



5th Follow-Up Report

Mutual Evaluation of Sri Lanka

November 2020



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Cover image: The “Nine Arch Bridge” also called the Bridge in the Sky, is an iconic bridge on the Colombo – Badulla Line, Sri Lanka.

Photo credit: Kasun De Silva.



SRI LANKA: 5th ENHANCED FOLLOW-UP REPORT 2020

I. INTRODUCTION

1. The mutual evaluation report (MER) of Sri Lanka was published in September 2015. This FUR analyses the progress of Sri Lanka in addressing the technical compliance deficiencies identified in its MER. Technical compliance re-ratings are given where sufficient progress has been demonstrated. This report also analyses progress made in implementing new requirements relating to FATF Recommendation 15 which has changed since Sri Lanka's last FUR in 2019.

2. This report does not analyse any progress Sri Lanka has made to improve its effectiveness. Progress on improving effectiveness will be analysed as part of a later follow-up assessment and, if found to be sufficient, may result in re-ratings of Immediate Outcomes (IOs) at that time.

3. The assessment of Sri Lanka's request for technical compliance re-ratings and the preparation of this report was undertaken by the following experts:

- *Ragni Singh, Manager, Financial Institution Supervision, Reserve Bank of Fiji*
- *Samina Chagani, Deputy Director (Analysis), Financial Monitoring Unit, Pakistan*

4. Section III of this report summarises the progress made to improve technical compliance. Section IV contains the conclusion and a table of Sri Lanka's current technical compliance ratings.

II. FINDINGS OF THE MUTUAL EVALUATION REPORT

5. Sri Lanka's original MER ratings and updated ratings based on earlier FURs are as follows¹:

IO 1	IO 2	IO 3	IO 4	IO 5	IO 6	IO 7	IO 8	IO 9	IO 10	IO 11
Mod.	Low	Sub.	Low	Low						
R 1	R 2	R 3	R 4	R 5	R 6	R 7	R 8	R 9	R 10	
(PC) LC	(PC) LC	LC	PC	C	LC	(NC) LC	PC	LC	(NC) LC	
R 11	R 12	R 13	R 14	R 15	R 16	R 17	R 18	R 19	R 20	
LC	(NC) LC	(NC) LC	NC	(PC) LC	(NC) LC	(NC) LC	(PC) LC	(NC) LC	C	
R 21	R 22	R 23	R 24	R 25	R 26	R 27	R 28	R 29	R 30	
C	(NC) LC	(PC) C	NC	(NC) LC	PC	C	(NC) PC	(PC) LC	C	
R 31	R 32	R 33	R 34	R 35	R 36	R 37	R 38	R 39	R 40	
LC	PC	(PC) LC	(PC) LC	PC	LC	(PC) C	(PC) LC	LC	PC	

6. Sri Lanka was moved from enhanced (expedited) to enhanced follow-up in 2016².

¹ Original MER ratings which have changed since the MER are in brackets on the left and current ratings are on the right of the cell.

² There are three categories of follow-up based on mutual evaluation reports: regular, enhanced and enhanced (expedited). For further information see the APG Mutual Evaluation Procedures.

III. OVERVIEW OF PROGRESS TO IMPROVE TECHNICAL COMPLIANCE

7. In keeping with the APG Mutual Evaluation Procedures, this FUR considers progress made up until 1 June 2020. This section summarises the progress made by Sri Lanka to improve its technical compliance by:

- a) addressing the technical compliance deficiencies identified in the MER, and
- b) implementing new requirements where the FATF Recommendations have changed since the MER was adopted.

3.1. Progress to address technical compliance deficiencies identified in the MER

8. Sri Lanka requested re-rating of Recommendation 14 (which was rated NC). The APG welcomes the steps that Sri Lanka has taken to improve its technical compliance with Recommendation 14. Following this progress, Sri Lanka has been re-rated largely compliant with R.14. In light of the additional requirements placed in R.15, Sri Lanka is re-rated partially compliant with R.15.

Recommendation 14 (Originally rated NC)

9. The Sri Lanka MER identified major deficiencies in relation to Recommendation 14. These were the absence of a proper licensing/registration regime for legal non-bank money value transfer services (MVTS) providers, few efforts to identify illegal MVTS providers and apply appropriate sanctions given the high sectoral risks, inadequate monitoring of MVTS providers for AML/CFT compliance, and a lack of AML/CFT requirements for MVTS providers.

10. *Criterion 14.1 is met.* Sri Lanka has established a licensing/registration regime for non-bank MVTS providers. Sri Lanka enacted the Foreign Exchange Act of 2017 (“FEA”) and repealed the Exchange Control Act of 1953. FEA establishes the Central Bank of Sri Lanka (“CBSL”) as the regulator for authorised foreign exchange dealers (i.e. licensed banks) and restricted foreign exchange dealers (any persons licensed to remit within Sri Lanka, or outside the country through authorised foreign exchange dealers). CBSL is also the regulator for mobile money service-providers under the Payment and Settlement Systems Act enacted in 2005. Sri Lanka has a standard procedure in place for authorising a specialised bank to engage in foreign exchange business. The procedure involves assessing the viability of the specialised bank to deal in foreign exchange following which a letter of authorisation including the specifically permitted transactions is issued. Restricted dealers are provided a letter of authorisation upon authorisation by the CBSL. While there are no standard set of procedures to be followed for granting such authorisations, the criteria for the authorisation are set out in the statute. The process of granting approval includes initial approval for a two year period, following which it may be renewed for a further term. This is determined upon satisfactorily complying with FEA regulations and the terms and conditions imposed by the CBSL.

11. *Criterion 14.2 is partly met.* There is a lawful basis for investigating and sanctioning illegal MVTS activity (Section 11(5) of the FEA). Directors, partners, and members of a body corporate or incorporate are also personally liable (Section 14 of the FEA), although the available penalty is up to 1 million rupees (around USD 3,500), or an amount not exceeding the value of transaction conducted or value of foreign assets including expenses incurred by the CBSL (Section 26 of FEA), which may not be dissuasive. Considering the high risk posed by the informal MVTS sector, Sri Lanka did not demonstrate it has identified illegal MVTS providers nor sanctioned them appropriate to the risks.

12. *Criterion 14.3 is met.* Sri Lanka has demonstrated monitoring of registered MVTS providers for AML/CFT compliance, in contrast to a previous reliance on foreign MVTS providers to ensure AML/CFT compliance by local MVTS providers. By end of 2019 Sri Lankan supervisors had conducted 22 on-site inspections of restricted dealers in 2019 (24% of all restricted dealers) and 34

investigations on both authorised and restricted dealers. Actions were taken for breaches, including financial penalty and a warning letter.

13. *Criterion 14.4 is met.* MVTS providers are now required to maintain a list of their agents (CDD Rule No. 1 of 2016). As the supervisory institution for MVTS providers (see paragraph 11), CBSL is empowered to access their documents and information—which includes lists of agents—for the purposes of examining, surveilling and otherwise evaluating their capacity to operate as licensed service providers (Section 10(2)(b) of the FEA, No. 12 of 2017; and Regulation 15 of the Payment Cards and Mobile Payment Systems Regulation, No. 1 of 2013). Furthermore as the AML/CFT supervisor, the FIU or any person authorised by it are able to access records, which includes lists of agents, and make inquiries (Section 18(1), FTRA).

14. *Criterion 14.5 is met.* MVTS providers are also required to include agents under their AML/CFT programs and monitor them for compliance (CDD Rule No. 1 of 2016).

15. *Weighting and conclusion:* Noting the absence of competent authorities taking action against illegal MVTS providers, Sri Lanka has mostly met the requirements of Recommendation 14. **Sri Lanka is re-rated to largely compliant with R.14.**

3.2. Progress on Recommendations which have changed since adoption of the MER

Recommendation 15 (Originally rated PC, upgraded to LC in 2016 FUR)

16. In its 2015 MER, Sri Lanka was rated PC with R.15 due to a lack of risk assessment associated with new technologies and no obligations for FIs to mitigate such risks. In Sri Lanka's 2016 FUR, R.15 was re-rated to LC. In October 2018, R.15 was amended to include requirements relating to virtual assets (VA) and virtual asset service providers (VASPs).

17. *Criterion 15.1 is met.* There is now coverage for all FIs in Sri Lanka to identify and address ML/TF risks arising from new product development and business practices. The 2016 FUR found that insurance companies and their agents were not subject to enhanced requirements to identify and assess ML/TF risks arising from new products, business practices, and delivery mechanisms nor obliged to take appropriate measures to manage and mitigate risks. These two gaps was addressed by the May 2019 Insurers (Customer Due Diligence) Rules No. 1 of 2019.

18. *Criterion 15.2 is met.* The CDD Rules 2016 require every FI (except insurance) to conduct a risk assessment prior to launch or use of new products, practices and technologies and to take appropriate measures to manage and mitigate the risks which may arise in relation to the development of new products and new business practices. Insurance companies are now required to assess and to take appropriate measures to manage and mitigate the risks (Rule 22 of Insurers (Customer Due Diligence) Rules, No. 1 of 2019).

19. *Criterion 15.3(a) is not met.* In relation to VASPs, Sri Lanka has yet to conclude an initial identification and assessment of ML/TF risks emerging from VA activities and VASP operations. At this point Sri Lanka is studying the market and identifying any VASPs which service its banking sector. Competent authorities report they have not detected any VASP-related business thus far. However there is no finished assessment of ML/TF risks arising from VA/VASPs.

20. *Criterion 15.3(b) is not met.* The CBSL has issued a statement that it has not authorised or licensed any entity to operate schemes involving virtual currencies including cryptocurrencies, nor authorised any initial coin offerings. However, this does not constitute a comprehensive prohibition of VA/VASPs. Therefore criteria 15.3(c), 15.4, and 15.6 to 15.10 were assessed in accordance with footnote 44 of the FATF methodology. Sri Lanka has indicated it will make legislative amendments to

regulate VASPs as financial institutions. However this was not in place at the time of the FUR, and Sri Lanka has yet to establish risk-based controls for VASPs based upon an understanding of risk, including a supervisory framework for VASPs.

21. *Criteria 15.3(c), 15.4 and 15.6 to 15.9 are not met.* There are no measures in place with respect to these criteria. Sri Lanka has not prohibited VA or VASPs, and has indicated they plan to regulate VASPs. In the absence of a prohibition, the criteria relating to VASP-specific regulatory measures must be assessed as per footnote 44 of the FATF Methodology.

22. *Criterion 15.5 is not met.* Sri Lanka's ongoing studies of the market (see paragraph 20) have yet to detect any VASP-related business. However, there are no licensing or registration obligations in place for VASPs.

23. *Criterion 15.10 is partly met.* Targeted financial sanctions obligations — including communication mechanisms, reporting obligations and monitoring — apply to all legal and natural persons in Sri Lanka. Existing FIs and DNFBPs, which may or may not interact with VASPs, are guided by existing TFS guidance. However, these obligations and measures do not explicitly apply to VASPs which are yet to be regulated and supervised in Sri Lanka.

24. *Criterion 15.11 is partly met.* Sri Lanka is not constrained from providing and obtaining formal or informal assistance in criminal and related matters relating to ML, predicate offences, or TF involving VA/VASPs. Competent authorities have a broad legal basis to provide assistance on computer-enabled crime including the trading of digital currencies under the amended Mutual Assistance in Criminal Matters Act of 2008. However, in the absence of supervisory or regulatory regime to cover VASPs, Sri Lanka lacks a clear legal basis for information exchange with foreign counterpart VASP supervisors.

25. *Weighting and conclusion:* Sri Lanka has addressed deficiencies relating to identifying and addressing ML/TF risks, and requiring ML/TF risk assessments arising from new products, services and technologies, which was given some weighting. There is minor coverage of TFS obligations for FIs and ability to provide international cooperation relating to VA. This is balanced against the absence of an assessment of ML/TF risks emerging from VA/VASPs and a regulatory regime relating to VA/VASPs. Overall there are moderate deficiencies with Sri Lanka's implementation of Recommendation 15. **Sri Lanka is re-rated to partially compliant with R.15.**

3.3. Brief overview of progress reported on other recommendations rated NC/PC

26. **Recommendation 4 (rated PC)** – Authorities have sought Cabinet approval to amend the Prevention of Money Laundering Act, No. 5 of 2006 and address the deficiencies identified in the MER.

27. **Recommendation 8 (rated PC)** – The committee appointed to amend the NPO legislation has completed discussions on a new NPO Sector Act.

28. **Recommendation 24 (rated NC)** – Proposed amendments to the Companies Act, No. 7 of 2007 incorporating beneficial ownership requirements for legal persons are nearing final drafting.

29. **Recommendation 26 (rated PC)** – The FIU continues to conduct risk-based AML/CFT supervision. All relevant regulators have been advised to extend the fit and proper criteria for shareholders and beneficial owners.

30. **Recommendation 28 (rated PC)** – The FIU continues to conduct AML/CFT supervision in the DNFBP sector.

31. **Recommendation 32 (rated PC)** – Deficiencies identified in the MER will be included in the proposed amendments to the Foreign Exchange Act, No. 12 of 2017.

32. **Recommendation 35 (rated PC)** – Proposed amendments to the FTRA includes revisions of penalty structure have been forwarded to the Cabinet for approval.

33. **Recommendation 40 (rated PC)** – Proposed amendments to the Bribery Act have been finalised, including amendment on sharing of information with domestic and international counterparties.

IV. CONCLUSION

34. Sri Lanka has made progress to address the technical compliance deficiencies identified in its MER, including through the Foreign Exchange Act of 2017 and CDD Rule No. 1 of 2016.

35. In relation to R.14 Sri Lanka has made sufficient progress to be re-rated from non-compliant to largely compliant. With respect to R.15, Sri Lanka has been re-rated from largely compliant to partially compliant.

36. Overall, in light of the progress made by Sri Lanka since its MER was adopted, Sri Lanka is rated compliant or largely compliant with 31 of the 40 Recommendations. Sri Lanka’s technical compliance with the FATF Recommendations is as follows as of the reporting date (June 2020):

R 1	R 2	R 3	R 4	R 5	R 6	R 7	R 8	R 9	R 10
LC	LC	LC	PC	C	LC	LC	PC	LC	LC
R 11	R 12	R 13	R 14	R 15	R 16	R 17	R 18	R 19	R 20
LC	LC	LC	NC (LC)	LC (PC)	LC	LC	LC	LC	C
R 21	R 22	R 23	R 24	R 25	R 26	R 27	R 28	R 29	R 30
C	LC	C	NC	LC	PC	C	PC	LC	C
R 31	R 32	R 33	R 34	R 35	R 36	R 37	R 38	R 39	R 40
LC	PC	LC	LC	PC	LC	C	LC	LC	PC

37. The Sri Lanka FUR was adopted out-of-session by the APG membership in November 2020. In keeping with the APG Mutual Evaluation Procedures 2020, Sri Lanka will remain in enhanced follow-up, and will continue to report back to the APG on progress to strengthen its implementation of AML/CFT measures.