Executive Summary

1. This report summarises the AML/CFT measures in place in the Republic of Korea as at the date of the on-site visit from 30 June to 18 July 2019. It analyses the level of compliance with the FATF 40 Recommendations and the level of effectiveness of Korea’s AML/CFT system, and provides recommendations on how the system could be strengthened.

Key Findings

| a) | Korea shows a good understanding of its money laundering (ML) and terrorist financing (TF) risks informed by an ongoing risk assessment process. Its identification and cross-government response to the emerging risks posed by virtual assets is particularly positive. A deeper understanding of the risks relating to legal persons and arrangements would be useful. Strong policy and operational structures are in place to co-operate and co-ordinate at the national level on AML/CFT issues with involvement from a broad range of public and private sector agencies and institutions. However, co-ordination on proliferation financing (PF) issues is largely ad hoc and would benefit from a more formal system. |
| b) | Financial institutions (FIs) and casinos are subject to a comprehensive AML/CFT framework which is generally well implemented. However, there are technical gaps and shortcomings in implementation relating to TF and PF-related targeted financial sanctions (TFS), and requirements for domestic politically exposed persons (PEPs) and PEPs of international organisations. FIs and casinos and their supervisors generally have a sound understanding of AML/CFT risks. Supervisors largely take a risk-based approach to supervision with the exception of the casino supervisor in Korea’s self-governing province, Jeju. These strengths are somewhat undermined by designated non-financial businesses and professions (DNFBPs) other than casinos not being subject to Korea’s AML/CFT framework nor monitoring. |
EXECUTIVE SUMMARY

c) Law enforcement agencies (LEAs) make good use of financial intelligence. This could be strengthened by increasing the resources of the Korean financial intelligence unit (KoFIU) and enhancing the strategic and operational analysis, in particular related to high-risk areas such as tax crime. LEAs take a “follow the money” approach which has been further strengthened by operational and structural changes since 2017. Korea makes efforts to pursue ML in line with its risks. However, while tax crime is identified as Korea’s largest proceeds-generating offence, Korea’s predicate offence framework only covers a tiny portion of tax offences preventing the pursuit of ML related to tax crime. Despite steps to prevent and detect the use of borrowed name accounts, this remains a common typology and is inherently difficult to investigate.

d) Asset recovery is actively pursued and has been a formal government priority since 2017 which has allowed for increased resources and specialisation. Between criminal asset recovery, tax levies, and restitution, Korea is able to deprive criminals of a reasonable value of proceeds. Further efforts are needed to increase the recovery of assets subject to confiscation and take advantage of available mechanisms to facilitate and ensure recovery. Authorities confiscate and recover both proceeds and assets of equivalent value in a manner largely in line with Korea’s risks.

e) Korea has not had any TF prosecutions or convictions, which is consistent with its risk profile. Inquiries into 86 suspicions of TF show Korea is pursuing TF in line with its risks and vulnerabilities and demonstrate that authorities are well equipped to identify and investigate TF should it arise. Inter-agency cooperation and co-ordination in this area is strong and agencies actively use alternative measures.

Risks and General Situation

2. The main ML risks faced by Korea include seven major proceeds-generating offences: tax crimes; illegal gambling; fraud; corruption; market manipulation; trade-based ML related to property flight; and embezzlement/breach of trust. Korea identifies high ML risks from its vulnerability to the abuse of cash transactions (the main ML/TF instrument in Korea) and virtual assets (which have recently emerged). In response, Korea has issued regulations requiring the application of enhanced customer due diligence (CDD) when obliged entities are dealing with virtual assets. Virtual asset services providers (VASPs) are, however, not yet obliged entities.

3. The TF risk is currently low. Korea does not have any home grown terrorist groups, has not suffered any terrorist attacks in recent times and there is no evidence of Korean non-profit organisations (NPOs) being used for TF. To date, there has been only one confirmed case involving terrorist-related activity (incitement by one individual). Nonetheless, Korea is aware that it remains at risk of being an intermediary for TF activities and its TF risks are increasing.

4. Korea is exposed to cross-border ML/TF risks from its large international trade flows and open, export-driven economy which could create an environment

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1. No terrorist attacks have occurred since the bombing of Korean Air Flight 858 on 29 November 1987.
vulnerable to ML/TF activities, particularly via international transactions. On the other hand, Korea's exposure to cross-border remittance risks is much more limited as it has a relatively small foreign-born population and relatively small migrant remittance flows. Korea's foreign currency controls also help to mitigate the risks of cross-border transactions. "Borrowed name" accounts (where an individual allows a third party to use their account) are a common typology for both ML and tax crime (see para.39).

5. Korea has a well-developed financial sector, but is not a regional or international financial centre. Many of the DNFBP sectors (particularly lawyers, accountants, and dealers in precious metals and stones) are materially small.

6. A series of high-level and widely publicised corruption scandals involving two former Korean Presidents with strong ties to Korean conglomerates has greatly impacted public attitude and led to the strengthening of Korea's transparency, corporate governance and anti-corruption measures. Overall, FIs appear to be particularly sensitive to reputational risk. Financial inclusion is relatively high, and the estimated size of the shadow economy is below the global average.

Overall Level of Compliance and Effectiveness

7. Korea has implemented an AML/CFT system that is effective in some respects. Good results were achieved in Korea's use and development of financial intelligence, its understanding of its ML/TF risks, its efforts to recover criminal proceeds, its formal and informal co-operation with other jurisdictions, and its ability to pursue TF investigations and prosecutions, given its risks and context. Major improvements are needed to strengthen supervision and implement preventive measures, prevent misuse of legal persons and arrangements, investigate and prosecute ML, and implement TFS.

8. In terms of technical compliance, Korea's legal and institutional framework is largely strong and generally complies with the FATF Standards. However, improvements are required in relation to: applying a risk-based approach; TFS; NPOs; PEPs; requirements for and monitoring of DNFBPs; and the transparency of legal persons.

9. Since its last evaluation, Korea has improved its legal framework, including its ML and TF offences and confiscation regime. Confiscation has been formally designated as a high-government priority. CDD and enhanced measures have been strengthened, as have controls across financial groups and supervision. Suspicious transaction reporting (STR) requirements have been enhanced, and Korea has significantly enhanced inter-agency co-operation and information sharing. However, as at the time of its last MER, further work is required to prioritise ML investigations and ensure that all DNFBPs are brought within the scope of Korea's AML/CFT regime.

Assessment of risk, co-ordination and policy setting (Chapter 2; IO.1, R.1, 2, 33 & 34)

10. Korean authorities largely show a good and consistent understanding of Korea's ML/TF risks. Their risk understanding is informed by an ongoing risk assessment process that has generated three national risk assessments (NRAs) that demonstrate ongoing improvements to the risk assessment process and risk understanding. Additional input from NPOs and DNFBPs could further enhance Korea's
understanding of risk. National policies and activities are generally in line with the NRA, and could be further strengthened by a cohesive government-wide plan. Korea's response to virtual assets is a good example of the authorities' ability to co-ordinate and move quickly to address emerging risks.

11. National co-ordination and co-operation on AML/CFT issues is well developed at the policy and operational level. Policy co-ordination is enriched by dedicated sub-committees enabling representatives from a wide range of government agencies, private sector institutions and NPOs to provide input. Clearer co-operation mechanisms on PF would further strengthen the system.

Financial intelligence, ML investigations, prosecutions and confiscation (Chapter 3; IO.6, 7, 8; R.1, 3, 4, 29–32)

Use of financial intelligence (Immediate Outcome 6)

12. Korea’s LEAs regularly use financial intelligence to support investigations and prosecutions, trace criminal proceeds and identify risks. LEAs have access to a wide range of financial intelligence and make good use of KoFIU products, although there is scope for additional strategic analysis in high-risk areas. Additional permanent staff and continuing improvements to KoFIU's IT resources would further improve the quality of analysis and intelligence.

13. KoFIU has taken steps in recent years to improve the quality of suspicious transaction reports (STRs) which has improved the overall quality of reports. The utility of reports is limited by gaps in the reporting framework, as DNFBPs other than casinos are not subject to STR reporting requirements.

ML offence (Immediate Outcome 7)

14. Korean authorities take a “follow-the-money” approach in their law enforcement activities which leaves them well placed to identify and investigate ML. Policy and operational changes since 2017 have had a positive impact on the number of prosecutions and operational co-ordination among the relevant agencies works well. Korea’s efforts to pursue ML in line with its identified risks are seriously undermined by the fact that tax crime, the most frequent and prevalent proceeds-generating offence, is not a predicate offence for ML. LEAs are successful in investigating, prosecuting and obtaining convictions for self-laundering, but it is not clear that standalone ML, third party ML or ML based on a foreign predicate are actively pursued. It does not appear that a ML conviction has a notable impact on sentencing. Alternative measures are pursued in tax crime cases, but are otherwise rare.

Confiscation (Immediate Outcome 8)

15. Korean authorities robustly pursue asset recovery and take steps to deprive criminals of a range of assets, including tangible and intangible assets and property of equivalent value. The confiscation process is streamlined and efficient with several strong features that should be actively used by authorities. Confiscation outcomes and target areas are broadly in line with Korea's risks and between criminal asset recovery, tax levies, and restitution, Korea is able to deprive criminals of a reasonable value of proceeds. Korea has had notable recent successes confiscating virtual assets. Korea could strengthen the system further by continuing to pursue efforts to recover a higher
Executive Summary

16. Relevant authorities are aware of the risks of cross-border movements of currency and bearer negotiable instruments (BNI) and measures are in place to detect this activity. Seizure and confiscation powers are used relatively infrequently. The sanctions imposed tend to be low compared to the amounts moved, but nonetheless have proved somewhat dissuasive based on recidivism rates.

Terrorist and proliferation financing (Chapter 4; IO.9, 10, 11; R.1, 4, 5–8, 30, 31 & 39.)

TF offence (Immediate Outcome 9)

17. Korea has assessed its terrorism and TF risks as low, which is reasonable. It has had only one terrorism-related prosecution and one TF investigation with no TF prosecutions or convictions, which is consistent with its risk profile. There have been 86 instances where suspicions of TF have arisen but have not been substantiated following an LEA enquiry. These instances indicate that Korea is pursuing TF in line with its specific TF risks and vulnerabilities. Because of the lack of cases, LEAs lack TF experience, but have nonetheless demonstrated that they are well equipped to identify and investigate TF using a wide range of intelligence sources. There is strong inter-agency co-operation and TF investigations are integrated with national strategies. The penalties available for TF would allow effective, proportionate and dissuasive sanctions, but have not yet been tested in practice. Alternative measures are actively used, particularly deportation.

Preventing terrorists from raising, moving and using funds (Immediate Outcome 10)

18. TFS are implemented in Korea without delay, however, there are some technical gaps and a scope issue as DNFBPs (other than casinos) are not covered. FIs and casinos are prohibited from dealing with designated entities and subject to a freezing obligation, although there are concerns that due to the lack of TFS-specific guidance funds may be rejected (rather than frozen) in some circumstances. Due to the limited scope of Korea’s AML/CFT regime, DNFBPs (other than casinos) are not subject to or supervised for compliance with TFS. Korea has co-sponsored designations at the United Nations (UN), made a domestic designation, given effect to foreign designation requests, and frozen 272 million South Korean won (KRW) (206 666 euros (EUR)) of TF-related assets.

19. Korea has assessed NPOs as low risk for TF abuse. Korea has identified certain groups of at-risk NPOs based on their overseas operations or a particular shared characteristic. Involvement of NPOs themselves and a deeper understanding of the NPO sector as a whole would help strengthen and nuance this assessment. At-risk NPOs operating abroad are subject to strong reporting and supervision requirements and have access to ongoing outreach and support. Other at-risk NPOs would benefit from active engagement.

20. Korea has robust mechanisms for tracing and confiscating assets that could be used in the TF context, although there are no such cases to date. Overall, Korea’s TF measures are consistent with its TF risk profile which is low.
**Proliferation financing (Immediate Outcome 11)**

21. Awareness of PF issues related to the Democratic People's Republic of Korea (DPRK) is very high in Korea. A ministry (the Ministry of Unification) is solely dedicated to matters related to DPRK. Both DPRK and Iran-related sanctions are actively implemented. Korea has designated 108 natural persons and 90 legal persons/entities domestically pursuant to the PF-related UN Security Council Resolutions (UNSCRs) and has co-sponsored 11 designations, but has not yet frozen any assets under these resolutions. There is good co-operation between authorities on designations, but there is no formal co-ordination on PF-related matters which is done on an *ad hoc* basis when needed.

22. The same framework described above in IO.10 is used to implement PF-related TFS and raises the same serious concerns (including the absence of guidance on TFS). FIs and casinos showed a good understanding of TFS obligations, particularly in the banking sector where proliferation-related assets are most likely to be found. FIs and casinos are supervised for compliance with these requirements and supervisors provide regular outreach, including on TFS. The limited scope of Korea's AML/CFT framework means that DNFBPs (except casinos) are not subject to or supervised for compliance with PF-related TFS.

**Preventive measures (Chapter 5; IO.4; R.9–23)**

23. The banking, securities and insurance sectors undertake the majority of financial activity in Korea with other types of FIs having a much smaller financial sector penetration. FIs and casinos are subject to comprehensive AML/CFT measures covering most aspects of the FATF Recommendations. However, the regulatory framework does suffer from some gaps. Domestic PEPs are not covered which is a serious issue, given Korea's identification of corruption as a major predicate offence. Casinos are subject to comprehensive AML/CFT obligations which is positive, as illegal gambling is another major predicate offence in Korea. However, other DNFBPs are not covered, even though the NRA identifies existing or emerging ML/TF risks in some of these sectors.

24. Larger individual FIs and casinos have a good understanding of their ML/TF risks and obligations due in part to vigorous outreach, training, and other efforts by Korean authorities. Smaller FIs and some casinos have a reasonable risk understanding, but need further improvements. In general, FIs and casinos understand and implement their obligations relating to CDD, beneficial ownership (BO), TFS, new technologies and PEPs (including domestic PEPs, although this is not a legal requirement). However, the use of borrowed name accounts (see para.39) creates some challenges. Most FIs and casinos are reporting suspicious transactions and the quality of STRs is improving. However, concerns about defensive reporting remains, particularly in the banking sector.

**Supervision (Chapter 6; IO.3; R.14, R.26–28, 34, 35)**

25. Licensing and registration measures for FIs and casinos are largely robust. While Korea's institutional and supervisory framework is complex, entrusted agencies (see para.84) have excellent co-operation and co-ordination. Except for casinos, DNFBPs are not subject to the AML/CFT framework or supervised.
26. Most supervisors have a good understanding of the ML/TF risks in their sectors and have a strong risk-based system for supervision. The exception is the supervisor of casinos in Korea's self-governing province (Jeju) which takes a rules-based approach to supervision. Supervision by KoFIU and the Financial Supervisory Service (FSS) would benefit from increased resources. Supervisors take remedial actions through administrative or monetary sanctions which are effective and dissuasive, but not fully proportionate. KoFIU has been active in providing guidance and outreach to supervised sectors, but need to issue targeted TFS guidance.

**Transparency and beneficial ownership (Chapter 7; IO.5; R.24, 25)**

27. Korea has a growing understanding of the ML/TF risks associated with legal persons. It has identified the types of legal persons at risk of ML/TF, but authorities do not yet have a clear understanding of why these entities are particularly vulnerable and it is not clear that the risks are being effectively mitigated. This is important as LEAs reported seeing an increased use of complex typologies involving corporate structures in both ML and predicate offence cases. Steps have been taken to prevent misuse of legal persons, including prohibiting bearer shares, and nominee shares and directors. Basic and legal ownership information on legal persons is publicly available through a comprehensive network of registries. Competent authorities can trace BO information relatively easily through these registries, unless foreign ownership or a particularly complex corporate structure is involved. However, information on the registers may not always be accurate and up-to-date. Competent authorities may also seek BO information collected through the CDD process directly from FIs or casinos, although this channel will require a warrant in many cases so cannot be used at the intelligence-gathering stage. Sanctions for legal persons that fail to comply with their reporting obligations are limited.

28. Two types of trusts may be created under Korean law—commercial trusts and civil trusts (which are very rare). The risks of commercial trusts are significantly mitigated as these trusts are administered by licensed and regulated FIs. Limited information is available on the existence and characteristics of civil trusts and foreign trusts operating in Korea.

**International co-operation (Chapter 8; IO.2; R.36–40)**

29. Korea has an effective framework for seeking and providing mutual legal assistance (MLA) and extradition. Co-operation under bilateral treaties is particularly effective and arrangements are in place to streamline co-operation with major partners. Korea should explore similar arrangements with other jurisdictions, particularly those featuring most often in Korea's ML and tax crime cases.

30. Competent authorities, including LEAs and supervisors, have channels in place to co-operate with counterparts, including posting attachés and liaison points in strategically important countries. The number of requests to and from KoFIU is increasing and current staffing levels may need to be reviewed if this trend continues. Overall, Korea's level of co-operation with foreign jurisdictions is generally in line with its risks, although the assessment team expected to see a higher level of co-operation related to BO information given the risks posed by asset flight and tax crime.
Priority Actions

Korea should:

a) Extend the AML/CFT framework to apply to all DNFBPs, and designate a supervisor for these sectors.

b) Expand the scope of AML/CFT obligations to include domestic PEPs and PEPs of international organisations.

c) Amend the law to expand the range of tax crimes that are ML predicate offences (for example, to align this range of crimes with those that require STR reporting) to ensure Korea is able to prosecute ML based on tax crime.

d) Continue exploring measures to promote the actual recovery of assets ordered for confiscation and systematically take advantage of available mechanisms and measures to facilitate confiscation and recovery.

e) Continue the positive efforts to pursue policy measures to prevent the use of accounts in borrowed names and explore tools to facilitate and enhance LEAs’ ability to investigate and trace the movement of funds using such accounts.

f) Extend the freezing obligation to DNFBPs and all natural and legal persons, and address the identified technical deficiencies.

g) Issue targeted guidance on implementing TFS, including the freezing obligation, and ensure there is a forum for co-ordination on PF.

h) Continue to upgrade KoFIU’s IT resources and increase the number of permanent staff to ensure institutional knowledge is maintained within KoFIU.
Effectiveness & Technical Compliance Ratings

**Effectiveness Ratings**

<table>
<thead>
<tr>
<th>IO.1 - Risk, policy and coordination</th>
<th>IO.2 - International cooperation</th>
<th>IO.3 - Supervision</th>
<th>IO.4 - Preventive measures</th>
<th>IO.5 - Legal persons and arrangements</th>
<th>IO.6 - Financial intelligence</th>
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<td>IO.8 - Confiscation</td>
<td>IO.9 - TF investigation &amp; prosecution</td>
<td>IO.10 - TF preventive measures &amp; financial sanctions</td>
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**Technical Compliance Ratings**

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<tr>
<th>R.1 - assessing risk &amp; applying risk-based approach</th>
<th>R.2 - national cooperation and coordination</th>
<th>R.3 - money laundering offence</th>
<th>R.4 - confiscation &amp; provisional measures</th>
<th>R.5 - terrorist financing offence</th>
<th>R.6 - targeted financial sanctions – terrorism &amp; terrorist financing</th>
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<td>R.15 – New technologies</td>
<td>R.16 –Wire transfers</td>
<td>R.17 – Reliance on third parties</td>
<td>R.18 – Internal controls and foreign branches and subsidiaries</td>
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2. Effectiveness ratings can be either a High – HE, Substantial – SE, Moderate – ME, or Low – LE, level of effectiveness.

3. Technical compliance ratings can be either a C – compliant, LC – largely compliant, PC – partially compliant or NC – non compliant.