence etc.

378. *Criteria 40.9 - 11*. Sections 16 to 17 of the FTRA provide the legal basis for the Sri Lankan FIU to provide international cooperation via MOUs. The Sri Lankan FIU is a member of the Egmont Secure Web and has signed 24 MOUs with various countries. According to item 13 of the FIU Unit Operational Manual, feedback is provided by the Intelligence Management Division of the FIU. Copies of examples of feedback received were provided. The FTRA does not appear to place any further restriction to the extent to which information can be shared with its foreign counterparts.

379. *Criteria 40.12 - 16*. Section 45 of the Monetary Law Act No 58 of 1949 provides a limited ability for the Monetary Board to share information on effective supervision and financial co-operation with foreign financial sector supervisory authorities. The Banking Act 1988 and the Securities and Exchange Commission of Sri Lanka Act 1987 do not provide for the sharing of information internationally not relating to prudential or regulatory information. Foreign counterparts can secure banking information for the purposes of AML/CFT only if it is required at the stage of investigations or prosecution through mutual legal assistance

380. As a member of the IOSCO, the Securities and Exchange Commission can conduct inquiries and share information pursuant to the multilateral MOU under the IOSCO. In addition, seven bilateral MOUs have been concluded with countries in the region. Section 5 of the Regulation of Insurance Industry

(Amendment) Act No. 43 of 2000 provides the legal basis for the Insurance Board of Sri Lanka to provide international cooperation via MOUs. The Insurance Board of Sri Lanka is a member of the International Association of Insurance Supervisors and has an MOU with the Maldives, although it is not a party to the MMOU platform. However, in the last 3 years, the IBSL has not exchanged any information in relation to AML/CFT with its foreign counterparts.

381. *Criteria 40.17 - 19*. There appears to be no statutory restriction over other law enforcement agencies such as the CID, TID, the Narcotics Bureau, all located in the Sri Lanka Police, the Commission to Investigate Allegations of Bribery or Corruption , Department of Immigration and Emigration, Customs, and the NGO Secretariat, to share information with their foreign counterparts. While there are no documented mechanisms and processes, based on the successful examples provided by Sri Lanka, there appear to be open channels for international cooperation at least for law enforcement agencies such as the CID, TID and the Narcotics Bureau, through networks such as Interpol as well as other informal working relationships. No case examples of having formed joint investigative teams with foreign law enforcement authorities were provided.

382. *Criterion 40.20*. The Sri Lankan authorities have not provided any documented mechanisms or examples of exchanging information with foreign non-counterparts. Sri Lanka advised that indirect sharing is subject to conditions stipulated in an MOU concerning information sharing with another party not signatory to the MOU.

383. Sri Lanka's competent authorities are generally able to provide a wide range of direct and indirect international cooperation. However, there are deficiencies in lack of mechanisms and examples of international cooperation. **Recommendation 40 is rated partially compliant.**

Table of acronyms

AGD	Attorney General's Department
AML	Anti-money laundering
APG	Asia/Pacific Group on Money Laundering
BNI	Bearer negotiable instrument
BSD	Bank Supervision Department, Central Bank of Sri Lanka
CA 2007	Companies Act No. 7 of 2007
CIABC	Commission to Investigate Allegations of Bribery or Corruption
CBSL	Central Bank of Sri Lanka
CDD	Customer due diligence
CFT	Countering the financing of terrorism
CIABC	Commission to Investigate Allegations of Bribery or Corruption
CID	Criminal Investigation Division, Sri Lanka Police
CSE	Colombo Stock Exchange (Sri Lanka's national stock exchange)
CSTFA	Convention on the Suppression of Terrorist Financing Act No. 25 of 2005, as amended in 2013 (Act No.3) and 2011 (Act No.41)
CTR	Cash Transaction Report
DCD	Department of Cooperative Development
DNFBPs	Designated non-financial businesses and professions
DSNBFI	Department of Supervision of Non-Bank Financial Institutions, Central Bank of Sri Lanka
ECD	Exchange Control Department, Central Bank of Sri Lanka
EFT	Electronic funds transfer
Egmont	Egmont Group of Financial Intelligence Units
FATF	Financial Action Task Force
FIs	Financial institutions
FIU	Financial Intelligence Unit of Sri Lanka, and financial intelligence unit (generic)
FTRA	Financial Transactions Reporting Act No 6 of 2006
IAIS	International Association of Insurance Supervisors
IBSL	Insurance Board of Sri Lanka
INTERPOL	ICPO-INTERPOL, International Criminal Police Organisation – International Police
IOSCO	International Organisation of Securities Commissions
KYC	Know your customer
LCB	Licensed commercial bank
LEA	Law enforcement agency
LKR	Sri Lankan rupee currency
LSB	Licensed specialized banks
LTTE	Liberation Tigers of Tamil Eelam
MACMA 2002	Mutual Assistance in Criminal Matters Act No.25 of 2002
MEA	Ministry of External Affairs
ML	Money laundering
MOJ	Ministry of Justice
MOU	Memorandum of understanding
MVTS	Money or value transfer service
NDCB	National Drug Control Board

NGO	Non-government organisation (used interchangeably with NPO)
NPO	Non-profit organisation
NRA	National risk assessment
PEP	Politically-exposed person
PF	Proliferation financing
PMLA	Prevention of Money Laundering Act No. 5 of 2006, as amended 2011
PNB	Police Narcotics Bureau
PSO	Public Security Ordinance
PTA	Prevention of Terrorism Act
RGD	Registrar General's Department
RILO	Regional Intelligence Liaison Office (customs)
ROC	Registrar of Companies
SAARC	South Asian Association for Regional Cooperation
SEC	Securities and Exchange Commission of Sri Lanka
SIS	State Intelligence Service
SRB	Self-regulating body
STR	Suspicious transaction report
TID	Terrorist Investigation Division, Sri Lanka Police
TCSP	Trust and company service provider
TF	Terrorist financing
UN	United Nations
UNSCR	United Nations Security Council Resolution
USD	United States dollar currency
VSSO	Voluntary Social Service Organisations
WCO	World Customs Organisation

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September 2015

Anti-money laundering and counter-terrorist financing measures – Sri Lanka

Mutual Evaluation Report

In this report: a summary of the anti-money laundering (AML)/counter-terrorist financing (CTF) measures in place in Sri Lanka as at 12 December 2014. The report analyses the level of compliance with the FATF 40 Recommendations and the level of effectiveness of Sri Lanka's AML/CTF system, and provides recommendations on how the system could be strengthened.