

## Executive Summary

1. This report provides a summary of the anti-money laundering/combating the financing of terrorism (AML/CFT) measures in place in the People's Republic of China (China)<sup>1</sup> as at the date of the onsite visit (July 9–27, 2018). It analyses the level of compliance with the Financial Action Task Force (FATF) 40 Recommendations and the level of effectiveness of China's AML/CFT system, and provides recommendations on how the system could be strengthened.

### Key Findings

- a) China has undertaken a number of initiatives since 2002 that have contributed positively to its understanding of ML/TF risk, although some important gaps remain. Its framework for domestic AML/CFT co-operation and co-ordination is well established.
- b) China's de-centralised FIU arrangement consisting of CAMLMAC, AMLB and 36 PBC provincial branches has high potential to produce financial intelligence that supports the operational needs of competent authorities but its current functioning results in incomplete access by all parts of the FIU to all data, a fragmented analysis and disseminations, and limits the development of a holistic view. Therefore, major improvements are needed.
- c) LEAs have access to and use a wide range of financial intelligence throughout the lifetime of an investigation, but financial intelligence is not driving ML investigations. When using financial intelligence, LEAs identify predicate criminal behaviours and actively investigate these. Predicate crime investigation outcomes reflect that China has capable LEAs that are skilled in the investigation of complex financial crime and associated predicate crime. Effective, proportionate, and dissuasive sanctions are available and are applied for ML.
- d) China has an institutional framework in place to investigate and prosecute TF activities, in line with its understanding of TF risks and in line with its strategy to prevent TF and disrupt TF channels. Since the implementation

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<sup>1</sup> The following territories were not included as part of this assessment: Hong Kong Special Administrative Region (Hong Kong, China), Macau Special Administrative Region (Macau China) and Chinese Taipei.

of a new counterterrorism law in 2015 and related interpretations, the number of TF prosecutions and convictions has increased.

- e) The implementation of TF and PF targeted financial sanctions is negatively affected by three fundamental deficiencies, related to (i) scope of coverage of the requirements and a lack of a prohibition covering all persons and entities; (ii) the types of assets and funds of designated entities that can in practice be frozen, and the type of transactions that can be prohibited; and (iii) a lack of implementation without delay for non-domestic designations. That said, *the CTL* and relevant *PBC Notice* are a good starting point for future updates to the legal system in line with revised FATF standards, and to improve effective implementation. While not covered by the FATF standards, authorities have taken measures in relation to other aspects of UNSCRs related to DPRK.
- f) While FIs have a satisfactory understanding of their AML/CFT obligations, they have not developed a sufficient understanding of risks. Measures implemented to mitigate risk are generally not commensurate with different risk situations.
- g) China's AML/CFT supervisory system is almost exclusively focused on the financial sector, as there are no effective preventive or supervisory measures in respect of the DNFBP sector. The PBC has an inadequate understanding of risks overall. Although their understanding of risk impacting the financial sector is adequate, its understanding of institution-specific risk seems to be largely based on the FIs' own risk assessment rather than that of the authorities.
- h) China handles MLA and extradition requests in accordance with the procedures and standards for approval stipulated by domestic laws, bilateral treaties and multilateral conventions, but due to a complicated decision-making structure for providing MLA or executing extradition requests, it is often a protracted process. At the same time, China can arrange an expedited procedure for urgent requests or cases. There is an effective cooperation in some areas between China and some of its neighbours, however, there is a lack of data that would establish effective implementation of ML/TF related co-operation.

### *Risks and General Situation*

2. The main proceeds-generating predicate crimes in China are illegal fundraising, fraud, trafficking in illicit drugs, corruption and bribery, tax crimes, counterfeiting of products, and illegal gambling.

3. China faces a serious threat from terrorism. From 2011 to 2016, China registered 75 terrorist incidents that killed 545 people. The main conflict area and focus for the authorities is the northwest province of Xinjiang, from where the "Eastern Turkistan Islamic Movement" (ETIM) operates, but attacks occur

throughout China. Around 60 people each year from China have participated as foreign terrorist fighters in Syria and Iraq<sup>2</sup>.

4. With total assets of approximately RMB 252 trillion, banks dominate financial sector activity in China. Based on nature of their products/services and volume of activity, they are considered to be highly vulnerable to abuse with respect to ML/TF. China has witnessed a rapid increase in the activity of online lending entities, primarily via mobile phone platforms

5. The lack of coverage of designated non-financial businesses and professions (DNFBPs) by the AML/CFT framework is a significant vulnerability. The absence of coverage of domestic politically exposed persons (PEPs) is another significant vulnerability, which is particularly noteworthy in the context of a country where corruption is a major predicate offence and state-owned-enterprises play a dominant role in the economy.

6. A large amount of illicit proceeds flows out of China annually. As noted in the NRA, between 2014 and 2016, illicit proceeds totalling RMB 8 64 billion were repatriated to China from over 90 countries. China indicates that illicit proceeds also flow out of the country through underground banking operations. There are several instances in which criminals have fled the country, including suspects in corruption cases. The abuse of legal persons has also been identified as a method of laundering illicit proceeds. Such abuse is facilitated, in part, by ineffective arrangements in place for registering and retaining beneficial ownership (BO) information.

### *Overall Level of Effectiveness and Technical Compliance*

7. China has a good legal framework with respect to the criminalization of ML and TF, national coordination arrangements, the powers and responsibilities of law enforcement authorities and arrangements for international cooperation. There is scope for strengthening the legal framework with respect to a number of preventive measures and the coverage and supervision of DNFBPs.

8. An incomplete understanding of risk impacts negatively on the effectiveness of several aspects of China's AML/CFT arrangements. These include the

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<sup>2</sup> See for example *The Soufan Group Foreign Fighters Update Final 2015* ([www.soufangroup.com/foreign-fighters](http://www.soufangroup.com/foreign-fighters)), but also see paragraph 230 of this report for other estimates (up to 300 persons).

implementation of preventive measures by FIs, the supervision of these institutions and the investigation and prosecution of ML. Weaknesses in institutional arrangements and related practices impact negatively on the effectiveness with respect to the use of financial intelligence.

9. There are significant weaknesses in both technical compliance and effectiveness with respect to the transparency of legal persons and legal arrangements and the framework and practices related to targeted financial sanctions.

#### *Assessment of Risks, Coordination and Policy Setting (Chapter 2—IO.1; R.1, R.2, R.33)*

10. Overall authorities in China demonstrated a strong understanding of the contents of the NRA which was finalized just prior to the on-site visit. However, given the focus of the NRA and the activity of LEAs, on predicate offences and the lack of attention to how the proceeds of crime are actually laundered, beyond those directly implicated in the crime, China's overall understanding of ML risks, while achieved to a large extent, is hampered by such a focus. The assessment of risks of legal entities focuses on existing control measures. The TF assessment contained within the NRA is based mainly on qualitative analysis. The analysis collates information from departments involved in countering terrorism, primarily MSS, MPS and the PBC, identifying sources and channels of terrorist financing, and identifying the TF threats faced by China.

11. China has demonstrated strong co-operation and co-ordination at the political and policy-setting levels. China's main mechanism for national co-ordination and co-operation is the AMLJMC established in 2002 and comprising of 23 government departments. The AMLJMC is responsible for guiding the AML/CFT work throughout the country, formulating AML/CFT policies and strategies, and coordinating various departments in conducting AML/CFT activities.

#### *Financial Intelligence, Money Laundering and Confiscation (Chapter 3—IOs 6–8; R.3, R.4, R.29–32)*

12. Provincial and local investigative agencies conduct the majority of ML and predicate offence investigations in China. China's FIU arrangement set up within the PBC mirrors this decentralised approach with the following three largely independently functioning components: CAMLMAC and AMLB at the central level and

AML units within each of the 36 PBC provincial branches. While the decentralized FIU in China has the potential to produce financial intelligence that supports the operational needs of competent authorities, the FIU's ability to properly analyse and spontaneously share accurate and timely financial intelligence presents limitations. The analysis and dissemination by the various FIU components prevents the development of a holistic view. Other factors also limit the FIU's ability to properly analyse and share financial intelligence that is relevant for use by law enforcement. First, the STR reporting requirements only extend to FIs and their level of implementation is insufficient. Second, other sources of information, such as information on cross-border currency declarations and beneficial ownership information, are either limited or non-existent. Finally, the FIU's operational independence is potentially undermined.

13. LEAs at central, provincial, and local levels access and use financial intelligence and other information to identify and trace proceeds, and to support investigations and prosecutions of predicate offences, but do so for a limited extent for AML purposes. While LEAs recognise the value of "following the money," their focus (when developing evidence and tracing criminal proceeds) is on supporting investigations and prosecutions of domestic predicate offences, as opposed to supporting stand-alone ML and TF investigations more broadly. The use of financial intelligence by LEAs leads to dismantling criminal networks but does not result in an adequate identification of ML operations.

14. The Ministry of Public Security (MPS) and subordinate Public Security Bureaus (PSB) have responsibility for ML investigations. The Economic Crime Investigation Department (ECID) is the branch of MPS and PSB who have the lead responsibility for investigating complex financial crime including ML. Within this department, there are skilled and capable investigators who have adequate investigative tools and resources to undertake their function.

15. There are three discrete ML offences in China. Persons who are proven to have knowledge of the requirement to launder or conceal proceeds of crime prior to the commission of the predicate crime are routinely prosecuted as 'accomplices' to the predicate offence. Self-laundering is not criminalised. Accomplices and self-launderers are convicted and sentenced in accordance with the predicate crime penalty, based on the principle that serious crimes absorb less serious crimes. Authorities reported that the 'knowledge' element, that funds or property were derived from crime,

presented challenges. A review of ML prosecutions identified that these largely relate to family and close associates of the predicate offenders; on a limited number of occasions legal persons were prosecuted. The majority of ML convictions in China have been secured under Art. 312 of *the Criminal Law*. This same article criminalises the behaviour of receiving stolen property. China is of the view that purchasing or acquiring dishonestly obtained property (as opposed to concealment or disguise) constitutes a ML activity. The inability to separate convictions under Art. 312 or to quantify convictions associated with these discrete behaviours has challenged the assessment of effectiveness for IO.7.

16. The pursuit of criminal proceeds is a policy objective for China. Criminal proceeds and instrumentality forfeiture routinely occur as part of the sentencing process. China has the ability to confiscate property in the absence of conviction in certain circumstances such as where the criminal has absconded from China or has died.

#### *Terrorist Financing and Financing Proliferation (Chapter 4 - IOs 9-11; R.5-8)*

17. Authorities have taken some legal measures that enable the domestic designation of possible terrorists; however, these have not been used since 2012. As with these domestic freezing measures, measures by PBC to require the freezing of UN-designated entities focus mainly on the financial sector and are not effectively implemented. In general, the implementation of TF and PF targeted financial sanctions is negatively affected by three fundamental deficiencies, related to (i) scope of coverage of the requirements and a lack of a prohibition covering all persons and entities, (ii) the types of assets and funds of designated entities that can in practice be frozen, and the type of transactions that can be prohibited, and (iii) a lack of implementation without delay for non-domestic designations.

18. Authorities have expressed a high-level political commitment to establish a comprehensive legal framework for the implementation of targeted financial sanctions related to proliferation financing which is a positive step. While not covered by the FATF standards, authorities have taken measures in relation to other aspects of UNSCRs related to DPRK. On the other hand, authorities provided insufficient information to establish a degree of implementation of any of the targeted financial sanctions related to Iran.

### *Preventive Measures (Chapter 5—IO.4; R.9–23)*

19. FIs have a satisfactory understanding of their AML/CFT obligations. They generally have an insufficient understanding of ML/TF risks and apply mitigation measures that are not commensurate with these risks. Online lending institutions have not developed an understanding of ML/TF risks or AML/CFT obligations.

20. FIs apply CDD measures ineffectively, with notable weaknesses in customer identification and verification measures including for BO, and ongoing due diligence. Considering prevailing risks, FIs do not effectively apply measures for PEPs, TFS, and measures related to countries with high risk. FIs are relatively more successful in implementing measures related to record keeping, correspondent banking relationships, new technologies, and wire transfers.

21. Inconsistent practices of reporting suspicious transactions by FIs raise the risk of tipping-off. Types of proceeds reported in STRs seem inconsistent with the risk environment and are concentrated in the banking sector. The number of STRs reported appears to be modest, considering the size of the financial sector in China. Internal controls of financial groups are often inappropriate for mitigating risks, especially when regulations of host countries prevent access to information.

22. Overall, banks implement preventive measures better than the other FIs, with limited to no implementation of these measures by online lending institutions. DNFBPs generally do not apply such measures. The reporting of suspicious transactions by DNFBPs is virtually non-existent.

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

23. There are some shortcomings in the fit and proper framework in most of the regulated FI subsectors (see TC analysis), notably the period of scrutiny for criminal records does not have to go beyond three years. Entry requirements in the online lending sector are basic. A relatively small number of appointments of individuals are revoked each year, which, given the size of the financial sector and corruption as a major threat, seems quite low. In the DNFBP sector, the real estate, DPS, and CSP sectors are not subject to entry or ongoing criminal background checks.

24. The PBC demonstrates a moderate level of understanding of risk in the financial sector. Its processes are highly dependent on the correct implementation of the prescribed risk assessment methodology by FIs and their ability to understand

ML/TF risk (FIs are assessed in Chapter 5 as having a low level of understanding of risk). The quality of control measures is verified using about 20 criteria. Internal control information of uneven content and quality is also received from the sector FI regulators on their own observations on the effectiveness of internal controls applied to ML/TF risks. The online lending sector is not subject to this process. The PBC's level of understanding of risk in the DNFBP sector is low, as little work has been done in this sector.

25. The AML/CFT supervisory system in China is heavily oriented to the financial sector. The PBC's overall ability to require remedial measures to control systems seems generally consistent with the overall risk profile of the financial sector, with an emphasis on banking which presents the highest levels of risk. The level of inspections in the banking sector is not commensurate with the level of risk. Sector supervisors are generally supportive but do not play a major role. There are inconsistencies in the approach used by sector supervisors. Low or no levels of supervision apply in the DNFBP sectors, with sector supervisors or SROs not playing an effective role in supervision.

26. AML/CFT financial penalties applied by the PBC average about RMB 41 million a year (approx. USD 6.02 million a year) based on 2017 statistics; these are not effective, dissuasive, nor proportionate given the size of the banks and other FIs in the financial sector, and the lack of initial responses to remedial measures. No AML/CFT remedial actions or sanctions have been applied to any online lending institutions or to DNFBPs.

27. The PBC has had a moderate impact on FIs compliance and risk management processes. The sector supervisors play a supportive role, but their impact is lower as they are mostly limited to the assessment of risk controls. There is no discernible impact on the online lending sector as specific AML/CFT requirements are not applicable. In the DNFBP sectors, the PBC and sector regulators have had a low to non-existent impact up to the time of the onsite. The overall impact of the PBC and sector supervisors' activities on the sectors' understanding of risk and obligations is moderate in the financial sector and low in the DNFBP sector.

#### *Transparency of Legal Persons and Arrangements (Chapter 7—10.5; R.24–25)*

28. Basic or legal information is collected and publicly available on the internet for all types of legal entities, although the information is not always accurate, and it

seems relatively easy to circumvent the registration rules (for example through straw persons). BO information of legal entities (domestic or foreign) is not (publicly) available in China. Authorities make use of available basic information, CDD information collected by FIs, and law enforcement powers. Each of these sources poses shortcomings and significant challenges, and the combination of measures at the current stage falls short of an effective system for obtaining accurate, adequate and current BO information in a timely manner. That said, authorities have already initiated plans and measures that may improve effectiveness in the future, including through a BO register at PBC.

29. There is no granular understanding of the ML/TF risks of each type of legal person, and the risk classification that has been produced for the purposes of the NRA focuses on control measures related to technical compliance. *The Trust Law* provides for the existence of domestic civil trusts. No measures have been taken to mitigate the misuse of domestic trusts, although the current risks of civil trusts are low due to a lack of regulation that would foster the use of these arrangements. Foreign legal arrangements (i.e. foreign trusts) operate in China, such as the legal or beneficial owner of a Chinese legal company. Authorities have been able to detect foreign trusts that operate in China.

#### *International Co-operation (Chapter 8—10.2; R.36–40)*

30. China has a legal and procedural framework for providing and seeking mutual legal assistance, which it uses in practice (including for extradition). The complicated procedure of ensuring a request is consistent with Chinese legislation, results in a very lengthy process, although this can be expedited in urgent cases. Feedback from other jurisdictions on China's international co-operation was mixed.

31. Judicial and law enforcement authorities seek international co-operation and legal assistance in a wide range of cases, mostly related to predicate offences, but very seldom to ML or TF. They use different channels in the efforts to return funds to the country. While China requests detention of terrorists and freezing/confiscation of terrorist financiers' assets overseas, there is room for enhancing MLA and other international cooperation tools.

32. CAMLMAC exchanges information with foreign FIUs. In doing this, it sends requests abroad to a much lesser extent than it receives from foreign FIUs, which is not commensurate with the volumes of STRs analysed and work undertaken on

domestic LEAs inquiries. Supervisory authorities cooperate in a wide range of information exchange and other forms of cooperation with foreign counterparts.

### *Priority Actions*

The prioritised recommended actions for China, based on these findings, are:

- a) China should expand the information sources relied upon to formulate its NRA to include broader perspectives of the ML/TF threats, vulnerabilities, and risks it faces, such as academic and international organizations' publications on the subject as well as feedback from foreign jurisdictions. This will allow a more balanced understanding of the ML and TF risks faced by China beyond those directly linked to proceeds generating predicate offences.
- b) China should review the functioning of its FIU to ensure that all information received, analysed and disseminated by all three FIU components is readily available and accessible both at the central and provincial levels. This review should include the creation of a database to unify and centralise all components of the current (stand-alone) databases at central and provincial levels. In addition, to ensure the operational independence of the FIU, China should remove the signature of the president of the PBC provincial branch as a condition for dissemination of information to competent authorities.
- c) Reconsideration of the policy, which focuses on pursuit of those involved in predicate crime to combat ML, to include a broader focus to "follow the money" beyond those who are active participants in the predicate crime.
- d) Authorities should create comprehensive legal frameworks for the implementation of TF- and PF-related TFS that includes a general prohibition, extends to all assets of designated entities, and is implemented without delay, with regard to designations by the UNSC. In the interim, the PBC should update its existing *Notice* to address delays in freezing. The exiting legal framework for TF and the contemplated law on PF could be instrumental in this regard.
- e) Shortcomings in the AML/CFT legal framework related to the coverage of online lending institutions, DNFBPs, domestic PEPs, TFS, and the criteria for reporting suspicious transactions should be addressed. Corresponding guidance should be provided as needed.
- f) China's attention should focus on: (i) the robustness and usefulness of risk assessments of FIs, to ensure that these reflect actual threats and corresponding vulnerabilities exposing these institutions to risk; (ii) the effectiveness of ongoing due diligence, notably the monitoring of transactions; and (iii) the consolidated supervision of financial groups, to ensure a robust management of ML/TF risks by these groups.
- g) The PBC should introduce an effective system of assessing individual entities' risks and supervising and monitoring DNFBPs (apart from trust

companies and DPMS) for compliance with AML/CFT obligations. In doing so, China should review the strategy and necessity of collaborating with sector supervisors in the DNFBP sectors, given their low level of knowledge about ML/TF risks.

- h) Authorities should ensure that competent authorities can obtain adequate, accurate and current basic and BO information (beyond legal owner information), in a timely manner. This will require measures that ensure that such information is accurately registered or kept somewhere that is accessible.
- i) China should pay more attention to the exchange of information in ML/TF cases and increase the number of spontaneous requests sent to foreign counterparts, as a result of its strategic and operational analysis and should, in general, reduce the time taken to respond to foreign requests.

**Effectiveness and Technical Compliance Ratings***Effectiveness Ratings (High, Substantial, Moderate, Low)*

<b>IO.1 - Risk, policy and coordination</b>	<b>IO.2 - International cooperation</b>	<b>IO.3 - Supervision</b>	<b>IO.4 - Preventive measures</b>	<b>IO.5 - Legal persons and arrangements</b>	<b>IO.6 - Financial intelligence</b>
<b>Substantial</b>	<b>Moderate</b>	<b>Moderate</b>	<b>Low</b>	<b>Low</b>	<b>Moderate</b>
<b>IO.7 - ML investigation &amp; prosecution</b>	<b>IO.8 - Confiscation</b>	<b>IO.9 - TF investigation &amp; prosecution</b>	<b>IO.10 - TF preventive measures &amp; financial sanctions</b>	<b>IO.11 - PF financial sanctions</b>	
<b>Moderate</b>	<b>Substantial</b>	<b>Substantial</b>	<b>Low</b>	<b>Low</b>	

*Technical Compliance Ratings (C—compliant, LC—largely compliant, PC—partially compliant, NC—non-compliant)*

<b>R.1 - assessing risk &amp; applying risk-based approach</b>	<b>R.2 - national cooperation and coordination</b>	<b>R.3 - money laundering offence</b>	<b>R.4 - confiscation &amp; provisional measures</b>	<b>R.5 - terrorist financing offence</b>	<b>R.6 - targeted financial sanctions – terrorism &amp; terrorist financing</b>
<b>LC</b>	<b>C</b>	<b>PC</b>	<b>C</b>	<b>LC</b>	<b>PC</b>
<b>R.7 - targeted financial sanctions - proliferation</b>	<b>R.8 - non-profit organisations</b>	<b>R.9 - financial institution secrecy laws</b>	<b>R.10 - Customer due diligence</b>	<b>R.11 - Record keeping</b>	<b>R.12 - Politically exposed persons</b>
<b>NC</b>	<b>PC</b>	<b>C</b>	<b>LC</b>	<b>C</b>	<b>PC</b>
<b>R.13 - Correspondent banking</b>	<b>R.14 - Money or value transfer services</b>	<b>R.15 - New technologies</b>	<b>R.16 - Wire transfers</b>	<b>R.17 - Reliance on third parties</b>	<b>R.18 - Internal controls and foreign branches and subsidiaries</b>
<b>LC</b>	<b>LC</b>	<b>PC</b>	<b>PC</b>	<b>LC</b>	<b>PC</b>
<b>R.19 - Higher-risk countries</b>	<b>R.20 - Reporting of suspicious transactions</b>	<b>R.21 - Tipping-off and confidentiality</b>	<b>R.22 - DNFBPs: Customer due diligence</b>	<b>R.23 - DNFBPs: Other measures</b>	<b>R.24 - Transparency &amp; BO of legal persons</b>
<b>C</b>	<b>LC</b>	<b>LC</b>	<b>NC</b>	<b>NC</b>	<b>NC</b>
<b>R.25 - Transparency &amp; BO of legal arrangements</b>	<b>R.26 - Regulation and supervision of financial institutions</b>	<b>R.27 - Powers of supervision</b>	<b>R.28 - Regulation and supervision of DNFBPs</b>	<b>R.29 - Financial intelligence units</b>	<b>R.30 - Responsibilities of law enforcement and investigative authorities</b>
<b>NC</b>	<b>PC</b>	<b>LC</b>	<b>NC</b>	<b>PC</b>	<b>C</b>
<b>R.31 - Powers of law enforcement and investigative authorities</b>	<b>R.32 - Cash couriers</b>	<b>R.33 - Statistics</b>	<b>R.34 - Guidance and feedback</b>	<b>R.35 - Sanctions</b>	<b>R.36 - International instruments</b>
<b>C</b>	<b>LC</b>	<b>LC</b>	<b>PC</b>	<b>PC</b>	<b>LC</b>
<b>R.37 - Mutual legal assistance</b>	<b>R.38 - Mutual legal assistance: freezing and confiscation</b>	<b>R.39 - Extradition</b>	<b>R.40 - Other forms of international cooperation</b>		
<b>LC</b>	<b>PC</b>	<b>LC</b>	<b>LC</b>		

