



4<sup>th</sup> Follow-Up Report

# Mutual Evaluation of Sri Lanka

October 2019





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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: 4<sup>th</sup> ENHANCED FOLLOW-UP REPORT 2019

### I. INTRODUCTION

1. The mutual evaluation report (MER) of Sri Lanka was published in September 2015. This follow-up report (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. The report also analyses progress made in implementing new requirements relating to FATF Recommendations, which have changed since the MER was adopted: Recommendations 2, 5, 7, 8, 18 and 21.

2. This report does not analyse any progress Sri Lanka has made to improve its effectiveness. Sri Lanka's progress with effectiveness will be analysed as part of the 5<sup>th</sup> year follow-up assessment, and if found to be sufficient, may result in re-ratings of Immediate Outcomes 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:

- *Lim Hsin Ying, Deputy Director, Strategy & Policy Financial Intelligence and Enforcement Department, Bank Negara Malaysia*
- *Manuel Almeida, Legal Adviser, Permanent Technical Secretariat, Banco De Portugal*
- *Nicola Critchley, Assistant Director, AML/CTF Policy Section, Department of Home Affairs Australia*
- *David Shannon, Director, Mutual Evaluations, APG Secretariat*

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

### II. FINDINGS OF THE MER & PREVIOUS FUR

5. Sri Lanka's original MER ratings and current ratings based on progress recognised in FURs are as follows<sup>1</sup>:

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	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	PC	C	NC	(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	PC	LC	PC

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						

<sup>1</sup> 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.

6. Sri Lanka was moved from enhanced (expedited) to enhanced follow-up in 2016.

### III. TECHNICAL COMPLIANCE RECOMMENDATIONS REVIEWED

7. This section summarises the progress made by Sri Lanka to improve its technical compliance since 2018 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-ratings of the following Recommendations: 7, 25, 28 (originally rated NC), and 26, 37 and 38 (originally rated PC).

9. The APG welcomes the steps that Sri Lanka has taken to improve its technical compliance with 7, 25, 26, 28, 37 and 38. As a result of this progress, Sri Lanka has been re-rated on Recommendations 7, 25, 37 and 38. However, insufficient progress has been made to justify a re-rating of 26 and 28.

##### *Recommendation 7 (Originally rated NC)*

10. At the time of the 2015 MER onsite, Sri Lanka had taken no formal steps to give effect to PF sanctions under Recommendation 7. Since the 2015 MER, Sri Lanka has taken a number of legislative and implementation steps to improve its TFS regime for WMD proliferation.

11. Sri Lanka has implemented a legal framework for TFS for PF for both Iran and the DPRK. There are measures for monitoring and enforcing compliance with the relevant Regulations and there is a wide range of civil, administrative and criminal sanctions available for persons, FIs and DNFBPs should they not comply with the relevant Regulations.

12. There remains minor deficiencies in the implementation of sanctions under UNSC 1718 related to notification mechanisms to reporting entities for revoked designations, availability of information in relation to de-listing and protections for *bona fide* third parties acting in good faith.

13. **Sri Lanka is re-rated to largely compliant with R.7.**

##### *Recommendation 25 (Originally rated NC)*

14. The MER rated Sri Lanka NC for Recommendation 25. Very few measures were in place to implement transparency obligations in relation to parties to trusts and other legal arrangements.

15. Sri Lanka has addressed most of the deficiencies identified in the MER with amendments to the Trust Ordinance in 2018, which establishes a central register of trusts and provides additional powers to the Office of the Registrar General to obtain and maintain information relating to beneficial owners of express trusts. Trustees of express trusts are required to regularly provide a range of information, including BO information, to the Registrar-General. Under the provisions of the Ordinance, the FIU and LEAs, with the permission of the FIU, are able to access the register to obtain BO information.

16. Some minor deficiencies remain in relation to all trusts governed under Sri Lankan law and some doubt regarding measures to ensure that trustees disclose their status to FIs and DNFBPs.

17. **Sri Lanka is re-rated to largely compliant with R.25.**

*Recommendation 26 (Originally rated PC)*

18. In its MER, Sri Lanka was rated PC with Recommendation 26. The MER found gaps with market entry fit and proper, explicit prohibitions on shell banks, weaknesses in risk-based supervision, including supervisors reviewing risk profiles of sectors and individual enterprises or groups.

19. Sri Lanka reported a number of points of progress with fit and proper with the insurance and securities sectors, but these have yet to come into force and there appear to be gaps in their scope. No information provided on progress with finance companies, authorised money changers and non-bank MVTS providers.

20. Supervisors have implemented elements of risk rating based on offsite supervision and other factors with banks, securities and insurance, and the move to risk-based onsite supervision has developed further since the MER. Some gaps remain with NBFIs, including non-bank MVTS providers. The FIU and relevant supervisory authorities have begun to conduct periodic reviews on the ML/TF risk profile of FIs.

21. **Sri Lanka remains partially compliant with R.26.**

*Recommendation 28 (Originally rated NC)*

22. The MER rated Sri Lanka NC with Recommendation 28. Deficiencies noted in the MER included the operation of unlicensed casinos, no system in place for monitoring DNFBPs' AML/CFT compliance and no designated supervisor for DNFBPS.

23. Sri Lanka has made important progress with risk based regulation and supervision of some DNFBP sectors, however casinos remain outside of the framework for market entry fit and proper controls or AML/CFT supervision. Real estate agents, identified as high risk, are not licensed or registered and are not subject to market entry fit and proper.

24. Good progress has been made with outreach and risk-based supervision of other DNFBP sectors, including real estate, and the FIU has greatly enhanced its supervisory capacity and the conduct of risk based supervision, including enforcement action.

25. Despite the very significant progress with risk-based supervision of other DNFBPS (including real estate agents), weight is given to the lack of full coverage of casinos for supervision at the time of reporting and the lack of licensing and fit and proper controls on real estate.

26. **Sri Lanka is re-rated to partially compliant with R.28.**

*Recommendation 37 (Originally rated PC)*

27. The MER rated Sri Lanka PC with Recommendation 37. The MACMA did not provide for the application of its provisions on the basis of reciprocity and the range of assistance that may require use of coercive powers was only available under the MACMA to prescribed Commonwealth countries and specified countries with which Sri Lanka has an agreement. Sri Lanka lacked a comprehensive case management system with standard procedures, accountability and clear time lines for handling MLA.

28. Sri Lanka's 2018 amendments of the MACMA addressed the identified deficiencies. The amendments allow Sri Lanka to provide MLA on the basis of reciprocity, provide clear responsibilities and accountabilities for processing incoming and outgoing requests and require confidentiality for officers working on MLA requests. Sri Lanka has also established a case management system with standard procedures, accountability and clear time lines for handling MLA cases.

29. **Sri Lanka is re-rated to compliant for R.37.**

#### *Recommendation 38 (Originally rated PC)*

30. The MER rated Sri Lanka PC for Recommendation 38. The MACMA did not provide for the application of its provisions on the basis of reciprocity. Assistance in identifying, locating or assessing the value of property, and possibly freezing and confiscation, did not extend to instrumentalities intended for use and property of corresponding value. There was insufficient clarity in relation to the ambit of the provisions in the MACMA for asset tracing, freezing and confiscation. Provisions in the MACMA for asset tracing, freezing and confiscation were not broad enough to cover a wide range of foreign orders.

31. Important legislative changes to the MACMA in 2018 give a clear legal basis for Sri Lanka to take expeditious action in response to requests by foreign countries to identify, freeze, seize, or confiscate the widest range of property. This should be given particular weight. Sri Lanka has begun to support implementation of elements of asset sharing, and it is clear that there are no legal restriction in relation to sharing of confiscated assets when confiscation is a result of coordinated law enforcement action. Sri Lanka should stipulate in the Law the possibility of sharing confiscated assets or demonstrate successful cases so that the regime is clarified.

32. **Sri Lanka is re-rated to largely compliant for R.38.**

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

33. Since the adoption of Sri Lanka's MER, Recommendations 2, 7, 8, 18 and 21 have been amended. This section considers Sri Lanka's compliance with the new requirements (other than Recommendation 7, which is assessed above).

#### *Recommendation 2 (Originally rated PC, upgraded to LC in 2016 FUR)*

34. In October 2018 an amendment was made to the FATF standards which required countries to ensure that data protection and privacy rules were compatible between relevant coordinating and cooperating agencies. There was also an amendment to c.2.3 to add the requirement to exchange information domestically.

35. Sri Lanka was rated PC in the 2015 MER and upgraded to LC in the 2016 FUR for Recommendation 2.

36. No evidence of legislative instruments governing data protection or privacy rules were provided. However, Sri Lanka has good mechanisms for domestic authorities to cooperate and share information for AML/CFT purposes and there do not appear to be data protection and privacy obligations which impede this. Informal cooperation between relevant authorities helps to ensure the compatibility of AML/CFT controls and data protection or privacy rules.

37. Overall there do not appear to be data protection or privacy obligations on competent authorities, FIs or DNFBPs that impede the AML/CFT requirements.

38. **Sri Lanka remains largely compliant with R.2.**

*Recommendation 5 (Originally rated C)*

39. In February 2017 recommendation 5 was amended to cover financing the travel of individuals who travel to a State other than their States of residence or nationality for the purpose of the perpetration, planning, or preparation of, or participation in, terrorist acts or the providing or receiving of terrorist training. Sri Lanka demonstrated that while there have been no criminal proceedings related to these aspects of the TF offence, the TF offence criminalises the behaviour set out in criterion 5.2bis (implementing UNSCR 2178) and that “funds and other assets” are comprehensively covered.

40. Sections 2A, Section 3(2A) of the Convention on Suppression of Terrorist Financing Act, No. 25 of 2005 (CSTFA) amended in 2011 and 2013, has sufficiently covered the conduct considered in 5.2bis.

41. Section 3(2A) sets out that “Any person who unlawfully and willfully by any direct or indirect means provides or conspires to provide, material support or resources to any terrorist, terrorists or a terrorist organization shall be guilty of an offence”.

42. Section 16A defines funds or property in keeping with the FATF standards and further defines *material support or resources* to include “any tangible, movable or immovable property or service, including currency or monetary instruments or financial services, lodging, training, expert advice or assistance, safe houses, false documentation or identification, communications equipment or facilities, weapons, lethal substances, explosives, personnel and transportation, but shall not include medicines or religious material”.

43. The term *material support or resources* is very broadly defined in Section 16A of the CSTFA. The CSTFA clarifies that the TF offence applies to natural or legal persons who commit an offence criminalised under this law or where it is an offence under the law in any country where such person is temporarily residing. The TF offence is applicable for any person involved in it directly or indirectly, and includes any person aiding and abetting any such offence being punished with equal severity as the punishment availed for a main offender. The definition of ‘terrorist’ includes any person who contributes to the commission of terrorist act and with such aim to further a terrorist act or with the knowledge of the intention of the group to commit a terrorist act. This would cover any person who is not yet gone on to the level of terrorist but contributes to the commission of terrorist act and with such aim to further a terrorist act.

44. **Sri Lanka remains compliant with R.5.**

*Recommendation 8 (Originally rated PC)*

45. In October 2016 recommendation 8 was substantially changed to focus controls on NPOs on those with the greatest exposure to possible abuse for TF.

46. Sri Lanka reported that it is preparing to take a number of steps to address the new elements of recommendation 8.

47. **Sri Lanka remains partially compliant with R.8.**

### *Recommendation 18 (Originally rated PC, upgraded to LC in 2016 FUR)*

48. Through the APG follow up process, Sri Lanka's rating for R.18 was upgraded to LC in 2016. In November 2017 the INR.18 was revised to clarify the requirements on sharing information relating to unusual or suspicious transactions within financial groups.

49. Given the remaining gaps in enforceable requirements relating to the implementation of group wide-programmes, it is unclear if the existing requirements of Section 9(2)(a) of the FTRA which applies at the institutional-level can be applied in relation to information sharing at the group level.

50. **Sri Lanka remains largely compliant with R.18.**

### *Recommendation 21 (Originally rated C)*

51. In November 2017, R.21 (c.21.2) was revised to clarify that the tipping off provision is not intended to inhibit information sharing for R.18.

52. FTRA s.9 specifically refers to information sharing provisions and the exemption referred in s.9 2 (a) notes that tipping-off prohibitions should not impact information sharing.

53. **Sri Lanka remains compliant with R.21.**

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

54. Recommendations for which Sri Lanka was rated NC/PC in its 2016 MER, and is not seeking an upgrade are R.4 and 14 (NC) and R.24, 32, 35, and 40 (PC).

55. In relation to R.24, actions have been taken towards amending the Companies Act incorporating beneficial ownership requirements in the recommendation. The amendments are in the final stage of discussion.

## **IV. CONCLUSION**

56. Sri Lanka has made progress in addressing more of its technical compliance deficiencies identified in its MER and has been upgraded on four Recommendations.

57. R.7, 25 and 38 are now rated LC and 37 is now rated C. Important progress has been made with supervision, however moderate shortcomings are noted. As such recommendation 26 remains at PC while R. 28 is upgraded to PC. With respect to the recommendations amended after the adoption of Sri Lanka's MER, the review team assessed Sri Lanka's compliance with the amendments made to R.2, 5, 8, 18 and 21 after the adoption of Sri Lanka's MER. Sri Lanka has retained the ratings previously assigned in either its MER or earlier FURs for all the recommendations amended.

58. In light of the progress made by Sri Lanka since its MER was adopted, the review team assesses Sri Lanka's technical compliance with the FATF Recommendations is currently as follows:

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	<b>LC</b>	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	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	<b>LC</b>	PC	C	<b>(NC)PC</b>	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	<b>C</b>	<b>LC</b>	LC	PC

59. The Sri Lanka FUR was adopted by the APG at its Annual Meeting in August 2019. Sri Lanka will remain on enhanced follow-up, and will continue to report back to the APG on progress to strengthen its implementation of AML/CFT measures.