



Financial Action Task Force

Groupe d'action financière

**FIRST MUTUAL EVALUATION REPORT ON
ANTI-MONEY LAUNDERING AND
COMBATING THE FINANCING OF TERRORISM**

PEOPLE'S REPUBLIC OF CHINA

29 JUNE 2007

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PREFACE – information and methodology used for the evaluation of the People’s Republic of China

1. The evaluation of the anti-money laundering (AML)¹ and combating the financing of terrorism (CFT) regime of the People’s Republic of China (China)² was based on the Forty Recommendations 2003 and the Nine Special Recommendations on Terrorist Financing 2001 of the Financial Action Task Force (FATF), and was prepared using the AML/CFT Methodology 2004³. The evaluation was based on the laws, regulations and other materials supplied by China, and information obtained by the evaluation team during its on-site visit to China from 13 to 24 November 2006, and subsequently.⁴ During the on-site, the evaluation team met with officials and representatives of relevant Chinese government agencies and the private sector. A list of the bodies met is set out in Annex 2 to the mutual evaluation report.

2. This was a joint evaluation of the FATF and the Eurasian Group (EAG). The evaluation was conducted by an assessment team which consisted of experts from the FATF and EAG in criminal law, law enforcement and regulatory issues. The team was led by Ms. Valerie Schilling, Principal Administrator of the FATF Secretariat and Mr. Victor Kochenov, Executive Secretary of the EAG Secretariat, and included: Mr. Richard Berkhout, Administrator of the FATF Secretariat; Mr. Richard Chalmers, Adviser, International Strategy and Policy Co-ordination, Financial Services Authority (United Kingdom) who participated as a financial expert; Mr. Paul DerGarabedian, Senior Policy Advisor, Office of Terrorist Financing and Financial Crime, Department of the Treasury, United States of America, who participated as a law enforcement expert; Mr. Hans-Martin Lang, Head of Section and Senior Legal Advisor, Federal Financial Supervisory Authority (Germany) who participated as a financial expert; Mr. Anatoly Privalov, Deputy Head of Department for Combating Terrorism, Federal Financial Monitoring Service (Russian Federation) who participated as a law enforcement expert; and Mr. Boudewijn Verhelst, Deputy Attorney-General, Deputy Director of the Belgian FIU CTIF/CFI (Belgium) who participated as a legal expert. The assessment team was accompanied by Ms Lily Tse, Senior Government Counsel, Mutual Legal Assistance Unit, International Law Division, Department of Justice (Hong Kong, China), who acted as a facilitator without taking part in the assessment of China’s compliance with the FATF Recommendations. The assessment team reviewed the institutional framework, the relevant AML/CFT laws, regulations, guidelines and other requirements, and the regulatory and other systems in place to deter money laundering (ML) and the financing of terrorism (FT) through financial institutions (FIs) and designated non-financial businesses and professions (DNFBP), as well as examining the capacity, the implementation and the effectiveness of all these systems.

3. This report provides a summary of the AML/CFT measures in place in China as at the date of the on-site visit or immediately thereafter. It describes and analyses those measures, sets out China’s levels of compliance with the FATF 40+9 Recommendations (see Table 1), and provides recommendations on how certain aspects of the system could be strengthened (see Table 2).

¹ Annex 1 contains a full list of the acronyms and abbreviations used in this report.

² The following territories were not included as part of this assessment: Hong Kong Special Administrative Region (Hong Kong SAR), Macau Special Administrative Region (Macau SAR) and Chinese Taipei.

³ As updated in June 2006.

⁴ Annex 3 contains the text of key laws and regulations. Annex 4 contains a full list of the laws, regulations and other materials received by the assessment team.

MUTUAL EVALUATION REPORT

1. SECTION 1

1.1 General information on the country and its economy

1. The People's Republic of China (China) was founded on 1 October 1949 with Beijing as the capital. China is the third-largest country in the world, covering an area of approximately 9.6 million square kilometres. It is located in the northern hemisphere, in the mid-east of the Asian continent and on the west shore of the Pacific Ocean. China's territory is comprised of 34 provinces, autonomous regions, municipalities and special administered regions. As of the end of 2005, China had a population of about 1.3 billion. As of the end of 2004, the average life expectancy of China was 71.8, and its average annual growth rate was about 1% (from 1 July 1990 to 1 November 2000). China is a multi-ethnic nation consisting of 56 ethnic groups. The language in China is Chinese based on Mandarin. All but two of the 55 minority nationalities use their own language. All Chinese citizens over 18 years of age have the right to vote and stand for election.

Economy

2. China has changed from a purely communist planned economy to a socialist market economy. Economic restructure is one of the most crucial elements of China's reform and opening-up policy, which began in 1978. After about 20 years of reform, a socialist market economic system has now taken shape. The state-owned economy (i.e. the socialist ownership by the public of the means of production) is the dominant force in the country's economy, alongside of which there are individual and private companies. Since the reform and opening-up policy commenced in 1978, China has seen steady economic growth. From January to December 2005, over 44,000 foreign invested enterprises were approved for establishment, contracted foreign investment totalled 189 billion United States dollars (USD) and the foreign investment actually used totalled over USD 60 trillion. At the end of 2005, there were almost 552,942 foreign invested enterprises approved for establishment, total contracted foreign investment of almost USD 1.3 trillion and actually used foreign investment of USD 622 billion. In 2005, the gross domestic product (GDP) of China reached over 18 trillion Chinese Renminbi (RMB) (an increase of 9.9% from the previous year).⁵

System of government

3. China is a socialist state that follows a system of multi-party cooperation and political consultation under the leadership of one ruling party, the Communist Party of China (CP). There are also eight participating democratic parties which accept the CP's leadership and cooperate with it in the ruling of the state. The Chinese State has a functional division between the judicial, executive and legislative branches. The judicial and executive branches work under the leadership and guidance of the legislative branch which is led by the CP. All powers are concentrated in the legislative branch.

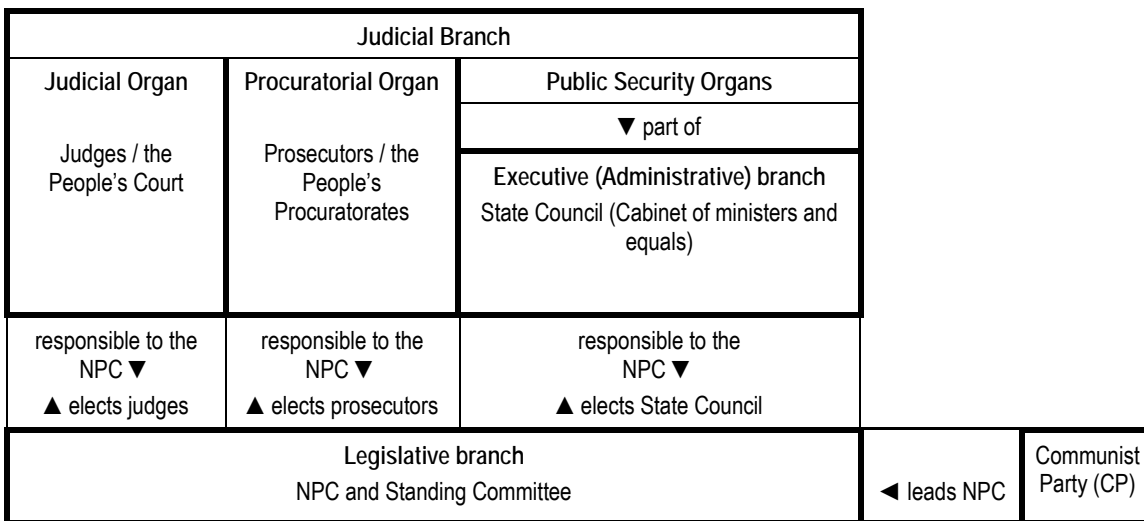
4. The National People's Congress (NPC) is China's legislative branch (parliament) and the country's highest organ of state power. The NPC elects all executive (administrative), judicial and prosecutorial organs of the state. It also has authority over the local people's congresses which exist at all levels of local government. When the NPC is between sessions, the Standing Committee of the National People's Congress (Standing Committee) executes the NPC's powers. Both the NPC and its Standing Committee exercise the power of national legislation. The NPC is empowered to amend China's constitution and supervise its enforcement, and to enact and amend basic laws (e.g. the criminal law, civil law and law on state institutions). The Standing Committee is empowered to interpret the constitution and laws, supervise the constitution's enforcement, and enact and amend

⁵ During the on-site visit, the exchange rate was approximately 1 RMB = 0.10 Euro (EUR) or USD 0.13.

laws other than those which should be enacted by the NPC. While the NPC is in recess, the Standing Committee can make partial supplements and amendments to the laws enacted by the NPC that do not conflict with those laws' basic principles.

5. China's executive branch is comprised of central executive state organs, topped by the State Council. The State Council is led by the Premier, who in turns leads the Ministers and Directors who are in charge of the various ministries and commissions. The State Council is China's highest executive organ and organ of state administration. The State Council is empowered to formulate administrative legislation and regulations in accordance with the provisions of the constitution and laws. Additionally, departmental regulations can be issued by the ministries and commissions of the State Council, the People's Bank of China (PBC)⁶, the National Audit Office and the institutions directly under the State Council which perform administrative functions, provided that those departmental regulations are in accordance with the laws and the administrative regulations, decisions and orders of the State Council. The State Council is responsible to the NPC. This model of the executive power being responsible to a legislative body is repeated on the regional and local level. Although regional or local state organs have some autonomy, they can always be overruled by the central authority.

6. Using popular terminology, the judicial *branch* is comprised of three parts: the people's courts, the people's procuratorates and the public security organs. Using the constitutional terminology, the judicial *organ* is the people's court. The people's procuratorate is referred to as the procuratorial organ. The public security organs are responsible to the State Council and are thereby part of the executive organs. The people's courts and the people's procuratorates are directly responsible to the NPC. The national judicial organs are elected by the NPC, report to the NPC and accept its supervision. The Supreme People's Court (SPC) and the regional people's courts are the state organs of adjudication, and handle criminal, civil and administrative cases. The Supreme People's Procuratorate (SPP) and the regional people procuratorates are the state organs of public prosecution and legal supervision. The Ministry of Public Security (MPS) and the local public security organs are the state organs of criminal investigation.



Legal system and hierarchy of laws

7. The Constitution of China is the organic law of the country, has the highest legal force and is the basis for enacting other laws. No laws, administrative regulations (which have lesser force than

⁶ The PBC is the Central Bank of China and has a status equal to a ministry. The Governor of the PBC is a member of the State Council.

laws), or regional laws and regulations should conflict with the Constitution. The hierarchy of laws is as follows (from high to low): the Constitution, laws, national administrative regulations, local regulations, and local administrative regulations. Laws and local regulations are enacted by the NPC and by local People's Congresses respectively. National administrative regulations and local administrative regulations are enacted by the ministries under the State Council and by the local executive organs respectively. National administrative regulations may be referred to as rules, regulations or measures, but are all secondary legislation.

8. The NPC has the right to amend or revoke improper laws made by the Standing Committee and to revoke the autonomous and specific regulations that are approved by the Standing Committee but violate the provisions of the Constitution and the Legislation Law. The Standing Committee has the right to revoke administrative regulations that conflict with the constitution and laws. The State Council has the right to amend or revoke the improper departmental and governmental regulations.

9. At various levels, the executive branches exercise the power of administrative enforcement in accordance with the provisions of the Constitution and related laws. There are two main categories of administrative enforcement. The first category deals with administrative enforcement by the executive. The State Council is in charge of formulating administrative regulations and has the full power to make decisions on government administrative affairs that have national implications. The second category deals with the enforcement activities conducted by the executive's administrative departments. There are more than 20 administrative enforcement departments which exercise specific administrative enforcement powers within their respective jurisdictions, including those responsible for industrial and commercial administration, taxation, finance, customs, civil aviation and banking. There is a broad range of administrative enforcement powers which include traditional criminal powers, such as the right to confiscate property.

Transparency, good governance, ethics and measures against corruption

10. China signed and ratified the United Nations Convention against Corruption (Merida Convention) on 10 December 2003, approved it on 27 October 2005, and submitted the instruments of ratification on 13 January 2006. The Chinese authorities state that corruption is a serious problem and poses a major threat to China. Corruption is currently one of the main predicate offences for money laundering. Corruption cases can be found at all levels of the government and the private sector. One of the aims of China's AML system is to fight against corruption, although corruption in both the financial and public sector could hinder this. Notwithstanding, China openly acknowledges its corruption problem and has taken steps on both the policy and law enforcement level to limit it. For instance, China established a high-level interagency co-ordination mechanism, the Joint Ministerial Conference against Corruption which is directly led by the Premier. In political terms, this means that the fight against corruption is one of the Chinese government's highest priorities. The criminal sanctions for corruption (embezzlement and bribery) can be found in the Criminal Law and range from confiscation of property (which is a fine) to fixed-term and life imprisonment. In serious cases of corruption, the penalty is capital punishment.

1.2 General Situation of Money Laundering and Financing of Terrorism

Money laundering

11. Based on information about case investigations, fund flows and related statistical data, the Chinese authorities believe that the amount of money laundered in China is significant, with a potential for it to increase. The Chinese authorities indicate that China's state of economic development makes it particularly vulnerable to money laundering activity and this is likely to be the case for some considerable time. This is because the economic framework is changing rapidly as China continues to deepen its economic and social restructuring, economic reforms and the integration of its domestic market with foreign markets.

12. Criminal cases handled by the public security organs indicate that the predicate crimes for money laundering continue to expand in scope. In addition to drug crimes, smuggling crimes and crimes against property, the incidence of other types of criminal activities, such as economic crime, is increasing. Additionally, money laundering has been connected to a large number of corruption cases. Often, criminal proceeds are laundered by several criminals or groups of criminals working together.

13. Four methods of money laundering are most frequently used in China. First, money is laundered through cash smuggling (e.g. carrying illicit funds in or out of the country by hiding them in transportation vehicles or in human bodies). Second, money is laundered through legitimate financial systems (such as banks) through cash transactions, account payments, offshore businesses, loans and other financial transactions. Sometimes fake identity (ID) cards are used to open bank accounts or make fund transfers. Third, proceeds are transferred by importing or exporting over/under priced goods, or falsifying/counterfeiting import/export contracts, shipment bills, customs declarations and other related documents (i.e. trade-based money laundering). Fourth, money is laundered through the underground banking system. Typically, the proceeds of crime are repeatedly moved in, out and within the country in order to conceal their source. Criminals also open shell companies abroad to which funds, disguised as legitimate trade or investment transactions, are transferred through banks.

14. The Chinese authorities have noticed a trend of money laundering activities spreading to more sectors and industries—particularly those sectors which are cash-intensive in China (e.g. real estate, securities, insurance, audit and the legal profession)—and being connected to activities outside of China. The Chinese authorities view the increase in the amount of funds going abroad and the number of requests from other countries for assistance in investigating money laundering cases as indicators that greater amounts of criminal proceeds are being moved out of China.

15. Another trend is the emergence of more complex money laundering techniques and better concealment of such activities. As new technologies such as e-currency and online financial services (e.g. banking, securities and insurance) have developed, new money laundering techniques have evolved, making investigations more difficult. The development and emergence of stock market options, forward exchange rate contracts and other new financial derivatives have also provided new tools through which money may be laundered.

16. The Chinese authorities have also noticed that, as a result of intensified AML efforts in the banking system, there has been an increase in money laundering through underground banks. Statistics show that underground banks have increasingly become a by-product of corruption, tax evasion, smuggling and other criminal activities, and are a vehicle through which proceeds are laundered before being transferred abroad. In response, the public security organs, in cooperation with banks and the exchange control authorities, have worked to shut down underground banks.

Terrorist financing

17. China has been a victim of terrorism. In collusion with the al-Qaeda organisation, a terrorist group instigated a series of explosions, assassinations and other forms of violence in Xinjiang and other part of Chinese Central Asia, posing a serious threat to the peace and security in these regions. In September 2002, the United Nations (UN) Security Council included this group on its list of terrorist organisations. The Chinese authorities believe that al-Qaeda has provided financial support and training for the movement.

1.3 Overview of the Financial Sector and DNFBP

18. The table below indicates what types of financial institutions in China conduct the financial activities that are specified in the Glossary of the FATF 40 Recommendations and to which the FATF Recommendations apply. It can also be used a reference table to link the terminology of the FATF 40 Recommendation Glossary with the Chinese legal terminology. In this report, the Chinese terminology is used where possible.

Types of financial activities to which the FATF Recommendations apply (see Glossary of the FATF 40 Recommendations)	Types of financial institutions in China that conduct these specified financial activities (including their legal basis for doing so)
Acceptance of deposits and other repayable funds from the public	<ul style="list-style-type: none"> • Commercial banks and credit cooperatives: 4 state-owned commercial banks, 13 joint-stock commercial banks, 113 city commercial banks, 559 urban credit cooperatives, 16,428 rural credit cooperatives (and credit unions), 7 rural commercial banks and 12 rural cooperative banks (Law on Commercial Banks). • Postal savings outlets throughout rural and urban areas (Law on Commercial Banks).
Lending (including consumer credit; mortgage credit; factoring, with or without recourse; and finance of commercial transactions (including forfeiting))	<ul style="list-style-type: none"> • Commercial banks, policy banks and credit cooperatives: 4 state-owned commercial banks, 3 policy-related banks, 13 joint-stock commercial banks, 113 city commercial banks, 559 urban credit cooperatives, 16,428 rural credit cooperatives (and credit unions), 7 rural commercial banks and 12 rural cooperative banks (Law on Commercial Banks; Notices of the State Council on the Formation of the China Development Bank, the Export and Import Bank of China and the Agricultural Development Bank of China). • 73 enterprise group finance companies (Measures for the Administration of Finance Companies of Enterprise Groups). • 5 automobile finance companies (Measures for the Administration of Automobile Finance Companies).
Financial leasing (other than financial leasing arrangements in relation to consumer products)	<ul style="list-style-type: none"> • 12 Financial leasing companies (Measures for the Administration of Finance Leasing Companies, Notice of the China Banking Regulatory Commission on Adjustment of Business Scope of Finance Leasing Companies). • 73 enterprise group finance companies (Measures for the Administration of Finance Companies of Enterprise Groups).
The transfer of money or value (including financial activity in both the formal or informal sector (e.g. alternative remittance), but not including any natural or legal person that provides financial institutions solely with message or other support systems for transmitting funds)	<ul style="list-style-type: none"> • Commercial banks, policy banks and credit cooperatives: 4 state-owned commercial banks, 3 policy-related banks, 13 joint-stock commercial banks, 113 city commercial banks, 559 urban credit cooperatives, 16,428 rural credit cooperatives (and credit unions), 7 rural commercial banks and 12 rural cooperative banks (Law on Commercial Banks, Notices of the State Council on the Formation of the China Development Bank, the Export and Import Bank of China and the Agricultural Development Bank of China). • Postal savings outlets throughout rural and urban areas (Law on Commercial Banks). • Western Union and Moneygram (both partnered with local financial institution) (no legal basis, by themselves they are not considered a financial institution in China; however, the financial institutions (banks) that they are partnered with are covered).
Issuing and managing means of payment (e.g. credit and debit cards, checks, traveller's checks, money orders and bankers' drafts, electronic money)	<ul style="list-style-type: none"> • Commercial banks, policy banks and credit cooperatives: 4 state-owned commercial banks, 3 policy-related banks, 13 joint-stock commercial banks, 113 city commercial banks, 559 urban credit cooperatives, 16,428 rural credit cooperatives (and credit unions), 7 rural commercial banks and 12 rural cooperative banks (Law on Commercial Banks, Notices of the State Council on the Formation of the China Development Bank, the Export and Import Bank of China and the Agricultural Development Bank of China). • Postal savings outlets throughout rural and urban areas (Law on Commercial Banks).

<p>Financial guarantees and commitments</p>	<ul style="list-style-type: none"> Commercial banks, policy banks and credit cooperatives: 4 state-owned commercial banks, 3 policy-related banks, 13 joint-stock commercial banks, 113 city commercial banks, 559 urban credit cooperatives, 16,428 rural credit cooperatives (and credit unions), 7 rural commercial banks and 12 rural cooperative banks) (Law on Commercial Banks, Notices of the State Council on the Formation of the China Development Bank, the Export and Import Bank of China and the Agricultural Development Bank of China). 73 enterprise group finance companies (Measures for the Administration of Finance Companies of Enterprise Groups). 59 trust investment corporations (Regulations on Trust Investment Corporations).
<p>Trading in money market instruments (checks, bills, CDs, derivatives etc.)</p>	<ul style="list-style-type: none"> Commercial banks, policy banks and credit cooperatives, financial leasing companies, securities companies, insurance companies, trust investment fund, finance companies, wholesale foreign exchange & RMB money broker and insurance asset management companies [Law on Commercial Banks, Notices of the State Council on the Formation of the China Development Bank, the Export and Import Bank of China and the Agricultural Development Bank of China, Measures for the Administration of Finance Leasing Companies, Notice of the China Banking Regulatory Commission on Adjustment of Business Scope of Finance Leasing Companies, Securities Law (revised), Measures on the Administration of Securities Companies, Insurance Law, Administrative Provisions on Insurance Companies, Regulations on Trust Investment Corporations, Interim Measures for the Administration of Capital Trust of the Trust and Investment Companies , Measures for the Administration of Finance Companies of Enterprise Groups, Measures for the Administration of Pilot Currency Brokerage Companies, Detailed Rules for the Implementation of Measures for the Pilot Administration of Currency Brokerage Companies , Interim Provisions on the Administration of Insurance Assets Management Companies].
<p>Trading in foreign exchange</p>	<ul style="list-style-type: none"> Commercial banks, policy banks and credit cooperatives, financial leasing companies, securities companies, insurance companies, trust investment fund, finance companies and insurance asset management companies [Law on Commercial Banks, Notices of the State Council on the Formation of the China Development Bank, the Export and Import Bank of China and the Agricultural Development Bank of China, Measures for the Administration of Finance Leasing Companies, Notice of the China Banking Regulatory Commission on Adjustment of Business Scope of Finance Leasing Companies, Securities Law (revised), Measures on the Administration of Securities Companies, Insurance Law, Administrative Provisions on Insurance Companies, Regulations on Trust Investment Corporations, Interim Measures for the Administration of Capital Trust of the Trust and Investment Companies , Measures for the Administration of Finance Companies of Enterprise Groups, Measures for the Administration of Pilot Currency Brokerage Companies, Detailed Rules for the Implementation of Measures for the Pilot Administration of Currency Brokerage Companies , Interim Provisions on the Administration of Insurance Assets Management Companies].
<p>Trading in exchange, interest rate and index instruments</p>	<p>The only product of this category available in China so far is RMB rate swap, provided by:</p> <ul style="list-style-type: none"> Commercial banks, policy banks and credit cooperatives, financial leasing companies, securities companies, insurance companies, trust investment fund, finance companies and insurance asset management companies [Law on Commercial Banks, Notices of the State Council on the Formation of the China Development Bank, the Export and Import Bank of China and the Agricultural Development Bank of China, Measures for the Administration of Finance Leasing Companies, Notice of the China Banking Regulatory Commission on Adjustment of Business Scope of Finance Leasing Companies, Securities Law (revised), Measures on the Administration of Securities Companies, Insurance Law,

	Administrative Provisions on Insurance Companies, Regulations on Trust Investment Corporations, Interim Measures for the Administration of Capital Trust of the Trust and Investment Companies , Measures for the Administration of Finance Companies of Enterprise Groups, Measures for the Administration of Pilot Currency Brokerage Companies, Detailed Rules for the Implementation of Measures for the Pilot Administration of Currency Brokerage Companies , Interim Provisions on the Administration of Insurance Assets Management Companies].
Trading in transferable securities	<ul style="list-style-type: none"> Securities companies, insurance companies, futures brokerage companies and insurance asset management companies [Securities Law (revised), Measures on the Administration of Securities Companies, Insurance Law, Administrative Provisions on Insurance Companies, Measures for the Administration of Futures Brokerage Companies, Interim Provisions on the Administration of Insurance Assets Management Companies].
Trading in commodity futures trading	<ul style="list-style-type: none"> Futures brokerage companies (Measures for the Administration of Futures Brokerage Companies).
Participation in securities issues and the provision of financial services related to such issues	<ul style="list-style-type: none"> Securities companies [Securities Law of the People's Republic of China (revised), Measures on the Administration of Securities Companies].
Individual and collective portfolio management (covers mgt. of collective investment schemes such as unit trusts, mutual funds, pension funds)	<ul style="list-style-type: none"> Fund management companies, insurance companies, trust investment corporations (Administration of Securities Investment Fund Management Companies Procedures, Measures for the Pilot Management of Establishing Fund Management Companies by Commercial Banks, Insurance Law, Administrative Provisions on Insurance Companies, Regulations on Trust Investment Corporations, Interim Measures for the Administration of Capital Trust of the Trust and Investment Companies).
Safekeeping and administration of cash or liquid securities on behalf of other persons	<ul style="list-style-type: none"> Commercial banks, trust investment corporations (Law on Commercial Banks, Regulations on Trust Investment, Interim Measures for the Administration of Capital Trust of the Trust and Investment Companies Corporations).
Otherwise investing, administering or managing funds or money on behalf of other persons	<ul style="list-style-type: none"> Not applicable.
Underwriting and placement of life insurance and other investment related insurance [including insurance undertakings and insurance intermediaries (agents and brokers)]	<ul style="list-style-type: none"> Insurance companies (Insurance Law, Administrative Provisions on Insurance Companies).
Money and currency changing	<ul style="list-style-type: none"> Commercial banks (Law on Commercial Banks).

Overview of the banking, securities and insurance sectors

19. Most of the key financial institutions are owned by the Chinese government, either fully or by a majority. The table below provides a schematic overview of the terminology used for financial institutions within China, showing the hierarchy in terminology.

Financial institutions			
Policy financial institutions	Commercial institutions		
<ul style="list-style-type: none"> • China Development Bank • Export-Import Bank of China • Agriculture Development Bank 	Banking institutions	Securities institutions	Insurance institutions
	See the separate tables below on the banking, securities and insurance sectors for an overview of these three types of commercial institutions		

20. The following table sets out an overview of the number of institutions, the volume of the market and the services provided for the banking, securities and insurance sectors. Money remittance and foreign exchange companies are listed as banks, since banks are the only type of financial institution that are authorised to conduct these types of activity in China.

Overview of the banking, securities and insurance sectors ⁷					
Sector	Number of entities	Percent of total entities	Total assets (billion RMB)	Percent of total assets	Financial regulator
Banking	27,877	91.5%	38,000	95.4%	China Banking Regulatory Commission
Securities	237	0.78%	329	0.8%	China Securities Regulatory Commission
Insurance	2081	6.69%	1523	3.8%	China Insurance Regulatory Commission
Total	30,195	100%	39,852	100%	

Banking sector

21. There are three policy financial institutions (policy banks) that were founded and capitalised by the government: China Development Bank, China Import and Export Bank of China, and China Agricultural Development Bank. They participate in financing and credit businesses to carry out and cooperate with the government's economic policies. Policy banks are non-commercial financial institutions.

22. Commercial banks are profit-oriented institutions mainly dealing with deposit absorption, lending and other fee-based businesses. By law, commercial banks are exclusively authorised to provide the following services: accept public deposits; issue short-term, medium-term and long-term loans; arrange settlement of both domestic and overseas accounts; handle bill acceptance and discount; issue financial bonds; issue, cash and sell government bonds as agents; buy and sell government bonds and financial bonds; do inter-bank lending and borrowing; buy and sell foreign exchange; provide bank card services; provide letter of credit service and guarantees; handle receipts, payments and insurance business as agents; provide safe deposit boxes; and undertake other business as approved by the banking regulatory authority under the State Council. (Law on Commercial Banks, article 3).

23. As of the end of December 2005, China's banking sector had a total of 27,877 financial institutions. The following chart sets out an overview of the types and number of entities that make up China's banking sector.

⁷ The total assets of securities sector only include securities companies and futures brokerage companies. The total assets of insurance sector only include insurance companies.

Banking institutions ⁸ (domestic and foreign invested, including numbers for 2005)		
Commercial Banks	Credit co-operatives and credit unions	Non-bank institutions
<ul style="list-style-type: none"> • State owned commercial banks (4) • Joint stock commercial banks (13) • City commercial banks (113) • Rural commercial banks (7) • Rural Cooperative banks (12) • Foreign-invested banks • Joint banks 	<ul style="list-style-type: none"> • City credit cooperatives (559) • Rural credit cooperatives and credit unions (16,428) 	<ul style="list-style-type: none"> • Financial asset management companies (4) • Trust investment corporations (59) • Enterprise Group Financial companies (73) • Automobile finance companies (5) • Post savings (numerous) • Financial leasing companies (12) • Wholesale foreign exchange and RMB money brokers

24. As of the end of December 2005, the China Banking Regulatory Commission (CBRC) has approved the incorporation of 20 operational institutions and 9 representative offices of foreign banks. A total of 73 foreign banks from 20 countries and regions have set up 187 branches and 245 representative offices in China, of which 104 branches have been approved to engage in Chinese Renminbi (RMB) business.

25. The total assets of China's banking sector (excluding financial asset management companies) reached RMB 38 trillion at the end of 2005, up RMB 6.1 trillion (18.6%) from 2004. The sector's total liabilities (excluding financial asset management companies) stood at RMB 37.2 trillion, an increase of RMB 5.7 trillion (18.1%). Deposits totalled RMB 92.9 trillion, up RMB 331 billion (18.95%) from the beginning of 2005. The assets of state-owned commercial banks increased to RMB 20.9 trillion, accounting for 52.5% of the total of the banking sector. The proportion of assets of joint-stock commercial banks and foreign-invested banks increased faster, to 23.7% and 1.8% respectively.

Securities sector

26. China's securities sector is comprised of three main types of institutions: securities organisations, futures and fund institutions. Securities organisations are institutions that provide intermediary services to security market participants. The following chart sets out an overview of the different types and numbers of entities that make up China's securities sector.

⁸ This chart does not include the three policy financial institutions, sometimes referred to as policy banks.

Securities institutions (domestic and foreign invested, including numbers for 2005)		
Securities organisations	Futures institutions	Funds institutions
<ul style="list-style-type: none"> • Securities companies (115) • Stock (2) and futures exchanges (3) • Securities registration and settlement institutions • Securities investment consulting companies (116) 	<ul style="list-style-type: none"> • Futures brokerage companies (183) 	<ul style="list-style-type: none"> • Fund management companies (47, of which 16 are sino-foreign) • Fund custody banks (12) • Fund sales agencies (>60,000)

27. At the end of 2005, there were 7 foreign-invested securities companies, more than 3,000 securities trading outlets and 90 representatives of foreign securities institutions in China. Securities companies recorded total assets of RMB 329 billion, total liabilities of RMB 244.1 billion, net assets of RMB 62.8 billion, net capital of RMB 35 billion, proprietary securities of RMB 36.8 billion, customer transaction settlement fund of RMB 166.4 billion and depository funds of RMB 53.1 billion at the end of 2005. Additionally, China has two stock exchanges—the Shanghai Stock Exchange and the Shenzhen Stock Exchange.

28. Securities institutions include comprehensive securities companies, brokerage securities companies, foreign-invested securities companies and overseas securities institutions' representatives in China. Comprehensive securities companies may engage in the following business activities: securities trading agency; service of principal and interest, and distribution of bonus and dividends for the entrusted securities; securities custody and authentication; registration and account opening as agents; proprietary securities trading; securities underwriting; securities investment consultation (including financial advisor services); management of entrusted management; and other business activities as approved by the China Securities Regulatory Commission (CSRC). Brokerage securities companies may engage in the following business activities: securities trading agency; service of principal and interest, and distribution of bonus and dividends for the entrusted securities; securities custody and authentication; registration and account opening as agents.

29. There is only one kind of futures institution in China, futures brokerage companies. China has established three futures exchanges—the Shanghai Futures Exchange, the Zhengzhou Commodity Exchange and the Dalian Commodity Exchange. At the end of 2005, the 183 futures brokerage companies had a total asset of RMB 21 billion, net assets of RMB 6.49 billion and margin of RMB 12.8 billion. These companies earned operating revenue of RMB 1.21 billion and incurred total losses of RMB 25 million in 2005. The three futures exchanges registered 306 million lots of futures transactions in 2005, with total transactions volume of RMB 1.345 billion, a year-on-year rise of 5.6% for the number of transactions and a decrease of 8.5% for the volume. The number of investors on these exchanges exceeded 370,000—up 9.6%. Future brokerage companies are allowed to engage in the following business activities: futures brokerage, futures consultation and training, and other business activities as approved by the CSRC.

30. Fund institutions principally include fund management companies and fund sales agencies. Among fund sales agencies, there were 15 commercial banks with open fund distribution qualification, 66 securities companies, 1 investment consulting agency, and more than 60,000 fund sales outlets. Existing fund products include stock, bond, hybrid and money market funds. Special fund products also comprise listed open-ended funds (LOF), exchange-traded funds (ETF) and principal guaranteed funds. At the end of June 2005, there were 191 funds, with a total size of 443.7 trillion tranches and a net value of RMB 426.2 trillion. Of these funds, money market funds numbered 23, with a size of

214.8 trillion tranches and a net value of RMB 214.8 trillion; non-money market funds numbered 168, with a size of 229.0 trillion tranches and a net value of RMB 211.4 trillion.

Insurance sector

31. China's insurance sector includes five kinds of insurance institutions, as set out in the chart below. The number of each type of institution is indicated in brackets.

Insurance institutions (domestic and foreign invested, including numbers for 2005)
<ul style="list-style-type: none"> • Chinese-invested or domestic-invested insurance companies (52) • Foreign-invested insurance companies(36) • Representative offices of foreign insurance institutions • Insurance intermediaries (1800) • Insurance asset management companies

32. China's insurance agencies number 120,000. The insurance sector has developed rapidly over the last few years. In 2005, the sector yielded premium income of RMB 492.8 billion. Property insurers and life insurers both witnessed fast business development. Insurance premiums in 2005 amounted to RMB 492.7 billion, of which RMB 123.0 billion was for property insurance, RMB 324.4 billion was for life insurance, and RMB 45.3 billion was for health and accident insurance.

33. Life insurers may provide accidental injury insurance, health insurance, traditional life insurance, new life insurance products, traditional annuity insurance, new annuity insurance products, other life insurance business and reinsurance. Property insurers may provide property damage insurance, liability insurance, compulsory liability insurance, credit and guarantee insurance, agricultural insurance, other property insurance business, short-term health insurance and accidental injury insurance, and reinsurance.

1.3.2 Overview of designated non-financial businesses and professions (DNFBPs)

Accountants

34. Accountants in China are not authorised to perform the specific types of financial activity that are referred to in FATF Recommendations 12 and 16. They are only authorised to perform auditing and related services. Consequently, the FATF Recommendations do not apply to accountants in the Chinese context. As of 31 December 2004, China had registered a total of 66,598 certified public accountants and 5,155 public accounting firms (of which 923 are partnerships and 4,232 are limited liability firms).

Casinos

35. The Penal Code specifically prohibits operating a casino (including internet casinos) and/or taking part in casino gambling in China.

Dealers in precious metals and stones

36. The import of gold and silver by all departments and units⁹ is subject to the approval of the PBC, and to import and export restrictions. Most of the bulk gold business is handled by the Shanghai Gold Exchange. The gold exchange has 150 members across China whose gold output, consumption

⁹ The term "unit" is defined in section 1.4 of this report.

and production capacity amount to 75%, 80% and 90% respectively of the country's total. According to the Gold Bureau of the State Economic and Trade Commission (SETC), in 2004, China traded 665.30 tons of gold and 27.8 tons of platinum. In 2005, China traded 906.4 tons of gold and 40.8 tons of platinum, an increase of 36.24% and 46.90% respectively. These figures do not include the retail precious metal trade. No figures were provided concerning the business of dealing in precious stones.

Lawyers

37. At the end of 2004, China had 118,000 licensed lawyers, working for 11,691 law firms.

Notaries

38. In China, notaries are required to operate on a not-for-profit basis. They may verify the legality, objectivity and authenticity of documents and transactions, hold funds in escrow, or handle funds on behalf of other persons or entities. China has a total of 3,147 notary offices, with 12,000 notaries.

Real Estate Agents

39. Private ownership of land is unknown in China. The real estate industry focuses its business on the buying and selling of rights to use land. The land in urban districts is owned by the state. Land in the rural and suburban areas, is collectively owned by the people, except as otherwise provided for by the state. Exceptionally, land and hills can be retained (not owned) by farmers for personal use. Land owned by the state or collectively owned by the people may be allocated for use by units¹⁰ or individuals according to the Land Administration Law.

40. There are two ways to acquire rights to use land in China. First, for public interest purposes such as schools or hospitals, the government may authorise an entity (but not a person) to use land without paying any fee. Second, the government may sign a contract with a natural or legal person allowing particular uses of land in return for a fee which must be paid in advance. Increasingly, the government is using market mechanisms to set prices for such usage rights. The maximum terms of use vary from 40 to 70 years and may be extended upon renegotiation, provided that an extension is in the public interest. Limited usage rights may be sold on a secondary market at market rates, but terms and restrictions on use may not be amended without renegotiation with the government. The government retains the right to reclaim land if it is not developed within two years. In 2005, the commercial housing purchases in China amounted to RMB1.4 billion.

Trust and company service providers

41. Trust investment corporations are financial institutions under China's law that generally act as the trustees of a trust. China also has entities that act as registration agents for legal persons (i.e. company service providers). Other trust and company services, as defined in the FATF Recommendations are generally not provided.

1.4 Overview of commercial laws and mechanisms governing legal persons and arrangements

42. A legal person is defined as an organisation that independently enjoys civil rights and assumes civil obligations in accordance with the law, from the time that it is established to when it is terminated (Civil Law, article 36). In addition to the term "legal persons", Chinese nomenclature also uses the term "unit". A unit is a much broader concept than a legal person. In general, a unit can refer to various organisations, such as companies, enterprises, official (state) organs, social organisations,

¹⁰ *Ibid.*

lease-holding farm households etc. A unit can hold civil, administrative and criminal responsibility. A natural person acting individually cannot be unit.

43. All business activities in China are licensed, regulated and, to various degrees, supervised. This means that the legal person is first established, after which it may (like a natural person) request authorisation to conduct a particular business activity. This report focuses on the rules relating to legal persons authorised to do business (LPAB). In China, the following types of LPAB exist.

- (a) ***Enterprise under collective ownership:*** This category of legal person (which includes companies and partnerships) can be classified as either urban or rural enterprises under collective ownership, depending upon the type of community that has established the enterprise and owns its assets collectively. The operation and workload incurred in the operation of such an enterprise are shared within the establishing community, as are the rewards, according to the share of labour provided by each individual (Company Law, article 3; Partnership Enterprise Law). An enterprise qualifies as a legal person if it has sufficient funds (as stipulated by the State), articles of association, an organisation and premises, the ability to independently bear civil liability and has been approved and registered by the competent authority.
- (b) ***Chinese foreign equity joint venture (or Chinese-foreign contractual joint ventures or foreign-capital enterprises):*** These are enterprise-legal persons jointly established by foreign companies, (or enterprises, or other economic organisations or individuals) in co-operation with Chinese companies (or enterprises or other economic organisations) and structured as a limited liability company (Regulations for the Implementation of the Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment, article 16).
- (c) ***Limited liability company:*** Any person or entity (except civil servants, criminals, and minors) may incorporate a limited liability company. The shareholder is liable for the company to the extent of the capital contributions it has paid.
- (d) ***Joint stock limited company:*** Joint stock limited companies may be incorporated by any person or entity (except civil servants, criminals, and minors) by means of sponsorship or share offer, subject to the approval of a department authorised by the State Council or a people's government at the provincial level. A share offer can be made to the general public, including persons outside of China.
- (e) ***Partnership:*** A partnership is any business set up by partners within Chinese territory through the signing of an agreement and using contributions made by all of the partners. All of the partners share jointly in the operation, incomes, risks and unlimited liabilities of the business.

44. The following other types of legal persons, which do not engage in business activities, are also recognised in China:

- (a) ***Social organisation:*** A social organisation is a non-profit social organisation that is constituted by Chinese citizens voluntarily to carry out activities with the purpose of realising the common will of its members.
- (b) ***Independently funded official organ or social organisation:*** These are entities that are established by a state agency or by other entities using state-owned assets. They engage in social services (e.g. educational, scientific research, cultural or sanitarian activities).
- (c) ***Association:*** Associations are social organisations that are established, on a voluntary basis, by an enterprise of the same industry or professionals for the purpose of furthering the common interests of its members (i.e. an industry union or professional association). For every business or industry, only one such association is allowed to exist.
- (d) ***Foundation:*** A foundation is a non-profit legal person that makes use of property which has been donated by natural persons, legal persons, or other organisations for the purpose of pursuing welfare undertakings (Regulation on Foundation Administration).

- (e) ***Private non-commercial unit:*** These are social organisations that are engaged in non-profit social services and which are established by enterprises, social organisations or other social forces and individuals using non state-owned assets. They may be classified as legal persons, partnerships or individuals, depending upon how civil liability is lawfully borne.

45. Chinese law allows the creation of domestic express trusts, but foreign trusts are not recognised. The Trust Law defines a trust as “the settler, based on his faith in the trustee, entrusts his property rights to the trustee and allows the trustee to, according to the will of the settler and in the name of the trustee, administer or dispose of such property in the interest of a beneficiary or for any intended purposes”.

1.5 Overview of strategy to prevent money laundering and terrorist financing

a. AML/CFT Strategies and Priorities

46. The Chinese authorities state that, while carrying out economic reforms and opening-up policies, China emphasises a strict AML/CFT policy, with a view to supporting international co-operation and co-ordination, and maintaining global security, prosperity and stability. China’s AML/CFT strategy is based on the following four pillars.

- (a) Effectively prevent criminals and terrorists from misusing the financial system, improve the integrity and risk-management of financial institutions, maintain the soundness of the financial system, and deepen the development and opening up of China’s financial system with the view to further integrating it with the global economy.
- (b) Develop a unified monitoring system for the movement of funds, improve the reporting of large-value and suspicious transactions, strengthen cooperation and information sharing among government departments working on AML/CFT, and raise the capacity of the financial regulators, law-enforcement agencies and judicial authorities in detecting, investigating and combating criminal activities.
- (c) Prevent and combat ML/FT by participating more effectively in international co-operation with the aim of building a more effective and efficient international network for AML/CFT, particularly in targeting cross-border money laundering and terrorist financing activities.
- (d) Participate more actively in international and regional AML/CFT organisations, with a view to contributing to the development and improvement of the international AML/CFT framework.

47. For the next three years, China has prioritised the following six areas for AML/CFT efforts.

- (a) Based on the newly enacted AML Law, strengthen the AML rules and regulations applicable to financial institutions and expand AML/CFT measures gradually to DNFBCPs.
- (b) Strengthen supervision of financial institutions (including finishing the current round of AML inspections for the commercial banks), take actions to ensure compliance where appropriate, and extend AML inspections to the insurance and securities sectors.
- (c) Strengthen the capacity to monitor fund movements for AML purposes by interfacing the AML monitoring system with the bank account management system, the payment and settlement system, the management systems for the resident’s IDs and the credit system for individuals and enterprises.
- (d) Raise investigative capacity with regard to suspicious transactions and normalise the referral procedures for the suspicious transaction dossiers involving possible criminal activities.
- (e) Intensify efforts to have an optimal institutional structure and division of AML responsibilities, enable synergy between organisations and guarantee sufficient levels of personnel, funds and information.

- (f) Continue to deepen international cooperation on a reciprocal basis and implement bilateral cooperation with related countries and regions.

48. The Chinese government has also indicated that it resolutely opposes all forms of terrorism, including terrorist financing. In particular, China's public security departments have taken action to detect, monitor, intercept, seize and confiscate terrorist funds. In the future, China intends to use its AML framework to combat terrorist financing.

b. The institutional framework for combating money laundering and terrorist financing

Policy co-ordination bodies

49. **AML Joint-ministerial Conference:** China's AML/CFT efforts are led and inspired by the AML Joint-ministerial Conference, a national interagency cooperation framework that is led by the governor of the PBC. All of the agencies (among others) that work on AML/CFT issues (and which are described below) have joined the Conference.

People's Bank of China

50. **People's Bank of China (PBC):** The PBC is the central bank of China, led by the Governor of the PBC who is a member of the State Council and ranks equal to a minister. The PBC is responsible for organising and coordinating China's AML efforts. This includes: (1) taking charge of international cooperation and information exchange relating to AML; (2) steering and planning AML for the Chinese financial industry; (3) researching and developing, in conjunction with related departments, AML policy instruments for the financial industry and the monitoring and reporting system on suspicious money transactions; (4) monitoring AML-related money flows; (5) gathering and tracing departmental information on suspicious fund transactions in domestic and foreign currencies, and forwarding cases where a crime is suspected to the judicial authority; (6) assisting the judicial authority in investigating and prosecuting money-laundering crimes; (7) researching major and difficult AML issues facing the financial industry, including proposing solutions; (8) coordinating and managing the financial industry's external AML cooperation and exchange projects; and (9) directing and planning the AML efforts of non-financial high-risk sectors in conjunction with related departments. The PBC also supervises all financial institutions that are subject to AML measures.

51. **China Anti-money Laundering Monitoring & Analysis Center (CAMLMAC) and Anti-Money Laundering Bureau (AMLB):** China's financial intelligence unit (FIU) is comprised of two departments of the PBC—the CAMLMAC and the AMLB. CAMLMAC is responsible for collecting, analysing, and monitoring AML intelligence. The AMLB is responsible for administrative investigation, dissemination and policy oversight. Additionally, the AMLB is responsible for organising and coordinating the PBC's overall AML functions.

Law enforcement, prosecutorial and judicial authorities

52. **Ministry of Public Security (MPS):** The MPS is China's main law enforcement body. It is responsible for organising, coordinating and directing the local public security organs (i.e. law enforcement authorities), including in their investigation of money laundering crimes. It also investigates cases involving suspicious transactions.

53. **Ministry of State Security (MSS):** The MSS is responsible for investigating terrorist crimes against state security, including related money laundering and terrorist financing crimes. It also participates in the collection and processing of money laundering intelligence, and develops solutions for sharing information and investigative cooperation. It relies on international cooperation with other jurisdictions to investigate and verify suspicious transactions that have foreign connections and may be related to money laundering activities.

54. **Supreme People's Procuratorate (SPP):** The SPP supervises and directs the approval of arrests, prosecution, and supervision of cases involving money laundering crimes. It is also responsible for detecting and penalising occupational crimes which are committed by government officers who are behind money laundering cases, and developing judicial interpretations on questions involving the interpretation and applicability of laws. It works closely with the SPC and is accountable to the NPC.

55. **Supreme People's Court (SPC):** The SPC supervises and directs the trial of money laundering crimes, and gives judicial interpretations on questions raised in the course of a trial which involve the interpretation and applicability of laws. It works closely with the SPP and is accountable to the NPC.

56. **General Administration of Customs (GCA):** The GCA monitors and regulates China's ports of entry, including implementing applicable AML measures to prevent the illegal cross-border transportation of currency. This includes supervising and inspecting all currencies, deposits, priced securities, and gold and silver products that flow into and outside China in the course of foreign trade. The GCA also monitors imports and exports to China.

Supervisory authorities in the public sector

57. **Ministry of Supervision (MS):** The MS investigates and handles irregularities involving the state administrative organs, civil servants and other officers appointed by such organs, including when they are involved in money laundering activities. It works to strengthen the development of AML regimes, mechanism and systems within the state administrative organs by attaching importance to verifying the source of funds, researching and establishing information sharing mechanisms, and encouraging interagency cooperation in the investigation of corruption and bribery cases which are related to money laundering.

58. **State Administration of Industry and Commerce (SAIC):** The SAIC enforces company establishment and market access requirements. It also assists in the investigation of money laundering activities by sharing information with the PBC, MPS, MSS, GCA and tax authorities. It also assists relevant departments in regulating AML in non-financial fields that have a high incidence of money laundering.

Supervisory/regulatory authorities in the financial sector

59. **China Banking Regulatory Commission (CBRC):** The CBRC is the prudential supervisor for the banking sector and assists the PBC in supervising the banking sector's compliance with AML regulations. It also assists the PBC in developing AML measures for the sector (including those related to establishing a system for monitoring and reporting suspicious transactions) and conducting AML policy research.

60. **China Securities Regulatory Commission (CSRC):** The CSRC is the prudential supervisor for the securities sector and assists the PBC in supervising the industry's compliance with AML regulations. It also assists PBC in developing AML measures for the sector (including those related to establishing a system for monitoring and reporting suspicious transactions) and conducting AML policy research.

61. **China Insurance Regulatory Commission (CIRC):** The CIRC is the prudential supervisor for the insurance sector and assists the PBC in supervising the industry's compliance with AML regulations. It also assists PBC in developing AML measures for the sector (including those related to establishing a system for monitoring and reporting suspicious transactions) and conducting AML policy research.

62. **State Administration for Foreign Exchange (SAFE):** SAFE, a state agency that is administered by the PBC, is the regulatory authority with responsibility for foreign exchange transactions. In that context, suspicious transaction reports (STRs) and large-value transaction reports (LVTs) that are

reported to branches of the PBC and which relate to foreign exchange may be copied to the SAFE staff located in the branch for use in carrying out SAFE's regulatory functions. SAFE conducts on-and off-site monitoring of financial institutions for compliance with foreign exchange regulations.¹¹

63. **State Post Bureau:** The State Post Bureau analyses and supervises the postal remittance system's compliance with AML regulations. It also assists the PBC and CBRC in conducting AML policy research in relation to the postal savings business.

Supervisory/regulatory authorities in the DNFBP sector

64. **Ministry of Civil Affairs (MCA):** The MCA is responsible for registering and supervising non-profit organisations.

65. **Ministry of Construction:** The Ministry of Construction is responsible for formulating laws and regulations for the real estate industry, supervising the industry and conducting AML awareness raising, outreach and policy research. It is also responsible for qualifying, admitting and supervising real estate development and transaction enterprises and institutions, including real estate agencies that develop and manage real estate for profit.

66. **Ministry of Justice:** The Ministry of Justice is responsible for licensing and supervising lawyers and notaries, and is working to prepare the industry for the implementation of AML measures.

67. **All China Lawyer Association (ACLA):** The ACLA is the national SRO for lawyers.

68. **China Notaries' Association (CNA):** The CNA is the national SRO for notaries.

69. **China Institute of Real Estate Appraisers and Agents (CIREA):** The CIREA is the national SRO for the real estate brokers and appraisers.

70. **Shanghai Gold Exchange (SGE):** The Shanghai Gold Exchange is a non-profit SRO established under the State Council by the PBC and registered with the State Administration for Industry and Commerce. Its purpose is to supervise the gold transactions conducted by or with its members.

International co-operation

71. **Ministry of Foreign Affairs (MFA):** The MFA develops policies on international cooperation involving money laundering and facilitates China's cooperation with other governments. It also facilitates China's accession to international or regional AML organisations and works to fulfil China's international obligations.

72. **Ministry of Justice:** The Ministry of Justice co-ordinates AML-related mutual legal assistance pursuant to relevant treaties and conventions.

c. Approach concerning risk

73. China has not taken a risk-based approach to determine which sector should (or should not) be brought under AML/CFT regulation. Additionally, financial institutions and DNFBPs are not allowed to take a risk-based approach in relation to their AML/CFT obligations

¹¹ From 2003 to 1 July 2006, SAFE was fulfilling the role of receiving, analysing and disseminating STRs and large value transactions (LVTs) relating to foreign exchange transactions. Since 1 July 2006 all STR and LVT reporting has been made to CAMLMAC.

d. Progress since the last mutual evaluation

74. This is the first mutual evaluation of China.

2. LEGAL SYSTEM AND RELATED INSTITUTIONAL MEASURES

Laws and Regulations

2.1 Criminalisation of Money Laundering (R.1 & 2)

2.1.1 Description and Analysis

Recommendation 1 (Criminalisation of money laundering)

75. China has criminalised different forms of manipulating criminal proceeds in three separate articles of the Penal Code (PC). In chronological order of introduction they are as follows:

- (a) Article 312 PC was introduced on 1 July 1979 as a receiving and handling illegally acquired goods offence on the basis of an all crimes approach. It was extended on 29 June 2006 to cover all “income or proceeds therefrom” and certain money laundering activity (disguising or concealing).
- (b) Article 349 PC was introduced on 28 December 1990 to criminalise the handling or laundering of proceeds generated from drug-related offences.
- (c) Article 191 PC was introduced on 14 March 1997 to criminalise the laundering of proceeds generated from four broad categories of offences (drugs, smuggling, organised crime and terrorism). It was last amended on 29 June 2006 to add three additional broad categories of predicate offences (corruption or bribery, disrupting the financial management order and financial fraud).

All-crimes laundering provision (Article 312)¹²

76. Conceived basically as a typical “receiving and handling” offence, article 312 PC was very recently expanded to a broader concept criminalising the concealment or disguise of illegal proceeds by any other means. Essential elements constituting the offence are:

- (a) *Mental/moral element*: The defendant performed one of the actions enumerated below, knowing that the assets involved were generated by any criminal activity.
- (b) *Physical element*: The defendant harboured, transferred, purchased or sold such illegal proceeds or gains from those proceeds “as an agent” (other translation: “helps to sell”), or disguised or concealed them by any other means.
- (c) *Predicate criminality*: The proceeds or gains were generated from the commission of any criminal offence.

¹² Art. 312 PC was translated as follows: “Where anyone, who obviously knows that the income or the proceeds that are generated therefrom are obtained from the commission of any crime, harbours, transfer, purchases or sells them as an agent or disguises or conceals them by any other means, he shall be sentenced to fixed-term imprisonment of not more than three years, detention, or surveillance, and/or shall be fined. If the circumstances are serious, he shall be sentenced to fixed-term imprisonment of not less than three years but not more than seven years, and shall be fined.”

Laundering proceeds of drug offences (Article 349)¹³

77. Article 349 PC was introduced after China ratified the UN Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances, 1988 (the Vienna Convention) with the intention of specifically criminalising, *inter alia*,¹⁴ certain types of handling of drug-related proceeds

- (a) *Mental/moral element*: The defendant (knowingly) performed one of the actions under (b), involving proceeds from a drug-related offence.
- (b) *Physical element*: The defendant harboured, transferred or covered up proceeds (“pecuniary and other gains”) generated by such criminal activity.
- (c) *Predicate criminality*: The proceeds were generated from the commission of a drug-related offence.

Laundering proceeds of specific serious crimes (article 191)

78. Finally, article 191 PC specifically makes it an offence to launder the direct and indirect proceeds of crimes related to drugs, terrorism, organised crime, smuggling, embezzlement and bribery, financial fraud or disrupting the order of financial administration. Essential elements constituting this offence are:

- (a) *Mental/moral element*: The defendant performed one of the actions listed below, knowing that the proceeds were obtained from one or more of seven specific categories of crimes and with the purpose to disguise or conceal the illegal origin or nature thereof.
- (b) *Physical element*: The defendant:
 - (i) provided fund accounts;
 - (ii) helped to exchange property into cash or any financial negotiable instruments;
 - (iii) helped to transfer capital through transferring accounts or any other form of settlement;
 - (iv) helped to remit funds to any other country; or
 - (v) disguised or concealed by any other means the nature or source of the illegally obtained proceeds and the gains derived there from.
- (c) *Predicate criminality*: The proceeds were obtained from drug-related crimes, crimes committed by organisations in the nature of criminal syndicate, crimes of terrorism, crimes of smuggling, crimes of embezzlement and bribery, crimes of financial fraud or crimes of disrupting the order of financial administration.¹⁵

¹³ Art. 349 PC was translated as follows: “Whoever shields offenders engaged in smuggling, trafficking in, transporting or manufacturing of narcotic drugs or whoever harbours, transfers or covers up, for such offenders, narcotic drugs or their pecuniary and other gains from such criminal activities shall be sentenced to fixed-term imprisonment of not more than three years, criminal detention or public surveillance. If the circumstances are serious, he shall be sentenced to fixed-term imprisonment of not less than three years but not more than 10 years.”

¹⁴ The article also criminalises activity of protecting the drug offender himself and of handling/hiding drugs, which is irrelevant in the context of this report.

¹⁵ Art. 191 PC was translated as follows: “Where anyone who obviously knows that any proceeds are obtained from any drug-related crime, crimes committed by organisations in nature of syndicate, terrorist crime, crime of smuggling, crime of corruption or bribery, crime of disrupting the financial management order, crime of financial fraud, etc. as well as the proceeds generated therefrom, yet commits any of the following acts for the purpose of disguising or concealing the origin or nature thereof, the incomes obtained from the commission of the aforementioned crimes as well as the proceeds generated there from shall be confiscated, and the offender shall be sentenced to fixed-term imprisonment of not more than five years or detention, and/or shall be imposed a fine of 5% up to 20% of the amount of laundered money. If the circumstances are serious, he shall be sentenced to fixed-term imprisonment of not less than five years but not more than ten years, and shall be imposed a fine of 5% up 20% of the amount of laundered money:

- (a) Providing any capital account;

79. As a general principle, the specific provisions of article 191 and 349 PC take priority over the general provision of article 312 PC (“*lex specialis derogat generalibus*”). Money laundering is considered to be an instantaneous offence. The statute of limitations is 5 or 10 years starting from the laundering act, depending on the maximum punishment for the particular offence (less than 5 years or less than 10 years). The statute of limitation is suspended in certain circumstances, namely when the suspect has absconded, or when the civil party files a claim in the absence of any law enforcement action.

Consistency with the United Nations Conventions

80. When taken together and if accepting the broad terminology of articles 191 and 312 PC as addressing all forms of concealment, the behavioural aspects of the three relevant offences are meant to cover the laundering activities addressed by the Vienna Convention and the UN Convention against Transnational Organized Crime, 2001 (the Palermo Convention). Common to articles 191, 312 and 349 PC is the “knowledge” element. Negligent money laundering is not an offence.

81. The inclusion of catch-all terminology such as “by any other means” in articles 312 and 191 PC (inserted by the amendment of 29 June 2006) was clearly intended to cover all possibilities and eventualities of laundering activity. As said, articles 191 and 349 take priority over article 312. As to the relationship between 191 and 349, article 349 is a more specific provision that focuses on criminalising the laundering of drug proceeds through a limited number of means. The criminalisation of money laundering activity in three distinct provisions is however not conducive to a coherent legislative approach:

- (a) Clauses (1) to (4) of article 191 PC focus on specific and typical money laundering techniques mainly through the financial market (e.g. the disguising and concealing concepts of the Vienna and Palermo Conventions). The addition of clause (5) goes beyond covering money laundering through financial institutions, as the activities listed in clauses (1) to (4) suggest, and gives the provision a broader impact in respect of the behavioural aspects by expanding it beyond financial sector activities. The added wording is very general, but it cannot be read outside the logic and the context of the article, which is clearly targeting money laundering activity beyond the primary phase of “receiving”.
- (b) The simultaneous addition of identical wording in article 312 PC is supposed to catch those aspects that are not covered by article 191 PC. As with article 191 PC, the added wording must, however, be understood in line with the preceding text enumerating specific actions (harbouring, transfer, purchase or selling) and as such it does not alter the general tenor of article 312 PC as targeting primarily “receiving” or “handling” activity in the first ML phase. The difference between (the seriousness of) the criminal behaviour covered by the respective provisions is emphasised by the maintaining of two separate articles and is also reflected in the (lesser) penalty of article 312 PC. Moreover, the Chinese authorities themselves confirm the character of article 312 PC as a “receiving” offence: article 312 PC is a predicate offence to money laundering that covers the designated category of “illicit trafficking in stolen goods”.

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- (b) Assisting the transfer of property into cash, financial instruments, or negotiable securities;
 - (c) Assisting the transfer of capital by means of transfer accounts or any other means of settlement;
 - (d) Assisting the remit of funds to overseas;
 - (e) Disguising or concealing the source or nature of any crime-related income or the proceeds generated therefrom by any other means.
 - (f) Where an entity commits the crime as mentioned in the preceding paragraph, it shall be fined, and any of the persons who are directly in charge and the other persons who are directly responsible for the crime shall be sentenced to fixed-term imprisonment of no more than five years or criminal detention; if the circumstances are serious, any of them shall be sentenced to fixed-term imprisonment of no less than five years but no more than ten years.”

(c) There is a clear overlap between article 191 and article 349 PC as far as drug proceeds are concerned¹⁶. Objectively there does not seem to be a difference between the mental/moral (intentional) and behavioural element of both offences, both having the purpose to conceal drug proceeds, whereas the differentiation between “concealing or disguising the origin and nature” (in article 191 PC) and “covering up” (in article 349 PC) is too subtle to make any difference in practice.

82. In summary, it is not evident that the three offences are indeed fully complementary and that all possible gaps are covered by article 312 PC. On the other hand they do overlap quite substantially in certain aspects, such as for instance in their coverage of drug proceeds.

83. As for the subjective (moral) aspects, the Chinese judicial authorities stated that there are no fundamental legal principles opposing the criminalisation of the possession, acquisition and use of illegal proceeds based solely on the knowledge of its criminal origin (Beijing vs. Huang Quanhua case, 2007 CXCZ no. 1558). Article 191 PC explicitly refers to the general purpose of concealing and disguising as an essential element of the offence and so does article 349 PC in using wording such as “covering up”. In article 312 PC there is an explicit reference to a concealing purpose in the recent addition expanding the coverage of this provision, beside criminalising some acts of knowingly possessing (“harbours”, which in itself has a connotation of concealing), acquiring (“purchases”) and using (“transfers”, “sells”)¹⁷. The Chinese authorities stated that the feature common to all three provisions was that they cover all acts that have the intention and effect to obstruct justice, thus inferring the notion of avoidance of the legal consequences of criminal actions as referred to in the relevant Conventions.

Definition of proceeds

84. There is no definition of the term “proceeds” in the Penal Code. Articles 191 and 312 PC refer to proceeds (or “income”) and the “gains derived there from”, article 349 PC to “pecuniary or other gains”. According to the Chinese authorities this terminology is to be understood to encompass all direct and indirect proceeds, including substitute assets and investment yields, as well as related titles and interests, as long as there is a causal link to the profit generating offence, but no substantive documentation was provided¹⁸. The Chinese authorities advise that it has been consistently interpreted as such by legal practice and jurisprudence. The wording used in the relevant articles may be considered broad enough so as to cover all forms of proceeds, but there is certainly an element of confusion resulting from the fact that a different formulation is used throughout all three offences, which gives the impression that the extent of coverage is not the same.¹⁹ However, confirmation of the broad scope of the “proceeds” concept was found in one of the recorded ML cases (*Li Yushu, 2002*) where the court confiscated the proceeds from the sale of two cars (which were themselves the proceeds of a bribery offence).

85. There is no evidential requirement in the Penal Code, nor in the Criminal Procedure Code (CPC), that a conviction for the predicate offence is needed to prove that the property is the proceeds of crime. This has recently been confirmed by the article 191 PC jurisprudence²⁰, and has been a

¹⁶ See footnote 10.

¹⁷ The examiners were confronted with different versions of the translation of Penal Code provisions in English. The citations in the report appeared to be the closest to the original text

¹⁸ The Prosecutor General issued binding instructions on 27 March 2006 “on the Seizure and Freezing of Money and Property by the People’s Procuratorates”, that however make no reference to indirect proceeds in the form of converted and transformed criminal assets.

¹⁹ “the income or the proceeds that are generated therefrom” (art. 312); “pecuniary and other gains” (art. 349 PC); “any proceeds as well as the proceeds generated therefrom,” (art. 191 PC).

²⁰ In none of the three convictions for money laundering on the basis of article 191 PC, does the court require proof of a conviction concerning the predicate criminality.

constant position in article 312 PC cases²¹. The burden of proof of the predicate offence depends on what basis the prosecution is initiated: the all-crimes coverage of article 312 PC does not require the proof of a precise and identified predicate criminality, whereas article 191 PC (which follows a list approach) requires establishing the link to one of the types of listed offences (without requiring proof that the proceeds are connected to a specific predicate offence).

Predicate offences

86. China has adopted a combined list and all-crimes approach to define the scope of predicate offences. Article 312 PC takes an all-crimes approach. Article 349 PC specifically targets drug-related crimes as predicate criminality. Article 191 PC applies a list approach that defines seven categories of predicate offences, including drug offences.

87. In addition to defining drug-related crime as a predicate offence for money laundering, article 191 PC sets out six additional categories of predicate offences: terrorism, organised crime, smuggling, embezzlement and bribery, financial fraud and disrupting the order of financial administration. Through the seven categories of predicate offences, only half of the designated FATF categories of predicate offences are covered. This gap is, however, covered by article 312 which takes an “all crimes” approach to predicate offences.

88. The activities that are criminalised by article 312 PC (i.e. harbouring, transferring, purchasing, selling, or disguising or concealing) apply to all (profit generating) offences of the Chinese criminal law. There is however no full correspondence with the 20 categories of designated FATF categories of predicate offences, as the TF offence of article 120bis PC does not cover an adequate range of activity (see comments in sect. 2.2). Consequently, the terrorist financing offence also does not fully meet the required standards as a predicate to money laundering. The chart in Annex 5 sets out in detail how the FATF designated categories of offences are criminalised in China, including the range of offences in each category and whether they are predicate offences for 191, 312 and/or 349 PC.

89. Predicate offences for money laundering extend to conduct that occurred outside the territory of China. The text of the relevant provisions does not imply any limitation in that respect, nor does any principle in the Chinese legal tradition oppose this interpretation. Moreover, there is confirming jurisprudence on article 312 PC and recently on article 191 PC (see the *Quanzhou Cia Jianli* case, where the predicate drug offence was committed outside the territory of China). According to the Chinese judicial authorities dual criminality in respect of the predicate behaviour is a prerequisite however. Moreover, China relies on the general jurisdictional provisions of its Penal Code in such circumstances. This may, however, raise an issue in that China’s jurisdiction extends only to the conduct of its citizens, regardless of where in the world that conduct takes place. Consequently, China would be unable to take jurisdiction over a foreigner who is located outside of China and who committed a predicate offence outside of China, but laundered his proceeds *himself* within China (see also below in relation to self laundering by foreigners).

Self laundering

90. All three money laundering offences apply to third parties, not to the perpetrator of the predicate offence. The three articles contain phrasing that describes aiding or supporting behaviour, such as “providing”, “assisting”, “helping to sell”. Chinese judicial and legislative authorities always hold the view that self-laundering is a natural continuity of the predicate behaviour or that the predicate offence is a *conditio sine qua non* for money laundering as far as self launderers are concerned. As such the predicate offence is used to convict the whole process of criminal activities, and the continuous behaviour (laundering) is absorbed by the predicate offence. They also state that in Chinese legal practice, the court will use the predicate offence to convict the self-launderers and that the sanctions

²¹ Only receiving offence cases.

pursued by the criminal offences are sufficient to punish the offender and achieve the dissuasive objective. Reference is also made to jurisprudence and legislative texts that view the forms of criminal activity resulting from primary (predicate) offences as a continuation of that initial criminal behaviour (such as stealing credit cards and using them later with a forged signature, or purchasing counterfeiting money and subsequently using it).

91. However, the assessment team is not satisfied that there is indeed a fundamental principle in the Chinese legal tradition that prohibits the criminalisation of laundering behaviour by the predicate offender. Certainly the theory of crime absorption may apply to the act of “acquisition” and “possession”, as this comes automatically with the commission of the predicate offence and does not imply a new act by its author. Also, the principle of the *non bis in idem* or double jeopardy prohibition, which seems to be the *ratio* of the Chinese legal position on the issue of self-laundering, is such a fundamental human rights principle to be universally accepted in any law system. However, the self-laundering exclusion based on this reasoning negates the autonomous nature of money laundering. It is the result of the application of the classic civil law *adagium* that “the thief cannot be his own receiver” to an offence such as money laundering, that is substantially different from the receiving offence, both in nature and in effect. Whereas the receiving offence reflects a simple static and instantaneous act, money laundering is a dynamic phenomenon that genuinely implies different stages or techniques and spreads out in time. In respect of the predicate offender it infers renewed actions separate from the criminality originating the proceeds. So applying the *non bis in idem* rule on self-laundering is based on a misinterpretation of this principle and ignores the specificity of the money laundering offence.

92. The thesis of the legal principle of the absorption of the continuing criminal activity by the primary act, as being prohibitive to the criminalisation of self-laundering, is equally not convincing. It is certainly accepted that related criminal activity can be seen as being the expression and execution of one and the same criminal intent, and consequently punished as one sole offence, but this starts from the assumption that the court has jurisdiction over both offences. If on the other hand the court would only hold jurisdiction over the derivative criminal activity alone (such as the use of forged money or stolen credit cards) then nothing prevents the judge from convicting for this offence alone. There is no reason why he would be prohibited to rule likewise on self-laundering. So basically it is a question of jurisdiction: if the court holds jurisdiction over both the predicate offence and the ensuing laundering, then it can be seen and judged as a whole. If however this is not the case (particularly when the predicate offender is a foreigner who committed the offence outside the PRC jurisdiction and subsequently launders the proceeds in the PRC), then the theory of absorption is not applicable and does not stand in the way of a conviction of the predicate offender.

93. The practice to prosecute only for the predicate offence in case of self-laundering is an option that does not necessarily provide a satisfactory solution. If the predicate criminality is performed by a foreigner on foreign soil, then the Chinese courts may find themselves without jurisdiction over the predicate offence when it is argued that this has been committed by the foreign money launderer himself. This would then mean that such ML activity in China remains untouchable for law enforcement, which obviously seriously impedes the effectiveness of the AML effort. This is particularly of concern in the present growing economy with its enormous influx of investments from foreign sources.

Ancillary offences

94. Ancillary offences to all offences, including money laundering, are specified in the general section of the Penal Code. The Penal Code criminalises preparation (article 22), attempt (article 23), discontinuation (article 24), joint offenders (article 25), principle crime leader, ring leader and criminal organisation (article 26), accomplice (article 27), coercion (article 28) and instigation (article 29). Art. 22 and 25 PC combined cover the “association or conspiracy” to commit a crime. “Counselling” is covered by respectively article 25, 27 and article 295 PC (giving instructions how to commit a crime).

Additional elements

95. In the opinion of the judicial authorities, predicate activity committed outside the territory of China, which is not criminalised in the other country, cannot serve as the basis for a money laundering prosecution in China, even if the predicate would constitute an offence there. There is, however, no jurisprudence on this issue.

Recommendation 2 (Criminalisation of money laundering)

Scope of liability

96. All three relevant offences apply to any natural person who at least knowingly launders proceeds. The text of the provisions is quite clear in this respect. Money laundering is not an offence of negligence, but of knowledge and intent. Article 191 PC also expressly applies to legal persons (article 30 PC). This is not the case for articles 312 and 349 PC although there are no fundamental legal principles that are prohibitive, as article 191 PC demonstrates. However, natural persons directly responsible for or representing the legal persons can be criminally liable. Legal persons incur administrative liability which may lead to withdrawal of their licence or confiscation of their assets.

97. The categories of evidence are reflected in article 42 CPC: material and documentary evidence, witness testimony, victim statements, statements and exculpations of criminal suspects or defendants, expert conclusions, records of inquests and examinations, and audiovisual materials. Proof should be given of “the guilt or innocence of the defendant and the intention and purpose of his acts” (Interpretation by the SPC concerning the implementation of the CPC). Inference from objective factual circumstances and behaviour to prove the intentional or moral element is not only perfectly acceptable, but also standard practice in the judicial proceedings.

98. Criminal proceedings do not preclude the possibility that civil and administrative liability is applied against the same defendant (article 110 General Principles of the Civil Law; articles 36-37 PC; article 77 CPC). Natural or legal persons who bear civil liability will also bear administrative responsibility if necessary (article 110 General Principles of the Civil Law). Even if a natural or legal person escapes criminal sanctions because of attenuating circumstances, he/she can still be reprimanded or ordered to make a statement of repentance, offer an apology or pay compensation for the damages, or be subjected to administrative sanctions by the competent authority (article 37 PC).

Sanctions for money laundering

99. Natural persons convicted of money laundering pursuant to article 191 PC are punishable by up to 5 years imprisonment or criminal detention, a fine of between 5 to 20 percent of the amount laundered and confiscation of the laundered proceeds and gains. If the circumstances are serious, the penalty goes from 5 to 10 years imprisonment, beside fines and confiscation. Legal persons are punishable by a fine. On top of that, the natural persons who are directly in charge of the legal person and natural persons who are directly responsible for the criminal activity of the legal person can also be held liable and subjected to the penalties applicable to natural persons.

100. Natural persons convicted of handling drug money pursuant to article 349 PC are punishable by up to 3 years imprisonment, criminal detention or public surveillance. If the circumstances are serious, the penalty is between 3 to 10 years.

101. Natural persons convicted of the article 312 PC offence are punishable by up to 3 years, criminal detention or public surveillance and/or a fine. If the circumstances are serious, the penalty is between 3 to 7 years, in addition to a fine.

102. The level of penalties is comparable with that for other economic crimes. There is an increased deterrent effect by the higher penalties for “serious” money laundering, but there is no formal

definition of what is meant by “serious circumstances”: basically the amount of money or damage involved and specific behaviour are determining factors. The amount of the fine is also not defined but depends on the (serious) circumstances of the offence (article 52 PC). It is left to the discretion of the judge, and as such there is no limit on the fine or guarantee for a more or less uniform application of the concept of “serious circumstances”. The large latitude the penal legislation leaves to the judge in defining this notion and also in determining the fine was explained by the substantial differences between the various Chinese regions in the economical circumstances and living standard which necessitates a flexible approach to ensure relative equal treatment. Although justified, this approach needs to be closely monitored by the higher judicial authorities as to not allow for aberrant rulings and punishments.

103. If a victim has suffered economic losses as a result of a crime, the criminal shall also be sentenced to compensate for the economic losses in the light of the circumstances, before paying the criminal fine (article 36 and 64 PC). This may be on demand of the victim who has suffered economic losses (article 77 CPC).

Statistics

104. In relation to money laundering investigations and prosecutions, the Chinese authorities collect and maintain annual statistics concerning the number of convictions that have been obtained in relation to art.191, 312 and 349 PC. Additionally, detailed information was available, concerning the criminal sanctions that were applied to persons convicted of these offences (see the chart below). Overall, from 2002 to 2006, 136 prosecutions related to criminal proceeds were filed, resulting in 151 persons being convicted. Of these, 17 were sentenced to more than 5 years imprisonment. Detailed statistics concerning article 312 are set out in Annex 7 of this report. However, it should be noted that the statistics for article 312 relate to cases of receiving stolen goods, not money laundering.

MONEY LAUNDERING INVESTIGATIONS, PROSECUTIONS AND CONVICTIONS							
Offence	Type of action taken	2002	2003	2004	2005	2006	TOTAL
Article 191 Money laundering	Number of cases investigated	0	5	4	3	11	23
	Number of cases filed for prosecution	0	0	1	1	1	3
	Number of completed prosecutions	0	0	1	1	1	3
	Number of persons convicted	0	0	1	2	1	4
	Number of persons acquitted	0	0	0	0	0	0
	Number of persons sentence to more than 5 years imprisonment	0	0	0	0	0	0
	Number of persons sentence to less than 5 years imprisonment	0	0	1	2	1	4
	Number of persons fined (in addition to being made subject to other punishments)	0	0	1	2	1	4
	Number of confiscations	0	0	0	0	0	0
	Number of persons punished by fines only	0	0	0	0	0	0
Article 349 Harbouring, transferring or covering up narcotic drugs or their	Number of cases investigated	0	0	0	0	0	0
	Number of cases filed for prosecution	29	23	28	23	29	132
	Number of completed prosecutions	25	25	29	23	28	130
	Number of persons convicted	24	33	34	29	26	146
	Number of persons acquitted	0	0	0	0	0	0
Number of persons sentence to more than 5 years imprisonment	4	3	4	4	2	17	

pecuniary and other gains	Number of persons sentence to less than 5 years imprisonment	12	21	26	18	14	91
	Number of persons fined (in addition to being made subject to other punishments)	11	7	15	14	7	54
	Number of confiscations	1	0	0	0	0	1
	Number of persons punished by fines only	0	0	0	0	0	0

Effectiveness of the money laundering offences

105. As of October 2006, three money laundering cases involving four defendants ended in a conviction based on article 191 PC. The following chart indicates the penalties that were imposed in each case.

CRIMINAL PENALTIES IMPOSED FOR MONEY LAUNDERING (ARTICLE 191)			
Role of the defendant in the money laundering offence / Amount of proceeds involved	Penalty imposed following conviction		
	Term of imprisonment	Fine	Confiscation
Accomplice (HKD 5.2 million in proceeds)	1.5 years	RMB 275,000	Car
Principal offender (RMB 9.5 million in proceeds)	3 years	RMB 330,000	
Principal offender (RMB 9.5 million in proceeds)	2.5 years	RMB 175,000	
Principal offender (RMB 140 million in proceeds)	5 years	RMB 6 million	RMB 1 million

106. Additionally, between 2002 and 2006, 130 prosecutions were completed and 146 people convicted on the basis of article 349 PC. However, these figures do not make a differentiation between cases related to harbouring drug offenders or drugs and those concerning harbouring drug proceeds.²²

107. The effectiveness of the AML system, in terms of prosecutions and convictions for money laundering, is low, particularly in the context of the size of the country and the level of money laundering risk. Although article 191 PC already covered 4 categories of predicate offences since 1997 (drugs, organised crime, smuggling and terrorism), only 3 genuine money laundering cases (involving 4 offenders) have yet been brought before the court. Prosecutions in relation to article 312 PC were relatively high between 2002 and 2005, but are not really relevant in the present context since, at that time, it was exclusively a receiving offence. There seems to be a reluctance to go after money laundering as a stand-alone offence, except as an offshoot of a known predicate criminal activity. It is typical that, with regard to each of the four money laundering convictions, the specific predicate offence was identified. On the other hand, both the judges and the prosecutors the assessment team met with were of the opinion that - contrary to the limited provisions of article 191 PC and article 349 PC that require identification of the originating criminality - there was no need for the all-crimes based article 312 PC to specify the predicate offence as the proof of an illegal origin would suffice. The absence of criminalisation of self-laundering constitutes also a restraining factor for an effective approach.

²² Between 2002 and 2005, 20,315 cases were prosecuted for violations of article 312 PC; however, these figures need to be put into the right perspective. Before the 29 June 2006 amendment that extended the scope of article 312 PC this provision was basically addressing limited acts of “receiving” and “handling”.

2.1.2 Recommendations and Comments

108. Addressing money laundering activity in three different, not fully complimentary but partially overlapping, provisions is questionable. It is the result of an *ad hoc* approach that leads to an incoherent and confusing picture, creating uncertainties as to the scope and application of these provisions. The use of terminology such as “disguising and concealing by (any) other means” may well be intended to close all gaps, but is not an example of precise legistics and still leaves questions as to what specific behaviour is covered here. Not all acts of knowingly acquiring and using are formally covered, although article 312 PC may allow for a broad interpretation. Furthermore, if it was the intention to create a specific money laundering offence with article 191 PC, it is unfortunate that article 312 PC was not absorbed to provide for a unique all-crimes laundering offence. As it is, article 191 PC does not comply with the mandatory international standard in that one designated category of predicate offence (“terrorism, including terrorist financing”) is not adequately covered because the collection of terrorist funds is not criminalised. The wording of article 312 PC with its all-crimes coverage is reflecting possession (“harbouring”) and some acts of acquisition (“purchase”) and use (“transfer and selling”), which was basically a receiving or handling offence before the typical money laundering elements of concealing and disguising were added. As such it is in its wording and scope not fully in line with the corresponding notions defined in the Vienna and Palermo Convention. Jurisprudence may yet provide an answer, but it is preferable and recommended to revise the three relevant provisions to create one transparent and well-defined money laundering offence.

109. The all-crimes approach of article 312 PC is to be commended. Full coverage in China’s criminal law of the designated categories of predicate offences, including all terrorism financing activities, should however be ensured.

110. As no fundamental principle in the Chinese legal tradition opposes the criminalisation of self-laundering, it should be expressly provided that money laundering activity (beyond acquisition and possession) by the predicate offender is also an offence. This is not only an issue of principle, but is of particular importance in terms of efficiency and to cope with laundering activity in China related to foreign predicate offences.

111. Corporate criminal liability should extend to all money laundering activity, including the activity covered by the article 312 and 349 PC offences.

112. The effectiveness of the criminal AML effort should be enhanced by raising awareness with the judicial authorities of the importance to recover the criminal proceeds and the opportunities that a sharper focus on money laundering creates in this respect. Jurisprudence on the proof of the predicate offence should be created by bringing more stand-alone money laundering cases before the court.

2.1.3 Compliance with Recommendations 1 & 2

	Rating	Summary of factors underlying rating
R.1	PC	<ul style="list-style-type: none"> • The money laundering provisions are not effectively implemented, as witnessed by the low number of convictions for money laundering. • Self-laundering is not criminalised, although no fundamental principle in Chinese law is prohibitive. • The relevant offences, taken together or separately, do not fully cover the sole and knowing acquisition and use. • One designated category of predicate offence (“terrorism, including terrorist financing”) is not adequately covered for the reasons set out in section 2.2 of this report. •

R.2	PC	<ul style="list-style-type: none"> • The money laundering provisions are not effectively implemented, as witnessed by the low number of convictions for money laundering. • No corporate criminal liability is provided for the offences covered by article 312 and 349 PC. •
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2.2 Criminalisation of Terrorist Financing (SR.II)

2.2.1 Description and Analysis

Special Recommendation II (Criminalisation of terrorist financing)

113. Article 120bis PC (which was introduced on 29 December 2001) criminalises terrorism financing in the sense that “any person who financially supports a terrorist organisation or an individual who commits terrorist activities” is guilty of a crime.²³

114. Although not expressly stated as such, given its neutral formulation article 120bis PC constitutes a generally wilful and intentional offence. The suspect must know that the individual or organisation is of a terrorist nature or purpose and he must have the intention to financially support them.

115. “Organisation” refers to the definition of a criminal group in article 26 PC as “a relatively stable criminal organisation formed by three or more persons for the purpose of committing crimes jointly”. The formation and leadership of, or participation in, a terrorist organisation is penalised according to article 120 PC.

116. The term “financially supports” is unspecified and should, according to the Chinese authorities, consequently be understood as unrestricted, covering any kind of funds or method of funding activity that has the objective effect of financing the individual or organisation. Such supply is not limited to the financing of specific (terrorist) activities, but should be understood to cover any form of support of the individual or group in general.

117. As a guidance for the judiciary on the substance of the “funds” aspect, reference is also made to article 6 of the Rules for the Implementation of the State Security Law of China, to include:

- (a) “(1) providing funds, premises and materials for domestic organisations and individuals engaged in activities jeopardising the state security; and (2) providing domestic organisations or individuals with funds, premises or materials used for activities jeopardising state security”; and
- (b) the relevant provisions of the UN International Convention for the Suppression of Terrorist Financing, 1999 (the TF Convention), it having been adopted by the NPC.

118. The Chinese authorities referred to the “Interpretation by the Supreme People’s Court regarding some issues in the specific application of law in the trial of theft cases” (1998), with a view to providing further clarification on the how the term “funds” is interpreted in Chinese law. However, this Interpretation dealt only with the definition of “public or private property”, and did not specifically address the definition of “funds”.

119. Article 120bis PC makes no reference to the activity of collecting funds for terrorist purposes as an autonomous criminal offence. The unspecific formulation also raises the question as to whether the assets need to be used or be intended to be used for terrorist purposes, excluding for instance the use

²³ There are also ongoing consultations on a draft anti-terrorism law, which includes provisions specifically relating to the implementation of UN Security Council Resolutions 1267 and 1373.

for livelihood or luxury expenses. It was stated that in the Chinese language verbs do not have tenses, which means that “financially support” covers all stages of the behaviour, such as “going to financially support”, “is financially supporting”, “have financially supported”, etc.

120. The wording “who commits...” is said to imply the intent and conspiracy to commit, in the sense that what counts is the nature and purpose of the entity, not the actual perpetration of certain activities. There is a linguistic nuance here (which is possibly lost in the translation), but terminology such as “that commits” or “committing” can just as easily be interpreted as actually effectuating the criminal actions. Again there is no jurisprudence or equivalent ruling to support either viewpoint. On the other hand it was argued that “commit terrorist activities” also covers ancillary behaviour, such as the planning and preparation of such acts.

121. There is no definition of the term “terrorist activities” for the purpose of article 120bis PC. The Chinese authorities again make reference to the common practice of the domestic judicial authorities to take guidance from the relevant provisions of the TF Convention. They also refer to the Shanghai Convention on Combating Terrorism, Separatism and Extremism, initiated and adhered to by China, that defines “terrorist activities” to cover the acts constituting an offence within the scope of the TF Convention and all of the treaties listed in the annex of the TF Convention.²⁴ This being said however, the Penal Code itself makes no reference at all to the generic definition of “terrorist acts” as formulated in article 2(b) of the TF Convention, nor to the offences listed in the annex as referred to in article 2(a) of this Convention.

Ancillary offences

122. As with the money laundering offence, the ancillary offences to terrorist financing are specified in the general section of the Penal Code that applies to all offences of the Code. Attempt is covered by article 23 PC. As for the other ancillary offences, the general section of the Penal Code criminalises preparation (article 22), discontinuation (article 24), joint offenders (article 25), principle crime leader, ring leader and criminal group (article 26), accomplice (article 27), coercion (article 28) and instigation (article 29). Art. 22 and 25 PC combined cover the “association or conspiracy” to commit a crime. “Counselling” is covered by respectively article 25, 27 and article 295 PC (giving instructions how to commit a crime).

Predicate offences for money laundering

123. The all-crimes coverage of article 312 PC obviously includes the article 120bis PC terrorism financing as a predicate. Terrorist financing is argued also to be a predicate offence to the article 191 PC money laundering offence, where it expressly refers to “crimes of terrorism”. It is indeed relevant to note that this provision targets broad categories of offences as predicate criminality, not specific offences. The arguments supporting the assertion that “crimes of terrorism” comprise all offences having a relation to terrorism, are valid or at least not contradicted by any objective element. However, the deficiencies of article 120bis PC in respect of the criminal activities covered (see section 2.1 and 2.2.2 of this report) also affect and limit the utility of this provision as a predicate offence.

Scope of liability

124. The location or position of the suspect in relation to the country of the terrorist (organisation) or terrorist activity is totally irrelevant, nor does it matter if the acts are intended or committed against China or another country, as long as the acts of financing have occurred under China’s jurisdiction. Reference is also made to article 9 PC on the universal jurisdiction of China based on international conventions that China has acceded to.

²⁴ No English translation was made available to the assessment team.

125. As with the money laundering offences, the moral or intentional element is inferred from objective factual circumstances as a standard practice, beside on the basis of other evidence pursuant article 42 CPC.

126. Article 120bis PC expressly provides for corporate criminal liability when the offence is committed under the umbrella of or through a legal person. This does not exclude the personal criminal liability of agents acting on behalf of or within the legal entity. “Persons ... directly in charge” and “other persons ... directly responsible for the crime” incur the same penalty as the individual offender. Both liabilities coexist.

127. Criminal proceedings do not preclude the possibility that civil and administrative liability is established against the same defendant (article 110 General Principles of the Civil Law; articles 36-37 PC; article 77 CPC). Natural or legal persons who bear civil liability will also bear administrative responsibility if necessary (article 110 General Principles of the Civil Law). Even if a natural or legal person escapes criminal sanctions because of attenuating circumstances, he/she can still be reprimanded or ordered to make a statement of repentance, offer an apology or pay compensation for the damages, or be subjected to administrative sanctions by the competent authority (article 37 PC).

Sanctions

128. Natural persons convicted of an offence pursuant to article 120bis PC, whether acting as an individual or through a legal person, are punished by imprisonment of no more than 5 years, criminal detention, public surveillance, or deprivation of political rights, beside the mandatory imposition of a fine. In serious circumstances, the offence is punishable by a minimum term of imprisonment of 5 years, and a fine or confiscation of property (see below for the confiscation aspect). According to article 45 PC, the maximum term for imprisonment is 15 years. Legal entities (article 30 PC) are punishable by a fine.

Statistics and effectiveness

129. At the time of the on-site visit there had been no terrorist financing investigations, prosecutions or convictions.²⁵

2.2.2 Recommendations and Comments

130. With the intent to cover their obligations resulting from the TF Convention, the Chinese legislator has drafted a brief and sweepingly formulated provision on what is in essence a complex offence. Article 120bis PC consequently lacks specification and needs further refining:

- (a) Art. 120bis PC does not cover the sole collection of funds for terrorist purposes, where it is irrelevant if the funds have been handed over to the terrorist (organisation) or not, as long as the intention is there. The linguistic argument of the meaning of the verb also including planned activity, and consequently the “collection” being an expression of the “financially support” activity, cannot be accepted as being in conformity with the TF Convention, that requires the specific criminalisation of the collection of the financial means as a separate or autonomous offence, and not as some form or part of the financing activity.²⁶

²⁵ Between 2002 and 2006, 28 prosecutions were initiated, and 47 people were convicted, for organising, leading or participating in terrorist organisations pursuant to article 120 (see a detailed chart in Annex 7 which provides statistics on the number of completed prosecutions).

²⁶ Without entering into a linguistic discussion, it is noteworthy that the Chinese character for the verb “collect” is a different from the one for “financially support”. (see the Statement of Draft on Amendment of the Criminal Law of the People’s Republic of China (III) by the National People’s Congress).

- (b) There is no definition or listing of what should be considered to constitute “terrorist activities”, neither in a generic formulation, nor by way of a list approach. This also reflects on what is to be understood as “terrorist” or “terrorist organisation” that perform such activities or intend to do so. The argument that judges should take guidance from the TF Convention again is not satisfactory, nor is the reference to common practices, as this is not a formal and compulsory rule in the absence of transposition into national legislation.
- (c) There is an interpretation issue on the exact understanding of the reference to the commission of terrorist activities (“...organisation or individual who commits ...”), if that requires the individual or organisation actually perpetrating or having committed such criminal actions before they are legally considered to be a terrorist or terrorist group. There is some value in the argument that “terrorist activities” may also encompass the planning or preparation of such activity, but again this is not unequivocally reflected in the language of article 120bis. A recent interpretation of the NPC Legal Affairs Committee, however, clarifies that the formulation also refers to intended activity²⁷.
- (d) The meaning of the “financially supports” formulation is indeed broad enough to also cover the support of the individual or group in general, including personal and other expenses, so the financing activity is not necessarily linked to the use of the funds for the perpetration of actual terrorist acts.
- (e) The Penal Code does not specify what is to be understood as funds that are used to give financial support. There are references to texts scattered over different instruments, such as article 6 of the Rules for the Implementation of the State Security Law of China and the Supreme Court interpretation of “property”, but either they address specific (ad hoc) situations that are not necessarily applicable in the terrorism financing context. In the absence of objective grounds justifying such a conclusion, the assessment team is not satisfied that all forms of funds are covered as required by the TF Convention. Also, ratification of a Convention implies the obligation to transpose appropriate provisions in national legislation for implementation. On the other hand the scope of the term “financially supports” does go beyond the simple supply of money, as it is indeed broad enough to include other forms of pecuniary or economical support. In the absence of case law or judicial interpretation, the uncertainty will need to be solved by a clear text in the law.

131. Generally there seems to be an over-reliance on the discretion of the judge to give substance to essential concepts such as financing/funding and terrorist activities. Criminal law needs to be precise and concrete on essential definitions and on the constitutive elements of an offence. Its implementation cannot rely on common practices or guidance that have no force of law. As a rule, such fundamentals should be determined by the law itself, and all the more this approach risks leading to divergent interpretations and rulings, jeopardising the requirements of basic legal security.

132. When terrorist financing investigations, prosecutions or convictions are obtained, the Chinese authorities should ensure that related statistics are kept.

2.2.3 Compliance with Special Recommendation II

	Rating	Summary of factors underlying rating
SR.II	PC	<ul style="list-style-type: none"> • The sole collection of funds in a terrorist financing context is not criminalised (i.e. where the funds have not been handed over to the terrorist or terrorist organisation), also affecting the utility of article 120bis PC as a predicate offence.

²⁷ “...or is going to commit terrorist activities” Interpretation of the Criminal Law of the People’s Republic of China, published in December 2006.

		<ul style="list-style-type: none"> • There is no definition or list of what should be considered to be “terrorist activities”. • The assessment team is not satisfied that terrorist financing offence extends to a sufficiently broad and clear definition of “funds” as that term is defined in the TF Convention.
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2.3 Confiscation, freezing and seizing of proceeds of crime (R.3)

2.3.1 Description and Analysis

Recommendation 3 (Freezing, seizing and confiscation)

133. There are several provisions concerning criminal asset recovery in the Penal Code (confiscation), the Criminal Procedure Code (seizure and management) and the AML Law (freezing). Criminal confiscation is conviction based and mandatory. Civil *in rem* confiscation is unknown in China, whose legal system leans toward the civil law tradition. Typical is, however, the administrative confiscation regime that gives large powers of confiscation to the administrative authorities.

134. As the Ministry of Finance statistics show, confiscation is quite actively pursued overall. The figures that were provided however only give a general view that does not allow differentiation according to the type of confiscation, the different sources or the criminality involved. Seizure of crime related assets is a standard practice for the law enforcement authorities, who routinely try to trace and identify property that may be subject to confiscation.

135. There is a fairly extensive administrative enforcement system that is mostly used in cases where the conduct, though unlawful, is not considered serious enough to warrant the application of criminal procedures. Most agencies with administrative enforcement powers can also seize and confiscate assets related to violations within their area of competence. For example, smuggled goods seized by the General Customs Administration (GCA) may be confiscated administratively as well as criminally (article 6 Customs Law). The tax authorities are also authorised to freeze, seize and confiscate property in the exercise of their functions and adopt compulsory tax collection or preservation measures (articles 37-38 and 54 Law on the Administration of Tax Collection).

136. Under the Criminal Procedure Code (article 118), seized property that is found to be irrelevant to proving the crime must be returned to the victim as soon as possible. Property that is confiscated is usually transferred to an auction house for disposition. The GCA and other law enforcement agencies are required to give 50% of the proceeds from the sale of confiscated assets to the local treasury, and 50% to the central treasury.

Confiscation

General

137. Article 64 PC generally imposes the mandatory confiscation (“recovery”) of:

- (a) all illegally obtained assets (“all money and property”);
- (b) “contrabands”; and
- (c) the items that the criminal used in the commission of the offence.

138. The translation of the Chinese character into “contraband” calls for some caution as to its correct interpretation. It should apparently be understood as “items prohibited or restricted by law” and as such leans toward the civil law concept of the object (*corpus*) of the offence.

Money laundering

139. Article 191 PC repeats (and according to the Chinese authorities emphasises) the confiscation obligation using somewhat different terminology, namely “proceeds and gains”. Article 312 PC and article 349 PC do not contain such a clause and consequently fall under the general regime of article 64 PC. Article 312 PC however uses wording similar to article 191 PC where it defines “proceeds and gains derived there from” as the object of the offence. Adding the word “gains” in article 191 and 312 PC could be interpreted as implying a broader coverage than article 64 PC. This again shows the importance of using the same terminology when identical situations are targeted.

140. In summary, both provisions combined (article 64 and 191 PC) cover the (mandatory) confiscation of:

- (a) the illegal proceeds;
- (b) any property or interest derived from the illegal proceeds;
- (c) the laundered assets (*corpus*); and
- (d) the (intended) instrumentalities.

Terrorism financing

141. On top of the article 64 PC regime, article 120bis PC provides for a specific measure of confiscation, namely “confiscation of property”. This is not a repetition, but refers to article 59 PC that provides for the possibility to confiscate all or part of the property of the criminal as an alternative punishment instead of the imposition of a fine. This measure is totally unrelated to any concept of proceeds or instrumentalities.

142. As for the confiscation of “clean” funds intended to finance terrorism, the Chinese authorities were of the opinion that these values were to be understood as items used in the commission of a crime. This is debatable: “items used” refer to instrumentalities, a term in the civil law tradition that normally covers objects facilitating or providing the means of committing an offence. Actually, the funds constitute the object of the offence itself, and may arguably then fall under the notion of “contraband”.

Corresponding value

143. The Penal Code does not contain any provision specifically covering the confiscation of property of corresponding/equivalent value. It was stated that the same effect could be achieved by the judge using the possibility of article 59 PC to confiscate all or part of the criminal’s (untainted) property (“confiscation of property”). Reference was also made to article 52 PC, imposing a (unlimited) fine commensurate to the circumstances of the crime as a possibility to obtain a similar effect. Even if for the sake of argument these provisions would be counted as a form of equivalent value forfeiture—*quod non*— article 59 PC is only a feature of the terrorism financing offence of article 120bis PC, while none of the money laundering offences contains such language or reference. Furthermore there does not seem to be a general rule as when to apply article 59 PC, which is totally left to the discretion of the judge anyway, As for article 52 PC, the imposition of a fine is no valid alternative for a measure that should be incorporated in and determined by a system of (mandatory) recovery of criminal proceeds in all its forms.

Proceeds

144. According to the Chinese authorities, article 64 PC covers all direct and indirect proceeds because of its general wording and the use of the word “all”. Somewhat in contradiction to this assertion it was also stated that confiscation of property derived indirectly from the proceeds of crime is left to the

discretion of the judicial authorities. Moreover, the article 191 PC money laundering offence expressly provides for the confiscation of investment yields (“gains”) of the illegally acquired assets, which is not the case with articles 312 and 349 PC. Art. 349 PC even uses different terminology (“pecuniary and other gains”). All in all, there is an issue with the exact coverage of “proceeds” in respect of confiscation that is the same as with the money laundering offence (see above).

Freezing and seizing

Seizing

145. Generally all law enforcement authorities are empowered to take provisional measures to safeguard property by way of seizure. Thus the state security services (handling crimes against state security) and the police (dealing with other types of crimes) have power to seize any items or documents that are discovered during an investigation and which may be used to prove the guilt or innocence of a suspect (article 114 CPC). Likewise, the Public Prosecutor and the police may in the course of their investigations accede to bank accounts and immobilise a suspect’s deposits or remittances. This power can only be exercised once (article 117 CPC). The courts have the power to conduct investigations, examinations, expert evaluations, inquiries and/or take an action to seize property when, in the course of a court hearing, doubts arise as to the veracity of the evidence (article 158 CPC). On conviction, all seized/frozen property (including all yields) are confiscated and turned over to the State Treasury—except for any property that has been returned to the victim according to law (article 198 CPC).

146. There is no express provision imposing, in general, seizure of all items that are subject to confiscation. Seizure according to articles 114 and 158 CPC is primarily intended for evidentiary purposes. In this respect instrumentalities and proceeds are perceived as constituting evidence. Furthermore the intention to also seize proceeds is evident in article 117 CPC (freezing of bank accounts) and in article 198 CPC ordering confiscation of all seized “illicit money and goods”.

Freezing

147. In cases involving “administrative discipline” (mainly related to corruption) the supervisory authorities have the power to impose restrictions on accounts and the sale or transfer of property and, if necessary, make submissions to the court to freeze deposits on bank accounts or other financial institutions (articles 20-21 Law on Administrative Supervision).

148. The new AML law provides for temporary freezing measures by the AML Bureau of the PBC, but only in cases where a client under investigation requests a fund transfer from his account to a foreign country. The freezing measure applies for a maximum of 48 hours.

149. Generally, property can be frozen, seized or detained without prior notice, unless such notice is otherwise required by specific legislation. No such notice is however required under the relevant articles of the CPC.

150. All of law enforcement agencies, including the courts, public prosecutors, police, state security and the customs that are entitled to seize or freeze have the necessary powers to identify and trace criminal proceeds and instrumentalities (articles 114, 117, 158 and 119 CPC). Other administrative authorities, such as the PBC and its AML Bureau, the administrative supervisors and the tax authorities, also have similar powers in their domain and within the confines of their specific assignments.

Third party protection

151. Confiscation of the proceeds is imposed wherever these assets are located, even when they are in the possession of third persons, without the necessity for a conviction of this party. Protection of the rights of *bona fide* third parties is generally provided by the possibility given by article 32 of the

“Provisions on the Seizure and Freezing of Money and Property by the People’s Procuratorates” to that party to intervene during the criminal procedure to oppose seizure and confiscation or to claim his/her rights. After the criminal procedure, and as a general rule, prejudiced *bona fide* third parties can rely on the Law on State Compensation giving them the right to apply for national compensation (article 4 and 16). Other, more specific measures are provided for in following circumstances.

- (a) At the request of the creditor, the confiscated assets can be used to pay the legitimate debts of the convicted person that he incurred before the confiscation (article 60 PC).
- (b) Real estate that has been transferred to a *bona fide* party remains his property if certain conditions are met (article 105 Law on Property Rights).

152. A *bona fide* third party may intervene during or after the criminal procedure to oppose confiscation or to claim his/her rights (Provisions on the Seizure and Freeze of Money and Property by the People’s Procuratorates). Once the SPP makes a decision to dispose of seized or frozen assets, it is required to notify the relevant parties within 7 days of their right to apply for review should they not be satisfied with the decision. Such a review must be made within 7 days by the case handling department of the SPP. Following the review process, if any party is still not satisfied, they can file an appeal with the SPP at the next higher level. The higher level of the SPP shall then re-examine the appeal and make a decision in a timely manner (article 32). Additionally, any party (including any *bona fide* third party) who has suffered from an unlawful administrative or judicial action to seal up, distraint or freeze property, has the right to apply for national compensation through compensation procedures (articles 4 and 16 Law on State Compensation).

153. As for administrative seizure, article 11 of the Administrative Procedure Law provides for means to oppose seizure and for compensation of “the victim”.

154. Civil actions (such as contracts) are null and void if they are performed with *mala fide* collusion and could prejudice the authorities in their ability to recover property subject to confiscation, violate the law or public interest, or are detrimental to the interest of the State, society or a third party. Civil actions that have the appearance of legitimate acts, but conceal illegitimate purposes are also null and void (article 58 General Principles of the Civil Law). Also, a contract is void when it involves a malicious conspiracy causing prejudice to the interests of the state, society or a third party, or when there is an attempt to conceal illegal goals in a legitimate form, or when social and public interests are harmed (article 52 Contract Law). It is also a criminal offence to conceal, transfer, sell, intentionally destroy or damage property that has been seized, detained or frozen by the competent authorities (article 314 PC).

Additional elements

155. Property belonging to a criminal organisation can arguably be confiscated when, in application of article 64 PC, the assets are considered to be proceeds, the object of the offence (“contraband”) or an instrumentality of the crime. This is however unprecedented in the jurisprudence. Moreover the absence of corporate criminal liability for the article 312 and 349 PC offences may raise an issue about the possibility of confiscating corporate assets based on a violation of these offences. As forfeiture has the character of a penalty that requires a conviction, an issue might come up in the sense that criminal proceeds belonging to or incorporated in a legal person may escape confiscation if that corporation cannot be criminally charged and convicted.

156. The legal property of the organisation may be confiscated as a fine after the organisation is convicted (articles 30-31 and 294 PC). Although some forms of confiscation exist outside the criminal system (e.g. articles 8-11 Law on Administrative Penalties), civil forfeiture is not a feature in the Chinese legal system. Generally the burden of proof is on the prosecution to demonstrate that property is of unlawful origin. Article 395 PC makes an exception in imposing the burden on State officials suspected of corruption to prove the legal origin of his assets (article 395 PC).

Statistics

157. No detailed statistics are kept concerning the number of freezing, seizing or confiscation actions, or the amount of assets involved. As well, there is no breakdown of the number of cases and amounts confiscated pursuant to administrative or criminal procedures, nor is there any differentiation between the criminal sources of the assets frozen, seized or confiscated (i.e. if it was generated from money laundering, terrorist financing or a predicate offence). The Chinese authorities were only able to provide very general statistics concerning the amount of money generated by the government after disposing of confiscated property at auction.

Effectiveness

158. Although mandatory, property was confiscated in only two of the three money laundering cases in China and, more significantly, only in one case were the proceeds confiscated. This demonstrates a lack of awareness by the judicial authorities of the legal obligations concerning confiscation and of the importance of such measure in terms of efficient law enforcement. On the other hand there is evidence of law enforcement actions focusing on the financial aspects of certain criminal phenomena, such as smuggling and underground banking.

159. As confiscation is linked to a conviction, it raises the issue of the application of this punitive measure in case the criminal proceedings have to be ceased because the defendant has absconded or died. The Penal and Criminal Procedure Codes are silent on this, so the absence of a specific regulation for such eventuality may have a negative efficiency impact. It was stated that in those cases administrative confiscation would be sought, but that would only be an alternative if the criminal activity can also be translated in an administrative violation.

160. Accurate statistics are not available on the number of freezing actions, seizures and confiscations in relation to criminal proceeds and instrumentalities. Although court judgments often indicate whether property has been confiscated, the value of such property is typically not indicated and no national statistics have been compiled.

161. There is some data available concerning the proceeds of the sale from confiscated property. Each of the judicial, law enforcement and administrative authorities is responsible for keeping statistical data regarding the freezing, restraining and confiscating of property. However, each authority uses different formats for collecting statistics, and none of them specify if the measures relate to money laundering or terrorist financing.

162. Confiscated property is usually transferred to an auction house to be sold. The proceeds of the sale from property confiscated law enforcement agencies are transferred to the local and central treasury (50% each). The Chinese authorities estimate that the proceeds for the local and central government after auctioning totalled RMB 38.8 billion in 2001, RMB 42.1 billion in 2002, RMB 45.6 billion in 2003 and RMB 54.8 billion in 2005. More detailed statistics concerning confiscations for the years 2001 to 2004 appear in the chart below.

Table: Confiscated Assets Table (numbers have been rounded)²⁸

	China	Central Government	Local Government
2001	RMB 38.8 billion	RMB 3.1 billion	RMB 35.7 billion
2002	RMB 42.1 billion	RMB 2.6 billion	RMB 39.5 billion
2003	RMB 45.6 billion	RMB 2.4 billion	RMB 43.1 billion

²⁸ The Chinese authorities do not breakdown their statistics in relation to assets that were confiscated pursuant to criminal or administrative measures.

2004	RMB 54.8 billion	RMB 2.6 billion	RMB 52.3 billion
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163. As there have been no terrorist financing investigations, prosecutions or convictions, there have been no confiscations in this area. In the absence of precise statistics it is not known if confiscation was pursued or ordered in the terrorist organisation cases (see section 2.2.1 of this report).

2.3.2 Recommendations and Comments

164. The seizure and confiscation regime is generally both comprehensive and quite detailed. It provides sufficient legal instruments to enable an effective recovery of criminal assets. Some legal imperfections or hesitations remain, without however significantly jeopardising the performance of the system, as indicated below.

- (a) Equivalent value confiscation is not a feature of the Chinese criminal system. Although a judicious application of articles 52 and 59 PC may produce similar effects, the penalty of confiscation of property pursuant to these provisions is not a valid alternative as the law does not associate this measure with the (mandatory) confiscation regime nor is the amount linked to that of the dissipated assets. No money laundering provision refers to the application of article 59 PC anyway. Neither is seizure of untainted property to preserve a corresponding value confiscation covered by any of the relevant articles of the PC and CPC.
- (b) In the absence of established jurisprudence or authoritative interpretation on the legal basis for confiscation of “clean” terrorist financing means, it is advisable to expressly provide that such assets are subject to forfeiture as objects of the article 120bis offence.

165. In terms of efficiency the judicial authorities should give more attention to a systematic application of the confiscation provisions, which is a mandatory measure anyway under Chinese law. The impact of any AML/CFT system is not only judged on the number of convictions, but more importantly on effectively depriving the criminal (organisation) of his assets or funding. Also the confiscation regime should include clear provisions and procedures on how to deal with the assets in case the proceedings come to a halt before a conviction was pronounced.

166. The Chinese authorities should collect statistics are kept concerning the number of freezing, seizing or confiscation actions, or the amount of assets involved. Such statistics should include a breakdown of the number of cases and amounts confiscated pursuant to administrative or criminal procedures, and should differentiate between the criminal sources of the assets frozen, seized or confiscated (i.e. if it was generated from money laundering, terrorist financing or a predicate offence).

2.3.3 Compliance with Recommendations 3

	Rating	Summary of factors underlying rating
R.3	LC	<ul style="list-style-type: none"> • Equivalent value seizure and confiscation are not features of the seizure and confiscation regime. • Confiscation of proceeds, although mandatory, is not systematically pursued and imposed by the courts, indicating a lack of awareness and implementation that needs to be addressed.

2.4 Freezing of funds used for terrorist financing (SR.III)

2.4.1 Description and Analysis

167. China has not established a special dissemination procedure dealing with the freezing of assets of UN Security Council Resolution 1267 (1999) (UNSCR 1267) and UN Security Council Resolution

1373 (2001) (UNSCR 1373) designated terrorists and related measures. For the purpose of implementing the relevant UN Resolutions, it relies on the normal criminal procedure regime for seizure and confiscation of criminal assets. In other words, a suspicion of assets being related to terrorism, be it as a result of the UN lists or based on other sources, will either lead to a prosecution, seizure and confiscation, or to a dismissal of the case and release of the frozen/seized funds or property. There is no legal or policy distinction between the freezing (in fact seizing) of terrorist or other criminal funds. This applies to all aspects of the freezing/seizing system, including such requirements as the protection of the rights of *bona fide* third parties, or the penalties for non-compliance with freezing orders (chapter 6, article 305 *e.a.* PC; see also section 2.3.1 of this report for a full description of these measures).

Freezing terrorist funds in accordance with UNSCR 1267

168. Dissemination of the UNSCR 1267 list and its successive updates is initiated by the Ministry of Foreign Affairs that issues a notification to all law enforcement and administrative central government departments (including the PBC, CBRC, CIRC and CSRC), all provincial, municipal and autonomous region governments, and the governments of the Hong Kong and Macau Special Administrative Regions. This notification is published in the Gazette of the State Council of China, and requires that all departments and regions strictly enforce UNSCR 1267 by immediately seizing the assets of the designated persons and entities associated with Al Qaeda, Taliban and Osama bin Laden.

169. It is then up to the supervisory and administrative authorities (such as the PBC, the CBRC, CIRC and CSRC) to immediately inform the financial institutions operating in China to check their registers and to make a timely report of any such assets that they suspect or find to be related. The financial institutions, however, have no right to block the account or transaction at their own initiative. Instead they have to refer immediately to the appropriate law enforcement authority and await their instructions. They are even under no obligation to file a STR to CAMLMAC, as such eventuality is not considered to fall under the preventive AML/CFT regime but is regarded as a crime issue. The dissemination process appears to be primarily focused on the regulated financial sector, neglecting the non-regulated sectors. In addition, none of the securities and insurance firms interviewed could recall ever receiving any such list.

170. The law enforcement authorities, primarily the Public Prosecutor's Office and the public and state security agencies, are responsible for "freezing" (actually seizing) the suspect assets according to the relevant Criminal Procedure Code provisions. Investigation and, eventually, prosecution will then be initiated for violation of article 120 and/or 120bis PC. No such assets have yet been discovered in China however.

Freezing terrorist funds based on UNSCR 1373

171. No extraordinary procedure in line with the Special Recommendation III requirements has been elaborated in China to deal with the national lists based on UNSCR 1373. Persons or entities that might be designated in China pursuant to UNSCR 1373 are dealt with as suspected terrorists, so their assets will be seized under the general Criminal Procedure Code regime and the ordinary provisions apply. Dissemination follows the same channels as with the UNSCR 1267 designations. However, no investigations, prosecutions or convictions for terrorist financing have taken place as yet because no match was found. Also, although the MPS has drafted and publicised a list of domestic terrorist organisations, they have not yet been designated under UNSCR 1373. In addition, none of the securities and insurance firms interviewed could recall ever receiving any list.

172. On the other hand China does comply with requests from other countries to give effect to the freezing measures of other jurisdictions. On receipt of such request China immediately informs the law enforcement agencies, banking supervisory and administrative authorities to take the appropriate action, provided it does not impair state interests or infringe on the relevant legal principles. A good example is the response by China to the U.S. Executive Order 13224 (the so-called OFAC list) and the

related U.S. request for review and freezing. A total of 25 such lists and requests have been disseminated this way by the Ministry of Foreign Affairs.

173. The process of dissemination and implementation of foreign freezing actions happens automatically, without a central or designated competent authority intervening or a specific procedure being followed to screen the requests and evaluate its appropriateness and foundation.

Definition of funds

174. In the absence of a formal definition of “funds” under the Criminal Procedure Code, the term should be understood in its common sense. No authoritative legal text, instruction or guidance exists in relation to determining what assets should be targeted by the freezing/seizing actions in the sense of the relevant UN Resolutions and ensuring full coverage. There is no certainty at all, for instance, that the relevant sectors are aware that those actions should also target assets indirectly controlled or owned by terrorist individuals or entities. According to the Chinese authorities the competent (law enforcement) authorities are entitled to a certain discretion in this respect. Possibly they could also take guidance from the wording of the UN Resolutions themselves. However, this contention could not be ascertained in the absence of supporting practical examples.

Guidance

175. The PBC has issued regulations to guide financial institutions in their co-operation with the law enforcement authorities in their “freezing” actions generally (article 3 Administration Regulations for Financial Institutions on Assisting with Enquiries into, Freezing or Transferring Saving Deposits). These regulations only concern those financial institutions that manage saving deposits. No other relevant guidance has been given to the banks, nor have any instructions or guidelines been promulgated to other relevant sectors such as the NBFIs. No feedback arrangements between the law enforcement authorities and the affected sectors exist either, except a general notification by the Ministry of Foreign Affairs to report to them if any issues or questions arise.

De-listing and unfreezing

176. Although China has designated terrorist entities in the domestic context, no specific de-listing procedures have been put in place. As the whole “freezing” procedure is based on terrorism (financing) investigations that are governed by the CPC provisions, deletion from the list depends on the outcome of the police investigations. This is also the case for unfreezing actions, with this provision however that the freezing of saving accounts is automatically lifted after six months if the law enforcement authority involved does not ask for an extension (article 16 Administration Regulations for Financial Institutions on Assisting with Enquiries into, Freezing or Transferring Saving Deposits). Of certain relevance is also article 118 CPC that orders the release within three days of all seized assets that the investigation has shown to be irrelevant to the case, although this provision cannot be counted as instituting a de-listing procedure.

177. China has no laws or procedures providing for the release of seized funds to cover basic expenses. However, any citizen, legal person or other organisation that refuses to accept any compulsory administrative measures, such as freezing orders, can file an administrative suit to the SPC (article 11 Administrative Procedure Law). This procedure applies only to persons whose assets have been administratively frozen. No such possibilities exist in respect of seizures based on the CPC.

178. The general provisions of article 64 PC cover all terrorist related funds captured by articles 120 and 120bis PC. The comments made under section 2.3 of this report on these issues also apply here. Generally the seizure and confiscation system is adequate to deal with terrorism related assets, although the deficiencies identified in respect of the TF offence should be remedied to ensure a fully comprehensive and effective regime. The confiscation requirement of untainted funds in the terrorist financing context would also benefit from further clarification by law or jurisprudence.

Monitoring and sanctions

179. Organised and specific monitoring of compliance in the domain of terrorist assets freezing is non-existent. The law enforcement authorities rely on the discipline of the implicated sectors to report the existence of suspected terrorist assets. The supervisory authorities for the financial sector could take such monitoring on board with their normal supervisory activities and examinations but, as interviews with representatives from the financial sector indicated a great degree of ignorance of the terrorist lists, in reality no special attention is given to compliance with the freezing obligations. In case of a failure to inform the law enforcement authorities of the existence of suspected terrorist assets, criminal sanctions may be applied on the basis of relevant articles of the Penal Code, such as aiding and abetting, laundering or of the offences in Chapter 6, Section 2 of the Penal Code on interference with justice. No specific administrative sanctions have been promulgated.

Additional elements

180. The measures set out in the Best Practices Paper for Special Recommendation III have not been implemented. There are no laws or procedures to consider requests for the release of funds to cover basic expenses for seized funds in any event.

Statistics

181. No assets have yet been frozen pursuant to UNSCR 1267 or based on any national or foreign lists, so no related statistics exist.

Effectiveness

182. Currently, no assets have been reported in China within the context of the UN Security Council Resolutions on freezing terrorist funds or on the basis of the domestic terrorist list. Consequently no such terrorist assets have been seized on the basis of the CPC. As for the other terrorist related assets, no seizure or confiscation figures are available (see section 2.3.1 of this report).

2.4.2 Recommendations and Comments

183. China has not implemented UNSCR 1267 and UNSCR 1373 in a manner that meets the specific requirements of FATF Special Recommendation III. For the implementation of the UN resolutions, China has opted for a one-sided criminal procedure approach, using traditional and existing means, to an international requirement that is predominantly of a preventive nature necessitating exceptional measures and adapted procedures. It is clear that these means are inadequate, at the very least incomplete, to meet the obligations deriving from the UN resolutions in an appropriate and effective way. Although some elements are already present to some extent (such as a rudimentary communication and dissemination process to some financial institutions), the approach needs to be revisited as a whole²⁹, with special attention to:

- (a) giving clear instructions and guidance to all relevant sectors, including the non-regulated, on their obligations in this respect, defining in particular what assets the freezing orders target and their relation to the individuals and entities involved;
- (b) ensuring that there are efficient communication lines between the law enforcement authorities, the supervisory bodies, the financial institutions and other affected sectors;
- (c) implementing a screening procedure and authority responsible for evaluating the foreign list based requests;

²⁹ China is in the process of drafting an Anti-Terrorism Law that is intended to include special provisions on freezing terrorist funds. No text was provided to the team, as the draft is still in an early stage.

- (d) implementing effective compliance monitoring by supervisory bodies within an adequate sanctioning framework;
- (e) establishing appropriate and publicly known procedures for de-listing, unfreezing or in any other way challenging the listing and freezing measure before a court or other designated authority; and
- (f) enacting regulations on (restricted) access to the frozen assets and protecting the rights of *bona fide* third parties.

184. The general seizure and confiscation regime of terrorism related assets is solid enough to be used effectively, even if some deficiencies in the definition of terrorist acts, terrorist assets and terrorist financing need to be addressed to strengthen the system. Reference is made to the comments under 2.3.2 of this report.

185. The Chinese authorities should ensure that, if assets are frozen pursuant to UNSCR 1267 or in line with UNSCR 1373, related statistics are kept.

2.4.3 Compliance with Special Recommendation III

	Rating	Summary of factors underlying rating
SR.III	NC	<ul style="list-style-type: none"> • The direct criminal procedure (seizure) approach is insufficient to adequately and effectively respond to the freezing designations in the context of the relevant UN resolutions. • The present regime does not address the non-regulated sector in a meaningful way. • No procedure is in place to ensure an adequate and qualitative screening of foreign freezing requests. • Guidance for and monitoring of all implicated sectors is not effectively organised. • There is no clear determination of the scope of the freezing obligations in respect of what assets need to be targeted and their link with the terrorist individuals and entities. • No de-listing or (partial) unfreezing procedure is provided. • No adequate regulation on <i>bona fide</i> third party protection is provided.

Authorities

2.5 The Financial Intelligence Unit and its functions (R.26)

2.5.1 Description and Analysis

Recommendation 26 (FIU)

186. China's FIU system is influenced by its size and by existing institutional and legal traditions. While the Chinese law both gives a right and imposes an obligation on all citizens, entities, and government authorities to report suspected crimes to the police (article 84 CPC), this does not provide a direct mandatory obligation to report suspicious transactions to the FIU. China has therefore established a reporting system for suspicious and large-value transactions according to the AML Law, the Administrative Rules for the Reporting of Large-value and Suspicious RMB Payment Transactions (2003) [RMB-LVT/STR Rules] and the Administrative Rules for the Reporting of Large-Value and Suspicious Foreign Exchange Transactions (2003) [FX-LVT/STR Rules]. It should be noted that the RMB-LVT/STR Rules and the FX-LVT/STR Rules ceased to be in effect on 1 March 2007 when the recently-enacted Administrative Rules for the Reporting of Large-Value and Suspicious Transactions by Financial Institutions [the new LVT/STR Rules] came into force. The system, in fact, is an unusual

transaction reporting system (i.e. financial institutions are obligated to report numerous specified types of unusual transactions and, additionally, any other transaction deemed to be suspicious); however, the applicable laws and regulations refer to all of them as “suspicious” transactions. Throughout this report, the Chinese terminology will be used, however, where appropriate, the distinction between unusual and suspicious transactions will be pointed out.

Organisation of the FIU

187. China’s FIU is located in the PBC. The PBC’s AML role and functions, including its designated FIU function, are set out in the AML Law with more detailed requirements being set out in rules (regulations) that are issued by the PBC (articles 8 and 10 AML Law). All FIU functions must be carried out in accordance with the AML Law and related rules, or the laws covering the operations of the PBC. Due to existing institutional divisions, the FIU function has been divided between two units that are contained within the single overarching authority of the PBC—the AMLB and CAMLMAC.

188. From 2003 to 1 July 2006, SAFE was fulfilling the role of receiving, analysing and disseminating STRs and LVTs relating to foreign exchange transactions. However, SAFE is no longer involved in FIU functions. Since 1 July 2006, all “suspicious” transaction reports (meaning both suspicious and unusual transaction reports (“STR”) and large value transaction (LVT) reporting by financial institutions have been made to CAMLMAC. SAFE still retains its role as a regulatory authority with responsibility for foreign exchange transactions and, in that context, STRs and LVTs that relate to foreign exchange and are reported to local PBC branches may be copied to the branch’s SAFE staff for use in carrying out SAFE’s core role as a regulatory authority. This means that, as of October 2006, the FIU functions are performed exclusively by the AMLB and CAMLMAC.

189. CAMLMAC was established in April 2004. Its powers are delegated by the PBC, to which it is affiliated. CAMLMAC specialises in data collection, processing and analysis. Its function is to receive and analyse STRs and LVTs, and to act as the central point of contact for foreign FIUs (article 10 AML Law).³⁰ The AMLB, which was established in October 2003 organises and coordinates China’s AML affairs, and carries out administrative investigation, dissemination and policy oversight.³¹ Decisions about whether to carry out an administrative investigation into an STR or whether to disseminate an STR to the MPS are made pursuant to articles 23 to 26 of the AML Law. While CAMLMAC and the AMLB work together to conduct follow-up analysis on LVTs and STRs, most of the additional analysis and dissemination functions are carried out by the AMLB. In that way, the core FIU functions are centralised in two operational bodies of the PBC. The heads of CAMLMAC and the AMLB both report to a single deputy governor.

190. CAMLMAC has established a preliminary monitoring network that covers all types of banking institutions, including policy-oriented banks. By the end of September 2006, 1,126,903 RMB STRs, 3,623,996 Foreign Currency STRs (FX STRs) and 214,909,566 LVTs have been received through this system. For technical reasons, FX STRs are counted by transaction, while RMB STRs are counted by report (one report can contain more than one related transaction). Consequently, it is not possible to aggregate these numbers for comparison purposes. The analytic functions of the system have commenced and a number of STRs have been disseminated to the investigation authorities. Also, an exchange of financial information with FIUs in foreign countries has started.

Receiving STRs and LVTs

191. All STRs and LVTs are ultimately received by CAMLMAC. There are four procedures for sending STRs and LVTs to CAMLMAC, depending on the nature of the transaction. The first

³⁰ References in the AML Law to the “AML Intelligence Centre” mean CAMLMAC.

³¹ References in the AML Law to the “Administrative Department of AML of the State Counsel” mean the AMLB/PBC. The AMLB, the functional bureau of the PBC, fulfills the AML administrative responsibilities of the PBC in practice..

procedure applies to STRs involving RMB. Those are received by the PBC regional and local branches³² from financial institutions within their administered areas, and then forwarded by the regional/local PBC branches to CAMLMAC through the PBC intranet. Since January 2005, all STRs involving RMB are reported electronically.

192. The second procedure applies to STRs relating to foreign exchange transactions. Those are gathered by the head office of the reporting institution or the principal reporting bank, and then reported to CAMLMAC through the Inter-networking Platform of Financial Industry, which is a special network that is not based on the internet. STRs involving foreign exchange are all filed electronically.

193. The third procedure concerns LVTs involving RMB and foreign exchange. Those are gathered by the head office of the reporting institution or the principal reporting bank, and then reported to CAMLMAC through the financial industry's Inter-networking Platform of Financial Industry. All LVTs are filed in electronic form.

194. The fourth procedure concerns those STRs that the reporting institution suspects may be related to a serious crime (so-called "Specialised STRs" or "SSTRs"). If a reporting institution detects an SSTR, it is forwarded to CAMLMAC according to the normal procedure (i.e. whichever one of the three procedures described above applies according to what type of transaction it is) and, at the same time, it is reported to the regional/local PBC branch and the local MPS branch. The PBC explained that this parallel reporting enhances the dissemination process because when the financial institution sees that a transaction is most likely related to a crime, no additional administrative investigation is required by the PBC, and the law enforcement authorities become involved as quickly as possible.

195. The new LVT/STR Rules (which came into force on 1 March 2007), require all STRs and LVTs to be reported directly to CAMLMAC via the headquarters of reporting institutions, bypassing the regional/local PBC branches [LVT/STR Rules, articles 7 and 8]. At the same time, financial institutions are required to review and analyse the reports that they have made to CAMLMAC. After analysis, if the financial institution has proper reasons to believe that the customer or transaction is relating to money laundering, terrorist activities or other law-violating and criminal activities, the transaction must also be reported to the regional/local PBC branch which may carry out an administrative investigation if necessary. In addition, the local/regional PBC branches have access to the transactions and information that have been reported to the CAMLMAC, for the purpose of facilitating their own analysis or administrative investigation.

Analysis of STRs and LVTs

196. STRs and LVTs are both used as analysis elements. Since STRs indicate more risk for ML activities than LVTs, STRs are usually the original information that triggers analysis while LVTs contained within the FIU's database are usually used to backup the analysis.

197. CAMLMAC's computerised processing system filters the incoming STRs and LVTs and generates lists of transactions for investigation by CAMLMAC's analysts. The filtering includes seeing whether the STRs or LVTs match red flag indicators of potential money laundering activity (e.g. transactions with offshore financial centres of concern to China; names that match UN sanctions lists; names that match lists of wanted criminals; or names that match with reports received from the general public via the CAMLMAC website).

³² Regional and local PBC branches have administrative jurisdiction over a specified geographical region, such as a province or large urban area.

198. The reporting process also allows STRs to be reported with an electronic “special attention needed” tag, if necessary. STRs with this designation have usually already been analysed and investigated by the compliance officer of the reporting entity. STRs received with the “special attention needed” tag are the first ones that the system brings to the attention of the CAMLMAC analysts.

199. The system also attaches different priorities to the reasons why the reporting institution identified the transaction as being suspicious. For instance, the system also allows reports to be run that extract STRs and LVTs which are related to government criminal justice priorities (e.g. fighting corruption or drug-trafficking in specific regions). CAMLMAC’s information technology analysts have developed a programme based on more than 150 rules to generate from all of the filed STRs and LVTs those that may be similar to typologies or to specific notable cases. It also scores transactions based on the number of accounts involved, the frequency of transactions and the amount of money involved. These software programmes are continuously under review. CAMLMAC is also currently reviewing its overall operational analysis function to see what improvements can be made.

200. Investigation by the CAMLMAC analysts involves making enquiries in the CAMLMAC database to produce reports that link the STRs or LVTs received with other transactions. The analysts also check the internet and may request information from other agencies to gather further background information. The analyst writes up a report that summarises the transactions, provides link analysis and recommends appropriate next steps.

201. One of the next steps can involve an administrative investigation by analysts in the AMLB case investigation division, which has a staff of seven. Such investigation is undertaken directly by the AMLB’s case division staff if it spans provinces, or involves a complex matter or sensitive information. However, the case division staff may also use the AML staff who are located in the relevant regional/local PBC branch to gather information for the investigation if the investigation is specific to that province or region and is not complex or sensitive.

202. In practice, the AMLB sends notices to the regional/local PBC branches and the headquarters of the reporting banks. The notice indicates who should be investigated, which information should be verified, and what information the AMLB needs back. The AML staff of regional/local PBC branches can investigate the suspects’ account information, transactions, and other materials related to the suspects. The AML staff located at the regional/local PBC branch then report the information which they have gathered back to the AMLB’s case division analysts.

203. The administrative investigation involves building up a dossier for each STR that contains background information about: (a) the chain of transactions, including where possible information about their nature and purpose; (b) accounts in the report considered to be the most relevant, such as large value transactions, transactions conducted by or with the main suspect(s); and (c) information about the account holder(s) of the accounts which most of the transactions flowed through. The additional information is gathered from the reporting entities and other persons that the transactions are linked to, the industrial and commercial registration authorities, and other government authorities. The investigators at the AMLB are not permitted to contact the suspect(s). The power to conduct these investigations is based on articles 23-25 of the AML Law and article 4 of chapter 1 of the Law on the PBC. Upon completion of an administrative investigation, consideration is given as to whether the STR dossier should be disseminated to the MPS.

Dissemination of STRs and LVTs

204. If at any time while the CAMLMAC or AMLB are dealing with an STR, they jointly consider that the information gathered establishes that an identified person has engaged in money laundering or any predicate offence for money laundering, and if the MPS agrees with that view, the STR is disseminated within a dossier to the MPS for criminal investigation. Decisions about whether to carry out an administrative investigation into an STR or whether to disseminate an STR to the MPS are

made pursuant to articles 23 to 26 of the AML Law. There is a mechanism of joint meetings (also known as intelligence conferences) which are established by the AMLB, CAMLMAC and the Economic Crime Investigation Department (ECID) of the MPS. Other competent authorities are invited to join the conference, as appropriate. The purpose of these meetings is to determine whether this information should be transferred to ECID/MPS for criminal investigation and what information should be sent.

205. When it is considered that a crime may have been committed but there is not sufficient information to forward the STR to the MPS, CAMLMAC and the AMLB jointly decide whether the STR should be referred immediately to the MPS for criminal investigation or whether the AMLB should first carry out an administrative investigation.

206. If the PBC cannot determine whether the transaction is legitimate after conducting its administrative investigation, the suspicious transaction dossier must be transferred to the ECID of the MPS according to art. 26 of the AML Law. Copies of the STR made to the MPS may also be sent to other interested agencies (such as SAFE if the transaction concerns foreign exchange, the tax authorities if it involves tax matters, or the MSS if it involves possible corruption).

207. The AMLB, in consultation with CAMLMAC, disseminates STRs by forwarding to the MPS a dossier that is comprised of a completed transmittal form and an investigation report containing: (1) a summary statement about the suspicious transaction (including basic information about the account, the account owner and the transaction amount and other relevant information); (2) an analysis of why the report is suspicious; (3) an attachment containing the account opening information held by the reporting financial institution; (4) an attachment containing detailed information about the suspicious transaction; and (5) an attachment containing background information about the transaction and other relevant material (Cooperation Provisions on the Investigation of Suspicious Transactions, which have been signed by the PBC and MPS). In practice, to simplify the procedure, after joint consultation, the CAMLMAC is delegated to consolidate the dossier and make the dissemination directly to the MPS. A dossier does not usually amount to evidence for use in prosecuting a case. Such evidence must be collected separately during the criminal investigation in accordance with the CPC.

208. The staff of the regional/local PBC branches also perform investigative and dissemination functions. In practice, at each local level, the regional/local PBC branch staff who are working on AML/CFT matters immediately conduct their own analysis and investigation when they receive an STR from a financial institution in their jurisdiction. Then, the STR and its accompanying dossier can be handed over to the local police department for further criminal investigation. At the same time, these documents are reported to CAMLMAC. The regional/local PBC branches are entitled to perform functions of the PBC if they are authorised to do so by the PBC headquarters (Law of the PBC and the AML Law).

209. The Chinese system for processing STRs and LVTs is designed to accommodate the geographic size of the country, and the widely-varying and rapidly-evolving ability of reporting entities to apply computer technology in their businesses and in the reporting process. According to the Chinese authorities, following up on particular reports would not be possible if it were attempted from a centralised agency in Beijing only (e.g. to clarify information provided, ensure that information provided is complete and accurate, or to obtain additional information as necessary).

Guidance

210. The PBC has issued guidance via administrative regulations (secondary legislation): the Financial Institutions Anti-money Laundering Provisions (FIAML Provisions), the RMB-LVT/STR Rules and the FX-LVT/STR Rules. All three of these regulations were promulgated by the PBC in January 2003, and put forward overall requirements on the subject, including the reporting procedures and required content of reports. These rules were replaced by the new LVT/STR Rules effective 1 March 2007.

211. In 2003, when it was responsible for performing FIU functions, the SAFE issued regulations and guidance in form of official papers concerning specific procedures for reporting suspicious transactions involving foreign exchange, including the reporting obligations of financial institutions, the criteria of data and the format of reporting.³³ SAFE also published its Implementation Rules of the FX-LVT/STR Rules on 12 October 2004 to provide guidance for commercial banks. These rules reinforced the AML responsibilities of the foreign exchange administrations and financial institutions, and specified the content, criteria and procedures for financial institutions to report suspicious and large-value foreign exchange transactions [SAFE Decree (2004) No.100]. The objective of these rules is to improve the development of AML laws and systems in the foreign exchange sector, including the further standardisation of LVT and STR reports. The PBC has also issued a total of 12 guidance papers, in support of the reporting duties.³⁴

212. In August 2004, the PBC issued standards for financial institutions for the development of AML monitoring and analysis systems in relation to domestic and foreign currencies.³⁵ These were developed by CAMLMAC.

213. In December 2004, the PBC issued to financial institutions the Template for the Completion and Submission Format of Reports on Suspicious Transactions, and provided technical standards and arrangements on relevant activities with regards to the completion, submission and channel of suspicious transaction reports in domestic or foreign currencies. This document contains key content of the reporting form for STRs. Additionally, CAMLMAC offered six successive training programs on reporting and submitting the data related to STRs and LVTs to more than 350 heads and reporters in the AML sections of the branches and sub-branches of the PBC and the head offices of commercial banks.³⁶

214. CAMLMAC has also published the Comments and Analyses on the Cases of Money Laundering which elaborates methods and types of money laundering activity through case studies.

³³ Notice of the SAFE on Submitting Statements Related to the Administrative Rules for the Reporting by Financial Institutions of Large-Value and Suspicious Foreign Exchange Transactions; Notice of the SAFE on Standardising the Completion and Submission of Statements Related to the Administrative Rules for the Reporting by Financial Institutions of Large-Value and Suspicious Foreign Exchange Transactions; Notice of the SAFE on Improving the Completion and Submission of the Administrative Rules for the Reporting by Financial Institutions of Large-Value and Suspicious Foreign Exchange Transactions; and Notice of the State Administration on Simplifying Part of the Report Content Related to the Administrative Rules for the Reporting by Financial Institutions of Large-Value and Suspicious Foreign Exchange Transactions.

³⁴ Notice of the PBC concerning the reporting standard of RMB and foreign currency transactions through CAMLMAC system (trial)(2004); Notice of the PBC General Office concerning the networking schedule of the CAMLMAC system (2004); Notice of the PBC on Observing the large-value and suspicious transaction reporting obligations (2004); Notice of the PBC on several issues concerning improving networking with CAMLMAC system and reporting RMB and foreign currency transactions (2005); Notice of the PBC General Office on enlarging the monitoring scope of large-value transaction and accelerating the team building of reporters (2005); Notice of the PBC General Office on accelerating networking with CAMLMAC system and reporting RMB and foreign currency transactions by urban commercial banks (2005); Circular of the PBC General Office on Work concerning Large-value and Suspicious Transactions Reports in 2005 (2006); Notice of PBC concerning implementing the reporting standard of RMB and foreign currency transactions through CAMLMAC system (2006); Notice of the PBC concerning issuing the Glossary of Large-value and Suspicious Transactions Components for the Banking Sector and the Standard of Large-value and Suspicious Transactions Data Reporting Interface for the Banking; Notice of the PBC concerning issuing the Glossary of Large-value and Suspicious Transactions Components for the Securities and Futures Sector and the Standard of Large-value and Suspicious Transactions Data Reporting Interface; Notice of the PBC concerning issuing the Glossary of Large-value and Suspicious Transactions Components for the Insurance Sector and the Standard of Large-value and Suspicious Transactions Data Reporting Interface for the Insurance Sector; and Notice of the PBC on the Financial Institutions' Enforcing the AML Rules Strictly and Keeping the ML Risks Away (2005).

³⁵ Standards for the Reporting and Submission of Data on Domestic and Foreign Currencies in the Anti-Money Laundering Monitoring and Analysis System.

³⁶ The PBC, through CAMLMAC, intends to issue guidance to financial institutions that will contain indicators of money laundering activity. This guidance is aimed at enhancing the ability of financial institutions to detect and report STRs.

Access to information

215. According to the AML Rules, the RMB-LVT/STR Rules and the FX-LVT/STR Rules, the PBC's staff in CAMLMAC and the AMLB have the authority to obtain additional transaction information from financial institutions relating to STRs and LVTs.

216. With the enactment of the AML Law, the RMB-LVT/STR Rules and the FX-LVT/STR Rules have been replaced by the new LVT/STR Rules which came into effect on 1 March 2007. Further, article 11 of the AML Law authorises the PBC to obtain necessary information from relevant departments under the State Council in order to fulfil its responsibility to monitor transactions for AML purpose and requires the relevant departments under the State Council to provide such information. If suspicious transactions are detected and need to be confirmed, the PBC is authorised to perform an administrative investigation on those relevant accounts (articles 23-24 AML Law). Financial institutions are required to cooperate with the investigation and provide relevant documents and material. When investigating the suspicious transactions, the PBC is authorised to make inquiries directly to relevant employees of a financial institution.

217. According to the Cooperation Provisions on the Investigation of Suspicious Transactions signed by the PBC and the MPS, the PBC (CAMLMAC and AMLB) staff do not have automatic access to any information that is held by the MPS, but can request law enforcement information from it. They may also acquire the identity information of the transacting parties through the MPS's National Citizen Identity Information Inquiring System; however, the parameters for accessing this information are still under negotiation. They can also obtain information about companies from the Company Registry which is maintained by the SAIC. The PBC's own macroeconomic data is also used by CAMLMAC in the strategic analysis of the STRs and LVTs that are received. The PBC has also had discussions with other organs of government to seek routine access to information such as tax and customs information. Currently such information must be requested on a case-by-case basis and could be facilitated by the joint-ministerial conference mechanism.

218. Up to the enactment of the AML Law, if a reporting party did not provide all of the information required by the STR reporting template (Document 169), the CAMLMAC relied on the PBC's general status to require the reporting party to provide the missing information and, in practice, the reporting parties complied. Additional information that is not otherwise required by Document 169 and which may be relevant to the background of an STR can be obtained from the reporting entity through PBC's generic administrative investigation powers which are exercised by the AMLB case investigation division or the AML staff in the relevant regional/local PBC branch.

219. The PBC has specified relevant work disciplines, such as PBC management measures for archives of AML supervision, check and investigation. The CAMLMAC has also prepared the Measures for Financial Intelligence and Archives, and standardised the collection, management, confidentiality, storage, use and transfer of intelligence, and disseminates vigorously in accordance with relevant provisions of the PBC.

220. Physical access to the FIU function premises is protected. There is perimeter security and all staff must have valid security passes to gain access. In the process of data reporting, the Inter-networking Platform of Financial Industry (which is used for LVTs) and the PBC (which is used for STRs) are both physically isolated from the public internet. The required user name and password, in combination with the application of PKI (Personal Key Identification) technique provides security for data transferring. In the process of data storage and data use, a special AML subnet was divided through a VLAN (Virtual Local Area Network) method, which is logically independent and isolated from other systems of the PBC. User name and password are required to access these data.

221. The PBC also prepared the Management Measures for Archives on AML Supervision and Investigation, to hold the information on AML supervision and investigation properly. With regard to reports storage, STRs in electronic copies are stored in the database of AML monitoring and analysis

system, STRs in hard copies are stored in the intelligence archives office of CAMLMAC and all the LVTs are stored in the database of AML monitoring and analysis system.

222. Until the enactment of the AML law, information is basically disseminated when there is sufficient information to meet the requirements of the Regulations of the MPS and the PBC on Cooperation during Examination and Verification of Suspicious Transaction Dossiers. Since the issuance of the AML Law, dossiers have been disseminated to the MPS when the PBC has been unable to determine (through administrative investigation) whether the suspicious transaction is legitimate. Improper disclosure of FIU function information is subject to sanction either as a crime or administratively under the AML Law (see article 5).

223. The AMLB has published two annual reports (the China AML Report) for the years 2004 and 2005. In 2005, the CAMLMAC published a book of cases about money laundering in China and foreign countries. CAMLMAC also publishes some general statistics on its website.

224. The Director-General of the CAMLMAC has written to the Chairman of the Egmont Committee concerning membership in the Egmont Group. At the date of this report, membership has not yet been granted. Nevertheless, the guidelines of the Egmont Group are taken into account when doing information exchanges, which the PBC may do on a case-by-case basis. The PBC has concluded an agreement with Russia on AML/CFT cooperation and intelligence exchange, and signed MOUs with FIUs in Belarus and Malaysia. Memorandums of understanding on AML/CFT cooperation have also been formally signed between the CAMLMAC (on behalf of the PBC) and FIUs in South Korea, Georgia, Indonesia, Mexico and Ukraine. Moreover, exchanges are carried on between CAMLMAC and FIUs in a number of countries to conclude a memorandum of understanding on information exchange and cooperation of AML/CFT. In practice, CAMLAC has made only one formal reply as a result of an MOU request. Other MOU requests are in process of being dealt with. However, CAMLMAC has received a number of requests from other FIU that do not have an MOU to which they have replied that the information exchange will only take place with the signing of an MOU.

Recommendation 30 – Resources of the FIU

225. In October 2003, the PBC established the AMLB to organise and coordinate China's AML affairs, constitute the AML rules for financial institutions by itself or with other relevant financial supervising agencies under the State Council, supervise and examine financial institutions' fulfilment of their AML obligations, investigate suspicious transactions within its jurisdiction, etc. The budget appropriated to the AMLB in 2006 was RMB 44 million. A large part of that budget was used to execute the training program, technical assistance program and the AML compliance monitoring program for the banking sector. There are 30 staff in the AMLB, including one Director-General and two Deputy General-Directors. The Director-General of the AMLB reports to a Deputy Governor of PBC. Currently the AMLB has divisions, including the general office, the coordination and cooperation division, the policy supervising division and the case investigation division. Additionally, in PBC regional branches, there are about 300 staff that performs FIU functions full time, and around 7,000 staff that perform FIU functions part time. The main tasks of people who perform FIU functions in regional branches are making on-site or off-site inspections of the local financial institutions, assisting in the investigation of STRs and so on, with the authorisation from the PBC Head Office.

226. The CAMLMAC is an institutional legal entity that was established with the approval of the Office of the Central Organisation Establishment Committee. All of its operational funds come from budgetary appropriations and are included in the budget of the PBC. The fund appropriated to CAMLMAC in 2004 were about RMB 21 million, of which 2 million RMB was invested to develop IT infrastructure. The funds appropriated to CAMLMAC in 2005 totalled about RMB 29 million, of which 8 million RMB was invested to develop IT infrastructure. The budget appropriated to CAMLMAC in 2006 is about RMB 35 million, of which RMB 20 million will be invested to develop IT infrastructure. CAMLMAC has an institutional staff of 60 in its headquarters and 20 AML staff in its Shanghai branch (which is currently under construction), including one Director-General and four

Deputy Director-Generals. The Director-General of CAMLMAC reports to the same Deputy Governor of the PBC as the AMLB. Currently the CAMLMAC is organised into 13 offices, including the General Office, the Research Department, the Information Collection Department, the Transaction Analysis Departments I to V, the Investigation Department, the Technical Backup Department, the International Exchange Department, the Finance Department, and the Human Resources Department.

227. The PBC has a policy of applying high standards when recruiting staff. Since 2005, a competition mechanism has been applied to important posts (including the FIU department). This mechanism specifies professional skills and integrated capability for the staff. The Management Measure for AMLB stipulates the responsibility, confidentiality and morality of the AMLB staffs.

228. The CAMLMAC carries on recruitment under the instruction of the PBC, and imposes strict requirements on candidates in terms of confidentiality, professional qualifications and integrity. A review will be made on the personal files of the candidates, which records their history, including past awards or sanctions made on the person. For the staff recruited from the public, the applicant's professional skill, integrity records and personal files are also checked, including those from the applicant's former employer or other agencies. Efforts have been made to prepare highly qualified professional personnel by referring international experiences, providing well-aimed technical training and conducting internal and international exchanges. A host of systems including confidentiality, attendance checking, remuneration, incentives and punishments, and recruitment are also developed to improve the internal control mechanism and standardise the day-to-day behaviour of employees, hence leading to a more standardised framework. The Confidential Notice for CAMLMAC Staffs, the Management Measure for CAMLMAC Staffs and other PBC staffs provisions clearly stipulate the staff requirements of responsibility, confidentiality and morality.

229. By the end of December 2005, seven AML/CFT training meetings had been provided under the technical assistance programs of IMF, the World Bank and the British Embassy: (1) the Training Program on the Practical International Operation of AML; (2) the International Symposium on the IT Keynote of FIUs; (3) the Seminar on the Role of FIU and Relevant Authorities in the AML/CFT Mechanism; (4) Advanced Training Program on the Practical Operation of Analysing an STR and the Types of Money Laundering; (5) the training program for AML trainers; (6) the training program for senior AML compliance officers; and (7) the program for AML compliance officers. These programs covered almost all the FIU function personnel as well as members of related departments, commissions and principal reporting and submitting entities.

230. From 2004 to 2005, a total of 52 FIU staff personnel received special AML training conducted by other organisations in China with a total training period of 218 days. Twelve personnel were sent to the United States, Canada, Australia and New Zealand in two successive trips to study local AML analysis systems. Twelve personnel were also sent, after a selection process, to the World Bank and the FIUs of four countries for field practice (training). The practice (training) period amounted to 204 days.

231. In the first half of 2006, more than 30 PBC staff who perform FIU functions have participated in training programs, including the EAG evaluator training class, the IMF AML/CFT training seminar (Singapore), PBC operation training, the FATF typologies seminar (Belgium), the IMF AML/CFT seminar on intelligence analysis and investigation, and the Securities Industry Association (United States) on AML training program in security and future industry, etc.

Statistics

232. The Chinese authorities collect and maintain annual statistics concerning the number of STR and LVT that are received by the CAMLMAC, including breakdowns of the type of person or entity making the STR and the number of STR which are analysed by the CAMLMAC and disseminated by the AMLB.

	Time Frame	Number of RMB LVT (Transactions)	Foreign Currency LVT (Transactions)	RMB STR (Reports)	Foreign Currency STR (Transactions)
1	Aug. 2004	0	0	335	0
2	Sep. 2004	0	0	439	0
3	Oct. 2004	97,271	9,615	1,328	7,576
4	Nov. 2004	992,154	51,763	1,092	19,820
5	Dec. 2004	3,355,579	59,468	1,766	20,055
	2004 Total	4,445,004	120,846	4,960	47,451
6	Jan. 2005	6,115,463	106,995	3,220	83,414
7	Feb. 2005	4,740,563	106,758	1,186	133,370
8	Mar. 2005	7,011,838	353,111	3,649	198,980
9	Apr. 2005	7,408,641	812,849	4,297	112,656
10	May 2005	7,548,071	723,023	3,534	109,973
11	Jun. 2005	8,768,876	806,199	6,761	109,499
12	Jul. 2005	7,151,423	758,841	10,803	138,833
13	Aug. 2005	9,449,988	999,379	43,470	264,074
14	Sep. 2005	9,659,605	1,048,693	70,066	154,470
15	Oct. 2005	9,343,854	1,013,642	37,254	184,972
16	Nov. 2005	11,904,741	1,282,717	36,324	219,025
17	Dec. 2005	12,966,621	1,340,432	62,791	279,721
	2005 Total	102,069,684	9,352,639	283,355	1,988,987
18	Jan. 2006	11,074,594	682,858	45,967	186,886
19	Feb. 2006	7,686,801	451,431	41,016	127,284
20	Mar. 2006	10,728,013	979,053	85,088	124,137
21	Apr. 2006	9,661,877	806,787	64,688	99,129
22	May 2006	8,761,288	891,171	44,993	195,423
23	Jun. 2006	8,014,789	757,298	77,502	271,313
24	Jul. 2006	7,519,388	448,670	55,407	244,238
25	Aug. 2006	13,904,711	1,120,856	330,277	339,148
26	Sep. 2006	14,413,499	1,018,309	93,650	290,303
27	Oct. 2006	8,494,616	840,819	113,460	643,854
28	Nov. 2006	12,165,301	1,081,658	140,870	933,808
29	Dec. 2006	11,865,079	1,156,947	442,125	771,286
	2006 Total	124,289,956	10,235,857	1,535,043	4,226,809
	Grand Total	230,804,644	19,709,342	1,823,358	6,263,247

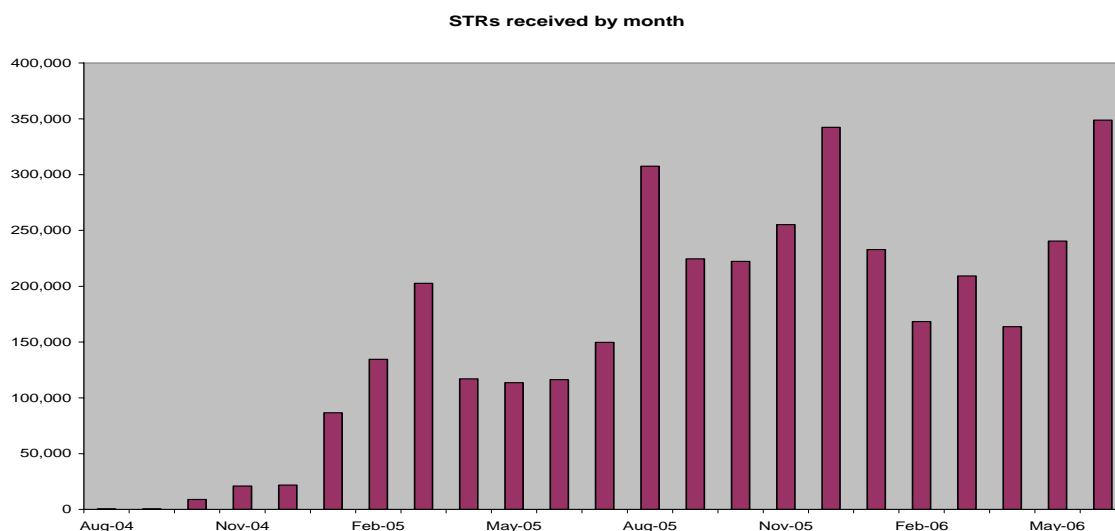
Effectiveness

STRs received

233. CAMLMAC began to receive, in paper form, STRs on suspicious RMB transactions (RMB STRs) in August 2004, and electronic STRs reports of suspicious RMB transactions through the PBC intranet in January 2005. At present, the CAMLMAC mainly receives reports on suspicious transactions that are submitted by banking institutions, and postal deposit and remittance institutions across the country. From August 2004 to the end of 2005, the CAMLMAC has received 288,315 reports on suspicious transactions of RMB and more than 2,036,438 suspicious foreign exchange transactions (FX STRs) via the monitoring and analysis system. The table below shows a breakdown of the STRs received by CAMLMAC.

Types of data received	Number of reports received	
	August – December 2004	2005
RMB STRs (number of reports)	4,960	283,355
FX STRs (number of transactions)	47,451	1,988,987
Total	Since RMB STRs are registered per report and FX STRs per transaction, cumulative figures can not be given	

234. Each report on an STR identifies all of the transactions, bank accounts and the names of holders of those accounts in the CAMLMAC database that relate to the STR received. The graph below indicates that after an initial settling in period, CAMLMAC now receives around 130,000 RMB STRs and 350,000 foreign currency suspicious transactions each month. Last year (from 1 July 2005 to 30 June 2006), CAMLMAC received 619,962 RMB STRs and 2,245,267 foreign currency suspicious transactions. The value of those STRs was approximately RMB 2,181 trillion.



STRs handed on by CAMLMAC

235. By the end of September 2006, the CAMLMAC had identified over 1,070 reports on suspicious transactions for administrative investigation or for dissemination to the MPS (683 of which had been identified by the end of 2005). These involved RMB 137 billion in domestic currency, USD 1 trillion in foreign exchange, about 80,000 transactions and 4,926 accounts. Each report on an STR identifies all of the transactions, all of the bank accounts and the names of holders of those accounts in the CAMLMAC database that relate to the STR received. It attempts to create a chain of transactions related to the STR received. Each report that was generated in 2005 on average contained information about approximately 100 transactions. Information from 335 of those investigations has been fed back into the CAMLMAC processing system.

Year	STRs	Amounts involved (round sums)		Transactions	Accounts
		RMB	Foreign currencies (in USD)		
2004	150	60 billion	> 200 million	> 10,000**	> 1,000
2005	533	80 billion	> 800 million	> 60,000**	nearly 4,000

STRs disseminated

236. In total, 57 files containing 82 suspicious transaction dossiers involving about 80,000 suspicious transactions³⁷ have been transferred to the MPS for investigation (7 in 2004, 14 in 2005, and 36 so far in 2006). Nine of those disseminations have resulted in cases being filed for investigation and one of these has been transferred to the SPP for prosecution. More than 10 suspicious transaction dossiers have been transferred to other agencies, including 5 to the MSS since October 2005. Four of those cases are still being investigated by the MSS. The other one was closed after investigation.

2.5.2 Recommendations and Comments

237. After streamlining the STR reporting process so that STRs flow directly from the headquarters of financial institutions to CAMLMAC, consideration should be given to the problem of how to deal effectively with such a large volume of STRs coming directly to CAMLMAC (60 staff strong).

238. The access of CAMLMAC/AMLB to information held by other bodies could be improved or streamlined.

2.5.3 Compliance with Recommendation 26

	Rating	Summary of factors relevant to s.2.5 underlying overall rating
R.26	LC	<ul style="list-style-type: none">• Effectiveness: The CAMLMAC/AMLB does not have sufficient staff to effectively manage the very high volume of STRs and other reports that it receives.• The CAMLMAC/AMLB does not have (timely) access to other bodies' information.

2.6 Law enforcement, prosecution and other competent authorities – the framework for the investigation and prosecution of offences, and for confiscation and freezing (R.27 & 28)

2.6.1 Description and Analysis

Recommendation 27 (Designated law enforcement and prosecution authorities)

239. China's law enforcement and prosecutorial framework is structured as follows. The law enforcement authorities (the MPS and, to some extent, the MSS) are responsible to the NPC. The judicial authorities (SPC, the local people's courts, military courts and other special courts) and the prosecutorial authorities (SPP, the local people's procuratorates, military procuratorate and other special procuratorate) are independent from the administrative organs and are responsible to the NPC directly. The regional and local police forces are part of the regional and local Councils, which are responsible to the regional and local People's Congresses, which are responsible to the NPC. Therefore, all law enforcement, prosecutorial and judicial powers operate on the basis of the same source of power (i.e. the NPC which represents the people) to which they are responsible and by which they are supervised. This concept sometimes leads to a different attribution of competences than one would expect in jurisdictions that have another model of separation of powers (i.e. where power is divided between the executive, the legislative and the judiciary).

240. The MPS and MSS both work on the state level, but have regional branches. Regions and cities also operate their own law enforcement bodies under the auspices of regional and local People's Congresses (legislatures) and as part of regional and local Councils (executives), next to the

³⁷ The number of 80,000 refers to suspicious transactions—not suspicious transaction reports. (One STR may relate to many individual suspicious transactions.) Statistics are not maintained concerning how many of the 80,000 transactions are RMB transactions and how many are foreign exchange transactions.

decentralised MPS and MSS. AML/CFT investigations are mainly within the jurisdiction of the MPS and MSS, without precluding regional and local law enforcement bodies from working on AML/CFT and related issues.

Law enforcement authorities (MPS)

241. The main law enforcement or police body is the Ministry of Public Security (MPS). The MPS has many branches, of which the ECID is one. The ECID under the MPS is responsible for guiding and coordinating public security authorities across China in the investigation of economic offences. The Anti-Money Laundering Division of the ECID, which was established in April 2002, is responsible for guiding and coordinating public security authorities across China in investigations involving money laundering and the seizure, freezing and confiscation of proceeds of crime. References in this report to the “public security agencies or authorities” or simply “the police” concern the MPS, including its regional and local branches.

242. The public security authorities are responsible for investigating money laundering, terrorist financing and predicate offences (e.g. drug crimes, organised crime committed by the mafia, terrorist crimes, the crime of interfering with the order of financial administration and the crime of engaging in financial fraud). Special agencies and personnel are available in the public security authorities of all provinces, municipalities and counties to perform the investigation of money laundering, terrorist financing and other relevant tasks.

243. In addition, the Criminal Crime Investigation Bureau, the Anti-Terrorism Bureau, the Narcotics Control Bureau and the Smuggling Crime Investigation Bureau under the MPS are responsible for investigating crimes relating to criminal organisations or syndicates, drugs, terrorism and smuggling respectively. They are also responsible for investigating money laundering, terrorist financing and predicate offences related to the cases within their jurisdiction.

State security agencies with law enforcement powers (MSS)

244. The Ministry of State Security (MSS) is an intelligence body, but also has law enforcement powers which it exercises in certain cases. The state security authorities are responsible for investigating terrorist crimes against state security as well as related money laundering and terrorist financing crimes. In this respect, the MSS has the same criminal investigative responsibility as the MPS and also follows the CPC.

Customs and other authorities (GCA and MS)

245. Other bodies, such as the GCA and the MS, also have law enforcement responsibilities within their area of jurisdiction. The GCA, for instance, has special anti-smuggling departments that are responsible for investigating smuggling activity, including any money laundering that is related to it.

246. As well, in accordance with the AML Law and the AML Joint-Ministerial Conference Mechanism, the PBC, GCA, tax authorities, administrative supervisory authorities and the SAIC has some law enforcement powers specifically related to their AML/CFT responsibilities in the sectors over which they have jurisdiction.³⁸ These agencies are supported in terms of responsibility, organisation, finance, personnel and technology.³⁹

³⁸ Articles 10-11 and 30 AML Law; articles 4, 32 and 46 Law on the PBC; articles 2 and 6 Customs Law; articles 5, 37-38, 40, 54-58 Law on the Administration of Tax Collection; articles 2, 15-16 and Chapter 4 Law on Administrative Supervision.

³⁹ Law enforcement responsibilities are defined in: articles 3, 4 and 18 CPC; article 4 Customs Law; article 6 State Security Law; and article 6 People’s Police Law.

Prosecutorial authorities (SPP)

247. The prosecutorial authorities work under the leadership and guidance of the SPP, a nationwide centralised system. The same centralised model applies for the judicial authorities, led by the SPC. The prosecutorial authorities are responsible for prosecuting money laundering, terrorist financing and related predicate crimes. They are also responsible for investigating corruption and bribery, including related money laundering and terrorist financing.

Powers of arrest

248. To carry out their investigative functions, the law enforcement and other investigative agencies are authorised to use a wide range of investigative techniques that include the power to arrest suspects and seize suspicious funds.⁴⁰ The law enforcement agencies (including the public security authorities, the supervision authorities, the state security authorities and the anti-smuggling criminal investigation organs) may postpone (or waive in very rare cases) the arrest of a suspect and the seizure of funds, subject to the specifics of the case and the demands of the investigation.

Additional elements

249. Law enforcement authorities including the public security authorities, the prosecutorial authorities, the state security authorities and the anti-smuggling criminal investigation organs are entitled to adopt special investigation techniques.⁴¹ Such techniques include controlled payments, investigative experiments, uninformed searches, and the inspection and verification of electronic communication devices. These powers may be used in the context of money laundering and terrorist financing investigations, subject to rigid approval formalities. The evidence obtained through such techniques can be used in court. In practice, such techniques have been used in the context of investigations involving money laundering, terrorism and predicate crimes. According to the Chinese authorities, these special investigation techniques played a significant role in the successful conclusion of these investigations.

250. China also uses special investigative techniques in co-operative investigations with foreign counterparts. This can be done in accordance with the international treaties that China has concluded or entered into, or in accordance with the police cooperation agreements that the MPS has signed with the police authorities of 26 other countries. It is the policy of the MPS to actively enhance the cooperation with foreign (overseas) law enforcement authorities and to facilitate joint efforts in investigating and combating cross-border economic crimes. For instance, in April 2004, the MPS and the Immigration and Customs Enforcement Bureau under the U.S. Department of Homeland Security successfully investigated an illegal bank by using the investigative technique of controlled payment. This cooperation proved to be effective, as the U.S. side acquired evidence for the prosecution of suspects in the United States, and the Chinese side discovered information to help identify domestic underground banks.

251. The MPS attaches great importance to studies on methods, technologies and trends in such economic offences as money laundering and terrorist financing. It informs the financial supervisory authorities (such as the PBC and the CBRC) of the latest research findings on an occasional basis. At the periodic meetings for money laundering intelligence exchanges, the AMLB, the ECID of the MPS and CAMLMAC inform each other of new techniques, technologies and trends relating to economic crimes such as money laundering and terrorist financing, with a view to helping relevant agencies improve their ability to analyse clues related to suspicious and large-value transactions. The MPS also actively participates in the EAG's typologies exercises.

⁴⁰ Criminal Procedure Law.

⁴¹ Article 16 Police Law; articles 10-12 State Security Law; article 172 Provisions on the Procedures of the Public Security Organs in Handling Criminal Cases.

Recommendation 28 (Law enforcement powers)

252. The law enforcement agencies (including the public security authorities, the supervision authorities, the state security authorities and the anti-smuggling criminal investigation organs) are authorised to use a wide range of powers when conducting investigations of money laundering, terrorist financing and predicate offences. These powers include: (1) the compulsory acquisition (i.e. inquiry and detention) of articles, documents and other materials relevant to the crimes; (2) the search of persons, articles, houses and other premises where suspects or criminal evidence may be hidden; and (3) the seizure and acquisition of articles relevant to the crimes.⁴²

253. These powers may be exercised, subject to obtaining the law enforcement agency obtaining a search warrant or other relevant authorisation. These powers may also be used together with freezing and confiscation actions. For instance, law enforcement agencies may seize, detain and freeze the identified articles, documents and proceeds related to crimes in the course of searching houses and persons or requesting relevant information from financial institutions, enterprises or individuals.

254. Likewise, the PBC, GCA, tax authorities, administrative supervisory authorities and the SAIC are authorised to exercise powers of inquiry, detention, freezing, search and questioning when investigating cases under their jurisdiction. The evidence thus acquired (including any frozen funds or detained articles) may be used in any subsequent prosecution and enforcement procedures.⁴³

255. Law enforcement and state security organs, the GCA, PBC, CBRC, CSRC, CIRC, tax authorities and the SAIC are empowered to seize and obtain transaction records, identification data obtained through the customer due diligence (CDD) process, account files and business correspondence, and other records, documents or information held or maintained by financial institutions and other businesses or persons.⁴⁴ Detailed provisions on the obligation of deposit holding institutions to assist competent authorities are set forth in article 13 of the PBC Regulation Administration Regulations of Financial Institutions on Assisting in Works of Inquiring into, Freezing or Transferring Saving Deposits.

256. The power to take witness statements is based on the CPC and the State Security Law. Witness statements may be used as evidence during the prosecution and trial. In addition, witness testimony may be quoted during the investigation process.⁴⁵ Witness testimony was used effectively in all three of China's successful money laundering prosecutions under article 191 PC.

Recommendation 30 – Resources of law enforcement and prosecutorial authorities

Law enforcement authorities (MPS and MSS)

257. The organisation and funds of the public security agencies is set out in the law.⁴⁶ The budgetary resources of the police are guaranteed by the state, and respectively incorporated into central and local financial budgets in accordance with the division of authority. Necessary communication and training facilities, basic transportation and fire fighting structures, local police stations and premises for supervision and control purposes are incorporated into the infrastructure and overall plans for urban and local construction by the government at all levels. Additionally, the government is focused on

⁴² Chapter 6 CPC; articles 4 and 6 Customs Law; chapter 2 State Security Law.

⁴³ Article 26 AML Law; article 32 Law on the PBC; article 6 Customs Law; articles 37-40 and 54-58 Law on the Administration of Tax Collection; chapter 4 Law on Administrative Supervision.

⁴⁴ Article 34 Law on Banking Supervision and Administration; article 180 Securities Law; article 109 Insurance Law; article 2 Regulations on the Management of Foreign Exchanges.

⁴⁵ Chapter 3 Measures for the Supervisory Authorities to Handle Cases Regarding Political Disciplines on evidence and the inquiry of witnesses.

⁴⁶ Articles 37-40 Police Law.

modernising the armament of the law enforcement authorities, including equipping them with more scientifically and technologically advanced tools.

258. The law enforcement authorities are subject to the civil servants' remuneration system, and enjoy police rank-based and other subsidies, allowances, insurance and welfare. Police personnel are required to fulfil their responsibilities in pursuance of laws, and are protected by law and are free from improper influence and interference.⁴⁷ According to incomplete statistics, there are 35,000 police officers in the public security authorities available for investigation of money laundering and terrorism financing and other relevant tasks, and 200 police officers in the ECID/MPS. The AML Division of the ECID only includes 10 persons who are responsible for the investigation of money laundering and terrorist financing crimes. This number seems insufficient.

259. The law enforcement personnel of the public security authorities and the state security authorities are required to have high professional standards and qualifications. They are also subject to strict confidentiality rules (Police Law, chapters 3-4). Policemen Police officers are recruited through public examination, and must meet strict assessment and selection criteria. Persons serving in leading positions in the police must have: (1) professional knowledge of law; (2) experience in political and judicial work and having specified organisation, management and command abilities; (3) an educational background at or above college level; and (4) passed examinations after training at a police academy.

Prosecutorial authorities (SPP)

260. The SPP exercises prosecutorial power in pursuance of law and is free from interference from other administrative agencies, groups and individuals (article 131 Constitution of China; article 9 Organic Law of the People's Procuratorates; article 4 Public Procurators Law). Departments of Investigation and Supervision, and public prosecution are responsible for authorising arrests and prosecutions in criminal cases (including those related to money laundering and terrorist financing cases). Anti-embezzlement and bribery departments were established in the procuratorate system to be responsible for investigating cases related to offences. Currently, there are about 35,000 prosecutors in China. Additionally, there are 50,000 people responsible for investigating cases related to embezzlement and bribery.

261. Prosecutors are required to maintain high standards of professionalism, integrity and confidentiality (articles 8 and 10-11 Public Procurators Law).

Customs authorities (GCA)

262. Article 4 of the Customs Law specifies that a special police department must be established within the GCA to investigate smuggling offences (including money laundering related to smuggling cases). This department is staffed with about 8,000 anti-contraband policemen, who are responsible for conducting investigations, making detentions and arrests, and carrying out preliminary inquiries into smuggling cases under the department's jurisdiction. The law enforcement personnel of the GCA's anti-smuggling investigation departments must meet the same professional standards and qualifications and are subject to the same strict confidentiality rules as the police officers of the MPS and MSS (chapters 3-4 Police Law; articles 72-73 Customs Law).

AML/CFT Training

263. By law, professional training (including specific AML/CFT training) must be provided to the law enforcement personnel in the public and state security authorities, the prosecutorial authorities,

⁴⁷ Article 5 Police Law.

and the GCA's anti-smuggling investigation departments (article 29 Police Law; article 73 Customs Law; article 29 Public Procurators Law).

264. The Chinese authorities state that law enforcement agencies have prioritised AML/CFT training for their personnel. Training courses have been provided by the law enforcement agencies, domestic and foreign experts, international organisations and other countries. The content of the trainings covers a full array of matters, including (1) the scope of predicate crimes and the types of ML/FT, (2) techniques for the investigating and prosecuting such crimes, (3) technologies that can be used to trace proceeds; (4) seizure, freezing and confiscation, (5) technologies that can be used by supervisory authorities to ensure that financial institutions comply with their AML/CFT responsibilities; and (5) how to adapt information technology and other resources to fulfil AML/CFT obligations.

Additional elements

265. All judges must have at least a Bachelor's degree in law, meet moral standards and must pass a national judicial exam (which only about 7% of the candidates pass). Examinees include those who graduate from law school with bachelors, masters or doctorate degree. Judges must be provided with professional training, which is provided by national judicial colleges, universities and other training institutions (chapter 9 Judges Law). These include lectures on how to practically apply theoretical concepts, with an emphasis on the practical results that must be adhered to. Each year, judges are also provided specialised training on new and emerging issues, such as AML/CFT, intellectual property, etc. Each judge's academic results and appraisals achieved during training are of importance to decisions concerning appointment and promotion.

Effectiveness

266. Typically, the MPS and other enforcement agencies focused their efforts on predicate crimes rather than money laundering, and used financial information as lead information and for intelligence purposes in the past. While the Chinese authorities continue to make efforts to combat economic crime, investigators are intended to integrate a financial approach into their overall investigation of the predicate offence. This is partially due to the fact that because self-laundering is not criminalised, self-launderers can only be prosecuted by the predicate offence. This philosophy is also evidenced in the MPS approach to combating illegal money remitters. While many of those investigations reveal money laundering activities, only the offence of operating an illegal financial institution/business is pursued as this is considered to be more convenient. The same holds true for pursuing cases of terrorist financing. Investigators have concluded that, of the 58 terrorist convictions, some of the suspects may have been involved in terrorist financing, but they were not charged with that offence. However, increased enforcement resources will be devoted to ML/TF cases, because the MPS recognises the value of financial information in identifying criminal behaviour.

2.6.2 Recommendations and Comments

267. Law enforcement and prosecutorial authorities currently focus on pursuing predicate offences, to the exclusion of ML/FT. Overall, China should take measures to improve the effectiveness of its AML/CFT regime by ensuring that law enforcement and prosecutorial authorities also focus on money laundering and terrorist financing cases. In this regard, China should consider creating multi-agency, multi-disciplinary task forces which combine the skills and expertise of a number of different agencies. These task forces should be focused on money laundering and terrorist financing investigations, as opposed to investigating particular predicate offences. This may help to address some of the overlap that currently exists between the MPS and MSS. Presently, the MPS and MSS both have responsibility for investigating terrorist financing, but their jurisdiction differs depending on where the crime takes place (the MPS focuses on domestic terrorist financing investigations) and whether it was committed against the state (the focus of the MSS). The system would also benefit from increasing the number of law enforcement staff who are specifically focused on AML/CFT (e.g.

at the ECID/MPS) to ensure that there is sufficient staff allocated to follow-up effectively on the STRs being received from CAMLMAC.

268. The Joint-Ministerial Conference Mechanism on AML should also be utilised to achieve the above-mentioned goals. In addition, the communication between the law enforcement and prosecutorial authorities should be improved, with a view to enhancing the understanding of investigators concerning the legal elements needed to successfully prosecute a money laundering case. For example, investigators from the MPS should work more closely with the SPP in determining which criminal charges will be pursued during an investigation and how best to make use of limited resources. Investigators also need to enhance their understanding of how to pursue money laundering cases where the predicate offence has been committed overseas, but the funds are laundered in China.

269. While much AML/CFT training has taken place, all agencies should train their investigators on conducting financial investigations including “follow the money” techniques and forensic accounting skills. Investigators should also increase their understanding of financial records and corporate documents.

2.6.3 Compliance with Recommendations 27 & 28

	Rating	Summary of factors relevant to s.2.6 underlying overall rating
R.27	LC	<ul style="list-style-type: none"> • There is no emphasis placed on pursuing ML/FT investigations. Investigators are not focused on attacking the money aspect of criminal offences. • Investigators do not seem to be fully aware of the legal elements of ML that they need to prove.
R.28	C	<ul style="list-style-type: none"> • This Recommendation is fully observed.

2.7 Cross Border Declaration or Disclosure (SR.IX)

2.7.1 Description and Analysis

270. China has opted to implement a combined disclosure/declaration system which is supervised by the General Customs Administration (GCA). A declaration system has been implemented in relation to cross-border transportations of cash in amounts above prescribed thresholds. Furthermore, cross-border transportations of RMB cash in amounts above prescribed threshold is strictly prohibited, and the cash will be seized or returned to its origin. Declaration obligations exist in relation to cash, gold and silver as well as its manufactured products. A disclosure system has also been implemented in relation to any cross-border transportations of cash, including those in amounts below the prescribed thresholds. This system pre-dates Special Recommendation IX, but has been updated with the enactment of the AML Law. The Customs Law and the AML Law attribute the necessary administrative powers to the GCA. Other supporting laws to control the cross-border transportation of these items include the PC and CPC.

Implementation of a declaration system

271. All inward and outward transportations of cash above the prescribed thresholds (including those between China and Hong Kong SAR or Macau SAR) must be truthfully declared and are subject to examination by the GCA (articles 46-47 Customs Law).

272. China uses threshold limits to control the inward and outward movements of RMB (Control Procedures of China on Carrying the State Currency Into or Out of the Country of 1993). The specific thresholds are decided by the PBC, in consultation with the GCA. Any amount of RMB being

transported across the border must be truthfully declared to the GCA on a declaration form if it exceeds RMB 20,000 (EUR 2,000 or USD 2,500).⁴⁸ Cross-border transportation of RMB through the mail system or in vehicles is not permitted. For foreign currency, any amounts over USD 5,000 (or any equivalent foreign currency) must be declared (Regulation on the Administrative of Carrying of Foreign Currency for Persons Entering or Exiting the Territory).

273. The obligation to declare only applies to cash (RMB or foreign currencies), not to bearer negotiable instruments. For instance, with respect to foreign currency, no declaration is needed when a person carries foreign currency in payment vouchers such as drafts, traveller's checks, international credit cards, certificates of bank deposits, certificates of postal savings etc. or foreign currency marketable securities such as government bonds, corporate bonds, stocks, etc (article 18 Regulation on the Administrative of Carrying of Foreign Currency for Persons Entering or Exiting the Territory). This gap may be filled by article 12 of the AML Law which states that the GCA should report to the PBC instances where individuals cross the border with cash and negotiable instruments over a certain amount. However, the GCA will first have to implement article 12 of the AML Law into its own regulations. The preliminary plans for implementation include: (1) GCA with other competent authorities issues Administrative Rules on the Transportation of Negotiable Instruments based on research, specifying the threshold and the declaration and disclosure obligations; (2) GCA and PBC specify the standard and procedures for the GCA to report information concerning transportation of cash or negotiable instruments above the threshold amount; (3) Establishing an information sharing arrangement between the GCA and PBC to create a effective AML monitoring system for the ports.

Implementation of a disclosure system

274. China has also implemented a disclosure system. In practice, China uses a risk-based targeting system where passengers are randomly identified through x-ray or observations for questioning. The law authorises GCA inspectors to ask questions or conduct investigations relating to any illegal carrying of cash across the border and to gather evidence during the investigation (article 6 Customs Law; articles 33-48 Implementing Regulations on Administrative Penalty for the Customs). Persons who are the subject of these inquiries are legally obligated to cooperate and answer truthfully (article 12 Customs Law). The Chinese authorities have indicated that future plans include having the GCA's inspectors conduct specific investigations targeting cross-border transportation of cash if they receive intelligence that it is suspicious or may be related to ML activities.

Powers of competent authorities upon discovery of a false declaration/disclosure or suspicion of ML/FT

275. The GCA is authorised to inspect particular, suspicious or random targets; check and examine cross-border vehicles, goods and articles; and may detain those in violation of the state regulations on the control of the cross-border transportation of cash or other relevant laws and administrative regulations (article 6 Customs Law).

276. Cross-border travellers who carry cash above the prescribed threshold, but fail to submit a declaration to the GCA, or cross-border travellers who fail to pass customs by the designated passages (meaning that they pass through the green "nothing to declare" channel rather than the red channel), can be dealt with in accordance with relevant provisions in the Customs Law and Implementing Regulations on Administrative Penalty for the Customs (article 15 Customs Regulations on Clearance of Entering and Exiting Passengers).

277. The GCA may seize any undeclared cash or impose punishments on the identified illegal transportation of cash that exceeds the prescribed thresholds (article 6 Customs Law; articles 7 and 19

⁴⁸ The RMB threshold was set by the PBC in November 2004. The foreign exchange threshold was set by SAFE in September 2003.

Implementing Regulations on Administrative Penalty for the Customs). Customs may also check inward and outward means of transportation, examine inward and outward goods and articles, and detain anyone who is entering or leaving the territory in violation of the law or relevant administrative regulations (article 6 Customs Law).

Information collected and retained

278. The process that travellers entering and exiting China at airports must follow, including the specification of the forms that must be completed, is set out in the 23rd notice of the GCA, the Notice on the Declaration System for Travellers Entering and Exiting China at Airports (2005). Each traveller is required to complete a “Baggage Declaration Form for Incoming/Outgoing Passengers” which contains the name, date of birth, passport number or identity number of the passenger, and the description and amount of the currency being transported. These forms are kept in both electronic and paper formats and are centralised at the GCA headquarters in Beijing. The SAFE may also collect information recorded in the declaration form (the Permit for Taking Foreign Exchange out of the Territory). This includes identity information such as the name, nationality and passport number of the carrier (Interim Measures for the Administration of Carrying Foreign Currency Cash for Persons Entering or Exiting the Territory).

279. Prior to the AML Law coming into force on 1 January 2007, CAMLMAC was not authorised to ask the GCA for information concerning cross-border transportations of cash, gold, silver or manufactured products. Article 12 of the AML Law now requires the GCA to report cash and bearer negotiable instruments over a prescribed amount to the PBC. The prescribed amount (i.e. the threshold for information exchange) is an amount to be decided by the GCA and the PBC and which may differ from the thresholds that trigger the reporting obligations. The GCA’s obligation to report does not automatically extend to reports on false disclosures, although the GCA indicated that they will be reforming their systems to enable immediate transfer of information to CAMLMAC, including information concerning legitimate cash disclosures. It should be noted that, at the time of the on-site visit, these information-sharing mechanisms between the GCA and CAMLMAC had not yet been implemented, and CAMLMAC confirmed that it has not yet received any such information from the GCA. Nevertheless, although mechanisms which would allow CAMLMAC to systematically obtain information concerning cross-border transportations of cash have not yet been implemented, the GCA does cooperate with CAMLMAC and can exchange information in special cases if warranted.

Coordination among domestic competent authorities

280. Special public security agencies with full-time coastguards have been established at the GCA to investigate smuggling acts (including currency smuggling) and carry out investigations, detentions, arrests and preliminary trials against smuggling cases within its jurisdiction (article 4 Customs Law). In practice, the GCA works very closely with immigration officers at the borders to identify passengers. On the policy level, the AML Joint-Ministerial Conference Mechanism provides a law enforcement information and coordination platform for the GCA, the PBC and other relevant agencies to implement Special Recommendation IX.

International cooperation and assistance

281. China has been a member of the World Customs Organisation (WCO) since January 1983. In January 2004, China began to establish a Regional Information Liaison Office (RILO) for the WCO in the Asia-Pacific region. The GCA also actively extended case investigation and intelligence exchanges by virtue of such cooperative frameworks as Asia-Pacific Economic Cooperation (APEC), Asia-Europe Meeting (ASEM), China-Association of Southeast Asian Nations (China-ASEAN) and the Shanghai Cooperation Organisation.

282. The GCA has also established business contacts with the customs authorities of 107 countries or territories, and has engaged in substantial cooperation with 75 of these. Long-term cooperative

relations have been maintained with over 10 countries, including the United States, Russia, Japan, South Korea, Australia and the Netherlands through mutual annual visits, routine cooperation meetings and ministerial meetings. As of April 2005, the GCA had entered into 28 bilateral agreements (e.g. accords, memorandums, arrangements, exchanges of notes, etc.) with foreign governments and customs authorities. These bilateral agreements, which apply to 51 countries or territories, are the framework under which the GCA can obtain assistance and respond to requests from foreign customs in relation to investigations.

283. In March 2003 and March 2004, the GCA signed the Arrangement on the Coordination and Mutual Assistance of Customs with the customs authorities of Hong Kong SAR and Macau SAR. This arrangement comprehensive governs the GCA's cooperation with the Hong Kong and Macau customs authorities in terms of the simplification of customs formalities; exchanges of experience, personnel and intelligence; special supervision, reviews and inspections; combating against drug smuggling, providing for joint actions; and protecting intellectual property rights and the Closer Economic Partnership Agreement (CEPA). It also established three liaison systems, (1) the annual top meetings, (2) Guangdong-Hong Kong (Macau) customs meetings and (3) periodic meetings of liaison officers.

Sanctions

284. A wide range of sanctions apply equally to those who make a false declaration or disclosure, and to those who carry out a physical cross border transportation that is related to money laundering or terrorist financing. In the latter case, the courier is also subject to the regular criminal sentences for money laundering and terrorist financing. Almost all of the sanctions stipulated—whether for making a false declaration disclosure or for transporting cash related to ML/FT—include the ability to freeze, seize and confiscate the cash involved.

285. The following provisions apply to illicit transportations that are related to legal currency (cash) but do not constitute “smuggling activities” as specified by articles 7 and 8 of the Regulations. Anyone who is found with “goods” (meaning legal currency, gold and silver, manufactured goods, produce, and other objects) or “articles” (meaning any goods that are for personal use and are of a quantity that is within the reasonable range for personal use) in any of the circumstances listed below will be given a warning, may be fined up to 20% of the value of the goods concerned and must forfeit any illegal income thereof [article 9(3) Implementing Regulations on Administrative Penalty for the Customs]:

- (a) unpacking, picking up, delivering, sending, transferring, or making other disposal of the goods that have not yet been allowed to enter into or get out of the boundary by the GCA, without its prior approval;
- (b) transporting, carrying, or mailing an unreasonable quantity of personal articles into or out of the country without reporting to the GCA;
- (c) transporting, carrying or mailing personal articles (the importation or exportation of which is restricted by the GCA) exceeding the regulated amount⁴⁹ into or out of the country without reporting to the GCA and attempting to avoid its supervision by means of hiding, disguising, etc.;
- (d) transporting, carrying or mailing personal articles into or out of the country with a false declaration to the GCA;

⁴⁹ Legitimate currency is considered to be a “restricted article”. In the context of transporting legal currency, “the regulated amount” in article 19(3) refers to the current reporting threshold of RMB 20,000 or foreign currency with a value of USD 5,000.

- (e) re-carrying, into or out of the country, articles that have been registered by the GCA as being tax-exempt without complying with relevant regulations; and
- (f) passing across the border and leaving articles within the country without the prior approval of the GCA.

286. Smuggling activities are sanctioned as follows. Anyone who does not submit a license as required, so as to smuggle goods or articles which the government has restricted from entering or leaving the country (even if they pay the applicable tax), is subject to having the smuggled goods or articles and illegal incomes forfeited, and in addition, may face a fine of up to the value of the smuggled goods or articles. Finally, anyone who complies with the administration of licenses requirement, but avoids or escapes tax payable, so as to smuggle goods and articles on which tax is payable, must forfeit the smuggled goods and articles and illegal incomes, and may be subject to a fine of up to three times to the amount of the tax payable [article 9(2) Implementing Regulations on Administrative Penalty for the Customs].

287. Counterfeit currency is prohibited from importation or exportation. Transportation of counterfeit currency may be punished by article 9(1) of the Regulation or article 151 of the Criminal Law, depending on the specific circumstances. Such punishments include seizure of the currency. Additional criminal penalties for specific types of smuggling activity are set out in the Criminal Law (chapter 3, section 2).

Gold and silver

288. China heavily controls the import of gold and silver. There is no limit to the quantity of gold and silver that may be carried into China; however, it must be declared to the GCA at the port of entry (Regulations on the Control of Gold and Silver on the control of cross-border gold and silver transportation).

289. Gold and silver that is being taken (or retaken) out of China must also be declared and be accompanied by a certificate that is issued by the PBC and which specifies the quantity of gold or silver in question. The GCA can only release the gold or silver after examination confirms that the quantity being taken out of the country matches the quantity specified in the PBC certificate or on the declaration form at the time of entry. If no certificate is presented or the amount exceeds the amount specified in the declaration form which was cleared at the time of entry, the gold and silver are prohibited from leaving China. When an unusual cross-border shipment of gold, precious metals or precious stones is discovered, the GCA considers notifying the customs service or other competent authorities of the countries from which the items originated or to which they are destined and cooperates with those authorities through the WCO with a view to establishing source, destination and purpose of the movement of such items.

290. Customs releases circulars on the smuggling of precious metals through the Customs Enforcement Network (CEN) of the World Customs Organisation (WCO).

Additional elements

291. The judicial authorities and law enforcement agencies (including the SPC, the SPP, the public security authorities and the state security authorities) are authorised by law to obtain from the PBC, GCA and SAFE data on the cross-border transportation of cash

292. The systems for reporting cross border transactions are subjected to strict safeguards to ensure proper use of the information or data that is reported or recorded. This is evidenced by the current procedures with how the FIU and other law enforcement authorities gain access to this data from customs.

Statistics

293. The GCA does not maintain statistics on the number of cash declarations made (i.e. the number of cross-border transportations of currency and bearer negotiable instruments) with the exception of limited statistics relating to cases of false disclosures of travellers who did not declare. The GCA provided some statistics on the amount of foreign currency seized at the border.

Effectiveness

294. The GCA has indicated that not many cash declaration reports exist, due to the fact that the declaration thresholds for cash are sufficiently high that people prefer to travel with credit cards and bearer negotiable instruments (although no such statistics are kept). The limited statistics that were available related to cases of false disclosures of travellers who did not declare. There were 4,926 such cases from January 2005 to October 2006. Of these, 1,740 related to cross-border transportations of currency in excess of RMB 10,000. This data is not effectively being utilised by CAMLMAC or other authorities who investigate ML or TF.

295. The GCA is able to use its own powers to confiscate in administrative cases. However, if a criminal offence or smuggling is involved, the decision to confiscate is made by a court. The following table sets out the amounts confiscated (in relation to both cross-border importations and exportations of RMB and foreign currency, including amounts that were re-exported) from 2002 to 2005.

Custom Statistics (all figures are in million RMB)	2002	2003	2004	2005
Confiscation of foreign currency at the Customs clearance for postal ⁵⁰ items and passengers	30.9	29.5	23.1	22.3
• of which on importation	0.4	0.1	5.3	8.3
• of which on exportation	30.5	29.4	17.8	14.0
Confiscation of RMB at the Customs clearance for postal items and passengers	3.2	8.1	8.4	4.5
• of which on importation	1.4	3.1	5.9	2.6
• of which on exportation	1.8	5.0	2.5	2.0
Foreign currency re-exported at the Customs clearance for postal items & passengers	325.1	240.9	235.3	402.6
• of which on importation	7.2	0.9	0.6	1.2
• of which on exportation	317.9	239.9	234.8	401.4
RMB re-exported at the Customs clearance for postal items & passengers	83.8	64.0	85.7	68.6
• of which on importation	18.1	13.0	17.5	20.0
• of which on exportation	65.7	51.0	68.2	48.6

2.7.2 Recommendations and Comments

296. China has a basic legal framework and structure that can be used to control the physical cross-border transportation of currency and monetary instruments that are related to money laundering and

⁵⁰ Postal items include checked-in luggage, luggage brought with passengers, and items by common post or by express post (article 64 Implementing Regulations on Administrative Penalty for the Customs).

terrorist financing. However, the existing system was not designed to meet this objective. China’s declaration/disclosure system was designed to control the amount of currency (by setting strict limits) that enters or exits the country. The system should therefore be modified to be more effective, and to address the requirements of Special Recommendation IX.

297. Specifically, article 18 of the Regulation on the Administrative of Carrying of Foreign Currency for Persons Entering or Exiting the Territory should be amended to stipulate the reporting of bearer negotiable instruments. In addition, the authorities will have to implement a system where all cash declarations are automatically provided to CAMLMAC, not only those which relate to false disclosures. It is also highly recommended that the threshold for reporting cash declarations to the FIU (article 12 AML Law) be consistent with the current thresholds for declaring currency.

298. The GCA should keep statistics on the number of cash declarations made.

2.7.3 Compliance with Special Recommendation IX

	Rating	Summary of factors relevant to s.2.7 underlying overall rating
SR.IX	PC	<ul style="list-style-type: none"> • System focuses exclusively on cash. Bearer negotiable instruments are not included. • Reports on cash declarations/seizures are not being provided to the FIU and are not being used to identify and target money launderers and terrorist financiers.

3. PREVENTIVE MEASURES - FINANCIAL INSTITUTIONS

Customer Due Diligence & Record Keeping

Preamble: Overview of the legal framework

Laws, regulation and guidance

299. Throughout this section of the report, extensive reference is made to various types of laws, regulations and guidance. Laws are primary legislation⁵¹. Regulations, Rules and Measures all constitute secondary legislation. All primary and secondary legislation is enforceable.

300. China’s AML/CFT framework is relatively new and is currently undertaking a process of transition from the so-called “one rule and two measures” regime (introduced in 2003) to a system based upon the AML Law enacted in October 2006 and its accompanying rules.

Outgoing AML measures (2003)

301. The outgoing AML regime, instituted in March 2003, comprised the Rules for Anti-Money Laundering by Financial Institutions (the Old AML Rules), supported by Administrative Rules for the Reporting of Large-value and Suspicious RMB Payment Transactions (the RMB-LVT/STR Rules) and The Administrative Rules for the Reporting by Financial Institutions of Large-Value and Suspicious Foreign Exchange Transactions (the FX-LVT/STR Rules) (“one rule and two measures”). These were all issued by the PBC. The Old AML Rules (which are no longer in force) applied to the banking, trust and finance sectors (i.e. institutions regulated by the CBRC). However, the RMB-LVT/STR Rules and the FX-LVT/STR Rules, which set out the STR reporting obligations, apply only to the banking sector, specifically policy banks, commercial banks, urban and rural cooperatives, postal savings institutions and any financial institutions that operate foreign exchange business.

⁵¹ Some laws are called Trial Law or Law in Trial. These are provisional laws, nonetheless, they are in force and have the same status as regular laws.

Incoming AML measures (2006)

302. The new legal framework is based on the AML Law (enacted on 31 October 2006) and the two new rules issued by the PBC on 14 November 2006: the "Rules for Anti-Money Laundering by Financial Institutions" (the AML Rules) and the "Administrative Rules for the Reporting of Large-Value and Suspicious Transaction by Financial Institutions" (the LVT/STR Rules). The AML Law and the AML Rules, which replace the Old AML Rules (i.e. the "one-rule"), came into effect on 1 January 2007.

303. The LVT/STR Rules came into force on 1 March 2007. Implementation of these new reporting rules was deferred to allow the banking sector to modify its systems, and the securities and insurance sectors to institute reporting procedures for the first time. In the meantime, the RMB-LVT/STR Rules and the FX-LVT/STR Rules (the "two measures") remain in effect. The authorities have also indicated that it is their intention to issue additional rules relating to the CDD obligations for financial institutions (and further rules covering the DNFBP sectors), which shall come into effect end of July 2007.

304. The AML Law covers "all financial institutions established in the territory of the People's Republic of China", that are: policy banks, commercial banks, credit cooperatives, postal savings institutions, trust investment companies, securities companies, futures broker companies, insurance companies, and other institutions engaged in financial businesses identified and proclaimed by the Competent Authority (article 34). Article 2(1) of the AML Rules refers to the explicitly mentioned financial institution and additionally to: trust investment corporations, futures brokerage firms, fund management companies, asset management companies, finance companies, leasing companies and money brokers (i.e. all of the financial sectors that are supervised by the three regulatory bodies, the CBRC, CSRC and CIRC). Additionally, these sectors were (and remain) subject to a variety of prudential and administrative laws and rules that also have some relevance to AML measures, particularly with respect to customer identification. While some of these laws also address the category of foreign-invested financial institutions, these are not a standalone category using the functional categorising approach by the AML Law and the AML Rule. They refer to any financial institutions with foreign investment.

305. The AML Rules also make it clear that the provisions "are applicable to institutions engaged in remittance, payment and clearing, and the sales of funds". In China, only banks are currently authorised to provide foreign exchange and money or value transfer (MVT) services. Therefore, for ease of reference in the following discussion of the financial sector, unless otherwise specified, the providers of these services are included in the term "bank". Where specific requirements apply to banks when providing foreign exchange or MVT services, these have been noted. There is provision for the PBC to designate additional types of institution by order, but no such order has been made so far.

Preamble: Approach taken towards the ratings

306. The transition to the new AML measures is taking place progressively over a period of several months. At the time of the onsite visit, both the new general AML Rules and the LVT/STR Rules had been promulgated, and the evaluation team had the opportunity to review them and discuss relevant issues with the authorities. Therefore, this section of the report contains a full description and analysis of these measures. However, because the LVT/STR Rules did not take effect within a sufficiently short time after the on-site, they are not taken into account within the ratings. Instead, the ratings are based on a combination of the AML Law and general AML Rules that came into effect on 1 January 2007, together with the RMB-LVT/STR Rules and the FX-LVT/STR Rules, both of which have been in force since 2003. No account is taken at all (nor is there any description) of the proposed new CDD rules, since these had not been drafted at the time of the on-site.

Preamble: Institutions in the financial sector to which AML/CFT obligations apply

3.1 Risk of money laundering or terrorist financing

307. China has decided to apply a uniform set of AML/CFT measures to the entire financial system. The authorities have not undertaken any risk assessment to decide whether particular sectors should not be included in the scope of AML/CFT regime. Likewise, China's legal and administrative framework currently does not provide for a risk based approach to the application of preventive measures for financial institutions.⁵² As a result, the following description and analysis is based on the existence of "hard" rules that apply to all covered institutions.

3.2 Customer due diligence, including enhanced or reduced measures (R.5 to 8)

3.2.1 Description and Analysis

Recommendation 5 (Customer identification and due diligence)

308. References to "financial institutions" in this section apply equally to the banking (including foreign exchange and MVT services), securities, insurance and all other financial sectors (see article 34 AML Law). The requirements that apply to all financial sectors are only mentioned once in the following section on the banking sector and are not repeated in subsequent sections. The AML Law and AML Rules set out customer identification requirements that apply to all financial institutions. The RMB-LVT/STR Rules and FX-LVT/STR Rules also contain some CDD requirements; however, these only apply to the banking sector (including foreign exchange and MVT services), and are no longer in effect as of 1 March 2007 (when the new LVT/STR Rules came into effect). Because the new LVT/STR Rules came into effect more than two months after the on-site visit, they were not taken into account in the ratings (although they are described throughout this report). In any event, they do not contain specific CDD obligations. The Chinese authorities are currently in the final stages of drafting rules that are intended to impose more comprehensive CDD requirements on all financial sectors.

Banking sector (including foreign exchange and MVT services)

309. There are two main types of bank accounts in China: (1) deposit accounts (i.e. savings accounts) (referred to in China as time, current or notice deposit accounts) which can only be used to deposit or withdraw funds; and (2) current accounts (referred to in China as "settlement accounts") which can be used to make and receive payments. Natural or legal persons can open deposit and "settlement" accounts in RMB or foreign currency.

310. **Anonymous accounts:** The AML Law explicitly prohibits financial institutions from opening or maintaining anonymous accounts or accounts in fictitious names. Additionally, financial institutions are not allowed to provide services to or conduct transactions with any customer whose identity is yet to be clarified (article 16 AML Law).

311. **When establishing business relations:** When establishing business relationships, financial institutions must require their customers to show an original and valid identity card or other identity document that has been issued by a reliable and independent source (article 16 AML Law). For instance, when opening an account, customers who are residents of China must produce an official or temporary ID card, or in the case of military unit servicemen or armed police, an army or police ID card. Customers who are residents of Hong Kong, Macau and Taiwan must produce valid ID cards that have been issued by their immigration/emigration authorities. Foreign citizens must produce passports. The financial institution must verify the customer's identity documents (i.e. examine their

⁵² The Chinese authorities indicate that they plan to implement a risk based approach in the future with respect to AML supervision.

authenticity, completeness and legality) and keep a record of the identity information contained therein (article 16 AML Law). Financial institutions may also, at their discretion, verify the customer's identity through the SAIC or public security departments (article 18 AML Law).

312. Additional verification requirements apply to the banking sector.⁵³ If the customer's application and supporting documentation meet the basic requirements for opening an account, the bank forwards these materials to the local branch office of the PBC. The PBC reviews the bank's conclusion and approves the opening of the account, if appropriate [article 27, Administrative Rules for RMB Bank Settlement Accounts (RMB SA Rules)]. Additionally, the customer identification information is entered into a processing system that is operated by the PBC. This system is designed to control and supervise the opening and use of bank accounts in China and to facilitate the sanctioning of those who open accounts illegally.

313. China's national identity card system facilitates the identification of Chinese citizens who are required to carry a national identity card at all times if they are of 16 years of age and older. For persons under 16 years of age, a certification of permanent residence registration (Hukou) is required for identification. (e.g. article 5(2) Provisions on the Real Name System for Personal Deposit Accounts). Every certification of permanent residence registration has the person's national identity number, which is assigned right after the birth. At the time of the on-site visit, China was in the process of replacing the first generation of identity cards with second generation identity cards, which contain a photograph of the cardholder and use secure printing and a digital ID-tag on the basis of a 18-digit citizen number that is assigned to each Chinese citizen at birth, that can be read by card reading machines. The Chinese authorities believe that approximately 315 million second generation cards have been issued so far. At this rate, the changeover from first to second generation cards will be completed in 2008. In the meantime, the NPC has not yet set an expiry date for the first generation cards, meaning that, for now, the majority of the population will still be able to use them.⁵⁴ This raises some concerns since, according to the Chinese authorities, the first generation card was easily forged and forgeries have been used to open bank accounts. Consequently, customer identification that is carried out on the basis of first generation cards is not necessarily reliable. Also, according to the Police, approximately 5 million citizens have identical ID card numbers because the first generation ID cards were issued manually⁵⁵. To some extent, these issues will be addressed when the changeover from first to second generation cards is complete, particularly as the second generation card is much harder to forge. According to the PBC, currently there is a regional trial to give financial institutions access via PBC to the database of the MPS to confirm whether the presented ID-card is authentic and the person appearing at the financial institution is the owner of this ID-card. It is intended to provide this service to all financial institutions by the end of 2007.

314. **When carrying out occasional transactions:** When providing occasional services above a "prescriptive amount" (e.g. cash remittance, currency exchange, payment for bills, etc.), financial institutions are required to follow the same customer identification and verification procedures as described above [article 16 AML Law; article 9(1) AML Rules]. The FATF requires CDD to be carried out in relation to occasional or one-off transactions that exceed EUR/USD 15,000, a requirement that is not met since such "prescriptive amount" has not yet been fixed by the Chinese authorities. Therefore, in the absence of a clear threshold for occasional transactions, it is questionable

⁵³ Articles 17 and 22 subsequent Real Name System Provisions; Article 6 subsequent RMB SA Rules; article 11 subsequent Regulation on Administration of Domestic Foreign Exchange Account; article 9 Measures for the Administration of Securities Registration and Clearing and RMB-LVT/STR Rules.

⁵⁴ ID cards issued to citizens of 45 years and older are valid indefinitely / never expire. ID cards issued to 16-26 year old citizens are valid for 10 years only, while ID cards issued to 26-45 old citizens are valid for 20 years.

⁵⁵ China Post, "Identity crises leaves many without license" (15 November 2006), citing an article from Chongqing Morning Post, on page 5.

whether the obligation itself is even enforceable.⁵⁶ The Chinese authorities stated that financial institutions are nevertheless required to conduct CDD on all of their customers (including all occasional customers regardless of the value of the transaction) by virtue of article 3 of the Rules for the Implementation of the Measures for the Administration of Financial Institutions' Report of Large-value and Suspicious Foreign Exchange Transactions. Article 3 states that financial institutions "shall stick to the principle of 'having good knowledge of your customers'...when developing business relations with its customers and handling the foreign exchange business". However, this argument is rejected on the basis that article 3 does not specifically address occasional services and, moreover, it is unclear how article 3 (which is contained in rules) could override an explicit reference in the AML Law to a "prescriptive amount".

315. When processing foreign exchange transactions for customers, banks (which are the only type of financial institution that conducts such activity) are required to verify the customer's name, ID document and its number, address, occupation, household income and other information about the customer's family (article 4 FX-LVT/STR Rules).⁵⁷

316. **When there is a suspicion of money laundering:** Financial institutions are required to undertake CDD when an abnormality (which would presumably include money laundering activity) is discovered in the course of doing business [article 9(3) AML Rules].

317. **When carrying out wire transfers:** According to the Rules for Payment and Settlement and the Accounting Measures for Payment and Settlement, the following elements are required for all kinds of payment instruments (both RMB and FX): payee's name, payer's name, definite amount, name of the bank that receives the transfer, name of the bank that issues the transfer, account number of payee and payer. Banks are required to examine related information when carrying out wire transfers [e.g. articles 171 and 174 of the Rules for Payment and Settlement; Part 6, 1(1)(2) of the Accounting Measures for Payment and Settlement]. The remitting and the receiving bank should not handle a transfer without all the required information [e.g. article 171 of the Rules for Payment and Settlement, and Part 1, II(IV) of the Accounting Measures for Payment and Settlement]. The aforementioned provisions refer explicitly to "telegraphic transfers and mail transfers", which is clarified in a notice from the PBC to include wire transfers. The Accounting Measures for Payment and Settlement specifically refers to "electronic remittance".

318. **When there are doubts about the veracity/adequacy of previously obtained customer identification data:** By law, customers who hold "settlement" accounts are required to report any changes in their identity information to the relevant financial institution. Additionally, banks are required to update customer information on annual basis or in a timely fashion if any change occurs (article 62 RMB SA Rules). Financial institutions are also required to re-identify the customer when the authenticity, validity or integrity of previously-obtained identification information is doubted or an abnormality is discovered during the course of business [article 16 AML Law; articles 9(1) and 9(3) AML Rules]. An abnormality would, obviously, include a suspicion of money laundering or terrorist financing.

319. **Legal persons:** The banking sector is subject to specific requirements relating to the identification of legal persons, as described below. These requirements do not apply to the securities or insurance sectors.

Legal persons may open "settlement" accounts. The account opening application must be filed by the legal person's head or authorised representative, and must include his/her personal ID card, authorisation to act and the following documents issued by the relevant government authorities:

⁵⁶ The Chinese authorities stated that a threshold will be set out in the new CDD rules which are expected to come into force shortly.

⁵⁷ As of 1 March 2007, article 4 of the FX-LVT/STR Rules is no longer in effect.

- (a) an original copy of its business licence (for an enterprise or self-employed entity);
- (b) a registration certificate (for a branch or office of a foreign company,⁵⁸ a financially independent subsidiary⁵⁹, a social organisation or private organisation⁶⁰ that is not an enterprise) which contains, *inter alia*, the name and address of the legal person's head office and information on its shareholders, directors and chief representatives; or
- (c) an approval letter and/or certificate (for a private organisation that is not an enterprise, a religious organisation, government agency, public institution, military unit, armed police unit or detachment, community agency, an office of an international organisation or any other types of organisation).

320. If the customer is a foreign company (i.e. registered overseas), it must also provide evidence that it has received government approval to operate in China. The foreign investment approval process is stricter if the foreign company is registered in a known offshore financial centre.

321. If a foreign exchange account is being opened, additional procedures must be followed, including obtaining written approval from SAFE to open and use the account (articles 11 and 12 Regulation on Administration of Domestic Foreign Exchange Account). When processing foreign exchange transactions, the bank must verify the identity of the customer and its head or authorised representative, the documents that were provided in support of opening the account, the legal person's registration code, address, registered capital, business scope, size of business operation and the average daily transaction volume of the account (article 4 FX-LVT/STR Rules).⁶¹

322. The name used by the legal person to open an account must be consistent with the name or title that appears in its identification documents. For instance, a self-employed entity with a brand name must ensure that the brand name which appears in its business licence is consistent with the name that is used to open its "settlement" account. In the case of a self-employed entity that has no brand name, the name(s) of its owner(s) as appears in its business licence and the phrase "Self-employed Entity" must be used (article 24 RMB SA Rules).

323. Banks are required to set up customer information files that enable them to understand the ownership and control structure of customers who are legal persons. However, they are only obliged to do so when the customer is opening a bank account (article 4 FX-LVT/STR Rules; article 10 RMB-

⁵⁸ If the foreign company's office is located outside of the company's place of residence, it must also produce an approval letter issued by the government of the jurisdiction where it is resident. It should be noted that branches and offices of foreign companies do not have shareholders or directors, as they are not considered to be independent legal persons. They do, however, have representatives.

⁵⁹ "Financial independent subsidiaries" are a very narrow category of entities—kindergartens, canteens or hotels affiliated with a unit. To obtain a registration certificate such entities must present the following information concerning the entity to which they are affiliated: the affiliated entity's registration certification for opening a settlement account and an approving letter (Article 17 Administrative Rules for RMB Bank Settlement Accounts; 1.(1).3 of Notice of the People's Bank of China on Relevant Issues for Regulating the Administration of RMB Bank Settlement Accounts).

⁶⁰ Social organisations and private non-commercial organisations do not have shareholders or directors. However, they do have sponsors, responsible persons and legal representatives. The registration certificate that is issued to such entities includes information on the legal representatives (article 16 Administrative Regulations of the People's Republic of China Governing the Registration of Social Organization; article 6 Interim Regulations on Registration and Administrative of Private Non-Commercial Units). Before the registration authority issues a registration certificate to such entities, the background and identity information regarding the sponsors and responsible persons must be submitted over to the registration authority (Articles 11 and 15 Administrative Regulations of the People's Republic of China Governing the Registration of Social Organization; Articles 6 and 7 Interim Regulations on Registration and Administration of Private Non-Commercial Units).

⁶¹ As of 1 March 2007, article 4 of the FX-LVT/STR Rules is no longer in effect.

LVT/STR Rules).⁶² The requirement to re-identify clients when there is doubt about the authenticity, validity or integrity of the customer's identity data does not expressly include the requirement to understand the ownership and control structure of customers who are legal persons.

324. **Legal arrangements:** Express trusts are legally recognised in China (Trust Law) and must have their assets managed by trust investment companies which are regulated financial institutions approved and supervised by the CBRC. When accepting a trust as a customer (i.e. establishing a business relationship), the trust investment company must obtain a copy of the trust deed which contains the names and addresses of the settlor, trustee and beneficiary (article 9 Trust Law; articles 28-29 Regulations on Trust Investment Corporations).⁶³ Additionally, an enforceable circular issued by the CBRC provides that trusts may open trust fund accounts (i.e. a special securities or deposit account for trust funds) in the name of a trust investment company and the trust itself. When opening such an account, the trust investment company must present a copy of the trust document to the financial institution where the account will be opened and verify its authenticity (articles II-III Notice on Issues Concerning Setting up Special Securities Accounts and Special Capital Accounts by Trust and Investment Companies).

325. **Authorised representatives:** If the customer is being represented by another person, the financial institution must verify the identity cards or other identity documents of both the customer and the authorised representative, and record the corresponding identity information [article 16 AML Law; article 9 AML Rules; articles 6-7 Real Name System Provisions (see below in the section on the Treatment of Existing Customer for a description of the real name system and its purpose); article 26 RMB SA Rules]. However, this obligation seems only to be triggered when the financial institution knows that the customer is acting on behalf of another person (e.g. in contractual relationships which contain a need for a declared beneficiary, as is the case with insurance policies or trust relationships). There is no explicit statutory requirement for financial institutions to determine whether a customer is acting on behalf of another person (e.g. by asking them). There is only an obligation on a customer who is acting as an agent to produce his/her identity documents and those of the principal in the context of opening a personal deposit account (article 6 Provisions on the Real Name System for Personal Deposit Accounts).

326. **Beneficial ownership:** There is no statutory requirement to identify the "beneficial owner" of customers that are legal persons or arrangements as defined in the Glossary of the 40 Recommendations [i.e. the natural person(s) who ultimately own or control the customer]. Although there is a requirement to identify the "beneficiary" when conducting businesses such as insurance or trusts (article 16 AML Law), the term "beneficiary" is not understood as being the ultimate owner or controller, as is required by the FATF Recommendations.⁶⁴

327. **Purpose of the business relationship:** When opening an account, the financial institution should obtain information on "the range of business, major parties of fund movement an average size of daily fund movement of the account" (article 9(2) AML Rules; article 4 FX-LVT/STR Rules;

⁶² As of 1 March 2007, article 4 of the FX-LVT/STR Rules and article 10 of the RMB-LVT/STR Rules are no longer in effect.

⁶³ The "beneficiary" is "the person that enjoys the right to benefit from a trust. He may be a natural person, legal person or an organisation established according to law". The settlor may establish a trust pursuant to which he/she is one of the (or the sole) beneficiaries. The trustee may be a beneficiary, but cannot be the only beneficiary under the same trust (article 43 Trust Law).

⁶⁴ The Chinese authorities advise that the new CDD rules, which are expected to be issued shortly, will contain a requirement to identify the "beneficial owner" as that term is understood in the FATF Recommendations.

article 10 RMB-LVT/STR Rules).⁶⁵ In addition, financial institutions must know the purpose and nature of the transactions made by their customers [article 9(2) AML Rules].

328. **Ongoing due diligence:** There are no comprehensive legal requirements for financial institutions to conduct ongoing due diligence on the business relationship. The only specifically required elements relating to ongoing due diligence are the requirements for financial institutions to re-identify their customers if doubts arise about the authenticity, validity or integrity of the customer identification record or if an abnormality is discovered during the course of business [articles 16 and 19 AML Law; article 9(3) AML Rules]. Although in practice, financial institutions may conduct some monitoring of transactions to comply with these specific rules, there is no obligation that would cover other elements of a comprehensive ongoing due diligence process on the business relationship.

329. There are only some prudential measures in place in the banking sector that might assist ongoing due diligence. For instance, in the context of extending credit to a customer, commercial banks are required to continuously monitor all of the factors that could affect the repayment, and must prepare a written monitoring report with focuses on: (1) whether the customer is using the extended credit for the purpose set forth in the contract, and is performing the contract fully and honestly; (2) whether the project under credit extension is being carried out normally; (3) whether the customer's legal status or financial conditions have changed; (4) information on the repayment terms; and (5) information on the acquisition of the mortgaged property, its quality and value, etc (article 41 Guidelines on Due Diligence in the Credit Extension Work of Commercial Banks).

330. Other prudential measures that require some elements of ongoing due diligence relate to the framework of the Bank Settlement Accounting System. Banks are required to monitor the use of "settlement" accounts and report any suspicious payment transactions, in a timely fashion, to the local branch office(s) of the PBC (article 62 RMB SA Rules). They are also required to review existing "settlement" accounts on an annual basis, examine their regulatory compliance and verify the authenticity of account opening application documents. However, the account review and monitoring process only applies to the information that the bank obtained during the account opening procedure. In contrast, the data that should be gathered by a financial institution in the context of a complete CDD-process should be more comprehensive and would include, for instance, gathering information about the customer's economic background. Although the provisions relating to credit extension work and bank "settlement" accounts contain some elements that are relevant in the context of ongoing CDD, these obligations are not designed for ensuring compliance with AML/CFT provisions, and only impose limited CDD requirements.

331. Financial institutions are also required to report *inter alia*, any transactions or activities that are not commensurate with the customer's business or his financial or economic background and are, therefore, qualified as being suspicious (article 13 AML Rules; FX-LVT/STR Rules; RMB-LVT/STR Rules; the new LVT/STR Rules).⁶⁶ Arguably, a financial institution would need to establish an ongoing monitoring process in order to comply with these provisions (e.g. to enable the financial institution to adjust transactions with the profile or the economic or financial background of the customer).

332. However, except for article 13 of the AML Rules, all other the aforementioned provisions apply only to specific financial institutions, and only in very specific cases. For instance, the provisions in the FX-LVT/STR Rules and RMB-LVT/STR, which contain many more requirements for entities than for individual customers, only set out how banks must deal with identified suspicious cases (that is to file a report), not what must be done to identify such cases (i.e. in terms of how to conduct ongoing

⁶⁵ As of 1 March 2007, article 4 of the FX-LVT/STR Rules and article 10 of the RMB-LVT/STR Rules are no longer in force.

⁶⁶ As of 1 March 2007, article 4 of the FX-LVT/STR Rules and article 10 of the RMB-LVT/STR Rules are no longer in force.

CDD). Even where abnormalities are discovered, the bank is only obliged to re-identify the customer. In particular, there is no explicit requirement to ensure that the transactions being conducted are consistent with the institution's knowledge of the customer, their business and risk profile, and where necessary, the source of funds, since banks are even not obliged to create such risk profile or to ask their customers for the source of funds.

333. **Customer risk:** Financial institutions are required to apply the same CDD measures to all customers, rather than classifying customer types by risk. The Chinese authorities clarified that, from their point of view, there are uniformly restrictive regulations in China.⁶⁷ This means that financial institutions are not required to perform enhanced due diligence for higher risk categories of customer, business relationship or transactions. Likewise, financial institutions are not allowed to perform reduced or simplified due diligence with regard to any kind of customer, business relationship or transaction. Although the new LVT/STR Rules introduce reporting obligations for higher risk categories of customers, they do not require enhanced CDD measures [for securities companies, futures broker companies and fund management companies, see article 12(5); for insurance companies, see article 13(15)].⁶⁸ The RMB-LVT/STR Rules, FX-LVT/STR Rules and new LVT/STR Rules do not contain guidelines for banks that may be considering voluntarily applying enhanced CDD measures to specific categories of customers (e.g. in support of the reporting obligations).

334. **Timing of verification:** Financial institutions are not allowed to provide any services to (such as opening an account) or conduct transactions with any customer whose identity is yet to be clarified. This applies to both new customers and existing customers who have to be re-identified (article 16 AML Law). Additionally, banks are not allowed to open personal deposit accounts for those who do not produce their identity documents or use names that differ from those appear in their identity documents (articles 6-7 Real Name System Provisions). Furthermore, customers are required to produce ID cards or other documents when applying to open "settlement" accounts (articles 6-7 Real Name System Provisions; RMB SA Rules). Banks are required to cancel accounts that are opened in violation of the rules (articles 22 and 62 RMB SA Rules).

335. Although financial institutions are not explicitly required to terminate the business relationship, in practice, the prohibition on performing any transactions for the customer produces the same result (article 16 AML Law). However, there is no corresponding obligation on the financial institution to consider making a suspicious transaction report, other than the general obligation (which currently only applies to banks) to file an STR when "other suspicious payment transactions" have been identified [article 8(15) RMB-LVT/STR Rules; article 13 FX-LVT/STR Rules].⁶⁹ Although the general reporting obligation has been extended to other types of financial institutions with the new LVT/STR Rules, there is still no explicit requirement to consider making a suspicious transaction report when CDD cannot be completed.⁷⁰

336. **Treatment of existing customers:** In 2005, the Payment and Settlement Department of the PBC began a verification of all existing "settlement" accounts throughout China to ensure the authenticity, completeness, and compliance of the account information so that this information could be entered into a customer identification system (RMB Settlement Account Administration System).⁷¹

⁶⁷ Although the PBC plans to introduce additional CDD Rules in 2007, it is uncertain whether these rules will include enhanced CDD-requirements.

⁶⁸ The LVT/STR Rules came into force in March 2007, over two months after the on-site visit and outside of the deadline set by the FATF mutual evaluation procedures.

⁶⁹ As of 1 March 2007, article 8(15) of the RMB-LVT/STR Rules and article 13 of the FX-LVT/STR Rules are no longer in force.

⁷⁰ The Chinese authorities indicate that this issue will be addressed in the new CDD Rules which they expect to issue shortly.

⁷¹ RMB SA Rules, Detail Rules for the Implementation of the Administrative Rules for RMB Bank Settlement Accounts, Measures for the Business Disposal of the Administration System of RMB Bank Settlement Account, and Real Name System Provisions.

Customers who had opened personal deposit accounts before the Real Name System Provisions were issued are re-identified and have their identities verified the first time that they make a deposit to the account after the Real Name System Provisions came into force (article 10 Real Name System Provisions).⁷² The procedures for verifying the customer's identity in this context are identical to the procedures described above for opening an account. The exception is that Chinese citizens under 16 years of age who are living within Chinese territory must show a residence booklet, Hong Kong and Macau residents must show an entry permit, and residents of Taiwan must show an entry permit or other valid travel passport which authorises them to enter and leave mainland China (articles 5-7 Real Name System Provisions). Any account that is found to be using incorrect customer information or incomplete business information must either have the information corrected and entered into the Real Name System, or the account must be closed. These provisions do not apply to other types of existing customers (i.e. existing customers in the securities and insurance sectors).

Securities sector

337. The CDD requirements that are contained in the AML Law and the AML Rules (as described above in relation to the banking sector), apply equally to the securities sector. Additionally, the following requirements apply.

338. **Occasional transactions:** It is not possible to conduct securities trading in China without first opening a securities account.

339. **Beneficial ownership:** The administrative rules and regulations of the CSRC require securities to be recorded in the securities account of the securities holder and in the securities account of a nominal holder (e.g. a fund company). In such cases, the securities registration and settlement institution may require the nominal holder to provide information concerning the person who has the rights to and interest in the securities [article 18 Measures for the Administration of Securities Registration and Clearing (SRC Measures)]. However, this provision is not to be seen as a compulsory requirement for the securities institutions to identify the beneficial owner and to verify its identity.

340. **Ongoing due diligence:** Securities companies are required to keep informed of the materials and the credit status of their clients, and shall supervise their customers' use of their securities accounts (article 24 SRC Measures). Any illegal activity that is detected must be reported to both the securities registration and clearing institution, and the stock exchange (article 24 SRC Measures). However, this provision is not intended to ensure that the transactions carried out by the customer are consistent with the securities company's knowledge of the customer and its economic background.

341. An application must be made to update or modify any of the registration information relating to a securities account. The application form must be submitted along with: (1) the securities account card and any duplicates; (2) the identity card of the principal account holder and other authorised users; (3) the identity documents of the legal person, sealed by competent authority; (4) update certificates issued by a competent authority; and (5) any other material required by the corporation. The customer's authorised representatives must also provide a certified power of attorney, and the represented customer's valid identification documents and duplicates. Overseas legal persons must also show a power of attorney that has been certified by the board of directors, directors and major shareholders, as well as copies of the principals' ID documents. If the application is accepted, the corresponding registration information must be changed within 5 business days, and the account-opening agency is required to print new securities account cards in accordance with the modified registration information. The securities company and the account-opening agency must keep a record of the original registration information, both before and after the modification (articles 4.7, 4.8 and 4.9 Administrative Rules on Securities Accounts).

⁷² The purpose of the Real Name System is to ensure that every individual only has one officially-recognised name, drawn from officially-issued documents, when opening a bank account. This system was implemented in view of the common practice of having a variety of popularly-used names, regional variations of names, etc.

Insurance sector

342. The CDD requirements that are contained in the AML Law and the AML Rules (as described above in relation to the banking sector), apply equally to the insurance sector. Additionally, the following requirements apply.

343. **When establishing business relations:** The Insurance Law requires that the names and residences of the insurant and the insured and the name and residence of the beneficiaries of life insurance are to be determined (article 19 Insurance Law). However, there is no legal requirement in the Insurance Law also to verify the given information. In practice, insurance companies require at least the customer and policyholder to show their ID (e.g. an ID card or passport) to prove their identity (article 19 Insurance Law).

344. **Purpose for the business relationship:** When concluding an insurance contract, the insurer must explain the contents of the clauses of the insurance contract and may raise inquiries on matters concerning the objects of the insurance or the insurant, and the insurant must make true representations. However, there is no mandatory requirement for the insurance company to raise such inquiries (article 17 and 19 Insurance Law).

345. **Ongoing due diligence:** In contrast to the banking and securities sectors, there are no provisions in the insurance sector, which oblige insurance companies to monitor transactions or business relationships even in limited cases. Also in contrast to the banking sector, insurance companies are not subject to any prudential requirements to keep documents, data or information collected under the CDD process up-to-date and relevant by undertaking reviews of existing records.

Effectiveness

346. The new AML Law was only recently enacted and extended CDD obligations to the securities and insurance sectors. It is too early to draw any conclusions about the effectiveness of their implementation.

347. The PBC advises that 3,000 banks were inspected in 2005. Of the 600 violations that were detected during the inspection process, 283 of them were violations of the CDD requirements. The assessment has no indication of the level of seriousness of these deficiencies, but the financial institutions with which the team met tended to suggest that they were largely of a technical nature.

Recommendation 6 (Politically exposed persons)

348. The Chinese authorities have not implemented any specific requirements in relation to politically exposed persons (PEPs). However, China has implemented enhanced measures for transactions to and from China that are conducted by any foreigners. Information such as the business nature, transaction objectives, customer background regarding all foreign customers is obtained and sent to SAFE for scrutiny when the following activities in China are conducted: (1) transfer funds into China; (2) open bank accounts; and (3) undertake investments. For these reasons, the Chinese authorities state that foreign PEPs are unlikely to enjoy the anonymity of presence that may be available in other jurisdictions. The Chinese authorities are also of the view that their LVT reporting system would likely result in many of the transactions that a foreign PEP is likely to undertake being reported to CAMLMAC. Moreover, each of these factors would act as a disincentive for foreign PEPs to launder their funds through the Chinese financial system. Accordingly, China has chosen to not impose specific AML requirements in relation to foreign PEPs. However, although the above requirements apply to all foreigners (and would, therefore, apply to foreign PEPs), there is no requirement to identify foreign PEPs as such or take any further enhanced measures in relation to them.

349. This approach is not consistent with the FATF Recommendations since countries are not allowed to opt out of Recommendation 6 on the basis of a risk-based approach. A country may take risk into account and may decide to limit the application of certain FATF Recommendations only if: (1) a financial activity is being carried out on an occasional or very limited basis (having regard to quantitative and absolute criteria) such that there is little risk of money laundering or terrorist financing activity occurring; or (2) in other circumstances, on a strictly limited and justified basis where there is a proven low risk of money laundering and terrorist financing.

350. The Chinese authorities have argued that non-residents in China are subject to specific requirements when opening accounts or doing business in China, and they point to this as a risk-mitigator vis-à-vis foreign PEPs. However, these requirements are not sufficient to address the higher risks associated with this category of customer and clearly neither financial institutions nor the authorities (who must give foreigners approval to open accounts or do business in the country) are required to identify whether foreign customers are, indeed, PEPs.

Additional elements

351. China signed and ratified the United Nations Convention against Corruption on 10 December 2003 and 27 October 2005 respectively. On 13 January 2006, China submitted the ratification statement to the UN. The Convention took effect on 12 February 2006.

352. In keeping with its strategy to eliminate corruption, China has placed an emphasis on tackling domestic PEPs. The MS and other government organs are engaged in tackling and eliminating corruption by government officials. The PBC has co-operated with these agencies (e.g. through the use of the CAMLMAC database) to facilitate investigations of potential corruption. Since 1995, China has been requiring government officials, above county or division head level, who work in the Communist Party organs, government agencies, the courts, the procuratorate, or the military, and those who are in charge of large or medium sized state-owned enterprises, to report their annual income to the human resource department at the upper level. The supervision and discipline inspection organs at all levels are responsible for supervising and inspecting for compliance with this requirement.⁷³ Nonetheless, as is the case with foreign PEPs, China has not implemented measures to extend the specific requirements of Recommendation 6 to domestic PEPs.

Recommendation 7 (Correspondent banking and similar relationships)

353. Banks are permitted to establish a correspondent relationship with banks at home or abroad (Provisions on Control of Foreign Exchange Operations for Banks, article 29 formulated by SAFE in September 1997). Financial institutions are required to satisfy themselves that an overseas financial institution with whom they are entering into a correspondent banking, agent or other similar business relationship has implemented effective customer identification procedures and is able to obtain the necessary customer identification information from the overseas financial institution [article 9(4) AML Rules].

354. However, the above provision only deals with the customer identification procedures of the correspondent bank. There is no compulsory legal requirement for banks to gather sufficient information about a respondent institution to understand fully the nature of its business, and to determine from publicly available information the reputation of the institution and the adequacy and quality of supervision and controls. Nor is it compulsory to document the respective AML/CFT responsibilities within correspondent relationships. For instance, there is no obligation to look at the STR reporting obligations of the correspondent bank.

⁷³ Regulation on Revenue Declaration by Officials above County (Division Head) Level in the CPC and Government Agencies (1995), and Replies to Issues concerning the Regulations on Revenue Declaration by Officials above County (Division Head) Level in the CPC and Government Agencies (1995).

355. China does not permit “payable-through accounts”. China’s financial market is supervised through an approval-based approach. In other words, financial institutions are only allowed to provide services that have been explicitly approved by law or in writing from the financial regulators. Such approval has never been granted in relation to “payable-through accounts”. Therefore, in practice, according to the regulator’s observation, there are no such “payable-through accounts” in China.

Recommendation 8 (New payment technologies)

General overview of new payment technologies in use in China

356. As noted above, supervision of the financial industry in China is approval-based, meaning that financial institutions are not permitted to conduct any type of business or new activity without the explicit approval of supervisory authorities. The following new payment technologies are approved and in use in China: electronic banking (through the internet, telephone or mobile phone networks), ATM cards and e-purses, on-line securities trading and on-line insurance business.

Banking sector

357. China has specific regulations that require banks to have policies in place to address non face-to-face risks. However, these measures do not apply to other types of financial institutions. In the banking sector, non-face-to-face business is only possible after the establishment of a face-to-face relationship. Additionally, financial institutions must adopt proper measures and technologies to identify and verify the identities of customers who are using electronic banking services, including measures related to electronic banking application and modification, risk management, management of data exchange and transfer, business outsourcing management, management of trans-boundary business activities, supervision and administration. The financial services being made available to the customer through electronic banking must also be managed (e.g. through transaction limits or the ability to transfer funds) pursuant to the relevant agreement concluded with the customer (Chapter 3 of the Interim Measures for the Control of Online Banking Operations, Risk Management for Online Banking Service, promulgated in June 2001 by the PBC; article 40 Measures for the Administration of Electronic Banking issued by the CBRC on 10 November 2005).

Securities sector

358. There are no specific CDD requirements that relate to non-face-to-face business in the securities sector, although such business exists. However, investors who have legally opened an account with a securities company, in person and through relevant procedures, may conduct online commissions (article 6, Provisional Measures on Online Securities Entrustment, issued by the CSRC). When handling on-line commissions for investors, securities companies must require the investor to provide originals ID documents and must offer the investors documentation that proves the securities company’s identity and qualifications. It is forbidden to handle on-line entrustment procedures by agency.

Insurance sector

359. In the insurance sector, there are no requirements relating to new payment technologies or non-face-to-face business, even though some on-line insurance business does exist.

3.2.2 Recommendations and Comments

360. Many of the existing CDD requirements are contained in the RMB-LVT/STR rules and FX-LVT/STR rules which only apply to banks. CDD requirements that are contained in the new LVT/STR rules (which came into effect in March 2007) apply to all financial institutions. Nevertheless, the deficiencies with regard to Recommendation 5 result, in almost every case, from the fact that there are no explicit and comprehensive laws or regulations that contain specific CDD provisions. The assessors

were told by the PBC that it intends to enact specific CDD-Rules by the end of July 2007. In this context the assessors recommend that such Rules should cover, at a minimum, the following subjects:

- (a) Financial institutions should be explicitly required to identify and verify the identity of the beneficial owner of a customer before opening an account, establishing a business relationship, or performing transactions, and to register this identity information.
- (b) Specific requirements relating to the identification of legal persons (e.g. requirements to verify their legal status by obtaining proof of incorporation, names of directors, etcetera) should be extended to the securities and insurance sectors.
- (c) There should be an explicit requirement to undertake comprehensive ongoing due diligence which includes the requirement to create risk profiles and determine the source of funds of all customers (both natural and legal persons). In this context, Chinese authorities should consider consolidating the various existing elements of ongoing CDD.
- (d) Financial institutions should be required to conduct enhanced due diligence in relation to high risk categories of customers (such as PEPs), business relationships and transactions.
- (e) Financial institutions should be required to consider filing an STR when CDD requirements cannot be complied with.
- (f) Financial institutions should be explicitly required to determine whether the customer is acting on behalf of another person.
- (g) An explicit threshold for all transactions that does not exceed EUR/USD 15,000 and which triggers the obligation to identify occasional or one-time customers should be set out.

361. The new CDD rules should be issued and effectively implemented as soon as possible. Additionally, the Chinese authorities should ensure that financial institutions cannot rely on first generation ID cards to identify persons.

362. The Chinese authorities should introduce requirements that address the specific risks associated with foreign PEPs, in accordance with Recommendation 6.

363. With regard to correspondent banking relationship the Chinese authorities should require banks to gather sufficient information about the respondent’s business, its reputation and the adequacy and quality of supervision and controls, and its AML/CFT controls. In this context the authorities should also establish a clear requirement for banks to document the respective AML/CFT responsibilities within correspondent banking relationships.

364. The Chinese authorities should require insurance companies to have policies and procedures in place to address the specific risks associated with non-face-to-face business.

3.2.3 Compliance with Recommendations 5 to 8

	Rating	Summary of factors underlying rating
R.5	PC	<ul style="list-style-type: none"> • No legal obligation to identify and verify the beneficial owner. • Only the banking sector (which includes foreign exchange and MVT services) is subject to specific requirements relating to the identification of legal persons (e.g. requirements to verify their legal status by obtaining proof of incorporation, names of directors, etcetera). • No specific and comprehensive legal requirement to conduct ongoing due diligence (e.g. financial institutions are not obligated to develop a risk profile of the customer or determine

		<p>the source of his/her funds; no obligation in the insurance sector to monitor transactions or business relationships even in limited cases, or to keep documents, data or information collected under the CDD process up-to-date and relevant by undertaking reviews of existing records).</p> <ul style="list-style-type: none"> • No enhanced due diligence requirements or guidelines for high risk categories of customers. • No requirement to consider filing an STR when CDD requirements cannot be complied with. • Concerns relating to the continuing acceptance of first generation ID cards which are prone to forgery and the duplication of numbers on about five million manually issued first generation ID cards. • There is no explicit obligation on financial institutions to determine whether the customer is acting on behalf of (i.e. representing) another person. • While the AML Law requires a threshold and rules for handling occasional transactions, such threshold itself has not been determined. • Effectiveness of implementation cannot be assessed due to the recent enactment of the law.
R.6	NC	<ul style="list-style-type: none"> • No AML requirements in relation to foreign PEPs.
R.7	PC	<ul style="list-style-type: none"> • There is no requirement for banks to gather sufficient information about a respondent institution to understand fully the nature of the respondent's business and to determine from publicly available information the reputation of the institution and the adequacy and quality of supervision and controls, in particular with regard to AML/CFT. • There is no requirement to document the respective AML/CFT responsibilities within correspondent relationships.
R.8	LC	<ul style="list-style-type: none"> • In the insurance sector, there are no requirements related to non-face-to-face business, even though some on-line insurance business does exist.

3.3 Third parties and introduced business (R.9)

3.3.1 Description and Analysis

Recommendation 9 (Third parties and introduced business)

365. Under the 2003 AML Rules, China did not permit third party introductions, even by companies within the same group. However, article 17 of the new AML Law now introduces the concept of third-party introductions. This provides that, in instances where a customer is identified through a third party, the financial institution must make sure that the third party has taken necessary measures to identify the customers in accordance with the customer identification provisions in the AML Law. The article also provides that the financial institution relying on the introduction retains the ultimate liability with respect to the CDD obligations in the event that the third-party fails to take the appropriate measures.

366. Article 9(4) of the new AML Rules requires financial institutions "to satisfy themselves that the overseas financial institution of an agent relationship or other similar business relation has effective customer identification procedures and [the financial institution] is able to obtain necessary customer identification information from the overseas financial institution". The authorities indicate that this provision is intended to capture third-party introductions where there is a contractual or similar relationship between the two parties, although it is also cited as a relevant provision in relation to correspondent banking relationships. Notwithstanding the uncertainty of its purpose, the provision is limited in coverage to foreign third-parties, and only extends the scope of the primary law by requiring

the domestic institution to satisfy itself that customer identification data is available for transfer. There are currently no other provisions that address the range of safeguards envisaged under Recommendation 9.

3.3.2 Recommendations and Comments

367. The authorities intend to move from a regime where covered financial institutions were required themselves to undertake CDD on all their customers, to one where reliance on third-party introductions may be permitted. However, the current legal framework for this transition is incomplete for compliance with the principles of Recommendation 9. Therefore, it is recommended that the introduction of this provision be suspended until the opportunity has been taken (with the intended promulgation of additional CDD rules) to supplement the existing provisions with the following requirements that the institution relying on the third-party should:

- (a) obtain immediately from the introducer the core information relating to the customer's identity and the purpose of the account; and
- (b) satisfy itself that the third-party is regulated and supervised for AML compliance, and complies with the FATF standards on CDD and record-keeping;

368. The authorities should also clearly identify the circumstances in which a reliance on foreign third-party introductions should not be permitted, in particular where the introducer is resident in a country that does not adequately apply the FATF Recommendations.

3.3.3 Compliance with Recommendation 9

	Rating	Summary of factors underlying rating
R.9	PC	<ul style="list-style-type: none"> • No requirement to obtain core customer identification data from the third-party. • No requirement to ascertain the status of the third-party with respect to regulation and supervision for AML purposes. • No conditions introduced in relation to reliance on third-parties emanating from countries with inadequate AML regimes.

3.4 Financial institution secrecy or confidentiality (R.4)

3.4.1 Description and Analysis

Recommendation 4 (Financial institution secrecy or confidentiality)

369. Secrecy provisions in China are mainly based on the Law on Commercial Banks. Under articles 29 and 30, commercial banks, when handling deposits for individuals or "units", must adhere to the principle of confidentiality for the depositors. This means that commercial banks have the right to refuse to answer the inquiries into, or to freeze, deduct or transfer deposits, at the request of any unit or individual. However, these secrecy provisions can be overruled, if required by other laws. Article 5 of the new AML Law extends the notion of customer confidentiality more widely to cover all financial institutions. This provides that all customer identification material and transactions information obtained while discharging AML obligations shall be confidential, unless otherwise specified by law.

370. The competent authorities' abilities to obtain information for AML/CFT purposes is based on several laws and the AML Rules, specifically the Civil Procedure Law, Law on Administrative Penalties, Criminal Procedure Law, Law of the PBC (article 35), Law on Banking Supervision and Administration (articles 33-36), Securities Law, Insurance Law and the AML Rules (articles 6, 13, 14,

17 and 18). These powers include survey, inspection and investigation rights and specific measures that may be taken by judicial authorities, investigation agencies, administrative agencies and regulatory institutions. Competent authorities and institutions can search for and copy relevant documents, and can also make inquiries to relevant parties in the financial institutions, which are required by law to provide assistances and co-operate, when requested. In addition, the provisions of the RMB SA Rules mean that information on all such accounts is transmitted directly to the PBC.

371. The AML Law provides that, in cases where additional investigation or verification of an LVT or STR is needed, and upon authorisation by the responsible person in charge within the PBC, account information, transaction records and other materials related to the case can be checked and copied. If the investigation involves any document or material that can be transferred, concealed, tampered or damaged, the document or material can be sealed for safekeeping (articles 6, 20, 23-24 AML Law).

372. Competent authorities and institutions may share the information obtained. The PBC, CBRC, CSRC and CIRC are required by article 6 of the Law on Banking Supervision and Administration to establish an information-sharing mechanism. In the course of their investigations, administrative law enforcement agencies must transfer cases to the public security agencies when they discover any illegal act. When a case is transferred to the security agencies, the regulators also have to transfer reports on the survey of suspicious criminal cases, lists of articles involved in criminal cases, relevant inspection reports or appraisal results.

373. There are no legal provisions that restrict the ability of foreign financial institutions to pass information to their head offices for global risk management purposes, and group internal audit departments are permitted access to all records when undertaking inspections in their Chinese operations.

3.4.2 Recommendations and Comments

374. The authorities' legal powers to override the confidentiality provisions, where necessary for regulatory or investigative purposes, are extensive. These powers appear to be used on a regular basis, and the financial institutions indicated that they recognise the authorities' right to access a broad range of information, and are generally willing to comply.

3.4.3 Compliance with Recommendation 4

	Rating	Summary of factors underlying rating
R.4	C	<ul style="list-style-type: none"> This Recommendation is fully observed.

3.5 Record keeping and wire transfer rules (R.10 & SR.VII)

3.5.1 Description and Analysis

Recommendation 10 (Record keeping)

375. A financial institution must create and maintain a depositor's database to record information of holders of bank "settlement" accounts, including, in the case of a corporate customer, the title of the institution, name of legal representative or person-in-charge and name and number of his/her valid ID, supporting documents for opening the account, organisation registration code, address, registered capital, range of business, major parties of fund movement, average size of daily fund movement of the account and, in the case of an individual customer, the name of the customer, name and number of his/her ID, address and other information (article 10 RMB-LVT/STR Rules).

376. Additionally, all enterprises and other organisations in China, including banks, securities and insurance companies and non-financial institutions, are required to keep a broad range of financial and accounting records for periods ranging from 3 years upwards. Most accounting documents are required to be maintained for 10 to 15 years, while some must be kept permanently. Although the aim of this regulation is not related to AML, these measures ensure the maintenance of general records. In addition, there is a broad range of record-keeping requirements contained within specific legislation governing the activities of banks, securities companies, insurance companies and trust investment corporations (Administrative Measures for Accounting Files).

377. The new AML Law contains specific record-keeping provisions that apply to financial institutions. Under article 19, each financial institution must establish a programme to keep the customer identity records and transaction records as required by law, relevant regulations or rules. In addition, customer identification information must be updated in a timely manner if any change occurs during the business relationship, and such information must be kept for at least five years following the termination of the business relationship. Customer transaction information must be kept for a minimum of five years following the completion of a transaction. If the financial institution goes bankrupt or into liquidation, the customer identification documents and transaction information must be transferred to an institution specified by the relevant authorities under the State Council. These provisions within the AML Law are reinforced by supplementary provisions in article 10 of the new AML Rules, which states that "financial institutions shall properly keep customer identification documents, as well as relevant document relating to each transaction such as data, vouchers, accounting materials, etc". The article provides for more detailed provisions to be formulated at a later date by the PBC and the regulatory authorities; however, these have yet to be promulgated. The Old AML Rules contained similar record keeping requirements.

378. While the terminology used in the AML Rules is quite broad to describe the range of documentation to be retained, there is no specific reference to supplementary records, in particular customer correspondence and other related items.

Timely access to records

379. Under the various pieces of legislation that govern the activities of the PBC and other regulatory authorities, all such agencies have the power to examine institutions for which they are responsible, and to require the submission of books and records. These provisions are described fully in section 3.10 of this report.

380. Under articles 23-25 of the AML Law, financial institutions are required to cooperate with an investigation being undertaken by a competent authority, and to provide relevant documents and information. This overall requirement is reinforced in article 21 of the AML Rules, and in both the AML Law and the AML Rules there are provisions describing the process by which documents and records may be accessed, reviewed and, if necessary, copied by appropriately authorised inspectors. No timeline is placed by the statute on the submission of documents upon request by the authorities, but the overall thrust of article 25 of the AML Law and article 18 of the AML Rules is that documents should be available on demand within the institution. However, some further clarification of this within the AML Rules would be helpful.

Effectiveness

381. The PBC advises that 3,000 banks were inspected in 2005. Of the 600 violations that were detected during the inspection process, 106 of them were violations of the record keeping requirements. The assessment team received no information concerning the seriousness of these deficiencies; however, the financial institutions with which the team met suggested that they were of a technical nature.

Special Recommendation VII (Wire transfers)

382. Only commercial banks and postal institutions in China are authorised to handle telegraphic transfers. There are different provisions for domestic and cross-border transfers.

Domestic transfers

383. Article 171 of the Rules for Payment and Settlement stipulates that the following items must be recorded by the customer on the remittance instructions:

- (a) a statement of whether it is to be a “mail transfer” or a “telegraphic transfer” (the term “telegraphic transfer” includes wire transfers);
- (b) an unconditional order to pay;
- (c) the sum to be transferred;
- (d) the name of the payee;
- (e) the name of the remitter;
- (f) the name and location of the remitting bank;
- (g) the name and location of the receiving bank;
- (h) the ordering date; and
- (i) the signature of the remitter.

384. Article 171 provides that banks must not accept the instructions if one of the aforementioned items is missing. It also provides that, if the remitter operates an account with the bank, the account number must also be specified, and that in the absence of such information, the bank should not make the transfer. The above information is required to be transmitted with the payment order.

385. Under Article 16 of the AML Law, financial institutions are required to verify and register the originator’s identity when the transaction exceeds a specified threshold, but this threshold has yet to be established. More generally, it is currently established practice that institutions go through such verification procedures for occasional transactions exceeding RMB 50,000 (USD 6,300). For occasional transactions below this threshold, there is nothing in law or practice that requires the remitting institution to record the customer address or to verify identity. There are certain additional procedures imposed on the postal savings institutions by the State Post Bureau, but these do not increase the general identification requirements.

386. In the case of certain domestic transfers it is necessary to convert electronic payment instructions into paper form because of the incompatibility of systems between different institutions across China. Article 22 of the Electronic Payment Guidelines (No.1) provides that, in such cases, the paper payment instrument must record the following things (although the specific form can be determined by the bank):

- (a) the name and seal of the bank in which a payer opens an account;
- (b) the remitter's name and the account number (if applicable);
- (c) the name of the receiving bank;

- (d) the payee's name and the account number; and
- (e) the issuing date and the transaction serial number;

Cross-border transfers

387. For cross-border transfers, the Administrative Rules on the Overseas Payment and Receipt Transactions by Domestic Banks issued by the SAFE require the domestic remitting bank to obtain a completed Application For Funds Transfers (Overseas), which must contain the remitter's name, address and account number. This form is then submitted to SAFE for approval under the foreign exchange rules. If approved, the application form is then used as the remittance instruction, and the information accompanies the payment instructions. In the case of cross-border transfers this information must be obtained in all cases, irrespective of the amount of the transfer. The verification requirements for cross-border transfers are the same as for domestic payments (i.e. article 16 of the AML Law applies) although no threshold has yet been set. There is also no difference in the requirements for batch transfers.

388. Postal savings institutions are required to follow the Administrative Measures of China Post on International Telegraphic Transfer Service, which impose similar requirements.

389. Intermediary banks are required by the Law of Negotiable Instruments, the Rules for Payment and Settlement, and the Accounting Measures for Payment and Settlement to ensure that all the originator information is passed on in the transfer chain. Every bank in the chain is also required to maintain a copy of the payment instructions. Electronic payment transactions data must be kept in either paper or magnetic form for five years, and must be easily retrievable (article 29, item 4 of the Guidance on E-payments (No. 1) issued by PBC in October 2005).

390. Files relating to the international transfer service provided by the postal service must be kept for 2 years. Accounting files must be kept according to the Accounting Measures of China Post on International Transfers, which requires that electronic files must be kept permanently. (Chapter 7 of the Administrative Measures of China Post on International Telegraphic Transfer Service (trial), 2003).

391. Part 10 of the Accounting Measures for Payment and Settlement provides that all the banks involved in the payment and settlement business (including the remitting, receiving and intermediary banks) must "make inquiries to the other bank of the payment chain if there is any doubt", and "reply in details for any inquiries from other banks of the payment chain". When receiving negotiable instruments or payment instructions with incomplete or questionable information, the bank must make inquiries to the relevant bank. Only after receiving clear replies can the enquiring bank complete the transaction according to relevant rules.

392. Inward remittances from abroad received by postal savings institutions must include the name, address and telephone number of the remitter and the payee. The institution is required to examine whether the remittance voucher is filled up completely and correctly, in particular whether the destination country (region) is the intended country (region) of remittance, whether the currency remitted is the one designated by both parties, and whether the remitter is the same person as the certificate holder. (Section 2 of Chapter 3 in the Administrative Measures of China Post on International Telegraphic Transfer Service (trial) in 2003).

393. The PBC is responsible for monitoring financial institutions' compliance with article 171. It conducts inspections to ensure compliance. Any violation of these measures can be sanctioned by the PBC using its general powers to impose administrative sanctions under the Rules of the PBC on the Administrative Penal Procedures, and The Administrative Penalty Law of the PRC. Any unit or individual who opens and uses an account in violation of the Management Method for Bank Account must undertake administrative responsibility, according to the applicable regulations. The PBC

entrusts commercial banks to impose administrative responsibility and sanctions on the responsible unit and individual (articles 238-239 Measures on Payment and Settlement).

Statistics

394. The following statistics have been provided relating to the number of international wire transfers being made into or out of China by the international payment statistics system operated by SAFE.

Value of international wire transfers from and to China (in Billion US\$)			
Year	Incoming	Outgoing	Total
2004	567.757	342.392	910.150
2005	762.282	436.980	1199.262
2006	956.691	574.611	1531.303
Total	2286.731	1353..84	3640.715

3.5.2 Recommendations and Comments

395. With respect to the general record-keeping requirements, the obligations on financial institutions are extensive and, for the most part, require the maintenance of books and records for long periods of time. However, the focus is largely on accounting and similar records, and there appears to be no specific provision requiring institutions to retain business correspondence and other related documents.

396. The threshold for the verification of customer identity for wire transfers should be implemented in line with the FATF requirement of no more than USD 1000.

3.5.3 Compliance with Recommendation 10 and Special Recommendation VII

	Rating	Summary of factors underlying rating
R.10	LC	<ul style="list-style-type: none"> No requirement for institutions to retain business correspondence and similar documents.
SR.VII	LC	<ul style="list-style-type: none"> Verification of customer identification only required for payments in excess of RMB 50,000 (EUR 5,000/USD 6,300).

Unusual and Suspicious Transactions

3.6 Monitoring of transactions and relationships (R.11 & 21)

3.6.1 Description and Analysis

Recommendation 11 (Attention to unusual transactions)

Banking sector (including foreign exchange and MVT services)

397. China has implemented both an unusual and suspicious transaction reporting system in the banking sector. In the laws and regulations, the term “suspicious” is used to mean both unusual and suspicious transactions. The regulations set out dozens of criteria that specify the particular types of suspicious and large value transactions which must be reported. These criteria include, *inter alia*, large value or unusual patterns of transactions that are “not commensurate with the nature and size of the [customer’s] business operation”, “not commensurate with the [customer’s] range and size of business” or without a “profit-seeking purpose” [articles 8(2)-(5) and (9) RMB-LVT/STR Rules; articles 9(1, 6 and 8), 10(8, 15-16), 13(1, 5-6, 8-13 and 18-21) FX-LVT Rules]. Banks are also required to monitor the use of “settlement” accounts and report any suspicious transactions in a timely fashion (article 62 RMB SA Rules). These rules are complemented by the obligation for all financial institutions (not just those in the banking sector) to know the purpose and nature of the transactions being made by their customers [article 9(2) AML Rules].

398. In practice, a bank is only able to fulfil its obligation to report suspicious (meaning unusual) transactions if it pays special attention to complex, unusual large transactions or unusual patterns of transactions with a view to identifying the types of transactions that are specified in the rules and which must be reported to CAMLMAC. CAMLMAC has received a significant number of reports relating to the types of unusual transactions that are specified in the reporting rules. This demonstrates that banks are monitoring customer transactions in order to detect such unusual transactions.

399. The regulations also require banks to record all unusual transactions, analyse them and keep such records for a minimum of 5 years from the date of the transaction (articles 5, 9, 10, 12 and 13 FX-LVT Rules; article 6, 8, 11 and 13 RMB-LVT/STR Rules).

All other financial sectors

400. There are currently no equivalent rules that cover the non-banking sectors with respect to RMB transactions. The foreign exchange rules define financial institutions to include all entities "that run foreign exchange business", but it has to be noted that the SAFE circular No. 100 of 2004 that relates to the implementation of the rules is only addressed to specific institutions in the banking sector. The new LVT/STR Rules came into force in March 2007 and apply to all financial institutions in the banking, securities and insurance sector. With the introduction of the new reporting rules, there has been a significant reduction in the number of indicators of unusual and suspicious activity. In addition to reporting any transaction that meets one or more of the specified criteria (i.e. unusual transactions), financial institutions are also required to report any other transactions that is abnormal in terms of amount, frequency, flow, nature, etcetera and is considered to be suspicious after analysis (i.e. a suspicious transaction) (article 14). Financial institutions are required to analyse any suspicious transaction (which includes any unusual transactions, which are also referred to as “suspicious”) (article 15).

Recommendation 21 (Countries that apply the FATF Recommendations insufficiently)

All sectors

401. Financial institutions are required to monitor and pay attention to transactions involving countries or regions with narcotics production, drug-trafficking, smuggling or terrorist activities or other crimes, with a view to reporting certain types of these transactions CAMLMAC [article 8(11) RMB-LVT/STR Rules; article 11(17) FX-LVT/STR Rules].

402. At present, China cannot take any countermeasures against countries that do insufficiently apply the FATF Recommendations.

3.6.2 Recommendations and Comments

403. The obligation to pay special attention to all complex, unusual large transactions, or unusual patterns of transactions should be extended to all financial sectors. This will be achieved by implementation of the new LVT/STR Rules. It is also noted that, in the new LVT/STR Rules, there is reference to a requirement for the securities and insurance sectors to take special note of business relationships with high risk money laundering countries or regions. As discussed in section 3.7 below, this obligation should be extended to all financial institutions.

404. Measures should be implemented which require financial institutions to pay special attention to business relationships and transactions with persons (natural and legal) and financial institutions from jurisdictions that have not sufficiently implemented the FATF standards. Such a requirement should be supported by sufficient information or guidelines provided by the authorities, and by a mechanism that allows the authorities to implement countermeasures against countries that do not sufficiently apply the FATF Recommendations.

3.6.3 Compliance with Recommendations 11 & 21

	Rating	Summary of factors underlying rating
R.11	PC	<ul style="list-style-type: none">• There is no legal obligation for insurance companies and securities companies to pay special attention to all complex, unusual large transactions, or unusual patterns of transactions, that have no apparent or visible economic or lawful purpose except when the transactions are done in foreign currencies.
R.21	NC	<ul style="list-style-type: none">• There is no requirement to give special attention to business relationships and transactions with persons (natural or legal) from or in countries that do not, or insufficiently, apply the FATF Recommendations.• China does not have a mechanism to implement countermeasures against countries that do not sufficiently apply the FATF standards.

3.7 Suspicious transaction reports and other reporting (R.13-14, 19, 25 & SR.IV)

3.7.1 Description and Analysis

Recommendation 13 and Special Recommendation IV (Suspicious transaction reporting)

All sectors

405. In 2003, the PBC formulated its RMB-LVT/STR Rules and the FX-LVT/STR Rules, which established a reporting system for suspicious and large-value transactions. The large value reporting obligations are discussed separately under Recommendation 19 below. The two rules deal separately

with RMB and foreign exchange transactions, respectively. Although the new AML Law is effective from 1 January 2007, these two existing reporting rules remained in force until 1 March 2007 when they were replaced by the new composite LVT/STR rules. As a result of this timing, the substantive assessment of the STR obligations (including the rating) is based upon the 2003 rules, although a description of the new obligations, and of their likely impact, is also provided in section 3.7.2 below.

406. The 2003 RMB-LVT/STR Rules apply only to banks, defined for this purpose to include policy banks, commercial banks, urban and rural credit cooperatives and postal savings institutions. While technically the FX-LVT/STR Rules apply to all financial institutions with foreign currency businesses, in practice only the banking sector has been engaged in foreign exchange business, and it alone has submitted reports under this rule. Both rules impose an obligation to report certain defined transactions, many of which are not required to be predicated on any suspicion on the part of the reporting institution. In the FX-LVT/STR Rules, 31 specific types of “suspicious” transaction are identified and must be reported by the banks on a monthly basis, while a further 23 types are listed for reporting on a “prompt” basis, although there is no further elaboration on the required timing. There is an additional category for reporting other, undefined suspicions on a subjective basis. Several of the specified suspicious transactions are, in effect, large transactions, but are not included within the large value transaction category because they do not necessarily fall within the dollar-value amounts used to define a transaction for those purposes. However, supplementary implementing rules provide specific thresholds for what constitutes “large” fund movements included within the “suspicious” categories. There are no equivalent implementing rules for the RMB reporting obligations. In the rule addressing RMB transactions, thirteen specific types of occurrence are listed, together with a general obligation to report any other suspicious transactions, which are defined as being of “abnormal amount, frequency, source, direction, use or any other such nature”. There is also provision for the PBC to add additional categories of transactions to the list if it so wishes. While there is no overarching minimum value threshold for transactions to be reported, the focus of many of the specific reporting criteria within the rules is on large or frequent transactions that match defined typologies.

407. There is no explicit obligation to report suspicions of terrorist financing, and there are only very limited provisions that might relate to the indirect reporting of such activity. Within the FX-LVT/STR Rules, the general obligation to report suspicions (as opposed to those linked to defined types of transaction) relates only to money laundering, while the RMB-LVT/STR Rules merely talk about “suspicious payment transactions”. One of the categories of transaction to be reported refers to frequent fund transfers taking place in regions with serious terrorist activities, but there is no broader reference to the need to report suspicions of terrorist financing generally. More generally, the rules do not seek to define the basis for suspicion as being linked to criminal activity. For the most part, the test is associated purely with the defined types of unusual transactions. Therefore, there is no clear indication as to whether the intention is that suspicion should relate to all crimes, or to a subset or to some other criteria. Moreover, while the rules were introduced in the context of AML provisions, the preamble to the rules refers also to measures “to strengthen supervision over RMB payment transactions” and the general administration of foreign exchange measures. This may be explained in part by the fact that, prior to the introduction of the AML Law on 1 January, these rules existed outside a substantive AML legal framework.

408. The reporting obligation relates, for the most part, very specifically to transactions that have been completed. Where attempted transactions are referenced, it is in relation to specific types of deal (e.g. “an enterprise seeking to conduct a swap between the local currency and foreign currency for a fund whose source and use is unspecified”), and there is no general requirement elsewhere to report attempted transactions that give rise to suspicion.

409. The STR regime established in 2003 does not provide for centralised reporting. Instead, regional branches or head offices of the banks are required to report to the local PBC office, which then has

responsibility for passing on the data to PBC, Beijing (i.e. CAMLMAC⁷⁴) on a weekly basis, although there is provision for immediate transfer of the information where the STR is considered to be serious. In addition, where a local branch of a bank identifies a transaction that it considers to be in need of immediate criminal investigation, it is obligated to report this to the local office of the MPS. This latter obligation parallels the general duty imposed on all citizens under article 84 of the CPC to report "the facts of a crime or criminal suspect" to the police, and appears to require a degree of certainty about the criminal nature of the transaction that far exceeds the normal threshold of suspicion.

Effectiveness of the STR system

410. The current STR regime has generated in excess of 8 million reports⁷⁵ since August 2004 when CAMLMAC was first established. As shown in the following table, the vast majority of these have been generated by the state-owned and joint stock commercial banks and by the foreign banks.

Table: STRs received from reporting entities between August 2004 and 31 December 2006

Reporting entity	Total STRs (RMB)		Total STRs (FX)	
	Number of reports	Percent	Number of transactions	Percent
Policy banks	339	0.02%	0	0.00%
State-owned commercial banks	964,815	52.92%	241,094	3.85%
Joint-stock commercial banks	744,008	40.81%	5,400,671	86.23%
Post savings institutions	10	0.00%	28	0.00%
Urban commercial banks	31,058	1.70%	6	0.00%
Rural commercial banks	41,910	2.30%	1,341	0.02%
Rural cooperative banks	948	0.05%	0	0.00%
Urban credit cooperatives	2,117	0.12%	0	0.00%
Rural credit cooperatives	32,684	1.79%	0	0.00%
Foreign banks	5,431	0.30%	620,107	9.90%
Total	1,823,320	100.00%	6,263,247	100.00%

411. An analysis (below) of the RMB transactions⁷⁶ shows that over 55% of these reports relate to just one of the types of transaction specified in the 2003 rules, i.e. "accumulated cash movement through an individual bank settlement account exceeding RMB 1 million within a short period of time" (type 10). Otherwise, just over 19% of the reports relate to "funds being moved out in large quantities after coming into a financial institution in small amounts and in many batches within a short period of time" (type 1), and only about 15% relate to the general category of "other suspicious transactions identified by a financial institution" (type 15). Unfortunately, no such analysis of the foreign currency transaction reporting is available because SAFE did not maintain data on the same basis prior to the merger of the receipt of foreign currency reporting within CAMLMAC; but the authorities indicated that only a small percentage of the foreign exchange STRs fell into the type 15

⁷⁴ Originally the reporting of foreign currency transactions was done to SAFE, but this aspect of SAFE's responsibilities has recently been consolidated within the PBC.

⁷⁵ The RMB and FX data are not entirely compatible. The RMB data collected by the authorities relates to "reports" which may involve one or more transactions. On the other hand, the FX data relates to "transactions", of which more than one may have been included within a single report.

⁷⁶ This analysis is broken down into 16 "types", which correspond to the defined categories of transaction contained in the RMB LVT/STR rules.

category. The authorities have indicated that the FX reporting regime has resulted in a significant number of investigations and prosecutions, but no data exist to confirm whether these were true money laundering cases or more straightforward breaches of exchange control regulations.

Table: RMB STRs statistics based on the types of suspicious transactions between August 2004 and 31 December 2006

Type of STR	RMB STRs	
	Number of reports	Percent
1	353,809	19.40%
2	46,618	2.56%
3	27,617	1.51%
4	23,028	1.26%
5	20,775	1.14%
6	124,143	6.81%
7	18,256	1.00%
8	6,945	0.38%
9	92,167	5.05%
10	1,000,796	54.89%
11	2,853	0.16%
12	6,955	0.38%
13	54,475	2.99%
14	63,248	3.47%
15	271,488	14.89%
16	1,677	0.09%
Total	2,114,850	115.99%

*The total percentage exceeds 100% because those reports complying with more than two types are broken down by their matched types and calculated in duplicate for the total.

412. There are significant doubts about the effectiveness of the reporting system established in 2003. The production of over 8 million STRs in just two years suggests that the vast majority of reports have little to do with genuine suspicions, but more to do with fulfilling the very specific criteria laid down in the rules. The system appears to operate principally as a rules-based unusual transactions regime (based on defined typologies), with only a very limited degree of discretion being given to the financial institutions to determine what might be genuinely suspicious. For instance, approximately 87% of the reports listed in the above table relate to defined types of transaction that do not necessarily contain a subjective element of suspicion of any kind. This perception is supported by comments from the banking sector where the view clearly is that the majority of reported transactions can be reconciled quite simply with the customer's expected profile, but that reporting is still mandated. In addition, defensive filing (or, indeed, competitive filing, i.e. the perception that it is better to file as many reports as possible) is strongly favoured by some institutions. One institution indicated that the system necessitated increased reporting by a factor of ten compared with what it would otherwise regard as *prima facie* suspicious. It may also be the case that the use of a highly prescriptive set of STR rules means that anyone wishing to launder funds has a very clear indication of what types of transaction will result in a report being filed.

413. The inclination towards excessive reporting is further supported by the supervisory approach taken by the PBC which tends, in its examination-targeting procedures, to consider those financial institutions that file large numbers of STRs as being of lower priority than those that file relatively few (see further discussion under section 3.10). The banks are also acutely aware of the fact that the PBC's practice leans towards sanctioning institutions for individual failures to report transactions that meet the defined criteria, rather than focussing primarily on the overall quality of the internal controls and systems for handling the STR process. For example, of the 3,000 banks that the PBC inspected in 2005, 454 of the 600 violations detected were violations of the reporting requirements, many of which were of a very technical nature, rather than reflecting a broader systems failure. The authorities believe that, currently, the biggest problem is the lack of experience and training that the employees of financial institutions have in identifying purely subjective suspicious transactions (i.e. transactions that are not suspicious or unusual because of one of the prescribed indicators).

414. The authorities have recognised that the current system tends towards over-prescription and have sought to modify the requirements under the new LVT/STR Rules (see further discussion under section 3.7.2 below).

Recommendation 14 (Tipping off)

All sectors

415. Under article 6 of the AML Law, financial institutions and their employees "are protected by law" when fulfilling their obligation to report suspicious transactions. The extent of this protection is not further defined, but the authorities have indicated that similar protection is stated in these terms in many other laws, and that there is extensive jurisprudence to show that the courts interpret this protection very widely to include criminal, administrative and civil liability.

416. Tipping off is prohibited under article 15 of the AML Rules, which prevents financial institutions and their staff from disclosing to their customers, or any other person, information relating to suspicious transactions and any resulting investigation by the PBC.

Additional elements

417. CAMLMAC maintains, in archives as financial intelligence, the personal information of financial institution staff who file STRs. These archives are managed by designated personnel, thus keeping it confidential. In July 2004, CAMLMAC established a staff disciplinary code, which requires CAMLMAC staff to maintain the confidentiality of its AML activities (article 6), and prohibits disclosing intelligence to others or taking intelligence documents outside of the office [article 5 Measures of the Management of CAMLMAC Intelligence (Trial) implemented on June, 2005]. Article 21 also stipulates the legal liabilities. However, it is uncertain to what extent the personal details of staff who disclose STRs are kept confidential during the investigation and prosecution phase.

Recommendation 25 (Feedback related to STRs)

All sectors

418. Every quarter, CAMLMAC and the AMLB host a regular meeting with banks to provide general information on how the STR/LVT reporting has been used, and to provide an opportunity for a questions-and-answers session. The authorities also provide policy and technical guidance on STR/LVT reporting. PBC and SAFE have also issued a number guidelines or notices to financial institutions, feeding back information on STR/LVT, giving risk indicators and providing policy or technical supporting. The PBC has issued 12 such documents since 2004.

Recommendation 19 (Other types of reporting)

All sectors

419. In 2003, China implemented a large-value transaction (LVT) reporting system which requires transactions above a certain threshold (in domestic or foreign currency) to be reported to CAMLMAC if they meet the following criteria.

- (a) For RMB transactions: (i) any single credit transfer above RMB 1 million between legal persons, other organisations and firms created by self-employed persons; (ii) any single cash transaction (or related transactions) above RMB 200,000; and (iii) any fund transfer exceeding RMB 200,000 involving a private individual's bank settlement account.
- (b) For foreign currency transactions: (i) any single cash transaction (or related transactions) exceeding USD10,000 or its equivalent; and (ii) any no-cash transfer in excess of USD 200,000 made by a private individual, or in excess of USD 500,000 if made by a corporate customer.

420. The new LVT/STR Rules that came into force in March 2007 modify these requirements. The cash reporting thresholds remain unchanged, but rules introduce the following additional types of transactions which must also be reported:

- (a) any fund transfer above RMB 2,000,000 or USD 200,000 in foreign currency involving legal persons, organisations or firms created by self-employed individuals;
- (b) any funds transfer over RMB 500,000 or USD 100,000 involving natural persons; and
- (c) any cross-border transaction over USD 10,000 involving a natural person.

421. Unlike the previous arrangements, the new rules provide for explicit reporting exemptions in relation to transactions that would not be untypical for particular customers.

422. The following chart sets out the numbers of LVT reports were received by CAMLMAC between October 2004 and December 2006.

Types of reports received	Received in 2004	Received in 2005	Received in 2006	Total numbers
Large value transactions in RMB	4,445,004	102,069,684	124,289,956	230,804,644
Large value transactions in FX	120,846	9,352,639	10,235,857	19,709,342
Total	4,565,850	111,422,323	134,525,813	250,513,986

423. LVTs in domestic or foreign currencies are reported by the financial institution's headquarters or main reporting bank by directly accessing the CAMLMAC processing system through the Inter-networking Platform of Financial Industry. The PBC has built up a monitoring and analysis system for AML activities, in which the LVT reports are collected and stored. Currently the system is used by CAMLMAC to conduct general analysis. The use of PKI Certification and secure socket layer (SSL) encrypted transmission technology helps ensure security during the data transmission phase. In the storage and use of data, an operational approach, based on an independent intranet system, is currently relied upon to maintain security, but a more advanced secure system has been proposed and will be developed in the ongoing construction of the system.

3.7.2 Recommendations and Comments

424. The current STR regime operates substantially as a highly prescriptive unusual transactions report system, with very little input from the reporting institutions by way of analysis to determine if

there is an underlying suspicion. This results in a very large number of reports, the majority of which are of relatively little value in respect of money laundering investigations. The authorities defend this position on the basis that it has been necessary to acclimatise the banks very quickly to the entire concept of an STR reporting programme, and that it would have been largely ineffective to have moved directly to a purely suspicion-based regime. This argument has much merit in the context of China's rapid progress towards implementing AML measures within the financial sector since 2003, and it is recognised that the very prescriptive nature of the 2003 rules has forced banks to focus on AML concepts. The new system in force from 1 March 2007 goes some way towards improving the system by reducing the number of prescribed transactions, but will continue to focus institutions' attention on specific types of transaction. While the authorities' arguments for introducing this approach in the first place are fully understood, it is recommended that a greater move towards a more subjective STR regime be implemented once the new sectors brought into the system in March have become familiar with the overall concepts.

425. The new LVT/STR Rules consolidate the previous two sets of reporting rules into a single document and provide for a number of significant improvements. Critically, they also extend the obligation beyond the banking system to cover the securities, insurance, trust company, asset management and finance sectors; and the PBC is given the discretion to extend the scope further by proclamation. The new LVT/STR Rules retain the approach of defining suspicious transactions by way of listing specific types of transaction which bring about mandatory reporting. However, this list is now reduced from over 60 types of transaction to approximately 50 categories, divided into groups that are considered relevant to each of the banking, securities and insurance sectors. In addition, subjective factors that might provide the basis for suspicion are added to many of the transaction types. In effect, the list of transactions that has relevance to any one sector includes no more than about 18 transactions. The general reporting requirement in relation to transactions that are not listed has been refined, in that the transaction must now not only be of an unusual nature, but must also give rise to suspicion of money laundering, which now links back to the predicate offences covered within the new AML law. The new rules continue not to impose an obligation upon financial institutions to report attempted suspicious transactions.

426. With respect to terrorist financing, article 1 of the new LVT/STR Rules refers to the reporting requirement only in the context of the prevention of money laundering, which includes terrorist financing as a predicate offence. However, this does not capture funds that are provided from legitimate sources, and the new rules do not contain an explicit obligation to report all suspicions of terrorist financing, whatever its source. Article 36 of the new AML Law makes reference to the monitoring of suspicious funds related to terrorist activity but does not impose an obligation to report suspicious transactions. There is, however, within article 15 of the new LVT/STR Rules a provision that appears to provide for a secondary form of reporting to CAMLMAC. This requires that, in the event of its undertaking additional analysis of the transactions, a financial institution must further report to CAMLMAC "if there are proper reasons to believe that the customer or transaction is relating to money laundering, terrorist activities and other law-violating and criminal activities"; but this would pre-suppose that the funding matched one of the defined typologies contained within the mandatory reporting categories.

427. Two amendments to the new LVT/STR Rules should be made at the earliest opportunity. First, reporting should be extended to attempted transactions; and, second, the relevance of the reporting obligation to suspicions of terrorist financing should be made explicit, so that institutions are left in no doubt about the obligation to report all such suspicions, whether or not related to the defined transactions.

428. The new LVT/STR Rules have prescribed suspicious criteria according to financial sector. However, in this regard, there are some generic criteria that should apply to all financial sectors, but where the new regulations appear to limit these to specific sectors (e.g. the requirement to monitor business relationships with high risk money laundering countries and regions, which appears only with

respect to the securities and insurance sectors). It is recommended that the rules are reviewed to ensure that such general provisions are clearly stated to apply to all financial institutions.

3.7.3 Compliance with Recommendations 13, 14, 19 and 25 (criteria 25.2), and Special Recommendation IV

	Rating	Summary of factors underlying rating
R.13	PC	<ul style="list-style-type: none"> • No RMB reporting obligation for the securities and insurance sectors. • No explicit obligation to report suspicions of terrorist financing. • No obligation to report attempted transactions. • The rules do not define the basis upon which suspicion should be founded (i.e. to include, at least, the required list of predicate offences). • Significant concerns about the overall effectiveness of the system and the lack of subjective assessment by reporting institutions.
R.14	C	<ul style="list-style-type: none"> • This Recommendation is fully observed.
R.19	C	<ul style="list-style-type: none"> • This Recommendation is fully observed.
R.25	LC	<ul style="list-style-type: none"> • With regards to these elements, this Recommendation is fully observed.
SR.IV	NC	<ul style="list-style-type: none"> • No explicit obligation to report suspicions of terrorist financing. • Concerns raised in relation to Recommendation 13 apply equally to SR IV.

Internal controls and other measures

3.8 Internal controls, compliance, audit and foreign branches (R.15 & 22)

3.8.1 Description and Analysis

Recommendation 15 (Internal controls)

429. References to “financial institutions” apply to all sectors described in this section. References to “banks” include foreign exchange and money/value transfer service providers.

430. General requirements for financial institutions and their subsidiaries to establish and maintain internal procedures, policies and controls to manage AML/CFT risks are based on the AML Law, the RMB-LVT/STR Rules, the FX-LVT/STR Rules and the AML Rules. Financial institutions are required to establish an internal AML control program which includes the obligation to implement CDD requirements, keep customer identification and transaction records, and implement a large-value and suspicious transaction reporting program (articles 16, 19-20 and 36 AML Law; articles 8 and 9 AML Rules; article 6 RMB-LVT/STR Rules; article 5 FX-LVT/STR Rules). Because there is no obligation to report terrorist financing activities, it must be assumed that the internal control environment is not set up to address this risk.

431. Financial institutions are also required to conduct relevant training and awareness raising with their employees concerning AML issues. However, this does not extend to providing training on issues related to terrorist financing. Moreover, there is no explicit requirement to communicate AML/CFT policies and procedures to their employees (article 22 AML Law). Persons in charge of the financial

institution are responsible for ensuring that the internal control program is implemented effectively (article 15 AML Law).

432. Additionally, there are prudential requirements in the banking, securities and insurance sectors to establish general internal control and audit function; however, these make no specific reference to ML/FT risk.⁷⁷

Designated AML units

433. With the enactment of the AML Law and its subsequent rules, China has introduced the requirement for all financial institutions to have an internal designated AML unit that is responsible for ensuring compliance with AML obligations. There is, however, no explicit requirement to designate an AML/CFT compliance officer at the management level, although all of the financial institutions that met with the assessment team during the on-site visit had done so (article 15 AML Law; article 8 AML Rules).

434. There are no specific legal provisions that require financial institutions to ensure that compliance officers and other appropriate staff have timely access to relevant information (although there are no legal provisions forbidding it).

Internal audit program

435. There is no explicit requirement in the AML Law or the related rules for financial institutions to maintain an adequately resourced and independent audit function to test compliance with internal AML/CFT controls. However, there are some general laws that impose some audit requirements for prudential purposes.

436. For general accounting purposes (not AML/CFT purposes), financial institutions are required to ensure that their internal accounting supervision system specifies approaches and procedures for conducting regular internal audits. Commercial banks are required to designate different agencies or sections to take charge of creating and implementing internal controls, and supervising and evaluating them respectively. For commercial banks, the superior institutions are required to conduct, on a regular basis, evaluations of the internal controls established in their subordinate institutions (article 27 Accounting Law; articles 132 and 135 Guidance on Internal Control of the Commercial Banks). Although these prudential measures may be used to monitor AML/CFT compliance, it should be noted that none of the aforementioned general auditing requirements specifically address or require independent auditing of AML/CFT systems.

Internal training programs

437. Financial institutions are required to carry out training and awareness-raising activities in relation to AML prevention and monitoring (article 22 AML Law). Such training requirements existed in the previous regulations. PBC has published several works which could be used as guidance for the scope and coverage of training, including interpretation of the AML Law PRC, and the Textbook of AML Knowledge.

⁷⁷ Article 59 Law on Commercial Banks; Law on Banking Regulation and Supervision; article 21 Guidelines on Internal Control of the Commercial Banks; article 28 Guidelines on Internal Control of the Securities Companies; articles 43 and 45 Guiding Principle of Internal Control System of Insurance Company; Guideline of Regulating Governance organisation of the Insurance Company (trial).

Screening procedures

438. There are no screening provisions in place to ensure high standards when hiring employees, with the exception of those that relate to senior management which are addressed in section 3.10 of this report relating to market entry.

Effectiveness

439. Of the 3,000 banks that the PBC inspected in 2005, 74 banks (out of the 600 banks in which violations were detected) were in violation of the requirements to implement adequate AML internal control systems. The PBC indicated that these violations were considered to be serious deficiencies that were of a technical nature, primarily the result of a lack of experience with AML obligations. Since 2005, the situation has improved. In 2006, only 10 of the banks inspected were punished for serious AML internal control failures.

Recommendation 22 (Foreign operations)

440. Article 14 of the AML Rules states that overseas branches of financial institutions are required to comply with the AML laws and regulations of the host country, and to assist and cooperate with the AML authority of the host country. However, there is no explicit requirement for financial institutions to apply the higher standard where the AML/CFT requirements of China and the host country differ.

441. Financial institutions are not required to inform the home country supervisor when a foreign branch or subsidiary is unable to observe appropriate AML/CFT measures. However, commercial banks are required to submit to the CBRC every six months a general consolidated report on the work of the overseas offices. This report, which is prepared for prudential purposes, must mention any violations of applicable laws and regulations. These requirements do not specifically require AML/CFT problems to be reported, although they do not preclude it either (Guidelines on the Supervision and Administration of Overseas Offices of Commercial Banks promulgated by the PBC in 2001). In practice, the Chinese authorities advise that such reports are always sent to the home country supervisor if any problems arise concerning the application of appropriate AML/CFT measures.

Additional elements

442. In China, there is no requirement to apply consistent CDD measures at the group level, while taking into consideration the global activities of customers.

3.8.2 Recommendations and Comments

443. The Chinese authorities should explicitly require financial institutions to establish and maintain internal procedures, policies and controls to manage both AML as well as CFT risks and to communicate such policies and procedures to their employees.

444. Financial institutions should also be required to designate a compliance officer at the senior management level and provide him/her with the necessary management and technical personnel.

445. The relevant laws or regulations should clarify that all branches and subsidiaries of financial institutions, including branches and subsidiaries abroad, should establish internal AML control programs, establish or designate an internal department to ensure compliance with AML measures, and provide AML/CFT training to their relevant staff.

446. Specific requirements should be implemented with respect to foreign branches and subsidiaries of Chinese financial institutions that operate in countries which do not (or insufficiently) apply the FATF Recommendations.

447. Financial institutions should be required to inform the home country supervisor when a foreign branch or subsidiary is unable to observe appropriate AML/CFT measures. The Chinese authorities indicate that they have already noted this problem and relevant regulations are being formulated to address it.

448. Where the AML requirements of China and the host country differ, foreign branches and subsidiaries of Chinese financial institutions should be specifically required to follow the higher standard, to the extent permitted by the laws and regulations of the host country. If they are unable to do so, they should be specifically required to inform the Chinese supervisory authorities.

449. Regulators should ensure that violations of these requirements are not structural (as opposed to being merely technical in nature).

3.8.3 Compliance with Recommendations 15 & 22

	Rating	Summary of factors underlying rating
R.15	PC	<ul style="list-style-type: none"> • The internal control environment is not set up to address terrorist financing risk. • There is no explicit requirement to communicate such policies and procedures to the employees of the financial institution. • There are no screening provisions in place to ensure high standards when hiring employees (with the exception of those that relate to senior management). • There is no explicit requirement in the AML Law or the related rules for financial institutions to maintain an adequately resourced and independent audit function to test compliance with internal AML/CFT controls. • There are no specific legal provisions that require financial institutions to ensure that compliance officers and other appropriate staff have timely access to relevant information • There is no requirement to provide relevant employees with CFT training. • There is no explicit requirement to designate an AML/CFT officer at the management level (although in all of the financial institutions the assessors spoke with during the on-site visit had their compliance officer at senior management level).
R.22	NC	<ul style="list-style-type: none"> • There is no requirement for foreign branches and subsidiaries of Chinese-funded financial institutions to apply the higher standard where the AML/CFT requirements of China and the host country differ. • There is no explicit requirement to inform the home country supervisor when a foreign branch or subsidiary is unable to observe appropriate AML/CFT measures.

3.9 Shell banks (R.18)

3.9.1 Description and Analysis

Recommendation 18 (Shell banks)

450. Although the term ‘shell bank’ is not recognised in Chinese law, the Law on Commercial Banks effectively prohibits establishing a bank with the nature of a shell bank, by explicitly specifying the requirements for the establishment of banks. An applicant needs to have a specified minimum amount of registered capital, a sound organizational structure and management system, and the required place of business, security and other facilities relevant to its business operations.

451. No natural or legal person is authorised to incorporate a banking institution or conduct operational banking activities without obtaining approval from the regulatory authorities in the banking sector (articles 16-17 and 19 Banking Supervision Law). Banking regulators are required, by law and regulation, to examine and approve the incorporation and termination of banking institutions, any changes in their ownership (in relation to a change of shareholders who hold a minimum of 5% of the shares or registered capital), or any changes to the scope of their business activities. This includes examining the banking institution’s source of funds, its financial situation, capital provision capacity and the integrity of its shareholders when considering an application for the incorporation of a banking institution or when an existing banking institution applies for a change of shareholders who hold a minimum of 5% of the shares or registered capital.

452. CBRC has been placing much importance on supervising the senior management personnel of foreign-funded banks.⁷⁸ If the senior management personnel is going to be outside of China for more than one continuous month, the bank is required to appoint a full-time delegate and file written reports to the local branch of the CBRC. If the duration of the absence is longer than three months, the bank shall appoint a successor formally. In its routine supervision practice, the CBRC checks to confirm that requirement is being complied with by reviewing related material such as important meeting records. Violations of these provisions are sanctioned (article 75 Detailed Rules for the Implementation of the Regulation of the People’s Republic of China on the Administration of Foreign-funded Financial Institutions).

453. In the case of Chinese banks, if the senior management goes abroad, they need to follow off-duty or vacation procedures. The bank must report to the CBRC if its senior management personnel are absent for 3 days without following those procedures, or if they are absent for more than 1 month (Notice of Establishing Reporting Regime of Major Issues of High-Level Management Personnel of Financial Institutions, issued on 24 December 2000).

454. There are no specific legal requirements that prohibit domestic banks from establishing connections with a foreign shell bank. Additionally, financial institutions are not required to satisfy themselves that respondent financial institutions in a foreign country do not permit their accounts to be used by shell banks.

3.9.2 Recommendations and Comments

455. Chinese authorities should prohibit financial institutions from establishing connections with a foreign shell bank. Additionally, financial institutions should be required to satisfy themselves that respondent financial institutions in a foreign country do not permit their accounts to be used by shell banks.

3.9.3 Compliance with Recommendation 18

	Rating	Summary of factors underlying rating
R.18	PC	<ul style="list-style-type: none"> • There are no specific legal requirements that prohibit the establishment of connections with a foreign shell bank. • There are no legal provisions that require financial institutions to satisfy themselves that respondent financial institutions in a foreign country do not permit their accounts to be used by shell banks.

⁷⁸ The term “foreign-funded bank” refers to the following types of financial institutions that have been authorised to do business in China: (1) a solely foreign-funded bank established by a single foreign bank, or by one foreign bank and other foreign financial institutions; (2) a Sino-foreign equity joint bank established by a foreign financial institution and a Chinese company or enterprise; (3) a branch of a foreign bank; and (4) a representative office of a foreign bank.

Regulation, supervision, guidance, monitoring and sanctions

3.10 The supervisory and oversight system - competent authorities and SROs

Role, functions, duties and powers (including sanctions) (R.23, 29, 17 & 25)

3.10.1 Description and Analysis

Recommendation 23 (Regulation and supervision)

Regulatory framework (designated authorities)

456. The AML Joint-Ministerial Conference (consisting of 23 ministries and committees), constitutes the overall framework of the AML institutional system of China, with special personnel in every section in charge of appropriate matters. This mechanism helps co-ordinate the overall regulatory environment for the financial sector. The AMLB is the coordinating body for the Ministerial Conference. There is also a specific AML coordination mechanism amongst the financial sector regulators. In addition, a memorandum of understanding has been signed between CBRC, CSRC and CIRC to clarify their respective responsibilities.

457. The basic regulator framework in China (which is laid down in a range of laws) is as follows:

Regulator	Financial institutions for which the regulator is responsible
People's Bank of China (PBC)	<ul style="list-style-type: none"> • Central bank • All Financial Institutions (for AML purposes only)
China Banking Regulatory Commission (CBRC)	<ul style="list-style-type: none"> • State-owned commercial banks • Joint-stock Commercial banks • Urban commercial banks, rural credit cooperatives • Rural credit cooperatives, rural commercial banks • Policy banks • Postal Savings • Foreign Banks • Financial Asset management companies • Non-bank financial institutions such as trust investment corporations, financial companies, financial leasing companies • Automobile finance company • Wholesale foreign exchange & RMB Money Brokers
China Securities Regulatory Commission (CSRC)	<ul style="list-style-type: none"> • Securities companies • Stock and futures exchange • Securities and futures companies • Securities investment fund management companies • Securities registration and settlement companies • Futures settlement institutions • Securities and futures investment consulting institutions • Other intermediaries involved in the securities and futures business • Securities and futures associations • Fund custody institutions

	<ul style="list-style-type: none"> • Securities institutions overseas by domestic institutions • Domestic securities institutions by overseas organisations • Listed companies
China Insurance Regulatory Commission (CIRC)	<ul style="list-style-type: none"> • Insurance companies and their branches • Insurance groups • Insurance holding companies • Insurance asset management companies • Insurance intermediaries such as agencies, brokerages, loss-adjusting companies and their branches • Societies and organisations such as China Insurance Association and China Insurance Society • Overseas insurance organisations by domestic insurance and non-insurance organisations • Representative offices by overseas insurance organisations

458. Prior to the enactment of the AML Law, the PBC exercised the power to inspect financial institutions for AML compliance, based on its powers under the "one measure and two rules" arrangements. The CBRC also played a role in the routine supervision and administration of the internal control system of the banking institutions, which extended to AML controls. The SAFE also had responsibilities for monitoring money laundering abuse of the foreign exchange markets, but this responsibility was recently wrapped directly into the AML function of the PBC.

459. The new AML Law stipulates that "the Competent Authority in charge of AML affairs under the State Council is the overarching organ that superintends the administration of the AML regime at the national level". According to the decision of the State Council, the PBC is this Competent Authority. In addition, all relevant authorities and institutions under the State Council are required under the law to carry out those responsibilities with respect to AML supervision that fall within their competence, and to cooperate with each other in fulfilling those responsibilities.

460. However, the AML law does not vest all of the responsibility for monitoring AML compliance within the PBC, but it establishes the following range of intertwined responsibilities for the financial sector regulatory authorities in China:

Role	Relevant Regulator(s)
Issuing AML/CFT regulations and rules	PBC solely or jointly with other regulators for each sector (CBRC, CSRC, CIRC)
Issuing requirements for AML internal control programmes	Each sector regulator (CBRC, CSRC, CIRC) in consultation with PBC
Supervision and inspection of financial institutions for AML requirements	PBC generally, but other regulators also examine systems and controls
Market entry examination of AML internal controls	Each sector regulator (CBRC, CSRC, CIRC)

461. This division of labour will mean, in practice, that the PBC will retain overarching responsibility for AML policy and compliance, but that the sector regulators will take the lead on formulating policy on, and assessing compliance with, appropriate internal control standards. While the PBC and, to a lesser extent, the CBRC have had experience since 2003 in exercising regulatory

responsibilities with respect to AML, the new legislation brings the CSRC and CIRC into the mainstream of AML for the first time.

Recommendation 30 (Resources of supervisory authorities)

462. The PBC, CBRC, CSRC and CIRC are funded and staffed as follows.

PBC

463. Within the PBC, the AMLB and CAMLMAC, the Payment and System Department, Currency Department, the Gold and Silver Bureau, the Legal Department, and some other bodies perform AML tasks. Branches and sub-branches of the PBC have gradually established AML divisions and have been equipped with full-time AML employees since 2004. There are more than 300 full-time and 7,000 part-time employees working in the AML field at the PBC. Part-time employees are officers that handle other duties in addition to AML supervision. For example, within the Shanghai regional headquarters of PBC, the AML division comprises a total of only nine full-time staff, but it has a cooperation agreement with the foreign exchange, market management and settlements departments to draw on their resources when conducting onsite examinations. While such part-time staff have only a limited amount of AML training, the PBC considers that their experience of onsite examination in operational areas provides a sound basis for the AML compliance inspections.

CBRC

464. The CBRC was established in April 2003 as a government agency directly under the State Council. Previously, the banking supervision function lay within the PBC. The CBRC has 36 provincial branches throughout China and its headquarters is in Beijing. It has 20,000 staff, of which approximately 300 at the head office, and more than 6,000 nationwide, work on enforcement issues. The enforcement staff carry out examinations of more than 20,000 banking sector entities. Where applicable this examination has included checking compliance for the AML/CFT internal control procedures stipulated under the "one rule and two measures" arrangements. The Department of Policy, Laws and Regulations, which has a staff of thirty-two, also represents the CBRC at the AML Joint Ministerial conference.

CSRC

465. The CSRC was established in 1992 as a government agency directly under the State Council. It has 36 provincial branches throughout China and its headquarters in Beijing. It has 3,000 staff, of which approximately 50 in head office and over 260 nationwide, work on enforcement issues. The enforcement staff carry out examinations of 115 securities entities and futures companies, and will have responsibility for assessing the AML internal control requirements introduced under the AML Law. The Enforcement Bureau I, which comprises 28 staff, represents the CSRC at the AML Joint Ministerial conference.

CIRC

466. The CIRC was established in 1998 as a government agency directly under the State Council. It has 35 provincial branches throughout China and its headquarters in Beijing. It has 800 staff, of which approximately 80 in the head office and over 250 nationwide, work on enforcement issues. The enforcement staff carry out examinations of 93 insurance entities. As is the case with the CSRC, the enforcement staff in CIRC will have responsibility for examining the AML compliance procedures within the insurance sector. The Finance and Accounting Department, which has a staff of twenty, represents the CIRC at the AML Joint Ministerial conference.

Professional standards

467. In general, the personnel of the competent AML regulatory agencies have backgrounds in finance, law, economics, accounting, statistics or computer science. The majority of the personnel have received special AML training and many of them have worked or studied overseas. Article 11 and 12 of the Law on Civil Servants applies to each of the PBC, CBRC, CSRC and CIRC. It sets out specific requirements covering ethical standards, breaches of which attract penalties laid down under article 56. Under these provisions the AML agencies require their personnel to have professional knowledge and work experience that are appropriate to the positions they hold; to work in pursuance of the law, and not take advantage of their positions to seek improper benefits or to assume positions in enterprises over which they have influence; and to maintain the confidentiality of information coming into their possession, emanating either from the state or from the financial institutions (and their customers) that they supervise. In addition, article 30 of the AML Law provides for specific sanctions for the employees of competent authorities who are found guilty of misconduct in the fulfilment of their duties under the law.

Training for AML staff

468. The authorities report that all relevant staff of the supervisory authorities have been provided with a range of training on ML and FT issues. This has included general awareness training as well as specific training relating to aspects of the AML/CFT supervisory role. The PBC, as the lead AML regulator, focuses on efforts to strengthen the skills of specialist AML personnel by conducting a variety of training activities, including a series of international workshops and training programmes

469. With respect to its AML training programmes and seminars with foreign participation, the PBC and SAFE conducted 11 major AML/CFT international symposiums together with the National Crime Intelligence Service (NCIS) of the United Kingdom, the Wolfsberg Group, the International Monetary Fund (IMF), the University of Illinois and the U.S. National Committee on U.S.- China Relations, the Financial Technology Transfer Association of Luxemburg and the ASEM. These symposiums and training programs were offered to approximately 600 staff from the PBC and from other relevant ministries and committees. From April 2005, the PBC began to use the AML electronic training systems offered by ASEM and by the UN Drug Control Office. About 16 staff attended the training per week and a total of 350 AML personnel from the head office and the subsidiary offices of the PBC had been trained by end-September 2005.

470. In 2005, the scope and depth of AML training was expanded, to include not only PBC staff, but also other members of Joint Ministerial Conference such as the Ministry of Foreign Affairs, public security organs, judicial, prosecutorial, customs and tax administrative authorities, as well as the supervisory authorities with responsibility for the banking, securities, insurance and foreign exchange sectors. In addition, the PBC (and SAFE) has arranged the preparation of AML-related training materials in Chinese (including translations of overseas publications and reference material) to make it more widely accessible. The following table provides an overview of the number of training sessions and the number of attendees from PBC, other governmental institutions and supervised entities (private sector bodies) in 2005.

Recommendations 29 (Powers of regulatory authorities)

471. According to the Law on the PBC, the AML Law, the Banking Supervision Law, the Securities Law, Regulations on Futures, the Insurance Law, the LVT/STR Rules and the AML Rules, the PBC, CBRC, CSRC and CIRC have the power to supervise and examine the observance of the AML/CFT regulations by financial institutions, to gain access to all relevant information, and to impose administrative penalties on those who fail to fulfil their obligations. The powers are set out in detail below. Although the detailed legal provisions relating to the powers of each agency vary significantly (e.g. those of the CIRC compared with those of the CSRC), overall they appear adequate to permit the authorities to gain appropriate access for the purposes of both routine and special AML inspections.

PBC

472. Under article 32(9) of the Law of the PBC, the PBC has the power to inspect and supervise financial institutions, as well as other organisations and individuals, to ensure compliance with the AML regulations, and to impose administrative penalties where appropriate. In addition, article 8 of the AML Law stipulates that the PBC must “supervise and inspect financial institutions on their fulfilment of the AML obligations”, and article 3 of the AML Rules repeats this by providing that the PBC “is responsible for supervising and regulating the anti-money laundering work of financial institutions pursuant to the law”.

473. Under article 18 of the AML Rules, the PBC can exercise the following powers in the course of its supervisory functions: (1) conduct on-site investigations of financial institutions; (2) question the staff of financial institutions for explanations of the issues being inspected; (3) search for and copy documents and materials that are kept by the financial institution and which are relevant to the issues of being examined; (4) attach documents and materials that might be destroyed, transferred or changed; and (5) check the computerised system storing the management or business data of the financial institutions.

474. Articles 23-25 of the AML Law provide that the PBC may investigate and verify suspicious transactions conducted through financial institutions. Financial institutions are obliged to co-operate with the investigation and to provide relevant documents and information. Article 22 of the AML Rules contains additional specific provisions empowering the PBC to check the account information, transaction record and other materials related to a customer under investigation. More generally, under article 17 of the AML Rules, the PBC is empowered to require the financial institution to submit financial statements, information and relevant inspection and audit reports that reflect AML practices within the institution.

475. The above general and specific powers can be exercised without the need for a court order. According to the authorities, the power to retrieve information from the regulated institutions has never been challenged, and this claim is supported by comments from the financial institutions themselves, which clearly believe that the PBC’s legal authority is extensive.

CBRC

476. Under articles 23 and 24 of the Banking Supervision Law, the CBRC has the power to conduct both off-site and on-site supervisory procedures in order to fulfil its general responsibilities with respect to banking supervision. Article 9 of the AML Law provides the basis on which the CBRC (and other regulatory authorities) is granted responsibility for AML compliance monitoring alongside the PBC. This responsibility is referenced specifically in relation to banks' AML internal control programmes.

477. Chapter IV of the Banking Supervision Law provides the CBRC with near-identical inspection and disclosure powers to those listed under article 18 of the AML Rules with respect to the PBC (see above). As in the case of the PBC, these powers can be exercised without the need of a court order.

CSRC

478. Article 7 of the Securities Law, the Regulations on Futures and other regulations empower the CSRC to supervise and inspect securities and futures business, and impose penalty on institutions or individuals who violate regulations including in relation to AML requirements issued jointly with the PBC. As is the case with the CBRC, the CSRC has been granted specific responsibility for monitoring institutions' internal AML control programmes under article 9 of the AML Law.

479. Under the securities legislation the CSRC has the right to take the following measures:

- (a) conduct an on-the-spot examination of a securities issuer, listing company, securities company, securities investment fund management company, securities trading service company, stock exchange or securities registration and clearing institution;
- (b) investigate and collect evidence in any place where a suspected irregularity has happened;
- (c) consult the parties concerned or any entity or individual relating to a case under investigation and require the relevant entity or person to give explanations on the matters relating to a case under investigation;
- (d) refer to and photocopy such materials as the registration of property right and the communication records relating to the case under investigation;
- (e) refer to and photocopy the securities trading records, transfer registration records, financial statements as well as any other relevant documents and materials of any entity or individual relating to a case under investigation;
- (f) seal any document or material that may be transferred, concealed or damaged;
- (g) consult the capital account, security account or bank account of any relevant party concerned in or any entity or individual relating to a case under investigation;
- (h) freeze or seal any property or evidence, and where there is evidence certifying that any property involved in a case (such as illegal proceeds or securities) has been or may be transferred or concealed or where any important evidence has been or may be concealed, forged or damaged; and
- (i) restrict certain transactions when investigating any major securities irregularity such as manipulation of the securities market or insider trading, provided that the term of the restriction may not exceed 15 trading days. In serious circumstances, the restriction term may be extended for another 15 trading days (article 180 Securities Law).

480. The above powers can be exercised without the need of a court order.

CIRC

481. Article 9 of the Insurance Law provides the general basis upon which the CIRC exercises its regulatory role with respect to the insurance sector, and this is supplemented by the provisions of article 9 of the AML Law relating to compliance monitoring of internal AML control programmes.

482. The inspection and investigation powers of the CISR under the Insurance Law are much less detailed than those provided to the other financial regulators under their respective laws. It talks simply of "the right to check the operations, financial situation and operation of funds of insurance companies" and "the right to demand the supply of related written reports and materials within the prescribed time limit". This section also gives the CIRC the power to check the deposits of insurance companies held in financial institutions. These powers can be exercised without the need of a court order.

Recommendation 17 (Sanctions)

483. Powers to apply criminal, civil and administrative sanctions to natural and legal persons that fail to comply with China's AML requirements can be found in Law on the PBC, the Law on the Administrative Penalties, the AML Law, the LVT/STR Rules and the Measures for Punishment of Illegal Financial Acts. The PBC and the corresponding regulatory authorities have the power to apply administrative penalties, including warnings, fines and removal from office, in relation to failures by

financial institutions to comply with the AML Law, the rules or the regulatory laws. In cases of criminal violations, the cases are transferred to the judicial authorities for investigation and prosecution, based on the Penal Code and the Code of Criminal Procedure.

Criminal sanctions

484. Under article 191 of the Penal Code, where a unit commits a money laundering offence, it may be fined, and the person who is directly in charge, and any other person who is directly responsible for the crime may be sentenced to fixed-term imprisonment of not more than five years or, in the most serious cases to criminal detention of not less than five but not more than 10 years. A fine, equivalent to not less than five percent and no more than 20 percent of the money laundered may be levied in addition to, or instead of the prison sentence.

Administrative sanctions

485. Under article 46 of the Law on the PBC, if any financial institution or other organisation or individual fails to comply with the AML Law and regulations, the specific sanctions provided within the relevant laws must be applied. However, if no specific sanctions exist, the PBC may issue a warning, confiscate any illegal gains, and levy a fine up to five times the value of the illegal gains in cases where the gains exceeds RMB 500,000, or a fine ranging from RMB 500,000 to RMB 2 million in cases where there is no illegal gains or the gains are less than RMB 500,000. In addition, any director, senior manager and other personnel directly responsible for the act may be issued with a warning or a fine ranging from RMB 50,000 to RMB 500,000.

486. Article 31 of the AML Law provides that in the case of any of the failings listed below, the PBC must order the institution to take corrective measures within a specified period. In the case of serious misconduct, the PBC must propose to the relevant financial regulatory authorities that they also apply administrative sanctions to the directors, senior managers, and other person(s) directly responsible for the misconduct. The deficiencies cited under article 31 comprise (1) failing to establish an internal AML control programme; (2) failing to establish a specialised unit or designate an internal unit to be responsible for AML; or (3) failing to provide AML trainings to its employees.

487. Article 32 of the AML Law adds that, in the case of any of the additional failings listed below, the PBC must order the institution to take corrective measures within a specified period. In the case of serious misconduct, a fine between RMB 200,000 and RMB 500,000 must be imposed on the institution. In addition, the directors, senior managers and other person(s) directly responsible for the misconduct must be fined between RMB 10,000 and RMB 50,000. The specific misconduct cited under article 32 involves (1) failing to fulfil the obligation to identify customers; (2) failing to keep the customer identity information and transaction records; (3) failing to report large-value or suspicious transactions; (4) conducting transactions with customers whose identities are yet to be verified or opening anonymous accounts or accounts in fictitious names; (5) disclosing relevant information in violation of the confidentiality provisions; (6) refusing or blocking AML inspection or investigations; or (7) refusing to provide information in the course of an investigation, or knowingly providing false information.

488. In the event that any of the misconduct mentioned in article 32 results in the actual occurrence of money laundering, the institution must be fined between RMB 500,000 and RMB 2 million. The directors, senior managers and other person(s) directly responsible for the misconduct must also be given a warning and be fined between RMB 50,000 and RMB 500,000. The PBC can also propose to the relevant financial regulatory authorities that they apply additional administrative sanctions to the directors, senior managers and other person(s) directly responsible for the misconduct, including disqualification from office and exclusion from working in the financial sector.

489. As indicated above, there are circumstances in which the PBC must refer a matter to the financial regulatory authorities for specific enforcement action against directors, managers and employees of institutions where such people are considered culpable. In addition, the regulators retain

overall responsibility for ensuring that institutions maintain appropriate internal controls and systems. The relevant enforcement powers are as follows.

CBRC

490. The powers of enforcement and sanction against financial institutions, and their directors or senior management for failure to comply with laws and regulations are set out in Articles 43 to 47 of the Banking Supervision Law. These provide that the CBRC may take the following measures depending on the circumstances: (1) to order the institution to discipline relevant directors, senior managerial personnel and other persons; (2) if the misconduct does not constitute a crime, to give a warning, and impose a fine of between RMB 50,000 and RMB 500,000 on the directors, senior managerial personnel and other persons directly responsible for the misconduct; (3) to disqualify the directors and senior managerial personnel from taking up such positions for a specific period, or to impose a life-time ban; (4) to prohibit the relevant directors, senior managerial personnel and staff from engaging in banking operations for a specified period, or to impose a life-time ban.

CSRC

491. Article 200 of the Securities Law stipulates that where any practitioner of a stock exchange, securities company, securities registration and clearing institution or any official of the securities industrial association provides any false material or conceals, forges, alters or damages any trading record for the purpose of inducing investors to purchase or sell securities, the securities practice qualification thereof must be revoked and a fine of RMB 30,000 up to RMB 100,000 must be imposed.

CIRC

492. The powers of enforcement and sanction against financial institutions, and their directors or senior management for failure to comply with laws and regulations are set out in Article 150 of the Insurance Law. It provides that, depending on the circumstances, the CIRC may give warnings or require the removal of staff, and impose a concurrent fine, ranging from RMB 20,000 and to RMB 100,000, on the senior management personnel or other persons directly responsible for an act that violates the provisions of the Law, but is not serious enough to constitute a crime.

Recommendation 23 (Market entry)

493. Under the various regulatory laws, all financial institutions wishing to undertake business in China must apply for, and be granted, a licence by the appropriate authority. It is also generally the case that approval is required for the establishment of each and every operating location within China. Separate approvals are also required for institutions wishing to engage in foreign exchange transactions. In addition, article 14 of the AML Law requires the relevant regulatory authority to examine the internal AML control programme of each applicant, and of each new subsidiary and branch of an existing licensee. Approval must be withheld if the authority cannot be satisfied that the programme will be adequate. The competent authorities in relation to market access by financial institutions are as listed in the following table:

Types of financial institutions	Competent authorities on market access
Financial institutions attracting public deposits such as: commercial banks, postal savings institutions, urban credit cooperatives, rural credit cooperatives as well as the policy banks, financial asset management companies, trust investment corporations, financial companies, financial leasing companies, automobile finance companies and foreign-funded financial institutions;	China Banking Regulatory Commission (CBRC)
Securities companies, securities registration and settlement companies, securities transaction agencies, futures brokerage agencies, fund management companies	China Securities Regulatory Commission (CSRC)
Insurance companies, insurance agents, insurance brokers, foreign-funded insurance companies	China Insurance Regulatory Commission (CIRC)

Banks (engaged in the business of the settlement and sale of foreign exchange) and non-bank financial institutions (engaged in foreign exchange operations)	SAFE
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494. In examining and approving the establishment of new financial institutions or a change of shareholders and senior managerial personnel, the competent authorities are required to examine whether the shareholders and senior management meet the relevant qualifications for assuming office. The process includes checking names against a “blacklist”, including persons that are known or suspected criminals, and against a register of credit-worthiness. There are specific provisions in the Company Law and in the sector-specific laws relating to financial institutions which specify a wide range of circumstances under which persons are deemed unsuitable or barred from taking up positions as directors or managers. These include situations where such persons have committed offences, have been subject to disciplinary measures for lack of professional integrity, have a history of poor financial management and have been associated with regulatory failings.⁷⁹

495. Each of the regulatory authorities has established formal guidelines on the appropriate qualifications expected, the general “fit and proper” tests that it applies, and the procedures to be adopted when assessing whether to approve an application to assume a senior position within an authorised institution.

MVT and foreign exchange services

496. The only financial institutions that can provide money or value transfer services, or currency exchange services in China are banks or the Postal Savings bank. These institutions are subject to licensing and supervision by the CBRC and SAFE (see also the discussion under section 3.11 below).

Licensing and registration of financial institutions other than those under the Core Principles

497. All financial institutions are subject to registration and supervision. Only the CBRC has supervisory responsibility over financial institutions that are not governed by the Core Principles. It fulfils this responsibility in line with the Measures for the Administration of the Financial Licenses, which apply to such financial institutions as financial assets management companies, trust and investment corporations, enterprise group finance companies, and financial leasing companies.

Recommendation 23 (Ongoing regulation and monitoring)

All financial institutions

498. The AML Law and the accompanying rules require all financial institutions to (a) establish internal AML control programmes; (b) designate a specialist AML unit; (c) establish a customer identification programme; (d) establish and maintain record-keeping procedures; (e) comply with the STR and large-value reporting requirements; and (f) provide appropriate training to their staff. The PBC and the regulatory authorities have been given the task, to varying degrees, to monitor and inspect for compliance with these obligations. Prior to the enactment of the AML Law, the responsibility fell primarily upon the PBC, but the new legislation maps out a division of responsibilities, such that the PBC will have an overarching responsibility for AML compliance (including a specific focus on the STR and LVT procedures), while the regulatory authorities will have primary responsibility for reviewing internal control procedures.

499. To date, there has been a very limited amount of work undertaken by the regulatory authorities on the specific issue of AML (not least because the substantive AML requirements only applied to the banking sector prior to the enactment of the AML Law). The CBRC, CSRC and CIRC have not

⁷⁹ Article 147 Company Law; article 27 Law on Banking Supervision and Administration; article 27 Law on Commercial Banks; article 30 Securities Law; article 15 Law on Securities Investment; article 17 Administrative Provisions on the Post-holding Qualifications of Directors and Senior Managers of Insurance Companies.

carried out any examinations relating to AML/CFT, and therefore the following description focuses on the procedures implemented by the PBC. However, information is provided on the existing regulatory programmes adopted by the other competent authorities, since these will be expanded to incorporate the new AML responsibilities. Until March 2006, the SAFE (an agency of the PBC) was given responsibility for monitoring AML compliance in the foreign exchange markets, but this role has now been absorbed directly by the PBC

PBC

500. The PBC undertakes both off-site and on-site surveillance for AML compliance, although the latter is currently based largely on the review of the STRs and LVTs. There is provision, under article 17 of the AML Rules, for the PBC to require financial institutions to submit "statistical statements, information materials and audit reports" relating to their AML activities. This provision has not yet been implemented by the PBC, as it will require the publication of instructions specifying exactly what is expected.

501. The PBC inspection programme is a devolved responsibility to the regional branches and offices, but is co-ordinated by the AMLB at the PBC's head office (see case study below relating to the operations of the Shanghai regional head office of the PBC). Each of the delegated offices has established an AML Division which reports directly to, and receives its authority from, the AMLB. Each year the Divisional heads are summoned to a meeting at which the strategic plan for the coming year is discussed on the basis of an initial proposal by the AMLB. Input will be provided by the regional offices, leading to a formal strategic plan being disseminated nationally. The regional offices are then required to formulate a local operational programme (to comply with the national objectives) which must be submitted to Beijing for approval. This local programme will include both high level objectives and detailed provisions relating to the number and target of the examinations to be undertaken during the year. The branches are required to report back quarterly to the AMLB on the implementation of the annual programme.

502. The AMLB has developed a pilot inspection manual, divided into three parts, addressing the purpose and focus of on-site examinations, the general procedures to be followed, and specific techniques to be employed. While many of the PBC branches will use the pilot manual, there is no obligation to do so, and offices are free to develop their own procedures based on local experience and circumstances provided that they fulfil their legal obligations to inspect and sanction for non-compliance. The targeting of financial institutions for examination is done through a combination of broader strategic and risk-based considerations (e.g. seeing retail operations as presenting a higher priority) and institution-specific issues. Typically, a review of the history of STR/LVT reporting by individual institutions is a key input, with a particular focus on those institutions that have a low level of reporting, as they are regarded as most the likely to have weak systems overall.

503. The actual inspection process is partly laid down by law and regulation (Law for Administrative Penalty; Measure for Punishing Illicit Banking Activities; Regulations for Administrative Penalty of PBC; article 18 AML Rules). This requires the PBC examination staff to submit in writing to the institution the scope and timetable for the inspection ("inspection notice"), and to detail the information that they require the institution to submit in advance. If, during the course of the inspection, the examiners conclude that they need to expand the scope of their work, they are obliged to obtain approval from PBC senior management prior to resubmitting a revised inspection notice to the institution. The PBC has indicated that this revision process rarely takes more than 48 hours, but can be expedited in the event of major concerns raised by the examiners. The rules also specify that the institution may refuse to permit the inspection if the notice is improperly presented, or if there are ever less than two examiners on-site at the same time. Following the inspection, the PBC is required by the rules to furnish the institution with a written report containing general comments on the situation within the institution, together with recommendations for improvement in the systems, controls and procedures.

Case study: The PBC's regional head office, Shanghai

The PBC regional head office in Shanghai has responsibility for the country's primary financial centre. It is one of the "dispatched institutions" referenced in the AML Law and AML Rules as exercising powers equivalent to those of PBC headquarters. Unlike other regional offices, it has no separate branches reporting to it, and so the Shanghai staff are solely responsible for the 20 domestic and 61 foreign banks operating in its catchment area.

The Shanghai office established an AML Division in late-2003, reporting directly to the PBC's AMLB in Beijing for operational purposes, but being part of the Shanghai office for management and administrative purposes. The AML Division has a total of nine staff, currently split between two sub-divisions, one being responsible for inspections, the other for monitoring and analysis. In due course, the number of sub-divisions will be increased to five, covering bank monitoring, non-bank financial institutions, information technology, training and liaison with the MPS. Because of the current limited staff resources, the AML Division has a co-operation agreement with the foreign exchange, market management and settlements departments to borrow an additional eight staff for the AML inspection programme. Such staff are given one week's specialist AML training, but are considered to have the core skills necessary for inspection work because this forms the basis for their work in their home departments.

In line with the national arrangements, the Shanghai office operates within the overall framework of the annual strategic plans established in consultation with the AMLB. It is also subject to the longer term strategy to undertake examinations of all the primary offices of the domestic banks within a three-year period from 2004. The AML Division undertook the inspection of five domestic banks in 2004, another six in 2005 and completed the domestic programme in 2006, together with visits to three foreign banks.

The limited AML staffing resources means that the AML Division has to undertake careful prioritisation of its work. In targeting its examinations, it takes account of a variety of available indicators (e.g. relating to geographic location and intelligence information), but focuses primarily on the history of STR/LVT reporting, to which it has direct access through the CAMLMAC database (but only for institutions within its region). Institutions with a low rate of STR filings are typically regarded as being a higher priority for inspection. Once the statutory inspection notice has been delivered, institutions are requested to undertake a self-assessment against a questionnaire, the results of which are used to help fine-tune the inspection. With respect to the foreign banks, the intention is to target initially those that undertake retail business (approximately 7-8), since these are regarded as more vulnerable to money laundering than the wholesale institutions.

Inspections usually involve 4-5 examiners and take approximately one month to complete. They are undertaken at the level of the individual offices of each institution (i.e. head office or the separate branches) rather than on a global basis for the institution as a whole. In Shanghai, the examiners generally employ the pilot manual developed by PBC headquarters. A standard part of the process is to request the preparation of about one month's data in a prescribed format, focussing primarily on STRs and LVTs. The data is run through various filters to help identify whether appropriate reports have been filed. Sample testing of account opening procedures is also undertaken. The results so far have revealed a relatively high level of non-compliance, with key deficiencies being in the areas of suspicious transactions reporting and training of staff. In 2005, all six institutions examined were sanctioned, with fines totalling RMB 6.3 million being levied. The maximum penalty in any one case was RMB 980,000. Follow-up procedures to ensure that remedial steps have been taken are, for the most part, based on reports received from the institution, but the intention is to undertake a further inspection after approximately two years to verify that the measures have in fact been taken.

The Shanghai office of the PBC also has a key role to play in the investigation of STRs filed by the institutions. Under the 2003 arrangements, it is the initial recipient of STRs filed by banks within its region, which must then be transferred to CAMLMAC. Those that are regarded by the AMLB to justify further investigation are then referred back to the Shanghai office so that it can use the PBC's powers to require additional information from the reporting institution. In those cases judged to be particularly serious, the Shanghai AML Division will undertake an initial review of the primary STR filed by an institution, and consider whether to make an immediate and direct report to the local office of the MPS. Also, if, in the course of their inspections, the examiners identify any transactions that they considers should have been reported by the institution, but were not, consideration will be given to whether these should be filed directly with the MPS, and copied to CAMLMAC. During 2005, a total of 44 STR referrals were made to the MPS, of which 36 arose from the AML Division's own inspections. Because of this close working relationship, the Shanghai office of the PBC has entered into a formal information-sharing and co-operation agreement with the local MPS, which is linked to the national agreement entered into by PBC and MPS.

Other regulators

504. The financial sector regulators have not so far undertaken any AML inspections in the role given to them under the 2006 AML Law. When they do take up this role, it is assumed that the inspections will be included within their existing prudential inspection framework. Therefore, a very brief overview of the current arrangements is provided for information purposes,

CBRC

505. The frequency of onsite inspection varies with the institutions. For most banks, the average level is 1-3 years, but on-site inspections of the state-owned banks takes place once or twice per year. Inspections of the foreign banks are done on a three-tiered risk-based approach. For high-risk banks, the inspections are completed twice per year; for medium-risk institutions, the frequency is once or twice per year; for low-risk institutions, the frequency extends to once every three years. On-site inspections of non-bank financial institutions under the authority of the CBRC take place once a year. In 2005 the CBRC carried out a total 15,280 on-site examinations, including visits to both head offices and branches. The examiners use a standard manual that is published on its website.

CSRC

506. CSRC conducts on-site inspections of securities firms in Beijing, Shanghai and Shenzhen once every 3-5 years, and of those in other regions once a year. As for fund management companies, the frequency is set at once every three years, while for futures brokerage companies annual inspections are undertaken. In 2005 the CSRC conducted over 100 examinations of securities companies, 16 of fund management companies and 183 of futures brokerage companies. The examiners nationally use a standard inspection manual. The securities exchanges (e.g. the Shanghai Stock Exchange) operate as self-regulatory organisations (SROs), but currently it is not envisaged that they will have any primary role in AML compliance monitoring.

CIRC

507. The CIRC examines the main provincial branches of the nationwide insurance companies once a year, and completes the institution's entire system in a cycle of 4-5 years. Provincial insurers are inspected on risk-based system with no overall target for completing a cycle of visits. Separate examination manuals have been developed for the different types of insurance business.

Statistics

508. The Chinese authorities collect and maintain the annual statistics concerning the number of on-site examinations conducted by supervisors relating to or including AML/CFT and any sanctions that were applied.

Effectiveness

509. The overall effectiveness of the AML compliance monitoring regime has yet to be tested under the new law. This will involve the financial sector regulators in examining the critical area of internal AML controls and systems. Although a general review of systems and controls forms a part of these agencies' existing examination procedures, they have yet to address the specifics of AML controls. Therefore, the effectiveness of the new arrangements will depend, in no small part, on the procedures that will need to be established to ensure close cooperation between the PBC and the other agencies. Critically, this will involve a free flow of information between the various parties. At present, the AML Law does not appear particularly helpful in this regard, since article 11 provides only for the PBC to report regularly to the other agencies on its AML work. While, under the same provision, the PBC can request information from the others, there is no presumption within the law that this would be done on a routine basis. Equally important, if not more so, will be the degree of co-

ordination between the PBC, the regulatory authorities and their respective regional offices. Given the size and regional complexity of China, this devolved approach to regulation makes sense, but it also poses major challenges in ensuring a consistency of approach and a timely flow of information.

510. The overall effectiveness of the current compliance monitoring regime can only be assessed against the performance of the PBC. While there is a high degree of centralisation at PBC headquarters with respect to strategic planning, much of the day-to-day inspection programme is devolved to the PBC's regional offices, of which there are over 40. Therefore, it has not been possible to evaluate the overall quality of the supervisory process.

511. In 2004, the PBC established a plan that required its branches to conduct full-scale AML examinations of all the domestic deposit-taking institutions in their respective regions within a period of three years. This required examinations to be undertaken of all the designated STR/LVT reporting branches (i.e. those that collate reports from the region to report to CAMLMAC) and a certain number of the other offices of each institution. From January to December 2005, the PBC and its branches conducted AML examinations of 3,351 deposit-taking institutions, including commercial banks, urban credit cooperatives, rural credit cooperatives, as well as policy banks. This programme has so far covered 31% of the main reporting units. It should be noted that, in this context, financial institutions are defined to include individual branches as separate entities.

512. The principal deficiencies identified are shown in the following table.

Main deficiencies	Breaches as a % of total accounts / transactions
Accounts with incomplete information, anonymous account and fake name account	2.21%
LVT-related violations	0.12%
STR-related violations	1.08%
Accounts with incomplete records	0.58%
Transactions with incomplete records	0.02%

513. Based on these examinations, the PBC imposed administrative penalties on 600 financial institutions for violations of the AML regulations for the reasons cited in the following table (in which the total exceeds 600 because some institutions were sanctioned for more than one deficiency).

Nature of deficiency	Number of institutions sanctioned
Failure to report STR/LVT	454
Breaches of customer identification programme requirements	283
Inadequate record-keeping	106
Inadequate internal controls	74

514. A total of RMB 56 million (USD 7 million) was levied in fines as a result of these failures. The most punitive sanctions (by value) were applied in the following cases.

	Location of the bank branch	Fine	Reason
1	Guangzhou	1.5 million RMB	Failure to file STRs
2	Qinghe	1.5 million RMB	Failure to file STRs
3	Qilihe	1.3 million RMB	Failure to file STRs, incompliant with CDD and AML internal

			control system
4	Xinchang	1 million RMB	Failure to file STRs, noncompliant with CDD
5	Daqing	1 million RMB	Failure to file STRs, noncompliant with CDD

515. From the information provided, it is apparent that the regulatory process is identifying a significant number of technical deficiencies within the banks that have been examined so far. These are generally attracting a very high volume of relatively low fines based directly on the number of individual deficiencies identified. It is questionable whether the sanctions regime established under the "one measure and two rules" arrangement, and carried forward into the AML Law provides the correct balance of proportionality and dissuasive effects. For instance, under article 31 of the AML Law, the structural weaknesses of not maintaining a proper internal control programme, failing to establish an AML compliance function, and failing to provide training to staff, can only be addressed by a referral from the PBC to the appropriate financial regulator (see further discussion below).

516. Where financial penalties can be applied for other breaches of the law (including technical failings on STR reporting and more fundamental concerns over record-keeping), the maximum fines available under article 32 of the AML Law appear to be relatively low. For example, in the case of "serious misconduct" a maximum fine of RMB 500,000 may be charged to an institution, and RMB 50,000 to an individual. These figures may rise by a multiple of 10 if the misconduct has led directly to the institution being used for money laundering. The authorities argue that these penalties are in line with those available generally under the regulatory laws, except that the regulators have the ability to set the fine at a multiple of any financial loss incurred as a result of a deficiency. The authorities also point out that the fines can be levied against individual branches for each and every failure, and not simply against the institution as a whole. This however encourages the fining of small technical breaches, instead of addressing systematic and fundamental failures. So far, the power to levy fines has not been used against an individual person (e.g. a manager or director).

517. Generally, therefore, three issues arise which might bring into question the overall effectiveness of the system.

- (a) While the PBC has developed a model inspection manual for its staff, there is no obligation on the regional offices to use this. Given that many of the staff in the smaller regional offices will have more limited exposure to AML issues than most staff in Beijing or the major regional centres, there may be concerns about the consistency of the inspection programme if staff are not required to follow certain common procedures.
- (b) The practice of the PBC is to inspect both the head offices and individual branches of financial institutions. This obviously places a substantial burden on the resources of the PBC, which makes accurate targeting of institutions for examination very important. One of the key factors that is taken into account for identifying institutions as a priority for examination is the history of STR/LVT filing. In particular, there appears to be a perception that the greater the number of filings, the better the institution's systems are likely to be, and vice-versa. This is a very crude indicator, which might well mask fundamental deficiencies within an institution, and it has helped feed a belief within certain institutions that they should file as many reports as possible.
- (c) There has to be a question-mark over whether the sanctions regime is acting as an effective mechanism to bring about structural change in institutions, where necessary. The practice appears generally to be to penalise institutions for each and every deficiency identified, however small. This certainly instils a degree of fear into the institutions, which will seek to avoid such fines, even if they are generally of relatively low value. However, the absence of a more measured approach to target and sanction (with significantly larger penalties) primarily those deficiencies that are material to the overall compliance culture, may lead institutions to focus excessively on the minutiae and not adequately address the broader structure of AML compliance.

Recommendation 25 (Guidance to Financial Institutions apart from STR)

518. The PBC promulgated a Notice on Strict Enforcement of AML Regulations of Financial Institutions to Prevent Money Laundering Risks to all financial institutions in 2005. This provides guidance on how to comply with the overall AML obligations, including those relating to customer due diligence, maintenance of transaction records, large-value and suspicious transaction reporting, and establishing AML internal control mechanisms. However, the introduction of the new AML Law, and the extension of all the AML measures to the non-bank sector, will require further guidance. The financial industry indicated that it eagerly awaits additional information that will assist in an understanding of the regulatory approach to be taken by the PBC and the other authorities, particularly if the examination procedures are to remain focused on a strictly rules-based approach⁸⁰.

3.10.2 Recommendations and Comments

519. The regulatory process is in a transitional stage, leading to the non-bank financial institutions being brought into the overall AML regime and the role of the financial regulatory authorities being expanded to encompass compliance monitoring of institutions' AML systems and controls. The new AML Law envisages that there will be close co-operation between the PBC and the regulatory authorities over the implementation of respective responsibilities. It is vital that this cooperation takes place in practice, and it is recommended that particular attention be applied to the following:

- (a) To clarify the intention of article 11 of the AML Law to ensure that there is an expectation that routine exchanges of information on their respective AML compliance responsibilities take place in both directions between the PBC and the financial sector regulators;
- (b) To develop compatible procedures for compliance monitoring, so that the scope of the inspection procedure is broadly consistent, and institutions nationally have a clear understanding of what is expected by the various regulators;
- (c) To give careful consideration to the objectives of the sanctioning regime, to ensure that the system focuses on bringing about structural change in those institutions that have major deficiencies; and
- (d) Generally to review the level and application of sanctions to ensure that they provide a genuinely dissuasive effect for institutions that persist in having significant weaknesses in their systems and controls.

520. Further guidance should be issued to the financial sector to assist it in the implementation of the new requirements contained in the 2006 AML Law and its associated regulations. This guidance should also be focused on ensuring that financial institutions fully understand the regulatory approach that will be taken (i.e. an approach that is focusing on bringing about structural change in those institutions that have major deficiencies).

3.10.3 Compliance with Recommendations 23, 30, 29, 17 & 25

	Rating	Summary of factors relevant to s.3.10 underlying overall rating
R.17	PC	<ul style="list-style-type: none">• The level of the sanctions provided in the AML Law appears relatively low for major deficiencies.• The sanctions regime focuses excessively on minor deficiencies and does not appear

⁸⁰ Since the onsite visit the PBC has issued three notices separately to banking sectors, securities sectors and insurance sectors on 6 February 2007, giving detailed measures and technical requirement for financial institutions to implement new law and new regulations on AML/CFT.

		effectively to target structural weaknesses.
R.23	PC	<ul style="list-style-type: none"> No supervisory programme yet implemented for the securities and insurance sectors following extension of law to these sectors.
R.25	LC	<ul style="list-style-type: none"> No guidance has been issued in relation to the new obligations under the recently-enacted 2006 AML Law and connected regulations.
R.29	LC	<ul style="list-style-type: none"> As for R17, with respect to the effectiveness of sanctions. Effectiveness of the new role of the CBRC, CSRC and CIRC still to be tested.

3.11 Money or value transfer services (SR.VI)

3.11.1 Description and Analysis (summary)

Special Recommendation VI

521. Only banks are authorised to provide money or value transfer (MVT) services in China. They are not allowed to have agents that could offer such services. It is expressly prohibited to operate an illegal financial institution or provide financial services illegally in China (Measures Banning Illegal Financial Institutions and Illegal Financial Business Activities, article 2). This means that operators of MVT services (i.e. banks) are subject to the same laws and regulations (including the same supervisory and sanctions regimes) that apply to banks and which relate to Recommendations 4-5, 7-11, 13-15, and 22-23.

522. Recommendations 4 (financial institution secrecy or confidentiality), 8 (non-face-to-face business), 11 (monitoring of accounts and relationships), 14 (tipping off) and 23 (supervision) have been fully implemented in the banking sector, including in relation to MVT services. Recommendation 10 (record keeping) and 15 (internal controls) have been substantially implemented in the banking sector, including in relation to MVT services. There has only been partial implementation of Recommendations 5 (CDD), 7 (correspondent banking), 9 (third party introducers), 13 (suspicious transaction reporting) and there are no requirements relating to Recommendations 6 (PEPs) and 22 (foreign branches and subsidiaries). All of these requirements and the corresponding deficiencies are described earlier in section 3 of this report.

523. Although sanctions apply for breaches of AML/CFT obligations, there is concern that the level of the sanctions provided in the AML Law appear to be relatively low for major deficiencies. As well, the sanctions regime is focused excessively on minor deficiencies and does not appear effectively to target structural weaknesses, as described in detail in section 3.10 of this report.

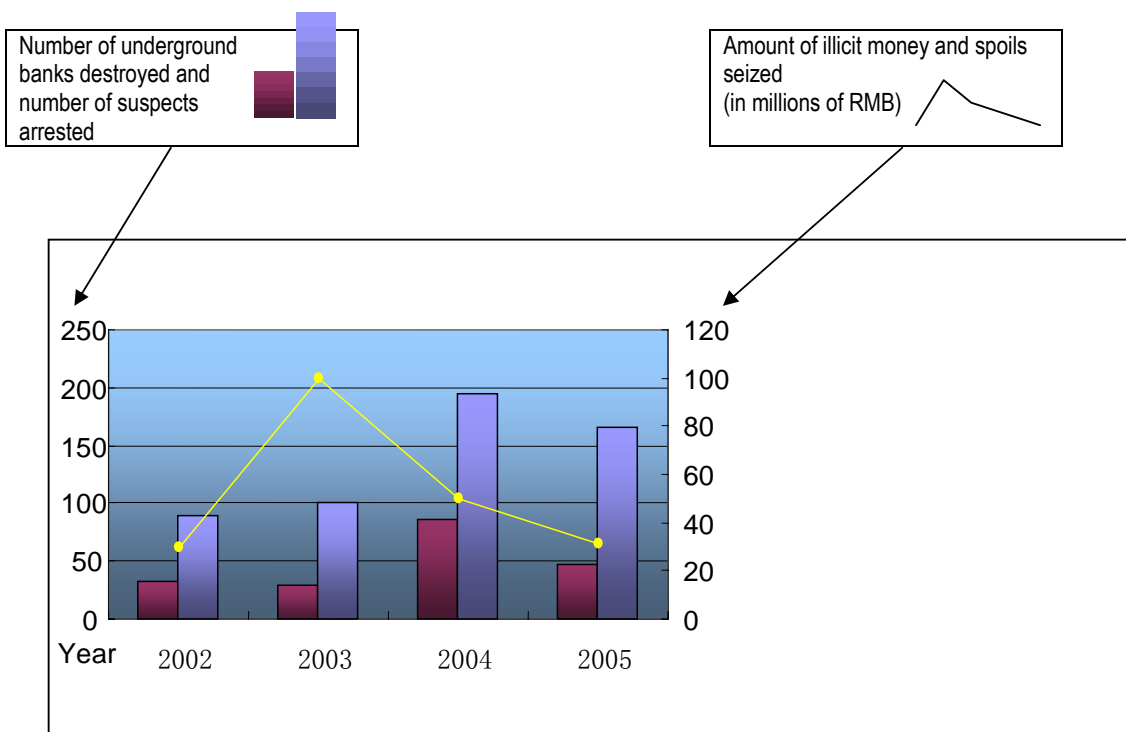
524. The Chinese authorities acknowledge that illegal underground banking exists; however, they have taken steps to combat it. SAFE receives intelligence about underground banks from CAMLMAC, the public, its own foreign exchange management systems (e.g. the Management Information System for Foreign Exchange Accounts and Statistical System for Foreign Exchange Purchases and Sales of Banks) and its own on-site inspections. If SAFE detects illegal banking activity, it conducts an investigation in the form of onsite inspections (either through one of its branches or, in the case of serious cases, its head office). If the results of the investigation warrant, the case will be transferred to the police, customs authorities, tax authorities, or (if appropriate) will be addressed by SAFE itself. Where underground banking is discovered, SAFE and the police will work together to follow up the preliminary investigation.

525. The public security organs, PBC and SAFE jointly undertook measures to combat underground banking which resulted in 47 underground banks being destroyed in 2005. These cases involved more

than RMB 10 billion worth of illegal foreign exchange transactions, including RMB 31 million worth of cash, 2,000 frozen bank cards, book accounts and bank accounts. These efforts resulted in RMB 1.7 million worth of funds being frozen, 165 suspects being arrested and fines worth RMB 10 million being imposed.

526. Shortly after the onsite-visit the Chinese authorities uncovered a large illegal underground banking operation that is suspected of handling RMB 5 billion, including making wire transfers between 25 major Chinese cities and a large international financial centre. In the course of the investigation, the Chinese authorities seized or froze accounts worth RMB 58 million. Furthermore, in December 2006, the Chinese authorities uncovered seven additional underground banks that were handling more than RMB 14 billion. Police arrested 44 people suspected of involvement in these underground banks operating in several Chinese provinces.

527. The following chart provides some statistics as to the action taken between 2002 and 2005. The numbers along the left hand side of the chart refer to the number of underground banks destroyed (as represented by the short dark purple bars) and number of arrested suspects (as represented by the tall light blue bars).. The numbers along the right hand side of the chart refer to the amount of illicit money and spoils seized in millions of RMB (as represented by the yellow line).



3.11.2 Recommendations and Comments

528. Overall, China has achieved good results in combating illegal underground banking. This is consistent with the objective of Special Recommendation VI that all MVT services be made subject to the FATF Recommendations.

529. However, in relation to MVT services, China should implement requirements in relation to Recommendations 6 (PEPs) and 22 (foreign branches and subsidiaries). It should also improve its implementation of There has only been partial implementation of Recommendations 5 (CDD), 7 (correspondent banking), 9 (third party introducers), 13 (suspicious transaction reporting), Recommendation 10 (record keeping) and 15 (internal controls), as discussed earlier in section 3 of this report.

530. Although sanctions apply for breaches of AML/CFT obligations, there is concern that the level of the sanctions provided in the AML Law appear to be relatively low for major deficiencies. As well, the sanctions regime is focused excessively on minor deficiencies and does not appear effectively to target structural weaknesses, as described in detail in section 3.10 of this report.

3.11.3 Compliance with Special Recommendation VI

	Rating	Summary of factors underlying rating
SR.VI	LC	<ul style="list-style-type: none"> Implementation of Recommendations 5, 6, 7, 9, 10, 13, 15, and 22 in the MVT sector suffers from the same deficiencies as those that apply to banks and which are described earlier in section 3 of this report. R.17: The level of the sanctions provided in the AML Law appear relatively low for major deficiencies, and the sanctions regime focuses excessively on minor deficiencies and does not appear effectively to target structural weaknesses.

4. PREVENTIVE MEASURES – DESIGNATED NON-FINANCIAL BUSINESSES AND PROFESSIONS

531. China has not yet applied specific AML/CFT measures to any category of DNFBP, other than trust service providers.⁸¹ The AML Law provides that the PBC and other relevant authorities under the State Council may issue regulations that designate categories of non-financial institutions which are subject to AML/CFT measures (article 35). Even though such implementing regulations have not yet been issued, during the second AML Joint Ministerial Conference the authorities discussed the possibility of designating accountants, lawyers, real estate agents (see Section 4.1 – 4.3 of this report), auctions, the lottery and pawning industries (see Section 4.4 of this report). The lead authority in the AML Joint Ministerial Conference, Governor of the PBC Zhou Xiaochuan, directed that “relevant authorities have to accelerate researches on issuing AML regulations for these sectors”. Consequently, discussions on this issue have begun within the ministries of the State Council.

Accountants

532. The Law on Certified Public Accountants defines an accountant as a certified professional who is commissioned to offer auditing, accounting consultancy and other accounting services (article 14 and 15). The Chinese authorities advised that, in practice, “accounting consultancy and other accounting services” are derivative services of auditing (e.g. providing proposals to the audited entities on the vulnerabilities of their internal financial systems and how to make improvements). With regards to the specific types of financial activities that are referred to in FATF Recommendations 12 and 16, natural or legal persons must be qualified and licensed by the appropriate authorities to legally perform them. However, since accountants are expressly prohibited from applying for such licenses, the FATF Recommendations do not apply to accountants in the Chinese context.

Casinos

533. Casinos and internet casinos are not legally authorised to operate in China. The Penal Code explicitly states that gambling is prohibited and opening a gambling house is a criminal act. The MPS is responsible for investigating illegal casinos.

Trust and company service providers (TCSPs)

534. Authorised trust investment companies are the only entities in China that are permitted to be in the business of administering trusts [Regulations on Trust Investment Corporations issued in 2001 (and revised in 2002)]. No other financial institutions, lawyers, accountants or other professionals are permitted to engage in this activity as a business. Trust investment companies are treated as financial institutions (non-bank banking institutions) under Chinese law. They are supervised by the CBRC, and have been incorporated within the current provisions under the AML Law and AML Rules as described in section 3 of this report. Therefore, no further discussion of this sector is provided in this section of the report, except with respect to the ratings.

535. Any individual or entity that has obtained authorisation from the administrative departments of the SAIC (the general enterprise registration procedure) can be a company service provider (i.e. someone who is authorised to be in the business of assisting in the establishment or registration of companies). No particular qualifications are necessary in order to obtain such authorisation.

⁸¹ The Chinese authorities advised that the PBC, with other relevant authorities, has drafted a Gold Transaction Regulation that is to be approved by the State Council and which would extend internal control, customer identification, record keeping and suspicious transaction reporting to gold exchanges, gold transactions agents and other gold transaction service providers.

4.1 Customer due diligence and record-keeping (R.12) (applying R. 5, 6, and 8 to 11)

4.1.1 Description and Analysis

Applying Recommendation 5 (CDD) and 10 (Record keeping)

536. Some of the general laws and regulations that apply to certain DNFBPs (as set out below) contain very limited customer identification and record keeping procedures—none of which substantially meets the specific elements that are required by Recommendations 5 and 10. For instance, none of these provisions contain the detailed customer verification or due diligence procedures that are required by Recommendation 5. As well, there are no requirements to make records available to the proper domestic competent authorities upon appropriate authority and on a timely basis, as is required by Recommendation 10. Moreover, except in the case of trust investment companies (as described in section 3 of this report), these are general requirements that are not done for AML purposes.

Lawyers and notaries

537. For clients who are legal persons, lawyers are required to determine whether the legal person is a “legal establishment or legal existence”, its current conditions, the scope of its business as confirmed in its business license and its actual major business scope. For customers who are natural persons, lawyers are required to determine their nationality, residence, vocation and “other natural conditions” (article 11 Rules on Legal Counsel for Lawyers). When performing notarial acts, notaries are required to examine the identity of the person concerned (article 28 Notarisation Law). No further customer identification, verification or due diligence requirements are specified.

538. Lawyers are required to keep a working diary of legal services provided⁸² Lawyers engaging in securities work are required to keep their working papers for 10 years.⁸³ However, the required content of these records is not specified.

Dealers in precious metals and stones

539. Members of the Shanghai Gold Exchange (SGE) (i.e. precious metals dealers) are required to identify their customers and verify their identity when performing transactions (article 30 SGE Regulations).⁸⁴ However, this is only a membership condition, not a legal obligation. Moreover, these conditions do not apply to dealers in precious stones, or to persons who are dealing in precious metals in other circumstances (i.e. not involving a transaction on the SGE).

540. The SGE keeps all transaction records (including clearing documents, financial statements, vouchers and account books) for at least 5 years.⁸⁵ There are no record keeping requirements for dealers in precious metals that are not a member of the SGE or dealers in precious stones.

Real estate agents

541. When applying to register an urban real estate transfer, the agent must submit the applicant’s identity card (in the case of a natural person) or certificates (in the case of a legal person) (article 13 Measures on the Administration of the Registration of Urban House Title and the Provisions on the Administration of Urban Real Estate Transfer).

⁸² Article 21 Work Rules on Legal Counsel.

⁸³ Article 17 Rules on Lawyers Engaging in Securities Business (Trial).

⁸⁴ Nine different types of precious metals, including gold, may be transacted on the SGE.

⁸⁵ Articles 15, 34, and 46 Measures on the Management of Fund Clearing for Spot Transactions of the SGE.

542. Real estate development enterprises are required to keep transaction records on the sale of commercial houses or the service provided for the real estate transactions, in accordance with their internal management system. These records include the name of the persons involved in the transaction (Regulations on Selling of Commercial Housing).

Company service providers

543. Company service providers are not subject to any specific CDD requirements. They are, however, subject to the general record keeping and accounting requirements which apply to all businesses operating in China

Applying Recommendations 6, 8-9 and 11

544. No requirements have been introduced which would extend any of the specific obligations under Recommendations 6 (PEPs), 8 (new technologies and non-face-to-face transactions), 9 (third party introducers) and 11 (unusual transactions) to any category of DNFBP.

4.1.2 Recommendations and Comments

545. China should impose specific customer identification and record keeping requirements, consistent with Recommendations 5 and 10, to dealers in precious metals and stones, lawyers, notaries, real estate agents and company service providers. China should also enhance the customer identification and record keeping requirements that apply to trust service providers (i.e. trust investment companies), as described in section 3 of this report. Specific AML/CFT requirements relating to Recommendations 6, 8, 9 and 11 should be extended to all DNFBP sectors, including trust investment companies.

4.1.3 Compliance with Recommendation 12

	Rating	Summary of factors relevant to s.4.1 underlying overall rating
R.12	NC	<ul style="list-style-type: none"> • Only very limited customer identification and record keeping requirements apply to dealers in precious metals and stones, lawyers, notaries, real estate agents and company service providers. However, none of these substantially meet Recommendations 5 and 10. • The customer identification and record keeping obligations that apply to trust service providers (i.e. trust investment companies) are deficient in the same ways as listed in section 3.2 and 3.5 of this report. • None of the DNFBP sectors legally authorised to operate in China are subject to obligations that relate to Recommendations 6, 8, 9 and 11.

4.2 Suspicious transaction reporting (R.16)

Applying R.13 to 15 & 21

4.2.1 Description and Analysis

Recommendation 16 (Applying R.13-15 and 21 to DNFBPs)

546. Reporting obligations have not been extended to any of the DNFBP sectors as is required by Recommendations 13 and 14. Likewise, none of the DNFBP sectors is required to give special attention to business relationships or transactions with persons from or in countries that do not (or insufficiently) apply the FATF Recommendations as is required by Recommendation 21.

547. With regards to Recommendation 15, trust investment companies are required to establish internal control programs in accordance with the provisions of the AML Rules (article 9). These obligations and the corresponding deficiencies in the requirements are described in more detail in section 3.8 of this report. This obligation has not been extended to any other category of DNFBP.

4.2.2 Recommendations and Comments

548. Reporting obligations should be extended to all categories of DNFBP. It should be noted that trust investment companies are subject to the new STR/LVT rules with effect from 1 March 2007.

549. DNFBPs should be required to give special attention to business relationships or transactions with persons from countries that insufficiently apply the FATF Recommendations.

550. The obligation to establish internal AML/CFT control programs should be extended to dealers in precious metals and stones, lawyers, notaries, real estate agents and company service providers.

551. The PBC has indicated that it will seek to extend AML/CFT coverage to certain DNFBPs in the first half of 2007. This process should be completed as soon as possible.

4.2.3 Compliance with Recommendation 16

	Rating	Summary of factors relevant to s.4.2 underlying overall rating
R.16	NC	<ul style="list-style-type: none"> • Reporting obligations have not been extended to any of the DNFBP sectors. • None of the DNFBP sectors is required to pay special attention to business relationships and transactions involving persons from or in countries that do not (or insufficiently) apply the FATF Recommendations. • Dealers in precious metals and stones, lawyers, notaries, real estate agents and company service providers are not required to establish internal AML/CFT control programs. • The obligations for trust investment companies to establish internal control programs are deficient in the same respects as described in section 3.8 of this report.

4.3 Regulation, supervision and monitoring (R. 24 & 25)

4.3.1 Description and Analysis

Recommendation 24 (Supervision and monitoring of DNFBPs)

552. With the exception of trust investment companies, none of the DNFBP sectors has implemented any supervision or monitoring mechanisms to ensure compliance with AML/CFT obligations, since no such obligations have yet been introduced. Dealers in precious metals and stones, lawyers, notaries, real estate agents and company service providers are, however, subject to licensing and registration requirements (approval from the authorities must be obtained to conduct any type of business in China), and supervision or monitoring by a government authority or SRO, as described below. It should be noted that since no AML/CFT obligations have been extended to any of these sectors (apart from trust investment companies), the supervisory procedures described below have no relevance to AML/CFT. This description is included, however, since it provides the basis for a possible future regime and, as these sectors are subject to at least general supervision, there is the possibility that illegal activity such as money laundering could be detected and reported to the appropriate authorities.

Dealers in precious metals and stones

553. The wholesale market for the production and circulation of precious metals in China is dominated by the members of the Shanghai Gold Exchange (SGE), a self-regulatory organisation that was established by the PBC and which is, by law, the department in charge of the Chinese gold market. The SGE is under the approval of the State Council and registered with the SAIC. The SGE organises precious metal transactions on behalf of its members with the objective of ensuring their integrity. The SGE's members are financial institutions that are engaged in precious metal transactions, and corporations which are registered in China to conduct the following businesses in relation to precious metals and products made of precious metals: production, smelting, processing, wholesale trade, import and export. The SGE now has 150 members, covering 26 provinces, cities and municipalities. According to the preliminary statistics, these members account for about 75% of gold sales, 80% of gold purchases, and 90% of gold smelting capacity in China.

554. The SGE oversees the activities of its members, and ensures they are legal entities in good standing. When applying for membership of the SGE, applicants must provide, *inter alia*: (1) an application signed by the applicant's legal representative; (2) its business licence; and (3) the past year's audited financial statements. After the membership is approved, the SGE issues a member certificate which is filed with the PBC. The SGE requires its members to observe laws and regulations, abide by the SGE's Articles of Association, pay fees on time and accept supervision (articles 2, 6.1-6.4, 8 and 10-11 Measures of the SGE for the Membership Management).

555. The SGE supervises and administers the transactions of its members. This includes conducting spot checks. The SGE has the right to investigate its members and gather evidence from them. Members are obligated to co-operate with the SGE in the exercise of its supervisory powers. SGE members that do not assist or block the SGE from performing its supervisory functions (e.g. by refusing to provide factual information, hiding facts or evading investigation intentionally) may be sanctioned (articles 72-75 and 77 Spot Transaction Rules of the SGE). Since there are no specific AML/CFT requirements for dealers in precious metals and stones, none of this is done for AML purposes. Moreover, the SGE requirements do not apply to dealers who are not members of the exchange. There is no specific regulatory framework for dealers in precious stones in China.

Lawyers

556. The State judicial departments are responsible for supervising lawyers. They do so through maintaining a registration system and by conducting annual inspections. Lawyers are required to obtain a legal practice certificate issued by the provincial judicial administrative authority. To qualify for such a certificate they must have been employed by a law firm for a full year, and be a person of good character and conduct. Lawyers who intend to establish a law firm must submit an application to the provincial judicial administrative authority (articles 4-15 Law on Lawyers). The judicial departments examine lawyers and law firms annually for compliance with rules relating to legal practice, internal management and professional ethics.

557. Lawyers are also supervised by the All China Lawyer Association (ACLA) which is the legal sector's national self-regulatory organisation. Lawyers are required to join their local lawyers' association (article 39, Law on Lawyers). Lawyers' associations formulate industry regulations, provide lawyers with training on business and professional ethics, further their lawful rights and interests, and sanction those who breach applicable laws or regulations.

Notaries

558. The establishment of a notary office is subject to the approval of the Ministry of Justice of the province, the autonomous region or municipality directly under the central government. Persons who have passed the national judicial examination, satisfied the qualifications stipulated by the Ministry of

Justice, served a full year's internship and passed a business examination after receiving pre-service training may be licensed by the Ministry of Justice to perform notarial services.

559. The Ministry of Justice supervises and controls the quality of notary offices and notaries, and supervises their activities. The China Notaries' Association (CNA), a self-regulatory organisation, supervises the sector in cooperation with the judicial and administrative organs. The CNA is a national SRO composed of notaries, notary offices, notary management personnel and other related professional persons and institutes. All of the provinces, autonomous regions and municipalities directly under China's central government have established their own notaries' association, as have some large and medium-sized cities. The CNA has 3,147 associate members and nearly 20,000 individual members.

Real estate agents

560. China has established a comprehensive legal framework for the real estate industry. The State Council has authorised the Ministry of Construction to be responsible for formulating the laws, regulations and policies for the real estate industry. It is also responsible for qualifying, admitting and supervising real estate development and transaction enterprises and institutions. Real estate development enterprises (which develop and operate real estate for profit) must be registered with the SAIC. Persons who provide real estate consultation and valuation services must, within one month after being awarded the business license, register with the state real estate authority at or above county level in the place where the registration authority is domiciled.

561. The State real estate administrations above the county level supervise real estate enterprises and professionals through a variety of licensing and reporting systems. Additionally, the China Institute of Real Estate Appraisers and Agents (CIREA) plays a role in supervising the real estate sector. The CIREA is a nation-wide, voluntarily-formed, SRO of professional real estate brokers and appraisers who are approved by and registered with the Ministry of Construction and the Ministry of Civil Affairs. The CIREA is responsible for ensuring the integrity of real estate intermediary institutions and professionals. It examines and registers real estate appraisers and agents.

Trust and company service providers

562. The PBC supervises trusts investment companies (which are the only entities authorised to be in the business of managing trusts in China) as financial institutions for compliance with AML/CFT obligations. The CBRC is the primary regulator of this sector for prudential purposes. A detailed description of the supervisory regime, including its deficiencies, is set out in section 3.10 of this report.

563. Company service providers are supervised by the administrative departments of the SAIC. Supervision includes regular examinations of the company service provider's business, on-going on-market monitoring of the operation, handling complaints about such businesses and conducting investigations of suspicious illicit activities. This is the same type of supervision that is conducted on all businesses in China and does not contain an AML/CFT component or objective.

Applying Recommendation 17 to the DNFBP sectors (Sanctions)

564. DNFBPs are subject to wide range of sanctions for violation of applicable laws, regulations, professional ethics and standards. However, with the exception of trust investment companies, none of these businesses and professions currently have AML/CFT obligations and therefore the current sanctions regime is not relevant for the purposes of this report.

565. Trusts investment companies (which are the only entities authorised to manage trusts in China as a business) are subject to sanctions for violations of AML requirements as set out in detail section 3.10 of this report.

Recommendation 25 (Guidance for DNFBPs, other than guidance on STRs)

566. No AML/CFT guidance has been issued to trust investment companies. Since no AML/CFT obligations have been extended to any of the other DNFBPs sectors, no related guidance has been issued to them either.

4.3.2 Recommendations and Comments

567. China should ensure that dealers in precious metals and stones, lawyers, notaries, real estate agents and company service providers are monitored or supervised for compliance with AML/CFT requirements, once such obligations have been imposed on them. China should also ensure that, once the AML/CFT requirements are in place, appropriate guidance is issued to these sectors. Additionally, China should issue appropriate AML/CFT guidance to trust investment companies (the only DNFBP sector that is currently subject to AML/CFT requirements).

4.3.3 Compliance with Recommendations 24 & 25 (criteria 25.1, DNFBP)

	Rating	Summary of factors relevant to s.4.3 underlying overall rating
R.24	NC	<ul style="list-style-type: none">• Dealers in precious metals and stones, lawyers, notaries, real estate agents and company service providers are not monitored or supervised for compliance with AML/CFT requirements, since no such requirements yet apply to them.• The sanctions regime that is applicable to trust service providers (i.e. trust investment companies) is deficient in the same ways as listed in section 3.10 of this report.
R.25	LC	<ul style="list-style-type: none">• No AML/CFT guidance has yet been issued for trust investment companies (the only category of DNFBP that is currently subject to AML/CFT requirements).

4.4 Other non-financial businesses and professions

Modern secure transaction techniques (R.20)

4.4.1 Description and Analysis

Recommendation 20 (Other non-financial businesses and professions)

568. China has already considered whether other non-financial businesses and professions (other than DNFBP) could pose an AML/CFT risk. In that regard, the Chinese authorities have identified the auction and pawn industries, and the state lottery⁸⁶ as being vulnerable to money laundering and terrorist financing activity. These sectors have been discussed during the second AML Joint Ministerial Conference and the lead authority of this Conference, PBC Governor Zhou, directed all ministries and commissions under the State Council to work on this issue. However, none of these sectors has yet been made subject to AML/CFT requirements.

569. China has taken measures to encourage the development and use of modern and secure techniques for conducting financial transactions through means that are less vulnerable to money laundering. Since 1988, China has pursued a policy of limiting the use of cash by entities that open accounts at commercial banks—although the economic reforms which took place during the last decade have rendered the existing

⁸⁶ In China, the gaming industry is limited to two types of lotteries: the China Welfare Lottery issued by the Ministry of Civil Affairs and the China Sports Lottery issued by the State Sport General Administration. To date, the Chinese authorities have not detected any money laundering cases in the lottery industry.

regulation somewhat outdated (Interim Cash Control regulations).⁸⁷ At present, the highest RMB denomination bank note is 100 Yuan (EUR 10/USD 12). Additionally, the PBC and CBRC have taken measures to develop and promote non-cash payment means, such as debit and credit cards and on-line payments. For instance, they have created a legal environment that is friendly to electronic means of payments, standardised practical business rules throughout China, and developed the physical infrastructure to support electronic payment systems. .

4.4.2 Recommendations and Comments

570. China is compliant with this Recommendation.

4.4.3 Compliance with Recommendation 20

	Rating	Summary of factors underlying rating
R.20	C	<ul style="list-style-type: none"> This Recommendation is fully observed.

5. LEGAL PERSONS AND ARRANGEMENTS & NON-PROFIT ORGANISATIONS

5.1 Legal Persons – Access to beneficial ownership and control information (R.33)

5.1.1 Description and Analysis

571. All legal persons are required to apply to the SAIC for registration. If the registration is approved (i.e. if it conforms to the prescribed standards), the authorities will issue relevant certificates of registration. The registration criteria differ, depending upon the type of legal person making the application. Additionally, to obtain authorisation to conduct business legally, a legal person must obtain a business licence before the incorporation process is complete. The relevant administrative authority will only issue the business license if the application conforms with pre-set criteria which vary, depending on the type of LPAB and the type of business activity for which authorisation is being sought.

572. The SAIC is responsible for registering LPABs and maintaining the corresponding registry system (one registry for every province). All registries keep both paper and electronic records of every LPAB within their jurisdiction. The registration system contains the following information related to the legal ownership and control structure of LPABs:

- (a) the registered details of a LPAB including its name, domicile, business place, legal representative or person in charge, economic nature or business type, registered capital, business scope, type of operation, competent authorities, investors, business term, registration number, date of approval and registration, etc.;
- (b) the documents submitted during the registration process (e.g. approval documents issued by relevant departments, articles of association, the capital verification certificate, the domicile certificate, the identity certificate of the legal representative, documents of tenure of office and identity certificates of the legal representatives, and the Notification of the “LPAB’s Name Pre-Approval”;
- (c) amended details of the LPAB [e.g. the approval dates for the establishment of subsidiaries or branches; registration documents and approval date of changes in name, domicile, legal

⁸⁷ The PBC intends to issue a new regulation to control cash circulation, encourage wire transfers, specify the costs for withdrawing cash from accounts, specify which inter banking transactions cannot be settled in cash and set limits to the amounts of cash that units may handle.

representative, economic nature, business type, registered capital, business scope, type of operation, etc.; the approval date of cancellation (revocation) of an LPAB (e.g. in the case of a court's adjudication of bankruptcy, a resolution or decision by the LPAB to close down, an order from an administrative organ to close the LPAB, or a liquidation committee's liquidation report)]; and

- (d) records and dates of sanctions imposed, and annual examination (excluding business performance, financial position, depository bank and accounts of the enterprise).

573. LPABs are required to update the registry information annually (at the end of each calendar year) concerning any change directors or shareholders.

574. Shares may be owned by domestic or foreign natural persons, legal persons, legal arrangements or a person acting on behalf of the legal person's actual owner or controller (i.e. beneficial owner). Every foreign natural, or legal person or arrangement who holds shares of a LPAB must to be approved by the competent authority.⁸⁸ Additionally, the local branches of the SAIC conduct annual examinations of the LPABs within their jurisdiction. Chinese authorities can collect foreign investors' names, the countries of registration, the legal address, business licenses, registration documents and capital credibility reports. If a foreign investor is a foreign natural person, the authorities can also ask for valid identification documents, biographical data and proof of net worth⁸⁹. However, none of these data, procedures and examination processes are directed towards determining beneficial ownership. The ultimate result is that the registry only contains information about the legal ownership of the legal person, not beneficial ownership, as defined in the FATF Recommendations. Additionally, there is no requirement for legal persons to keep a record of beneficial ownership information.

575. The public security and prosecutorial organs have sufficient ability to obtain access to the registry information, directly from the registry or the legal person itself, using their general powers to collect and obtain evidence from relevant entities and individuals who are required to provide such information truthfully (Criminal Procedure Law; Provisions on Procedures of the Public Security Organs in Handling Criminal Cases). Access to files by any public security agency is subject to the approval of the person in charge of that agency at or above the county level. A notice must be issued and presented when collecting data from the registry.

576. Likewise, during tax inspections and in the context of investigating relevant entities for tax purposes, the tax authorities can get the registry information of LPABs (Law on the Administration of Tax Collection). The GCA also has the right to examine and make copies of contracts, invoices, book accounts, bills, records, documents, business letter and cables, audio and video products and other materials related to the import and export of goods (Customs Law). Additionally, the SAIC has the right to obtain registry information concerning persons who are applying to incorporate a foreign-invested enterprise, so as to obtain a preliminary understanding of the ownership and control information of legal persons. Members of the general public (including financial institutions) may also obtain registry information (Measures for Consulting the Files of Enterprise Registration).

Bearer shares

577. Since 1 January 2006, joint-stock companies have been able to issue "unregistered stocks" or bearer shares (article 130, Company Law). This is a new provision and, as of the date of the on-site

⁸⁸ Regulations on the Administration of Company Registration; Measures on the Administration of Foreign Enterprises' Permanent Representatives Offices Registration; and the Measures on the Administration of Foreign Enterprises' Operation in Chinese Territory Registration.

⁸⁹ Rules for the Implementation of the Law on Foreign-funded enterprises, Detailed Rules on the Implementation of the Law on Sino-foreign joint cooperative ventures, Regulations for the Implementation of the Law on Joint Ventures Using Chinese and Foreign Investment, and Regulations on company Registration.

visit, no such stocks had yet been issued. The CSRC has established a new department to be in charge of issues related to regulating the use of “unregistered stocks”. However, currently there are no special provisions in place to ensure that unregistered stock (which are bearer shares) are not misused for money laundering.

578. The general provisions relating to unregistered stocks are as follows. The company is not required to record the name of the holder of an unregistered stock in its share register. The transfer of an unregistered stock takes effect as soon as the stockholder delivers the stock to the transferee (article 141). If the holders of unregistered stocks attend a shareholders' meeting, they must have their stocks preserved in the company during the period from 5 days before the meeting is held to the day when the shareholders' assembly is closed (article 103). Although no unregistered stocks had been issued at the time of the on-site visit, this development gives rise to concern since there will be no possibility to identify their beneficial owner.

5.1.2 Recommendations and Comments

579. Although the investigatory powers available to the public security, prosecutorial and customs agencies to compel the disclosure of information are generally sound and widely used, this system is only as good as the information that is available to be acquired. Currently, there are no measures in place to ensure that information on beneficial ownership can be available to the law enforcement authorities.

580. The Chinese authorities should implement measures to ensure that adequate, accurate and current information concerning the beneficial ownership of legal persons is available to the authorities on a timely basis. Such measures should extend to unregistered stocks. Therefore, the Chinese authorities should consider revising the existing regulations with regard to the registry and approval process of LPABs to include not only information on the shareholders names, but also on the beneficial owner of the LPAB. In addition, such a revision should be supported by specific measures to facilitate access by financial institutions to beneficial ownership and control information of LPABs.

5.1.3 Compliance with Recommendations 33

	Rating	Summary of factors underlying rating
R.33	NC	<ul style="list-style-type: none"> • There are no measures in place to ensure that there is adequate, accurate and timely information on the beneficial ownership and control of legal persons that can be obtained or accessed in a timely fashion by the competent authorities. • There are no measures to ensure that unregistered stocks (bearer shares) cannot be misused for money laundering.

5.2 Legal Arrangements – Access to beneficial ownership and control information (R.34)

5.2.1 Description and Analysis

581. Chinese law allows the creation of domestic trusts, but foreign trusts are not recognised. The Trust Law defines a trust as “the settlor, based on his faith in the trustee, entrusts his property rights to

the trustee and allows the trustee to, according to the will of the settler and in the name of the trustee, administer or dispose of such property in the interest of a beneficiary or for any intended purposes”⁹⁰.

582. Only express trusts (which may be discretionary trusts) are recognised. Article 9 of the Trust Law requires that the trust deed must contain the following information: (a) the purpose of the trust; (b) the names and addresses of the settlor, the trustee and the beneficiary (c) the scope, type and status of the trust property; and (d) the ways and methods by which the beneficiary receives the trust proceeds.

583. The Trust Law provides that a trust will be voided in circumstances (among others) where: the purposes of the trust are unlawful or will harm the public interest; the trust property cannot be identified; the trust is established using illegal proceeds; and the beneficiary or scope of the beneficiary cannot be identified. The trustee has to keep complete records of the trust business handled, and must report annually to the settlor and beneficiary on the administration and disposition of the trust property and the income and expenses that relate to the property.

584. Under article 24 of the Trust Law, any natural or legal person “with full civil capacity” may act as a trustee. However, under the Regulations on Trust Investment Corporations issued in 2001 (and revised in 2002) only authorised trust investment corporations may act as trustees by way of a business. These regulations provide for the licensing and supervision of such entities, with particular focus on their responsibilities under the Trust Law. Trust investment companies are regulated by the CBRC on a similar basis to that applied to the banking sector. No other financial institutions, lawyers, accountants or other professionals are permitted to administer trusts, unless they do so in a personal, unpaid capacity.

585. Because they have been regarded as quasi-banks, trust investment companies were partly included within the 2003 “one measure and two rules” arrangements, and have, therefore, been subject, since that time, to the AML provisions relating to systems and controls, customer identification and record-keeping. However, they were not included in the STR/LVT reporting arrangements, although they are included within the new rules with effect from March 2007. Under these arrangements the trust investment companies have been subject to inspection by the PBC, and the full powers of the PBC to examine the books and records, to require disclosure and to investigate suspicious transactions apply. This is in addition to the similar powers that can be exercised by the CBRC as the primary prudential supervisor (see section 3.10 above). Exercising these powers, the competent authorities have timely access to the information concerning trusts.

586. Special deposit accounts can be opened for trust funds (article 13 Administrative Rules for RMB Settlement Accounts). An enforceable circular issued by the CBRC provides that such trust fund accounts are only able to be opened by a trust investment company which is approved and regulated by the CBRC. The circular provides that the trust investment company must present copies of the trust document when opening the trust fund account with a financial institution and verify the authenticity of those documents.

5.2.2 Recommendations and Comments

587. The concept of the trust is new in Chinese law, and the authorities have indicated that, to their knowledge, very few such arrangements have been established. In practice, the business of the trust investment corporations is to administer unit trusts, mutual funds and similar investments, and not to act as professional trustees for private trusts. However, where they were to act as trustees, they would be bound by the same regulations as the banking system with respect to customer identification, record-keeping and other preventive measures, but, because of the deficiencies in the overall CDD

⁹⁰ While this definition would suggest the intention was to create something similar to a common law trust, a recent judgement by the Shanghai High People’s Court (Huabao Trust and Investment Co Ltd vs Yanxin Co Ltd) suggests that, in practice, they may be developing as more akin to classic contractual relationships.

regime, would not be required to establish the beneficial ownership of legal persons that are beneficiaries of trusts. While it may be the case that very few trusts have yet been established, and that most, if not all, those that exist may be administered by trust investment corporations, it remains legally possible for such arrangements to be established and administered outside the regulated sector. In such cases there would be no basis on which the competent authorities would be able to access information on the beneficial ownership and control of the trust. From the structure of the Regulations on Trust Investment Corporations it appears that the authorities may well have intended that trust administration should be the sole preserve of these corporations. If this is the case, they may wish to review whether the current framework should be amended to achieve that result.

5.2.3 Compliance with Recommendation 34

	Rating	Summary of factors underlying rating
R.34	PC	<ul style="list-style-type: none"> • No requirement to for trust investment companies to establish beneficial ownership of legal persons that are beneficiaries of trusts. • No means of obtaining timely information on beneficial ownership of trusts that may be administered by private individuals under the Trust law.

5.3 Non-profit organisations (SR.VIII)

5.3.1 Description and Analysis

Review of the NPO sector

588. The Ministry of Civil Affairs (MCA) is the responsible authority for reviewing adequacy of the laws and regulations that relate to non-profit organisations (NPOs), and for registering and supervising them. Governmental authorities supervise and administer the registration of NPOs based on a large number of laws and regulations.⁹¹

589. There are 346,138 non-governmental non-profit organisations (NPOs) in China, all of which fall into one of the following three categories.

- Social organisations** (186,000): These have been voluntarily constituted by Chinese citizens with a view to realising the common will of its members, by carrying out activities based on its articles of association.
- Foundations** (1138): These are organisations based on endowed property with the goal to raise public benefits. They can only be established if sufficient funds are available. They may be domestic, foreign-related or the representative offices of foreign foundations. Representative offices of foreign foundations are required to engage in public welfare activities that are appropriate for the nature of public benefit enterprises in China.
- Private non-commercial units** (159,000): These are organizations constituted by social forces or individual citizens based on non-state property with the view to be engaged in social services. There are three forms of private non-commercial units, depending on the civil liability the unit

⁹¹ Regulation on Foundation Administration, Administrative Regulations Governing the Registration of Social Organisation, Provisional Regulations on Control of Foreign Boards of Commerce, Provisional Regulations on Registration of Civilian Operated Non-enterprise Units, Interim Measures on Registration of Civilian Operated Non-enterprise Units, Interim Measures for Banning Illegal Non-Governmental Organisations, Measures for the Administration of Branches and Representative Offices of Social Organisations, Provisions on the Administration of Name of Foundations, Demonstration Version of Charters of Foundations, Measures for the Annual Inspection of Foundations, and Measures for the Information Disclosure of Foundations.

bears: legal person-private non-commercial units, partnership-private non-commercial units and individual-private non-commercial units.

Outreach to the NPO sector concerning terrorist financing issues

590. All NPOs in China are subject to registration and supervision requirements that promote transparency, accountability, integrity and public confidence in the sector (see the description below). However, China has not yet conducted any awareness raising or outreach to the NPO sector specifically in relation to terrorist financing risks.

Supervision or monitoring of the NPO sector

Scope of the sector that is subject to supervision or monitoring

591. All NPOs in China (domestic, foreign-related and the representative offices in China of foreign NPOs) are subject to registration and supervision by the MCA and the relevant competent authority. Supervision focuses on the source, management and expenditure of the NPO's funds. The supervisory framework includes annual inspection and information disclosure requirements, and the application of administrative sanctions for violations of the applicable laws and regulations.

Registration and publicly available information on NPOs

592. Registration is compulsory; non-registered NPOs are treated as illegal organisations. Before an NPO is registered, the competent authorities review its mission, nature, purposes, modes of operation, and legal representatives or principal officers. The establishment and registration of every NPO is subject to a double review: (1) by the registration authority (the MCA and its regional offices); and (2) by the relevant competent authority for that particular type of NPO. The relevant competent authority varies depending on the activities of a particular NPO. For example, the PBC is the competent authority for a foundation that has been established to provide education to the financial sector; the Ministry of Sports Affairs is the competent authority for a sports organisation; etc.

593. When registering, the NPO must present the identity certificates of its directors and leading officers. When the registered information of an NPO changes (including the name, domicile, type, missions, scope of public welfare activities, amount of original funds, legal representatives, branches and representative offices), it must register the changes at the registration authority. Without such registration and approval, then changes do not take effect. The law explicitly provides that NPOs can only be established for lawful purposes and should operate in accordance with the law.

594. In the case of registration applications by foreign-related foundations and representative offices of foreign foundations, the MCA requests the PBC to check whether there is any suspicious transactions related to the requesting NPO. China has also set up a Joint-Ministerial Conference Mechanism of Management of Foreign NPOs, the participants of which are, among others, the MFA, MCA, MPS and the PBC.

Use of funds, record keeping requirements and supervision

595. All NPOs in China are required to use the "national unified system of financial management". The law prohibits NPOs from using funds or other assets from illegitimate sources, and requires that funds only be used for the purposes and activities set out in the NPO's charter and/or sponsorship agreement. All NPOs are required to report donated funds to the relevant competent authority and the public. Foundations, and state-funded social organisations and private non-commercial units must undergo a financial audit, conducted by the MCA and the relevant competent authority, at the end of each term of service of their boards or when any of the legal representatives have been replaced. The following additional requirements apply, depending upon the type of NPO.

- (a) **Social organisations:** These are prohibited from allocating proceeds among their members.
- (b) **Foundations:** The source of the funds used to establish a foundation is supervised through special accounts set up by the MCA for capital verification. Public fundraising foundations are required to publicly announce, in detail, the intended use of their funds when raising money, and may only raise funds for purposes consistent with their charter. All foundations must establish a full and effective internal system for monitoring their accounts. They must also disclose annual reports to their donors, stakeholders and the general public. The MCA decides which media channel has to be used for the disclosure, so as to ensure optimal public coverage. If the foundation is dissolved, its remaining funds must be spent in accordance with its charter. Otherwise, the remaining funds will be transferred to other NPO with similar aims and objectives. Any such action will be made public. Representative offices of foreign foundations are not allowed to raise funds or accept donations within China.
- (c) **Private non-commercial units:** These must undergo regular audits by an accounting firm or a similar intermediary agency, which includes confirming that funds have only been used in accordance with the charter.

596. Should an NPO wish to open a bank account, the opening is reviewed by the competent authority, the registration authority (MCA) and the PBC. In addition, the accounts of the NPO are regulated by the financial and auditing authorities (MOF, tax authorities and accountant firms).

597. Both the MCA and the relevant competent authorities keep records of information about NPOs, in paper and electronic form, for a period of up to 20 years.

Information gathering, investigation and prosecution

598. The registration authority of any NPO (which is usually the MCA at or above the county level) is in charge of the annual inspection and information disclosure requirements. If an NPO violates any of the applicable laws or regulations, the MCA will, in cooperation with the relevant competent authority, initiate an investigation and impose administrative penalties on the NPO and/or its staff. At the domestic level, the Joint-Ministerial Conference Mechanism on Foreign NPOs specifically targets the misuse of foreign NPOs. If any suspected criminal activity is detected in the course of supervision, it will be reported to the local MPS branch for investigation.

599. Different government agencies such as the MPS, MSS, GTA, and others have full access to NPO information for the purposes of facilitating an investigation. This is in addition to the access to information that the MCA and relevant competent authorities have.

International requests

600. No specific point of contacts have been designated to handle international requests for information relating to NPOs that might be of concern. However, the regular gateways for international cooperation, including those of CAMLMAC, as described in Section 6.3.1 and 6.5.1 of this report can be used for this purpose.

5.3.2 Recommendations and Comments

601. China has a very robust and deep reaching system for the oversight of NPOs. However, since the system was established before the creation of Special Recommendation VIII, it has developed to serve purposes other than preventing NPOs from being misused by terrorist financiers. China is, therefore, advised to include specific measures against terrorist financing misuse in its system. In particular, China should undertake periodic reviews of the NPO sector for the purpose of identifying NPOs which are at a possible risk of being misused for TF by virtue of their activities and characteristics. Moreover, an effective outreach program should be developed, with a view to raising the sector's awareness of the risks of terrorist abuse and the available measures to protect against it. In

that regard, China should consider issuing advisory papers, developing best practices or conducting regular outreach events with the NPO sector.

5.3.3 Compliance with Special Recommendation VIII

	Rating	Summary of factors underlying rating
SR.VIII	LC	<ul style="list-style-type: none"> No outreach to the NPO sector with a view to protecting the sector specifically from TF abuse. Supervision and oversight of the NPO sector is not expressly focused on reviewing the sector's potential vulnerabilities to terrorist activities, or on discovering and preventing possible threats of misuse of the sector by terrorist financiers.

6.1 National co-operation and coordination (R.31)

6.1.1 Description and Analysis

Recommendation 31 (Domestic co-operation)

Policy-level co-operation and co-ordination mechanisms

602. **AML Joint-ministerial Conference:** China's AM/CFT efforts are led by the AML Joint Ministerial Conference which was convened by the public security minister and established in May 2002, following approval of the State Council. Since May 2003, the State Council has designated the governor of the PBC to lead the AML Joint-Ministerial Conference. All those working on AML/CFT issues have joined the Conference, which now has 23 members. A general office was established within the PBC/AMLB (directed by the head of the AMLB) to organise and maintain the AML Joint Ministerial Conference's activities. Each member of the Conference has designated one liaison officer to serve in the general office. The Joint Ministerial Conference meets once or twice per year to summarise and analyse AML matters, point out things that need improvement, and formulate a work plan for the following year. Meanwhile, a liaison meeting is held when it is necessary, to discuss significant AML problems, communicate important AML information and formulate key AML documents. However, the Joint-Ministerial Conference is not a formal decision-making body.

Review of the effectiveness of AML/CFT systems

603. The Joint Ministerial Conference is mandated with reviewing the effectiveness of the AML regime on a regular basis. The work of the various agencies that participate in the Joint Ministerial Conference is reviewed an annual report that is prepared by the PBC. This review examines legislative reforms, development of regulations, oversight of AML compliance, STR reporting, investigation, the prosecution of money laundering, international cooperation and training. In the last two years, the PBC has also published the annual China AML Report which summarises the progress of AML development in the previous year, and identifies weaknesses and future plans. The PBC uses the outcome of its supervisory activities as input for its own review. In relation to CFT measures, the MFA reviews the implementation of UN Security Council resolutions on a regular basis, and reports its findings to the UN Security Council. Overall, these mechanisms appear to be working effectively.

Operational-level co-operation and co-ordination mechanisms

604. An AML cooperation mechanism was established in April 2004 by the PBC in conjunction with the CBRC, CSRC, CIRC and SAFE to coordinate, direct and deploy AML responsibilities in the financial industry.

605. The MPS and the PBC jointly issued the Cooperation Regulations on the Investigation of Suspicious Transaction [Referrals] (“Cooperation Regulations”) on 18 March 2005. This interagency memorandum establishes communication and coordination mechanisms related to investigation, including regular coordination meetings and interim meetings (known as intelligence conferences) in case of emergencies. In addition, a monthly intelligence exchange system was established between both parties. Since March 2005, the MPS/ECID, the PBC/AMLB and CAMLMAC have held monthly meetings to review and analyse suspicious transaction dossiers. The purpose of these meetings is to determine whether this information derived from LVT/STR reporting should be transferred to the ECID for criminal investigation. Representatives from other competent administrative departments are invited to particular meetings if necessary. In November 2005, ECID established a standing liaison group at the AMLB.

606. The MPS also cooperates closely with the supervisory authorities in the financial sector. In April 2002, the MPS established a securities and futures crimes investigation bureau which is based at the CSRC and is responsible for investigating crimes in the securities and futures industry. When the CSRC discovers any suspicion of criminal behaviour (including ML/FT) during its supervision of the securities sector, this mechanism facilitates the timely dissemination of relevant documents and materials to the MPS. Additionally, the CBRC and the MPS are studying and formulating rules to combat illegal money-raising activities.

607. The GCA’s Anti-smuggling Criminal Investigation Bureau (which investigates smuggling activity at the border) has signed 23 memoranda of understanding (MOU) with other domestic authorities with a view to enhancing cooperation during anti-smuggling investigations (including those related to cash smuggling). Additionally, the National Office for Combating Smuggling established contact and communication channels with 30 departments and bureaus in 28 ministries and commissions via the liaison system for combating smuggling. The 30 departments and bureaus include the MPS/ECID, PBC, SPP, SPC, SAIC, SAFE and MOF.

Private sector consultation

608. Although not required by law or policy, the Chinese authorities indicate that it is a common practice for regulators to consult the financial sector on their view about a particular provision or policy. For example, the AMLB held consultation workshops with the financial sector on the (then draft) AML Rules more than four times. The most recent consultation took place in Shanghai and Beijing and was attended by more than 20 institutions from the banking, insurance and securities sectors.

6.1.2 Recommendations and Comments

609. It is of considerable practical importance to effectively incorporate new possibilities for enhancing cooperation and coordination contained in the provisions of the new AML Law into the framework of joint AML/CFT efforts at both policy and operational level. As has been pointed out in other parts of this report, the operational cooperation between the investigators (MPS) and the prosecutors (SPP) could be improved.

610. Operational coordination and cooperation between the MPS and the FIU (i.e. AMLB/CAMLMAC) is very good. The three main types of cooperation include: (1) the FIU transferring information/intelligence to the MPS based on LVT/STR reporting; (2) the MPS furnishing the FIU with new trends and techniques on economic crime; and (3) the MPS requesting the FIU for additional information on cases, as needed. In particular, the MPS/FIU cooperation mechanism has worked very effectively with regard to STR reporting. After the transfer of the information to the MPS the two agencies remain in contact with each other throughout the investigation. For instance, the MPS will ask the FIU for follow-up information or documentation if they uncover new criminal suspects. This coordination is mainly done in Beijing, but can also take place at the local level.

611. One of the highlights of China’s domestic cooperation is how the law enforcement, FIU and regulatory agencies work together to address the issue of illegal money remitters. A holistic approach is taken with respect to targeting, identifying and shutting down illegal money remitters. The MPS and PBC enjoy a very good cooperative working relationship on this approach.

612. With respect to fighting terrorism, the Anti-Terrorism Bureau of the MPS is solely responsible for counter-terrorism efforts, including CFT. This bureau has an information sharing agreement with the ECID and enjoys good cooperation with them. For example, in 2003 the MPS created a national list of four terrorist organisations and 11 terrorist individuals. This list has been announced publicly and the MPS has shared it with the PBC. In addition, the MSS has very good cooperation with domestic agencies, including the MPS, in providing information and assistance on ML/FT cases. It is therefore somewhat surprising that specific cases of terrorist financing have not yet been discovered in China.

6.1.3 Compliance with Recommendation 31

	Rating	Summary of factors underlying rating
R.31	LC	<ul style="list-style-type: none"> Operational co-operation between the law enforcement and prosecutorial authorities could be improved.

6.2 The Conventions and UN Special Resolutions (R.35 & SR.I)

6.2.1 Description and Analysis

R.35 and SR.I (Ratification and implementation of relevant international instruments)

613. China signed the Vienna Convention on 20 December 1988 and submitted the instrument of ratification on 25 December 1989.

614. China signed the Palermo Convention on 12 December 2000, and submitted the instrument of ratification on 23 September 2003.

615. China signed the FT Convention on 13 November 2001 and submitted the instrument of ratification on 19 April 2006.

616. Money laundering activity has been criminalised, but needs further fine-tuning to be fully in line with the Conventions and cover all of the behavioural aspects, more particularly in respect of the knowing acquisition and use (article 3, Vienna Convention). Particularly, the self-laundering issue needs to be addressed and corporate criminal liability does not extend to all relevant provisions (articles 6 and 10 Palermo Convention). Nearly all seizure and confiscation provisions have been fully implemented, with the exception of the measures related to equivalent value assets (article 5 Vienna Convention; article 12 Palermo Convention). Additionally, the implementation of the preventive requirements in the Palermo Convention (article 7) is rather deficient and still needs to be further developed, with emphasis on the CDD requirements for financial institutions and DNFBPs (particularly in respect of the beneficial ownership), and the deepening of the STR reporting regime to make it fully comprehensive. See sections 2.1, 2.3, 3.2 and 3.7 for a full discussion of these issues.

617. Some key provisions of the TF Convention are still not adequately addressed. The criminalisation of terrorist financing (as required by article 2 of the TF Convention) is deficient, especially in respect of the sole collection of funds and the definition of terrorist acts. Penalties are not proportionate (article 4, TF Convention). Dual criminality based extradition and mutual legal assistance is jeopardised by the incomplete TF offence (articles 9, 11 and 12, TF Convention).

Preventive measures (CDD and STR requirements) also need to fully extend to TF related matters (article 18, TF Convention). See sections 2.2, 3.2 and 3.7 for a full discussion of these issues.

618. As discussed in detail in section 2.4 of this report, China has taken some steps to implement UNSCR 1267 and the principles of UNSCR 1373; however, the implementation regime needs to be revised as a whole in order to comply with the requirements of FATF SR III in a meaningful way. No adequate procedures have been established, nor has any special attention been given to a clear determination of the assets that must be targeted and of their relation with the designated individuals/entities. Clear communication lines, effective monitoring and rules for acceding to the frozen assets should be integrated in the system.

Additional elements

619. China also signed the Shanghai Convention on Combating Terrorism, Separatism and Extremism along with Kazakhstan, the Kyrgyz Republic, the Russian Federation, Tajikistan and Uzbekistan on 5 June 2001 and ratified it on 27 October 2001. China is a member of all 9 international conventions listed in the Appendix of the TF Convention.

6.2.2 Recommendations and Comments

620. The PRC has signed and ratified the relevant Conventions, but is deficient in the effective implementation of these instruments and in the transposition of the specific FATF requirements surrounding the anti-terrorist UN Resolutions. Reference is made to the recommendations and comments in the respective sections, as indicated above.

6.2.3 Compliance with Recommendation 35 and Special Recommendation I

	Rating	Summary of factors underlying rating
R.35	PC	<ul style="list-style-type: none"> • Criminalisation of ML, the seizure/confiscation regime and preventative measures are not fully in line with the Vienna, Palermo and TF Conventions. • Criminalisation of FT and ability to provide mutual legal assistance not fully in line with the TF Convention.
SR.I	PC	<ul style="list-style-type: none"> • Criminalisation of TF, preventative measures and ability to provide mutual legal assistance not fully in line with the TF Convention. • Implementation of UNSCR 1267 and 1373 is inadequate.

6.3 Mutual Legal Assistance (R.36-38, SR.V)

6.3.1 Description and Analysis

Recommendation 36 and Special Recommendation V (Mutual legal assistance)

621. All rules relating to China's ability to provide mutual legal assistance equally apply to cases involving money laundering or terrorist financing.

622. There is no framework law on mutual legal assistance (MLA) in China. According to article 17 CPC, China provides mutual legal assistance in AML/CFT investigations on the basis of bilateral MLA treaties and international conventions that China is a party to or, in the absence of such formal agreements, on the basis of sole reciprocity. At the time of the on-site visit, China had concluded 40

mutual legal assistance treaties with other countries (of which 28 are in force⁹²) and 3 treaties on the transfer of sentenced persons (1 in force).⁹³

623. Under the MLA regime the following types of judicial assistance in criminal matters can be provided:

- (a) serving documents;
- (b) taking the testimony or statements of persons;
- (c) providing originals, certified copies or photocopies of documents, records or articles of evidence;
- (d) obtaining and providing expert evaluations;
- (e) making persons available to give evidence or assist in investigations;
- (f) locating or identifying persons;
- (g) executing requests for inquiry, searches, freezing and seizures of evidence;
- (h) assisting in forfeiture proceedings;
- (i) transferring persons in custody for giving evidence or assisting in investigations; and
- (j) any other form of assistance which is not contrary to the laws in the territory of the requested party.

624. Some treaties on judicial assistance in criminal matters include a clause which allows accredited diplomatic or consular officers to send judicial documents to and collect evidence from the citizens of the other party, without however being allowed to take compulsory measures against the persons or assets involved.

Mutual legal assistance channels

625. There are two channels of communication for MLA in China, depending on what basis the MLA is being provided.

626. The Ministry of Justice is the central authority designated in international conventions and bilateral treaties on MLA as the correspondent for China. Where the treaty designates another foreign authority, China adds its counterpart to be China's correspondent in addition to the Ministry of Justice. Where there is a bilateral treaty or multi-lateral convention concluded or signed by China, the Ministry of Justice will make a preliminary review of the request for judicial assistance according to the related treaty and domestic law. Provided that it complies with the conditions set out in the treaty, the request will be passed on to the authority that is competent to take the requested actions according to Chinese laws. Besides, the Ministry of Justice is responsible for following up the implementation and giving guidance if necessary, or communicating with the requesting state on difficulties met in the process of enforcement. If the request does not comply with the provided conditions, the Ministry will return it and giving reasons for doing so.

⁹² The treaties in force are with Belarus, Bulgaria, Canada, Colombia, Cuba, Cyprus, the Democratic People's Republic of Korea, Egypt, Greece, Kazakhstan, Kyrgyzstan, Laos, Latvia, Lithuania, Mongolia, Poland, the Republic of Korea, Romania, the Russian Federation, South Africa, Tajikistan, Thailand, Tunisia, Turkey, Ukraine, the USA, Uzbekistan and Vietnam.

⁹³ The treaty on the transfer of sentenced persons is with Ukraine.

627. Outside the context of a convention or formal agreement, the Ministry of Foreign Affairs is the correspondent for China. It reviews the request, forwards it to the appropriate law enforcement authorities and channels the reply. MLA is then granted on condition of the requesting state making a commitment of reciprocity to China that complies with Chinese law and judicial practice.

628. It was stated that the processing of an MLA request normally takes between 2 and 8 months on average, depending on the complexity of the request.

Conditions for mutual legal assistance

629. The Chinese authorities state they offer all possible help to other states in line with international treaties, or on a reciprocal basis, in an expeditious manner. They do not require judicial procedures to have been initiated as a condition for providing assistance in an investigation, and are quite flexible in the application of the dual criminality principle whenever that would apply. There are instances where they have given MLA even when the request was based on facts that were not considered an offence in China.

630. China does not refuse to provide judicial assistance on the sole ground that the offence is also considered to involve fiscal matters. This policy is based also on international conventions that China is party to, such as the Palermo Convention.

631. The financial sector secrecy provisions, as described previously in this report, are overruled for law enforcement investigations and prosecutorial actions (article 117 CPC), including those which are based on a foreign request. In this respect China follows the requirements of the Vienna Convention (article 7.5) and the Palermo Convention (article 18.8). In practice, China has already received MLA requests from foreign countries to enquire on or to freeze particular accounts, and has provided timely and effective assistance in response to such requests.

Powers of competent authorities

632. The treaties on judicial assistance in criminal matters that have been concluded or acceded to by China stipulate that the requested party must provide judicial assistance according to domestic laws. Consequently, all of the powers of competent authorities, as described in Section 2.6 of this report, are available for MLA.

633. The mutual legal assistance treaties concluded between China and other countries usually stipulate the principle of a “guarantee against double jeopardy” in order to avoid prosecutions in more than one country. They contain arrangements to deal with disputes and come to terms on the implementation of the agreement (see e.g. article 22 of the Agreement on MLA in criminal matters between the United States and China).

Additional elements

634. It was stated that when the Chinese police authorities receive a request for assistance directly from a foreign counterpart, there is no prohibition for them to act upon it to the extent that it does not involve coercive measures or the use of judicial procedures.

Recommendation 37 and Special Recommendation V (Dual criminality)

635. China applies the principle of dual criminality in its criminal judicial cooperation with other countries. This rule is however not a mandatory one, but provides an option for refusal⁹⁴. China also abides with the Conventions that it is party to (such as the Palermo Convention and the UN Convention against Corruption) and which provide for the possibility to give assistance in the absence of dual criminality. In fact, China has already given judicial assistance to foreign countries for behaviour that did not constitute an offence under Chinese laws.

636. Whenever dual criminality is applicable, China can comply with the request if it relates to any criminal behaviour under Chinese law, irrespective of whether this behaviour is defined as an identical or similar offence by both parties. This principle is set out in mutual legal assistance treaties that have been concluded by China and also applies to *ad hoc* MLA based on reciprocity.

Recommendation 38 and Special Recommendation V (Requests to freeze, seize or confiscate)

637. The domestic procedures pursuant to articles 109 to 118 CPC for identifying, tracing and seizing laundered property, proceeds or instrumentalities of crime (whether intended or actually used), as described in Section 2.3 of this report, apply also in the context of mutual legal assistance requests to that effect. Execution of foreign confiscation orders or decisions are not subject to a formal screening and implementation process (or *exequatur* procedure), but follow the normal way of mutual legal assistance. The same procedures for confiscation are applied as for domestic confiscation orders.

638. Requests to take seizing or confiscation action must be based on a bilateral treaty or multi-lateral convention that has been concluded or signed by China, or on the principle of reciprocity⁹⁵. As with other MLA issues, the Ministry of Justice has been designated as the competent authority to handle requests based on multi- or bilateral treaties. Diplomatic channels must be used when no such treaty or convention exists. In practice, the requests are passed on to the judicial authority in China that is the counterpart of the requesting foreign authority (public prosecutor or court), who then will decide on the legal conformity of the request and is in charge of having the order or judgment executed. No instances of undue delay or other obstacles have been reported. Efficiency is also supported by the coordination arrangements accompanying the confiscation actions, which are a typical feature in the MLA treaties⁹⁶.

639. It is a matter of debate if there is sufficient legal justification for executing equivalent value seizures and confiscations requests in China, as Chinese law does not specifically provide for such measures in the domestic context. The Chinese authorities refer to the Vienna and Palermo Conventions as providing a possible legal basis for them to comply with such requests, or alternatively to the measure of “confiscation of property” pursuant to article 59 PC (confiscation as a penalty instead of a fine). No precedents however support this assertion (yet). In light of the flexible attitude of the Chinese authorities in MLA matters, equivalent value seizure, as a conservatory and temporary measure, might not be a real issue. In view of the incisive and final character of confiscation however this measure needs firm legal grounds that are not open to challenge.

⁹⁴ For example, article 3.1(a) of the MLA in criminal matters agreement between China and the USA dd. 19 June 2000 stipulates that assistance may be denied if “the request relates to conduct that would not constitute an offence under the laws in the territory of the requested party, provided that the Parties may agree to provide assistance for a particular offence, or category of offences, irrespective of whether the conduct would constitute an offence under the laws in the territory of both Parties”.

⁹⁵ See as an example the Agreement on Mutual Legal Assistance in Criminal Matters between China and the Kingdom of Thailand, including several provisions on requests for and possible transfers of proceeds (articles 13 and 14.1-14.3).

⁹⁶ See art. 16 of the China – USA MLA agreement.

Sharing of confiscated funds

640. All confiscated funds are considered to be state revenue. Equal proportions of such funds (50:50) are paid into the general local and state treasury accounts, rather than to a designated asset forfeiture fund. Chinese law does not expressly prohibit sharing funds with other countries and in fact there have been instances of asset sharing, but this is not a regular practice due to the absence of specific provisions that authorise this form of cooperation. Recently a precedent was created where assets were shared with the United States.⁹⁷

Additional elements

641. Chinese law contains no specific provisions concerning how to deal with foreign requests that relate to non-criminal confiscation orders. The Chinese authorities indicate that any such request would be taken into consideration. The outcome would be uncertain and would mostly depend on whether the activity that led to the confiscation decision would be considered a criminal offence under Chinese law.

Statistics

642. The Chinese authorities collect and maintain detailed statistics concerning the number of mutual legal assistance requests that are made or received by China, including The nature of the request, whether it was granted or refused, the time taken to respond and how many of the requests related to money laundering offences.

Effectiveness of mutual legal assistance measures

643. The following statistics on MLA were provided by the Chinese authorities. These statistics are aggregated figures from the Ministry of Justice and the Ministry of Foreign Affairs. They also include figures from the SPP and the MPS given that, in practice, they process judicial assistance requests that are received or sent between counterpart agencies and which fall outside of the formal legal assistance channels (i.e. by treaties or diplomatic channels). More detailed statistics which set out the nature of the requests made and received are set out in Annex 7 of this report.

China's Statistics on Mutual Legal Assistance (2003-2006)								
	Requests received from other countries				Requests made to other countries			
Year	2003	2004	2005	2006	2003	2004	2005	2006
Number	137	106	152	155	18	11	27	10
Total	550				66			

644. The Ministry of Justice stated it had received 6 requests for legal assistance in matters that concerned money laundering. China made 1 MLA request related to a money laundering case. The Chinese authorities advised that usually the time taken to respond to a mutual legal assistance request is from 2 to 8 months, except in extremely complicated cases. The statistics kept by the Chinese authorities are quite detailed and reflect an expedient processing of mutual legal assistance requests. Moreover, no FATF member raised any substantial concern about their experience with China in relation to mutual legal assistance.

⁹⁷ The Chinese authorities state that the Ministry of Justice is advocating and pursuing the matter, which is presently under consideration.

6.3.2 Recommendations and Comments

645. The Chinese mutual legal assistance regime presents a coherent and comprehensive picture. The conditions and formalities of the MLA treaties indeed do not contain extraordinary burdening or delaying elements that may put obstacle to an efficient and expeditious execution of MLA. The procedures are firmly established and there is a general commitment of the Chinese authorities to view the requests favourably, be they treaty or reciprocity based.

646. The legal uncertainty surrounding the equivalent value confiscation is also an issue in the international context. In the absence of precedents or specific jurisprudence, the alleged legal basis seems deficient, or at the very least open to challenge. A specific clause allowing for such confiscation in the relevant provisions will provide for the appropriate legal remedy, both in the domestic and the international context.

6.3.3 Compliance with Recommendations 36 to 38 and Special Recommendation V

	Rating	Summary of factors relevant to s.6.3 underlying overall rating
R.36	C	<ul style="list-style-type: none">This Recommendation is fully observed.
R.37	C	<ul style="list-style-type: none">This Recommendation is fully observed.
R.38	LC	<ul style="list-style-type: none">The absence of a formal legal basis for equivalent value confiscation presents an obstacle to the execution of foreign MLA requests based on such orders.
SR.V	LC	<ul style="list-style-type: none">The partial coverage of the TF offence in article 120bis PC (sole collection of funds not criminalised) constitutes an impeding element when the dual criminality principle is applied in relation to a foreign MLA request.

6.4 Extradition (R.37, 39, SR.V)

6.4.1 Description and Analysis

Recommendation 39 and Special Recommendation V (Extradition)

647. All provisions relating to China's ability to provide assistance in relation to extradition matters, as described in this section, apply equally to cases involving money laundering, terrorist financing and predicate crimes.

648. Extradition by China is governed by the Extradition Law, enacted on 28 December 2002. China has signed extradition treaties with 26 countries, 20 of which are presently in force.⁹⁸ China's extradition treaties are not list-based and cover all crimes, including money laundering and terrorism financing. The relevant UN Conventions (Vienna, Palermo and TF Conventions) may also serve as a further basis for providing extradition and mutual legal assistance to the countries party to these Conventions. Finally, China can consent to extradite on an *ad hoc* basis, subject to reciprocity (art. 15 Extradition Law).

649. All extraditions are conditional to dual criminality, and to a punishment of either one year imprisonment or more in case of extradition in the context of criminal proceedings (which is the case for the money laundering and terrorism financing offences), or a sentence of at least six months for

⁹⁸ The treaties in force are with Belarus, Bulgaria, Cambodia, Kazakhstan, Kyrgyzstan, Laos, Lithuania, Lesotho, Mongolia, the Republic of Korea, Peru, the Philippines, Romania, Russia, South Africa, Thailand, Tunisia, Ukraine, the United Arab Emirates and Uzbekistan.

extradition for the purpose of execution of a criminal sanction (article 7 Extradition Law). The grounds for mandatory (article 8) and discretionary (article 9) refusal are universally accepted and not unreasonable.

650. Requests for extradition must be made to the MFA which also follows up the further procedure and response. All requests are subjected to the scrutiny of the SPC which conducts an examination of legal aspects and checks if the conditions for extradition are met. The ultimate decision on extradition rests with the State Council who often delegates this decision to the MFA. The duration of the procedure is not formally defined or limited, although the Extradition Law provides for some deadlines, especially in relation to the detention of the person to be extradited. The minimum duration of an extradition procedure was said to be 6 months, which is not an abnormal figure. All in all the law contains no legal conditions or formalities that could be considered excessive or having an unduly delaying effect.

651. China does not extradite its own nationals (article 8 Extradition Law). This principle is repeated in most of the extradition treaties that China has concluded. Nonetheless, most treaties also state that when one of the countries refuses to extradite based on nationality, the requested country must submit the request to its competent authorities for public prosecution in line with the request of the requesting party⁹⁹. At the time of the on-site visit such procedure was initiated at the request of the Republic of Korea. In such cases, the requesting party must submit to the requested party documents and evidence related to the case. If the relevant extradition treaty does not stipulate the procedures to be followed, the usual mutual judicial assistance procedures apply and any request needs to follow the normal channels, i.e. via the Ministry of Justice or via diplomatic channels to the MFA. The SPC ultimately decides whether the person will be prosecuted in China or not. China also respects the *aut dedere, aut judicare* principle when dealing with reciprocity based extradition cases.

Recommendation 37 and Special Recommendation V (Dual criminality)

652. China requires dual criminality in order to provide assistance in response to an extradition request. This is based on the Extradition Law and confirmed in treaties that China has signed¹⁰⁰. However, as with MLA, it is not necessary that both countries classify or define the criminal behaviour in an identical way. It is sufficient that the same behaviour is criminalised in both jurisdictions and the condition of the minimum penalty threshold is fulfilled (article 7 Extradition Law).

Additional elements

653. At present, there are no provisions in place that allow for simplified extradition procedures.

Statistics

654. The Chinese authorities collect and maintain general statistics concerning the number of extradition requests that are made or received by China. No incoming or outgoing requests have yet related to money laundering or terrorism financing. The authorities do not keep more detailed statistics concerning the time taken to respond to extradition requests. The Chinese authorities advised that, depending on the nature of the individual extradition case, the time taken to respond may vary from one month to two years.

Effectiveness

655. The following statistics on extradition were provided by the MFA.

⁹⁹ For instance, this is provided in article 5 of the Extradition Treaty between the PRC and Brazil (which has been negotiated, but is not yet in force).

¹⁰⁰ For instance, China's extradition treaty with Lithuania states that "whether an offence will be classified into the same crime category, or accused with the same charge according to the laws of both parties will have no effect on judging whether the offence constitutes a crime that violates the law of both parties".

China's Statistics on Extradition (2003-2006)								
	Requests received from other countries				Requests made to other countries			
Year	2003	2004	2005	2006	2003	2004	2005	2006
Number	5	0	4	3	2	0	3	1
Total	12				6			

656. Until now, no in- or outgoing extradition requests related to money laundering or terrorism financing have been made. The legal and organisational framework that is in place, however, has already proven its effectiveness.

6.4.2 Recommendations and Comments

657. The extradition regime of China is solid and well organised. To make the legal framework more comprehensive it would benefit from the introduction of the possibility of simplified procedures in line with the current international practices in this domain.

658. In the event that incoming or outgoing extradition requests related to money laundering or terrorism financing are received, the Chinese authorities should collect and maintain detailed statistics concerning the time taken to respond.

6.4.3 Compliance with Recommendations 37 & 39, and Special Recommendation V

	Rating	Summary of factors relevant to s.6.4 underlying overall rating
R.39	C	<ul style="list-style-type: none"> This Recommendation is fully observed.
R.37	C	<ul style="list-style-type: none"> This Recommendation is fully observed.
SR.V	LC	<ul style="list-style-type: none"> As a result of the dual criminality principle, the incomplete coverage of the TF offence in respect of the sole collection of funds may affect the legal capacity for China to comply with an extradition request based on such activity.

6.5 Other Forms of International Co-operation (R.40 & SR.V)

6.5.1 Description and Analysis

Recommendation 40 and Special Recommendation V (Other forms of international cooperation)

659. All of the provisions relating to the ability of China's competent authorities to provide other forms of international co-operation, as described in this section, apply equally to cases involving money laundering, terrorist financing and predicate crimes.

Law enforcement authorities

660. The Provisions on the Procedures for Handling Criminal Cases by Public Security Agencies state the principles, scope and procedures to be followed when cooperating with foreign counterparts (Chapter 13). The International Cooperation Department of the MPS has developed cooperation channels with a number of their foreign law enforcement counterparts. China also cooperates in Interpol.

661. To provide clear gateways for international cooperation, China has signed more than 120 cooperation agreements, MOUs or summaries on police affair and anti-crime cooperation with over 50 countries. In those agreements, there are clear articles stating that the two sides may have direct

contact channels to share intelligence and investigate cases. China has dispatched 26 police officers as liaisons to 16 countries and regions, including the United States, Canada and Thailand. Likewise there are 14 foreign law enforcement liaison officers based in China.

662. China's law enforcement authorities cannot spontaneously offer assistance to their foreign counterparts; assistance can only be given upon the request of another country. Nonetheless, China's law enforcement may conduct investigations within China on behalf of foreign counter parts, as long as this is done in accordance with bi- or multilateral treaties and MOUs, as well as China's domestic laws and regulations. The international police cooperation agreements specify that information received from foreign counterparts can only be used upon authorisation. The MPS participate in joint investigations and have undertaken freezing action on behalf of foreign counterparts.

663. There are no unduly restrictive conditions in law or in practice to hinder police-to-police exchanges of information. The MPS actively provides assistance to foreign police in accordance with bilateral treaties, agreements, protocols or MOUs. None of these instruments contains any restrictive conditions based on secrecy or confidential requirements. Since 2002, China's law enforcement authorities have received more than 300 requests from other countries for assistance in investigating ML/FT cases, including over 20 terrorist financing crimes requests. The Chinese authorities have stated that assistance was provide in 92% of the cases and that all requests have been investigated and that feed back on the results has always been provided within 3 months.

664. China has entered into over 70 cooperation agreements, MOUs and minutes on police affair cooperation and crime-combating with more than 40 countries. Since 1998, the Chinese police have assisted foreign law enforcement agencies in investigating more than 20 clues regarding terrorist-related funds and provided help to law enforcement agencies from the United States, Britain, Canada etc in carrying out relevant investigations and evidence collection in China

FIU (PBC and CAMLMAC)

665. Under articles 27 and 28 of the AML Law, the PBC is China's designated competent authority in matters involving cooperation on AML matters with foreign governmental or relevant international organisations, and exchanges of information or other material with overseas AML authorities.

666. The PBC, as China's FIU, has signed MOUs with the FIUs of Belarus, Malaysia and the Russian Federation concerning AML/CFT cooperation and intelligence exchanges. The PBC can also delegate its authority in international co-operation matters to CAMLMAC. CAMLMAC, with the authorization and on behalf of the PBC, has concluded MOUs on the exchange and cooperation of AML/CFT financial intelligence with the FIUs of Georgia, Indonesia, Republic of Korea, Mexico and Ukraine. Under the provisions of the AML Law (article 10 and 28) and rules set by these MOUs, the PBC (or CAMLMAC, as the PBC's designated authority) can actively communicate and cooperate with foreign FIUs or other foreign authorities (i.e. non-counterparts). Such information exchanges are generally processed in a prompt manner. The PBC and CAMLMAC may also take the initiative to forward information spontaneously. The information offered or exchanged may relate to ML, FT or related crimes and includes information that is contained within CAMLMAC's database (in relation to the countries that have signed a FIU MOU with China). Additionally, the PBC and CAMLMAC (with stand-alone authorization from the PBC) can share information on a case-by-case basis with FIUs from jurisdictions without agreement. The PBC and CAMLMAC may also conduct inquires and investigations within China on behalf of foreign counterparts, as long as this is done in accordance with bilateral or multilateral treaties and MOUs, reciprocity or on a case-by-case basis, in accordance with Chinese laws and regulations.

667. The conditions for exchanging information are set out in MOUs. Texts of the MOUs are drawn with regard to international practices and Chinese laws. There are no other conditions or restrictions on the exchange of information. No requests are denied solely on the basis that they involve tax matters or financial institution confidentiality. The AML/CFT agreements and MOUs that have been

concluded by the PBC and CAMLMAC stipulate that financial intelligence information can only be used for the internal investigation and analysis of FIUs and must not be provided to any third party without the provider's agreement. Since the FIU was established, the PBC and CAMLMAC have received 17 requests for assistance from 10 countries, and have provided feedback to two countries via the National Interpol Central Bureau of China. At present¹⁰¹, they are dealing with another 72 requests from the FIUs of other countries which have concluded MOUs with the PBC or CAMLMAC.

Customs authorities (GCA)

668. The GCA has established cooperative relationships with 110 foreign customs administrations. It has carried out substantive cooperation with 78 foreign customs authorities and maintained long-term cooperative relationships with the customs administrations of major trading partners and neighbouring countries, such as Australia, Japan, the Netherlands, the Russian Federation, the Republic of Korea and the United States. Long term co-operative relationships include annual exchange visits, routine cooperation meetings, and annual administration-level border meetings. As of April 2006, the GCA had also concluded 30 bilateral agreements with the governments and customs authorities of 53 other countries (regions), which, according to the Chinese authorities, cover all of the major political and economic powers that have connections with China.

669. In addition to providing assistance to requesting foreign customs authorities and putting forward requests for assistance in investigations to foreign customs within the framework of agreements, the GCA also cooperates with the customs administrations of other states in individual anti-smuggling cases, even though these countries have not entered into an agreement with China. Additionally, the authorities state that they hope to be able to exchange data on false or non-disclosures of cross-border cash declarations with other countries in the future.

670. Since 2000, the GCA has handled more than 1,000 co-investigation requests from foreign customs administrations. It has also put forward 150 of its own such requests, involving nearly 30 countries. The GCA has also attended and is considering joining 6 international combating-terrorist cooperation projects including the Sino-United States CSI cooperation, Sino-US combating-terrorist cooperation in finance, Sino-US PSI cooperation, Sino-Canada CSI cooperation, Sino-India combating-terrorist cooperation, and Sino-Pakistan anti-terrorist cooperation. Of these, the Sino-US CSI cooperation has been carried out in Shanghai in April 2005, and is about to be carried out in Shenzhen.

Supervisors

671. The Chinese financial regulatory departments may only co-operate with their international counterparts under the terms of an MOU or similar agreement. To date they have established regulatory cooperation mechanisms with a significant number of foreign counterparts. The CBRC has entered into 22 MOUs with its counterparts in other countries/territories.¹⁰²

672. The CSRC, which is a member of the International Organisation of Securities Commissions (IOSCO), can establish regulatory cooperation mechanisms with foreign regulators to assist cross-border regulation and cooperation (article 179 Securities Law). As at the end of 2006, the CSRC had signed

¹⁰¹ September 2006

¹⁰² Hong Kong SAR, Macau SAR, United Kingdom (all 2003); Canada, Germany, Kyrgyz Republic, Pakistan, Republic of Korea, Singapore, United States (all 2004); Australia, France, Hungary, Italy, Kazakhstan, the Philippines, Poland and Russian Federation (all 2005) and Jersey, Spain, Thailand and Turkey (all 2006).

MOUs on supervisory cooperation with 32 foreign counterparts.¹⁰³ The CSRC is required to carry out information exchange and supervisory cooperation with foreign counterparts in accordance with the MOUs. In addition, article 179 of the Securities Law (which came into force on 1 January 2007) states that the CSRC can establish supervision and regulation cooperative mechanism with securities regulatory agencies in other countries or territories. The new Administrative Rules on Futures Transactions promulgated on 6 March 2007 similarly enables the CSRC to provide assistance, including investigative assistance, to its foreign counterparts. The CSRC is also in the final stages of preparing its application to subscribe to the IOSCO Multi-lateral MOU, and hopes to enter into the arrangement in 2007.

673. CIRC has established 6 bilateral MOUs with its counterparts in other countries (including with Germany, the Republic of Korea, Singapore and the United States). It has also signed agreements of regulatory cooperation with Hong Kong, China SAR and Macau, China SAR.

674. The CBRC, CSRC and CIRC cannot spontaneously offer assistance to other countries. Assistance can only be provided upon the request of another country. Nonetheless, the CBRC, CSRC and CIRC may conduct investigations within China on behalf of foreign counter parts, as long as this is done in accordance with bi- or multilateral treaties and MOUs, as well as China's domestic laws and regulations. There are no disproportionate or unduly restrictive conditions either in domestic law or in the MOUs signed by CBRC, CSRC or CIRC which would unduly hinder the exchange of information. Requests for co-operation are not refused on the sole ground that the request is also considered to involve fiscal matters, or on the grounds of financial secrecy or confidentiality requirements.

Tax authorities

675. The State Tax Administration has established intelligence exchange mechanisms with 88 states pursuant to taxation agreements. The State Tax Administration cannot spontaneously offer assistance to other countries. Assistance can only be provided upon the request of another country. Nonetheless, the State Tax Administration may conduct investigations within China on behalf of foreign counter parts, as long as this is done in accordance with bi- or multilateral treaties and MOUs, as well as China's domestic laws and regulations. There are no disproportionate or unduly restrictive conditions either in domestic law or in the agreements signed by the State Tax Administration which would hinder the exchange of information. Requests for cooperation have never been refused on the sole ground that the request is also considered to involve fiscal matters or on the ground of financial secrecy or confidentiality, and no such grounds of refusal are set out in any of the bilateral instruments that have been signed by the State Tax Administration.

Statistics

676. Statistics are kept concerning the number of formal requests for assistance made or received by the CAMLMAC/AMLB; details concerning whether the requests were granted or refused are provided below.

Year	Number of Requests for Assistance Granted/Received/Sent by CAMLMAC		
	Received	Granted	Sent
2004	2	1	0
2005	13	1	0

¹⁰³ Hong Kong SAR (1993); United States (1994); Hong Kong SAR, Singapore (both 1995); Australia, United Kingdom (both 1996); Brazil, Japan, Malaysia, United Kingdom, Ukraine (all 1997); France, Germany, Luxembourg (all 1998); Italy (1999); Egypt (2000); Republic of Korea (2001); Belgium, Romania, the Netherlands, South Africa, United States (all 2002); Canada, Indonesia, Switzerland (all 2003); Indonesia, New Zealand, Portugal (all 2004); Nigeria, Viet Nam (both 2005) and Argentina, India, Jordan, Norway and Turkey (all 2006).

2006	12	11	0
TOTAL	27	13	0

677. Although CAMLMAC is authorised to make spontaneous referrals to foreign authorities, no statistics were provided concerning how many (if any) such referrals have been made.

678. The authorities also keep statistics concerning the number of formal requests for assistance that are made or received by the CSRC. No such statistics exist in the case of the CBRC or CIRC because, according to the Chinese authorities, no such requests have ever been received by these supervisors. More detailed statistics were not available concerning whether any of these requests related to AML/CFT.

679. In practice, to date, the CSRC has received 118 foreign investigation requests and has made 11 requests to other countries. The Chinese authorities indicate that the CSRC granted all of these requests, conducted investigations and provided the investigation results to the requesting parties rapidly and effectively. Additionally, between 2003 and 2006, the CSRC received 80 requests for mutual legal assistance from other countries or regions. In all cases, the requests were granted and all of the relevant material /investigation results were provided to requesting countries/regions. During that same period, the CSRC sent 9 requests for mutual legal assistance to other countries or regions. All of these requests were granted by the requested countries/regions.

YEAR	NUMBER OF REQUEST RECEIVED BY CSRC	NUMBER OF REQUEST MADE BY THE CSRC
2003	24	2
2004	18	1
2005	24	2
2006	14	4
Total	80	9

Additional elements

680. There are mechanisms in place for CAMLMAC, state agencies and financial regulators to engage in prompt and constructive information exchange with their foreign non-counterparts. The receiving authority forwards the request of foreign non-counterpart to the domestic counterpart authority, which in turn processes the request and replies directly to the foreign party or via the incoming route. There are no restrictions to disclosing, in general, to the requested authority the purpose of the request and on whose behalf the request is being made. China's FIU may request other competent authorities to provide related information that has been requested by a foreign FIU.

6.5.2 Recommendations and Comments

681. The task of establishing new bilateral and multilateral relations with foreign FIUs, signing new MOUs should be more actively pursued to improve the effectiveness of the system.

682. China is taking initiatives in conducting comprehensive co-operation with all countries in multiple areas such as police affair co-operation, intelligence exchange, assisted investigations and recovering illegally acquired property as well as arrest and seizure. It has entered into over 70 co-operation agreements, MOUs, minutes on police affair cooperation and crime-combating with more than 40 countries. China has exchanged police liaison officers with five countries, including the United States, Canada and Thailand; concluded treaties on criminal and judicial coordination with 26 countries; and concluded bilateral extradition treaties with 18 countries, including Russia, Thailand, Mongolia, etc. Since 1998, the Chinese police have assisted foreign law enforcement agencies in investigating more than 20 clues regarding terrorist-related funds and provided help to law enforcement agencies from the

United States, Britain, Canada etc in carrying out relevant investigations and evidence collection in China. Another highlight which demonstrates the excellent law enforcement cooperation is the fact that the police authorities hold regular meetings with foreign law enforcement agencies. In addition, 26 Chinese liaison officers have been sent to 16 foreign countries.

6.5.3 Compliance with Recommendation 40 and Special Recommendation V

	Rating	Summary of factors relevant to s.6.5 underlying overall rating
R.40	LC	<ul style="list-style-type: none"> • China's law enforcement authorities and financial supervisors cannot spontaneously offer assistance to their foreign counterparts. • The effectiveness of the FIU's ability to cooperate with its foreign counterparts is somewhat impeded by the relatively small number of MOU's that it has entered into.

7. OTHER ISSUES

7.1 Resources and statistics (R.30 & 32)

7.1.1 Description and Analysis

Recommendation 30 (Resources of competent authorities)

683. The text of the description, analysis and recommendations for improvement that relate to Recommendations 30 and 32 is contained in all the relevant sections of the report (i.e. all of section 2, parts of sections 3 and 4, and in section 6). There is a single rating for each of these Recommendations, even though the Recommendations are addressed in several sections. Section 7.1 of the report only contains the box showing the rating and the factors underlying the rating, and includes a cross-reference to the relevant section and paragraph in the report where this is described.

7.1.3 Compliance with Recommendations 30 and 32

	Rating	Summary of factors relevant to s.7.1 underlying overall rating
R.30	LC	<ul style="list-style-type: none"> • The number of FIU staff is inadequate given the large number of reports that it receives. •
R.32	LC	<ul style="list-style-type: none"> • No statistics are kept concerning: <ul style="list-style-type: none"> – the number of cross-border transportations of currency and bearer negotiable instruments; – the time taken to respond to extradition requests; and – the number of freezing, seizing or confiscation actions, or the amount of assets involved, including a breakdown of the number of cases and amounts confiscated pursuant to administrative or criminal procedures, and a differentiation between the criminal sources of the assets frozen, seized or confiscated.

TABLES

Table 1: Ratings of Compliance with FATF Recommendations

Table 2: Recommended Action Plan to improve the AML/CFT system

Table 1. Ratings of Compliance with FATF Recommendations

The rating of compliance vis-à-vis the FATF Recommendations should be made according to the four levels of compliance mentioned in the 2004 Methodology [Compliant (C), Largely Compliant (LC), Partially Compliant (PC), Non-Compliant (NC)], or could, in exceptional cases, be marked as not applicable (na).

Forty Recommendations	Rating	Summary of factors underlying rating ¹⁰⁴
Legal systems		
1. ML offense	PC	<ul style="list-style-type: none"> • The money laundering provisions are not effectively implemented, as witnessed by the low number of convictions for money laundering. • Self-laundering is not criminalised, although no fundamental principle in Chinese law is prohibitive. • The relevant offences, taken together or separately, do not fully cover the sole and knowing acquisition and use. • One designated category of predicate offence (“terrorism, including terrorist financing”) is not adequately covered for the reasons set out in section 2.2 of this report. •
2. ML offense—mental element and corporate liability	PC	<ul style="list-style-type: none"> • The money laundering provisions are not effectively implemented, as witnessed by the low number of convictions for money laundering. • No corporate criminal liability is provided for the offences covered by article 312 and 349 PC. •
3. Confiscation and provisional measures	LC	<ul style="list-style-type: none"> • Equivalent value seizure and confiscation are not features of the seizure and confiscation regime. • Confiscation of proceeds, although mandatory, is not systematically pursued and imposed by the courts, indicating a lack of awareness and implementation that needs to be addressed.
Preventive measures		
4. Secrecy laws consistent with the Recommendations	C	<ul style="list-style-type: none"> • This Recommendation is fully observed.
5. Customer due diligence	PC	<ul style="list-style-type: none"> • No legal obligation to identify and verify the beneficial owner. • Only the banking sector (which includes foreign exchange and MVT services) is subject to specific requirements relating to the identification of legal persons (e.g. requirements to verify their legal status by obtaining proof of incorporation, names of directors, etcetera). • No specific and comprehensive legal requirement to conduct ongoing due diligence (e.g. financial institutions are not obligated to develop a risk profile of the customer or determine the source of his/her funds; no obligation in the insurance sector to monitor transactions or business relationships even in limited cases, or to keep documents, data or information collected under the CDD process up-to-date and relevant by

¹⁰⁴ These factors are only required to be set out when the rating is less than Compliant.

		<p>undertaking reviews of existing records).</p> <ul style="list-style-type: none"> • No enhanced due diligence requirements or guidelines for high risk categories of customers. • No requirement to consider filing an STR when CDD requirements cannot be complied with. • Concerns relating to the continuing acceptance of first generation ID cards which are prone to forgery and the duplication of numbers on about five million manually issued first generation ID cards. • There is no explicit obligation on financial institutions to determine whether the customer is acting on behalf of (i.e. representing) another person. • While the AML Law requires a threshold and rules for handling occasional transactions, such threshold itself has not been determined. • Effectiveness of implementation cannot be assessed due to the recent enactment of the law.
6. Politically exposed persons	NC	<ul style="list-style-type: none"> • No AML requirements in relation to foreign PEPs.
7. Correspondent banking	PC	<ul style="list-style-type: none"> • There is no requirement for banks to gather sufficient information about a respondent institution to understand fully the nature of the respondent's business and to determine from publicly available information the reputation of the institution and the adequacy and quality of supervision and controls, in particular with regard to AML/CFT. • It is no requirement to document the respective AML/CFT responsibilities within correspondent relationships.
8. New technologies & non face-to-face business	LC	<ul style="list-style-type: none"> • In the insurance sector, there are no requirements related to non-face-to-face business, even though some on-line insurance business does exist.
9. Third parties and introducers	PC	<ul style="list-style-type: none"> • No requirement to obtain core customer identification data from the third-party. • No requirement to ascertain the status of the third-party with respect to regulation and supervision for AML purposes. • No conditions introduced in relation to reliance on third-parties emanating from countries with inadequate AML regimes.
10. Record keeping	LC	<ul style="list-style-type: none"> • No requirement for institutions to retain business correspondence and similar documents.
11. Unusual transactions	PC	<ul style="list-style-type: none"> • There is no legal obligation for insurance companies and securities companies to pay special attention to all complex, unusual large transactions, or unusual patterns of transactions, that have no apparent or visible economic or lawful purpose except when the transactions are done in foreign currencies.
12. DNFBP – R.5, 6, 8-11	NC	<ul style="list-style-type: none"> • Only very limited customer identification and record keeping requirements apply to dealers in precious metals and stones, lawyers, notaries, real estate agents and company service providers. However, none of these substantially meet Recommendations 5 and 10. • The customer identification and record keeping obligations that apply to trust service providers (i.e. trust investment companies) are deficient in the same ways as listed in section 3.2 and 3.5 of this report. • None of the DNFBP sectors legally authorised to operate in China are

		subject to obligations that relate to Recommendations 6, 8, 9 and 11.
13. Suspicious transaction reporting	PC	<ul style="list-style-type: none"> • No RMB reporting obligation for the securities and insurance sectors. • No explicit obligation to report suspicions of terrorist financing. • No obligation to report attempted transactions. • The rules do not define the basis upon which suspicion should be founded (i.e. to include, at least, the required list of predicate offences). • Significant concerns about the overall effectiveness of the system, and the lack of subjective assessment by reporting institutions.
14. Protection & no tipping-off	C	<ul style="list-style-type: none"> • This Recommendation is fully observed.
15. Internal controls, compliance & audit	PC	<ul style="list-style-type: none"> • The internal control environment is not set up to address terrorist financing risk. • There is no explicit requirement to communicate such policies and procedures to the employees of the financial institution. • There are no screening provisions in place to ensure high standards when hiring employees (with the exception of those that relate to senior management). • There is no explicit requirement in the AML Law or the related rules for financial institutions to maintain an adequately resourced and independent audit function to test compliance with internal AML/CFT controls. • There are no specific legal provisions that require financial institutions to ensure that compliance officers and other appropriate staff have timely access to relevant information • There is no requirement to provide relevant employees with CFT training. • There is no explicit requirement to designate an AML/CFT officer at the management level (although in all of the financial institutions the assessors spoke with during the on-site visit had their compliance officer at senior management level).
16. DNFBP – R.13-15 & 21	NC	<ul style="list-style-type: none"> • Reporting obligations have not been extended to any of the DNFBP sectors. • None of the DNFBP sectors is required to pay special attention to business relationships and transactions involving persons from or in countries that do not (or insufficiently) apply the FATF Recommendations. • Dealers in precious metals and stones, lawyers, notaries, real estate agents and company service providers are not required to establish internal AML/CFT control programs. • The obligations for trust investment companies to establish internal control programs are deficient in the same respects as described in section 3.8 of this report.
17. Sanctions	PC	<ul style="list-style-type: none"> • The level of the sanctions provided in the AML Law appears relatively low for major deficiencies. • The sanctions regime focuses excessively on minor deficiencies and does not appear effectively to target structural weaknesses.
18. Shell banks	PC	<ul style="list-style-type: none"> • There are no specific legal requirements that prohibit the establishment of connections with a foreign shell bank.

		<ul style="list-style-type: none"> There are no legal provisions that require financial institutions to satisfy themselves that respondent financial institutions in a foreign country do not permit their accounts to be used by shell banks.
19. Other forms of reporting	C	<ul style="list-style-type: none"> This Recommendation is fully observed.
20. Other NFBP & secure transaction techniques	C	<ul style="list-style-type: none"> This Recommendation is fully observed.
21. Special attention for higher risk countries final	NC	<ul style="list-style-type: none"> There is no requirement to give special attention to business relationships and transactions with persons (natural or legal) from or in countries that do not, or insufficiently, apply the FATF Recommendations. China does not have a mechanism to implement countermeasures against countries that do not sufficiently apply the FATF standards.
22. Foreign branches & subsidiaries	NC	<ul style="list-style-type: none"> There is no requirement for foreign branches and subsidiaries of Chinese-funded financial institutions to apply the higher standard where the AML/CFT requirements of China and the host country differ. There is no explicit requirement to inform the home country supervisor when a foreign branch or subsidiary is unable to observe appropriate AML/CFT measures.
23. Regulation, supervision and monitoring	PC	<ul style="list-style-type: none"> No supervisory programme yet implemented for the securities and insurance sectors following extension of law to these sectors.
24. DNFBP - regulation, supervision and monitoring	NC	<ul style="list-style-type: none"> Dealers in precious metals and stones, lawyers, notaries, real estate agents and company service providers are not monitored or supervised for compliance with AML/CFT requirements, since no such requirements yet apply to them. The sanctions regime that is applicable to trust service providers (i.e. trust investment companies) is deficient in the same ways as listed in section 3.10 of this report.
25. Guidelines & Feedback	LC	<ul style="list-style-type: none"> No guidance has been issued in relation to the new obligations under the recently-enacted 2006 AML Law and connected regulations. No AML/CFT guidance has yet been issued for trust investment companies (the only category of DNFBP that is currently subject to AML/CFT requirements).
Institutional and other measures		
26. The FIU	LC	<ul style="list-style-type: none"> Effectiveness: The CAMLMAC/AMLB does not have sufficient staff to effectively manage the very high volume of STRs and other reports that it receives. The CAMLMAC/AMLB does not have (timely) access to other bodies' information.
27. Law enforcement authorities	LC	<ul style="list-style-type: none"> There is no emphasis placed on pursuing ML/FT investigations. Investigators are not focused on attacking the money aspect of criminal offences. Investigators do not seem to be fully aware of the legal elements of ML that they need to prove.
28. Powers of competent authorities	C	<ul style="list-style-type: none"> This Recommendation is fully observed.

29. Supervisors	LC	<ul style="list-style-type: none"> As for R17, with respect to the effectiveness of sanctions. Effectiveness of the new role of the CBRC, CSRC and CIRC still to be tested.
30. Resources, integrity and training	LC	<ul style="list-style-type: none"> The number of FIU staff is inadequate given the large number of reports that it receives. The number of law enforcement staff that are specifically focused on AML/CFT is insufficient.
31. National co-operation	LC	<ul style="list-style-type: none"> Operational co-operation between the law enforcement and prosecutorial authorities could be improved.
32. Statistics	LC	<ul style="list-style-type: none"> No statistics are kept concerning: <ul style="list-style-type: none"> the number of cross-border transportations of currency and bearer negotiable instruments; the time taken to respond to extradition requests; and the number of freezing, seizing or confiscation actions, or the amount of assets involved, including a breakdown of the number of cases and amounts confiscated pursuant to administrative or criminal procedures, and a differentiation between the criminal sources of the assets frozen, seized or confiscated.
33. Legal persons – beneficial owners	NC	<ul style="list-style-type: none"> There are no measures in place to ensure that there is adequate, accurate and timely information on the beneficial ownership and control of legal persons that can be obtained or accessed in a timely fashion by the competent authorities. There are no measures to ensure that unregistered stocks (bearer shares) cannot be misused for money laundering.
34. Legal arrangements – beneficial owners	PC	<ul style="list-style-type: none"> No requirement to for trust investment companies to establish beneficial ownership of legal persons that are beneficiaries of trusts. No means of obtaining timely information on beneficial ownership of trusts that may be administered by private individuals under the Trust law.
International Co-operation		
35. Conventions	PC	<ul style="list-style-type: none"> Criminalisation of ML, the seizure/confiscation regime and preventative measures are not fully in line with the Vienna, Palermo and TF Conventions. Criminalisation of FT and ability to provide mutual legal assistance not fully in line with the TF Convention.
36. Mutual legal assistance (MLA)	C	<ul style="list-style-type: none"> This Recommendation is fully observed.
37. Dual criminality	C	<ul style="list-style-type: none"> This Recommendation is fully observed.
38. MLA on confiscation and freezing	LC	<ul style="list-style-type: none"> The absence of a formal legal basis for equivalent value confiscation presents an obstacle to the execution of foreign MLA requests based on such orders.
39. Extradition	C	<ul style="list-style-type: none"> This Recommendation is fully observed.
40. Other forms of co-operation	LC	<ul style="list-style-type: none"> China's law enforcement authorities and financial supervisors cannot

		<p>spontaneously offer assistance to their foreign counterparts.</p> <ul style="list-style-type: none"> The effectiveness of the FIU's ability to cooperate with its foreign counterparts is somewhat impeded by the relatively small number of MOU's that it has entered into.
Nine Special Recommendations	Rating	Summary of factors underlying rating
SR.I Implement UN instruments	PC	<ul style="list-style-type: none"> Criminalisation of TF, preventative measures and ability to provide mutual legal assistance not fully in line with the TF Convention. Implementation of UNSCR 1267 and 1373 is inadequate.
SR.II Criminalize terrorist financing	PC	<ul style="list-style-type: none"> The sole collection of funds in a terrorist financing context is not criminalised (i.e. where the funds have not been handed over to the terrorist or terrorist organisation), also affecting the utility of article 120bis PC as a predicate offence. There is no definition or list of what should be considered to be "terrorist activities". The assessment team is not satisfied that terrorist financing offence extends to a sufficiently broad and clear definition of "funds" as that term is defined in the TF Convention.
SR.III Freeze and confiscate terrorist assets	NC	<ul style="list-style-type: none"> The direct criminal procedure (seizure) approach is insufficient to adequately and effectively respond to the freezing designations in the context of the relevant UN resolutions. The present regime does not address the non-regulated sector in a meaningful way. No procedure is in place to ensure an adequate and qualitative screening of foreign freezing requests. Guidance for and monitoring of all implicated sectors is not effectively organised. There is no clear determination of the scope of the freezing obligations in respect of what assets need to be targeted and their link with the terrorist individuals and entities. No de-listing or (partial) unfreezing procedure is provided. No adequate regulation on bona fide third party protection is provided.
SR.IV Suspicious transaction reporting	NC	<ul style="list-style-type: none"> No explicit obligation to report suspicions of terrorist financing. Concerns raised in relation to Recommendation 13 apply equally to SR IV.
SR.V International co-operation	LC	<ul style="list-style-type: none"> The partial coverage of the TF offence in article 120bis PC (sole collection of funds not criminalised) constitutes an impeding element when the dual criminality principle is applied in relation to a foreign MLA request. As a result of the dual criminality principle, the incomplete coverage of the TF offence in respect of the sole collection of funds may affect the legal capacity for China to comply with an extradition request based on such activity.
SR.VI AML requirements for money/value transfer services	LC	<ul style="list-style-type: none"> Implementation of Recommendations 5, 6, 7, 9, 10, 13, 15, and 22 in the MVT sector suffers from the same deficiencies as those that apply to banks and which are described earlier in section 3 of this report. R.17: The level of the sanctions provided in the AML Law appear relatively

		low for major deficiencies, and the sanctions regime focuses excessively on minor deficiencies and does not appear effectively to target structural weaknesses.
SR.VII Wire transfer rules	LC	<ul style="list-style-type: none"> • Verification of customer identification only required for payments in excess of RMB 50,000 (US\$6,300).
SR.VIII Non-profit organizations	LC	<ul style="list-style-type: none"> • No outreach to the NPO sector with a view to protecting the sector specifically from TF abuse. • Supervision and oversight of the NPO sector is not expressly focused on reviewing the sector's potential vulnerabilities to terrorist activities, or on discovering and preventing possible threats of misuse of the sector by terrorist financiers.
SR.IX Cross Border Declaration & Disclosure	PC	<ul style="list-style-type: none"> • System focuses exclusively on cash. Bearer negotiable instruments are not included. • Reports on cash declarations/seizures are not being provided to the FIU and are not being used to identify and target money launderers and terrorist financiers.

Table 2: Recommended Action Plan to Improve the AML/CFT System

AML/CFT System	Recommended Action (listed in order of priority)
1. General	
2. Legal System and Related Institutional Measures	
2.1 Criminalization of Money Laundering (R.1 & 2)	<ul style="list-style-type: none"> • The effectiveness of the criminal AML effort should be enhanced by raising awareness with the judicial authorities of the importance to recover the criminal proceeds and the opportunities that a sharper focus on money laundering creates in this respect. Jurisprudence on the proof of the predicate offence should be created by bringing more stand-alone money laundering cases before the court. • As no fundamental principle in the Chinese legal tradition opposes the criminalisation of self-laundering, it should be expressly provided that money laundering activity (beyond acquisition and possession) by the predicate offender is also an offence. • Legislation should be amended to ensure that the sole and knowing acquisition and use are covered. It is preferable and recommended to revise the three relevant provisions to create one transparent and well-defined money laundering offence. • The collection of terrorist funds should be criminalised so as to ensure that the “terrorism, including terrorist financing” designated category of predicate offence is fully covered. • Corporate criminal liability should extend to all money laundering activity, including the activity covered by the article 312 and 349 PC offences. •
2.2 Criminalization of Terrorist Financing (SR.I)	<ul style="list-style-type: none"> • Art. 120bis PC should be amended to ensure that the sole collection of funds for terrorist purposes is covered. In doing so, it should be irrelevant if the funds have been handed over to the terrorist (organisation) or not, as long as the intention to do so exists. • The term “terrorist activities” should be specifically and unequivocally defined to be consistent with the TF Convention and Special Recommendation II. • The Penal Code should specify what is to be understood as “funds” for the purpose of article 120bis.
2.3 Confiscation, freezing and seizing of proceeds of crime (R.3)	<ul style="list-style-type: none"> • The legislation should be amended to provide for equivalent value confiscation, and the related freezing or seizure of assets that may become subject to such confiscation. • In the absence of established jurisprudence or authoritative interpretation on the legal basis for confiscation of “clean” terrorist financing means, it is advisable to expressly provide that such assets are subject to forfeiture as objects of the article 120bis offence. • In terms of efficiency the judicial authorities should give more attention to a systematic application of the confiscation provisions, which is a mandatory measure anyway under Chinese law. • Also the confiscation regime should include clear provisions and procedures on how to deal with the assets in case the proceedings come to a halt before a conviction was pronounced.

<p>2.4 Freezing of funds used for terrorist financing (SR.III)</p>	<ul style="list-style-type: none"> • China should revise its implementation of Special Recommendation III, giving special attention to: <ul style="list-style-type: none"> – giving clear instructions and guidance to all relevant sectors, including the non-regulated, on their obligations in this respect, defining in particular what assets the freezing orders target and their relation to the individuals and entities involved; – ensuring that there are efficient communication lines between the law enforcement authorities, the supervisory bodies, the financial institutions and other affected sectors; – implementing a screening procedure and authority responsible for evaluating the foreign list based requests; – implementing effective compliance monitoring by supervisory bodies within an adequate sanctioning framework; – establishing appropriate and publicly known procedures for de-listing, unfreezing or in any other way challenging the listing and freezing measure before a court or other designated authority; and – enacting regulations on (restricted) access to the frozen assets and protecting the rights of bona fide third parties.
<p>2.5 The Financial Intelligence Unit and its functions (R.26)</p>	<ul style="list-style-type: none"> • After streamlining the STR reporting process so that STRs flow directly from the headquarters of financial institutions to CAMLMAC, consideration should be given to the problem of how to deal effectively with such a large volume of STRs coming directly to CAMLMAC (60 staff strong). • The access of CAMLMAC/AMLB to information held by other bodies could be improved or streamlined.
<p>2.6 Law enforcement, prosecution and other competent authorities (R.27 & 28)</p>	<ul style="list-style-type: none"> • Law enforcement and prosecutorial authorities currently focus on pursuing predicate offences, to the exclusion of ML/FT. Overall, China should take measures to improve the effectiveness of its AML/CFT regime by ensuring that law enforcement and prosecutorial authorities also focus on money laundering and terrorist financing cases. In this regard, China should consider creating multi-agency, multi-disciplinary task forces which combine the skills and expertise of a number of different agencies, and are focused on money laundering and terrorist financing investigations, as opposed to investigating particular predicate offences. This may also help to address some of the overlap that currently exists between the MPS and MSS. The Joint-Ministerial Conference Mechanism on AML should also be utilised to achieve these goals. • Communication between the law enforcement and prosecutorial authorities should be improved, with a view to enhancing the understanding of investigators concerning the legal elements needed to successfully prosecute a money laundering case. For example, investigators from the MPS should work more closely with the SPP in determining which criminal charges will be pursued during an investigation and how best to make use of limited resources. Investigators also need to enhance their understanding of how to pursue money laundering cases where the predicate offence has been committed overseas, but the funds are laundered in China. • All agencies should continue to train their investigators on conducting financial investigations including “follow the money” techniques and forensic accounting skills. Investigators should also increase their understanding of financial records

	and corporate documents.
2.7 Cross Border Declaration & Disclosure	<ul style="list-style-type: none"> Article 18 of the Regulation on the Administrative of Carrying of Foreign Currency for Persons Entering or Exiting the Territory should be amended to stipulate the reporting of bearer negotiable instruments. In addition, the authorities will have to implement a system where all cash declarations are automatically provided to CAMLMAC, not only those which relate to false disclosures. It is highly recommended that the threshold for reporting cash declarations to the FIU (article 12 AML Law) be consistent with the current thresholds for declaring currency.
3. Preventive Measures – Financial Institutions	
3.1 Risk of money laundering or terrorist financing	<ul style="list-style-type: none"> There are no recommendations for this section.
3.2 Customer due diligence, including enhanced or reduced measures (R.5 to 8)	<ul style="list-style-type: none"> The assessors were told by the PBC that it intends to enact specific CDD-Rules by the end of July 2007. In this context the assessors recommend that such Rules should cover, at a minimum, the following subjects: <ul style="list-style-type: none"> Financial institutions should be explicitly required to identify and verify the identity of the beneficial owner of a customer before opening an account, establishing a business relationship, or performing transactions, and to register this identity information. Specific requirements relating to the identification of legal persons (e.g. requirements to verify their legal status by obtaining proof of incorporation, names of directors, etcetera) should be extended to the securities and insurance sectors. There should be an explicit requirement to undertake comprehensive ongoing due diligence which includes the requirement to create risk profiles and determine the source of funds of all customers (both natural and legal persons). In this context, Chinese authorities should consider consolidating the various existing elements of ongoing CDD. Financial institutions should be required to conduct enhanced due diligence in relation to high risk categories of customers (such as PEPs), business relationships and transactions. Financial institutions should be required to consider filing an STR when CDD requirements cannot be complied with. Financial institutions should be explicitly required to determine whether the customer is acting on behalf of another person. An explicit threshold for all transactions that does not exceed EUR/USD 15,000 and which triggers the obligation to identify occasional or one-time customers should be set out. The new CDD rules should be issued and effectively implemented as soon as possible. Additionally, the Chinese authorities should ensure that financial institutions cannot rely on first generation ID cards to identify persons. The Chinese authorities should introduce requirements that address the specific risks associated with foreign PEPs, in accordance with Recommendation 6. With regard to correspondent banking relationship the Chinese authorities should require banks to gather sufficient information about the respondent's business, its reputation and the adequacy and quality of supervision and controls, and its

	<p>AML/CFT controls. In this context the authorities should also establish a clear requirement for banks to document the respective AML/CFT responsibilities within correspondent banking relationships.</p> <ul style="list-style-type: none"> • The Chinese authorities should require insurance companies to have policies and procedures in place to address the specific risks associated with non-face-to-face business.
3.3 Third parties and introduced business (R.9)	<ul style="list-style-type: none"> • The authorities intend moving from a regime where covered financial institutions were required themselves to undertake CDD on all their customers, to one where reliance on third-party introductions may be permitted. However, the current legal framework for this transition is incomplete for compliance with the principles of Recommendation 9. Therefore, it is recommended that the introduction of this provision be suspended until the opportunity has been taken (with the intended promulgation of additional CDD rules) to supplement the existing provisions with the following requirements that the institution relying on the third-party should: <ul style="list-style-type: none"> – obtain immediately from the introducer the core information relating to the customer's identity and the purpose of the account; and – satisfy itself that the third-party is regulated and supervised for AML compliance, and complies with the FATF standards on CDD and record-keeping; • The authorities should also clearly identify the circumstances in which a reliance on foreign third-party introductions should not be permitted, in particular where the introducer is resident in a country that does not adequately apply the FATF Recommendations.
3.4 Financial institution secrecy or confidentiality (R.4)	<ul style="list-style-type: none"> • There are no recommendations for this section.
3.5 Record keeping and wire transfer rules (R.10 & SR.VII)	<ul style="list-style-type: none"> • Financial institutions should be specifically required to retain business correspondence and other related documents. • The threshold for the verification of customer identity for wire transfers should be implemented in line with the FATF requirement of no more than USD 1000.
3.6 Monitoring of transactions and relationships (R.11 & 21)	<ul style="list-style-type: none"> • The obligation to pay special attention to all complex, unusual large transactions, or unusual patterns of transactions should be extended to all financial sectors. This will be achieved by implementation of the new LVT/STR Rules. It is also noted that, in the new LVT/STR Rules, there is reference to a requirement for the securities and insurance sectors to take special note of business relationships with high risk money laundering countries or regions. This obligation should be extended to all financial institutions. • Measures should be implemented which require financial institutions to pay special attention to business relationships and transactions with persons (natural and legal) and financial institutions from jurisdictions that have not sufficiently implemented the FATF standards. Such a requirement should be supported by sufficient information or guidelines provided by the authorities, and by a mechanism that allows the authorities to implement countermeasures against countries that do not sufficiently apply the FATF Recommendations.
3.7 Suspicious transaction reports and other reporting (R.13-14, 19, 25 & SR.IV)	<ul style="list-style-type: none"> • Two amendments to the new LVT/STR Rules should be made at the earliest opportunity. First, reporting should be extended to attempted transactions; and, second, the relevance of the reporting obligation to suspicions of terrorist financing should be made explicit, so that institutions are left in no doubt about

	<p>the obligation to report all such suspicions, whether or not related to the defined transactions.</p> <ul style="list-style-type: none"> • The new LVT/STR Rules have prescribed suspicious criteria according to financial sector. However, in this regard, there are some generic criteria that should apply to all financial sectors, but where the new regulations appear to limit these to specific sectors (e.g. the requirement to monitor business relationships with high risk money laundering countries and regions, which appears only with respect to the securities and insurance sectors). It is recommended that the rules are reviewed to ensure that such general provisions are clearly stated to apply to all financial institutions. • It is recommended that a greater move towards a more subjective STR regime be implemented once the new sectors brought into the system in March have become familiar with the overall concepts of suspicious transaction reporting.
<p>3.8 Internal controls, compliance, audit and foreign branches (R.15 & 22)</p>	<ul style="list-style-type: none"> • The Chinese authorities should explicitly require financial institutions to establish and maintain internal procedures, policies and controls to manage both AML as well as CFT risks and to communicate such policies and procedures to their employees. • Financial institutions should also be required to designate a compliance officer at the senior management level and provide him/her with the necessary management and technical personnel. • The relevant laws or regulations should clarify that all branches and subsidiaries of financial institutions, including branches and subsidiaries abroad, should establish internal AML control programs, establish or designate an internal department to ensure compliance with AML measures, and provide AML/CFT training to their relevant staff. • Specific requirements should be implemented with respect to foreign branches and subsidiaries of Chinese financial institutions that operate in countries which do not (or insufficiently) apply the FATF Recommendations. • Financial institutions should be required to inform the home country supervisor when a foreign branch or subsidiary is unable to observe appropriate AML/CFT measures. The Chinese authorities indicate that they have already noted this problem and relevant regulations are being formulated to address it. • Where the AML requirements of China and the host country differ, foreign branches and subsidiaries of Chinese financial institutions should be specifically required to follow the higher standard, to the extent permitted by the laws and regulations of the host country. If they are unable to do so, they should be specifically required to inform the Chinese supervisory authorities. • Regulators should ensure that violations of these requirements are not structural (as opposed to being merely technical in nature).
<p>3.9 Shell banks (R.18)</p>	<ul style="list-style-type: none"> • Chinese authorities should prohibit financial institutions from establishing connections with a foreign shell bank. Additionally, financial institutions should be required to satisfy themselves that respondent financial institutions in a foreign country do not permit their accounts to be used by shell banks.
<p>3.10 The supervisory and oversight system - competent authorities and SROs. Role, functions, duties and powers (including sanctions) (R.23, 29,</p>	<ul style="list-style-type: none"> • The new AML Law envisages that there will be close co-operation between the PBC and the regulatory authorities over the implementation of respective responsibilities. It is vital that this cooperation takes place in practice, and it is recommended that particular attention be applied to the following:

17 & 25)	<ul style="list-style-type: none"> - To clarify the intention of article 11 of the AML Law to ensure that there is an expectation that routine exchanges of information on their respective AML compliance responsibilities take place in both directions between the PBC and the financial sector regulators; - To develop compatible procedures for compliance monitoring, so that the scope of the inspection procedure is broadly consistent, and institutions nationally have a clear understanding of what is expected by the various regulators; - To give careful consideration to the objectives of the sanctioning regime, to ensure that the system focuses on bringing about structural change in those institutions that have major deficiencies. and - Generally to review the level and application of sanctions to ensure that they provide a genuinely dissuasive effect for institutions that persist in having significant weaknesses in their systems and controls. <ul style="list-style-type: none"> • Further guidance should be issued to the financial sector to assist it in the implementation of the new requirements contained in the 2006 AML Law and its associated regulations. This guidance should also be focused on ensuring that financial institutions fully understand the regulatory approach that will be taken (i.e. an approach that is focusing on bringing about structural change in those institutions that have major deficiencies).
3.11 Money value transfer services (SR.VI)	<ul style="list-style-type: none"> • China should implement requirements in relation to Recommendations 6 (PEPs) and 22 (foreign branches and subsidiaries). It should also improve its implementation of There has only been partial implementation of Recommendations 5 (CDD), 7 (correspondent banking), 9 (third party introducers), 13 (suspicious transaction reporting), Recommendation 10 (record keeping) and 15 (internal controls), as discussed earlier in section 3 of this report. • China should raise the level of the sanctions provided in the AML Law in relation to major deficiencies, and should ensure that major structural weaknesses are the target of the sanctions regime (i.e. rather than focusing excessively on minor deficiencies).
4. Preventive Measures – Non-Financial Businesses and Professions	
4.1 Customer due diligence and record-keeping (R.12)	<ul style="list-style-type: none"> • China should impose specific customer identification and record keeping requirements, consistent with Recommendations 5 and 10, to dealers in precious metals and stones, lawyers, notaries, real estate agents and company service providers. • China should enhance the customer identification and record keeping requirements that apply to trust service providers (i.e. trust investment companies), as described in section 3 of this report. • Specific AML/CFT requirements relating to Recommendations 6, 8, 9 and 11 should be extended to all DNFBP sectors, including trust investment companies.
4.2 Suspicious transaction reporting (R.16)	<ul style="list-style-type: none"> • Reporting obligations should be extended to all categories of DNFBP. It should be noted that trust investment companies are subject to the new STR/LVT rules with effect from 1 March 2007. • DNFBPs should be required to give special attention to business relationships or transactions with persons from countries that insufficiently apply the FATF Recommendations. • The obligation to establish internal AML/CFT control programs should be

	<p>extended to dealers in precious metals and stones, lawyers, notaries, real estate agents and company service providers.</p> <ul style="list-style-type: none"> • The PBC has indicated that it will seek to extend AML/CFT coverage to certain DNFBPs in the first half of 2007. This process should be completed as soon as possible.
4.3 Regulation, supervision and monitoring (R.24-25)	<ul style="list-style-type: none"> • China should ensure that dealers in precious metals and stones, lawyers, notaries, real estate agents and company service providers are monitored or supervised for compliance with AML/CFT requirements, once such obligations have been imposed on them. • China should ensure that, once the AML/CFT requirements are in place, appropriate guidance is issued to these sectors. • China should issue appropriate AML/CFT guidance to trust investment companies (the only DNFBP sector that is currently subject to AML/CFT requirements).
4.4 Other non-financial businesses and professions (R.20)	<ul style="list-style-type: none"> • There are no recommendations for this section.
5. Legal Persons and Arrangements & Non-Profit Organizations	
5.1 Legal Persons – Access to beneficial ownership and control information (R.33)	<ul style="list-style-type: none"> • Although the investigatory powers available to the public security, prosecutorial and customs agencies to compel the disclosure of information are generally sound and widely used, this system is only as good as the information that is available to be acquired. China should implement measures to ensure that information on beneficial ownership can be available to the law enforcement authorities. • The Chinese authorities should implement measures to ensure that adequate, accurate and current information concerning the beneficial ownership of legal persons is available to the authorities on a timely basis. Such measures should extend to unregistered stocks. Therefore, the Chinese authorities should consider revising the existing regulations with regard to the registry and approval process of LPABs to include not only information on the shareholders names, but also on the beneficial owner of the LPAB. In addition, such a revision should be supported by specific measures to facilitate access by financial institutions to beneficial ownership and control information of LPABs.
5.2 Legal Arrangements – Access to beneficial ownership and control information (R.34)	<ul style="list-style-type: none"> • While it may be the case that very few trusts (other than unit trusts, mutual funds and similar investments) have yet been established, and most, if not all, that exist may be administered by trust investment corporations, it remains legally possible for such arrangements to be established and administered outside the regulated sector. In such cases there would be no basis on which the competent authorities would be able to access information on the beneficial ownership and control of the trust. From the structure of the Regulations on Trust Investment Corporations it appears that the authorities may well have intended that trust administration should be the sole preserve of these corporations. If this is the case, they may wish to review whether the current framework should be amended to achieve that result. Future amendments should ensure that adequate, accurate and current information concerning the beneficial ownership of legal persons is available to the authorities on a timely basis in relation to all trusts (including those that may be established and administered outside of the sector that is currently regulated).
5.3 Non-profit organizations	<ul style="list-style-type: none"> • China should include specific measures against terrorist financing misuse in its

(SR.VIII)	<p>system. In particular, China should undertake periodic reviews of the NPO sector for the purpose of identifying NPOs which are at a possible risk of being misused for TF by virtue of their activities and characteristics. Moreover, an effective outreach program should be developed, with a view to raising the sector's awareness of the risks of terrorist abuse and the available measures to protect against it. In that regard, China should consider issuing advisory papers, developing best practices or conducting regular outreach events with the NPO sector.</p>
6. National and International Co-operation	
6.1 National co-operation and coordination (R.31)	<ul style="list-style-type: none"> • It is of considerable practical importance to effectively incorporate new possibilities for enhancing cooperation and coordination contained in the provisions of the new AML Law into the framework of joint AML/CFT efforts at both policy and operational level. As has been pointed out in other parts of this report, the operational cooperation between the investigators (MPS) and the prosecutors (SPP) could be improved.
6.2 The Conventions and UN Special Resolutions (R.35 & SR.I)	<ul style="list-style-type: none"> • China should enhance its implementation of the relevant UN Conventions by criminalising the knowing acquisition and use of proceeds of crime, as required by the Vienna and Palermo Conventions. • Legislation should be amended to provide for the seizure and confiscation of assets of equivalent value. • The preventative measures (CDD and STR requirements) should be enhanced, consistent with article 7 of the Palermo Convention, particularly in relation to beneficial ownership. • Terrorist financing should be fully criminalised, as required by the TF Convention, and the STR reporting regime enhanced accordingly. • Implementation of the relevant UNSCRs should be enhanced as discussed in detail in section 2.4 of this report.
6.3 Mutual Legal Assistance (R.36-38 & SR.V)	<ul style="list-style-type: none"> • The legal uncertainty surrounding the equivalent value confiscation is also an issue in the international context. In the absence of precedents or specific jurisprudence, the alleged legal basis seems deficient, or at the very least open to challenge. A specific clause allowing for such confiscation in the relevant provisions will provide for the appropriate legal remedy, both in the domestic and the international context.
6.4 Extradition (R.39, 37 & SR.V)	<ul style="list-style-type: none"> • The extradition regime of China is solid and well organised. To make the legal framework more comprehensive it would benefit from the introduction of the possibility of simplified procedures in line with the current international practices in this domain.
6.5 Other Forms of Co-operation (R.40 & SR.V)	<ul style="list-style-type: none"> • The task of establishing new bilateral and multilateral relations with foreign FIUs, signing new MOUs should be more actively pursued to improve the effectiveness of the system.
7. Other Issues	
7.1 Resources and statistics (R. 30 & 32)	<ul style="list-style-type: none"> • The number of FIU staff should be increased to ensure that there is a sufficient number of staff to analyse the large number of reports being received. • The number of law enforcement staff who are specifically focused on AML/CFT (e.g. at the ECID/MPS) should be increased to ensure that there is sufficient staff

	<p>allocated to follow-up effectively on the STRs being received from CAMLMAC, and to increase the focus of law enforcement authorities on AML issues.</p> <ul style="list-style-type: none">• The Chinese authorities should collect statistics on:<ul style="list-style-type: none">- the number of freezing, seizing or confiscation actions, or the amount of assets involved. Such statistics should include a breakdown of the number of cases and amounts confiscated pursuant to administrative or criminal procedures, and should differentiate between the criminal sources of the assets frozen, seized or confiscated (i.e. if it was generated from money laundering, terrorist financing or a predicate offence);- the number of cash declarations made; and- the time taken to respond to extradition requests.
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