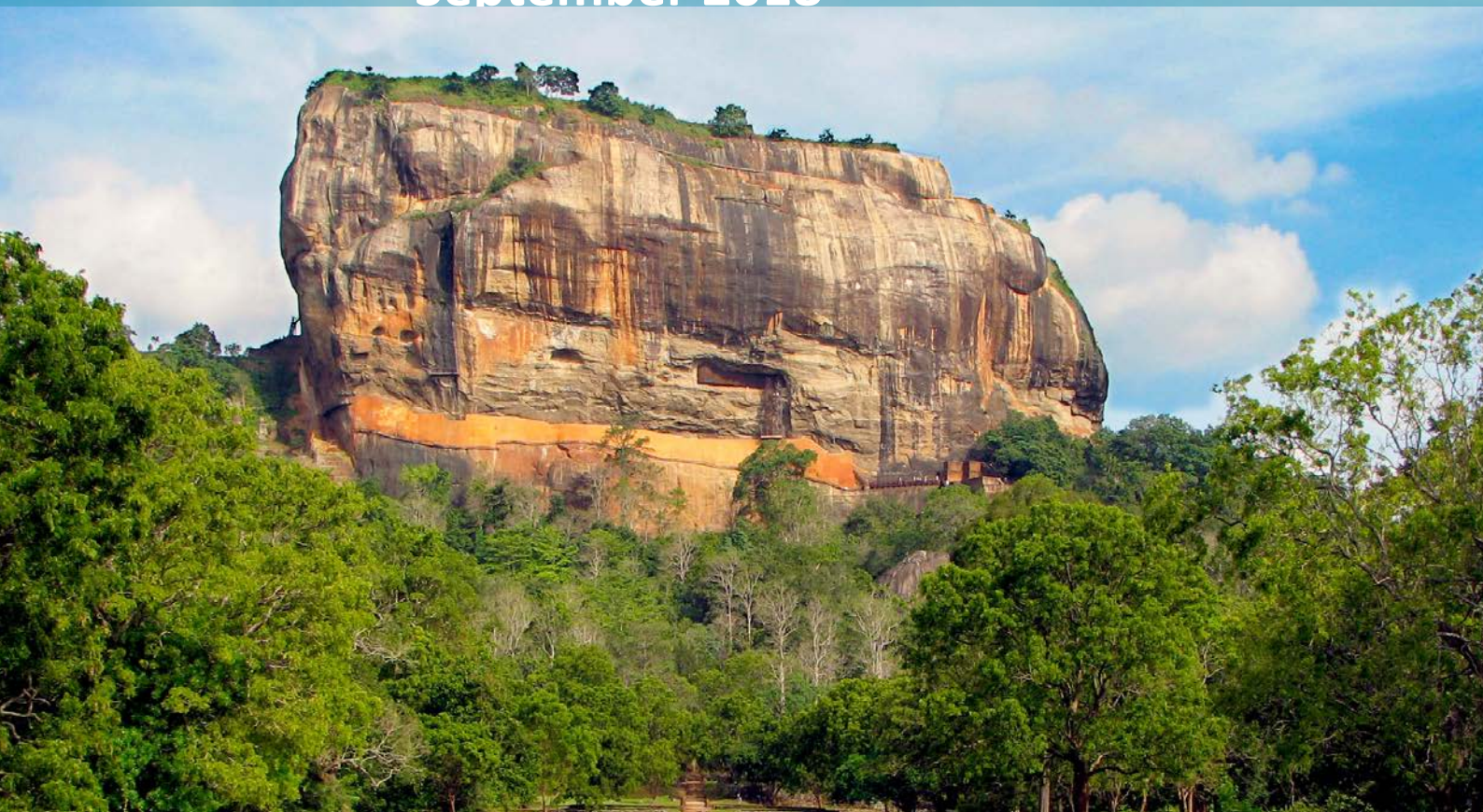




**3<sup>rd</sup> Follow-up Report**

# **Mutual Evaluation of Sri Lanka**

**September 2018**



The Asia/Pacific Group on Money Laundering (APG) is an autonomous and collaborative international organisation founded in 1997 in Bangkok, Thailand consisting of 41 members and a number of international and regional observers. Some of the key international organisations who participate with, and support, the efforts of the APG in the region include the Financial Action Task Force (FATF), International Monetary Fund, World Bank, OECD, United Nations Office on Drugs and Crime, Asian Development Bank and the Egmont Group of Financial Intelligence Units.

APG members and observers are committed to the effective implementation and enforcement of internationally accepted standards against money laundering and the financing of terrorism, in particular the Forty Recommendations of the FATF.

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Cover image: Sigiriya, the Lion Rock Fortress built by King Kasyapa in the 5th Century.



## SRI LANKA: 3<sup>rd</sup> ENHANCED FOLLOW-UP REPORT

### I. INTRODUCTION

1. The mutual evaluation report (MER) of Sri Lanka was adopted in July 2015. This follow-up report (FUR) analyses the progress of Sri Lanka in addressing the remaining technical compliance deficiencies identified in its MER. Technical compliance re-ratings are given where sufficient progress has been demonstrated. This report also reviews progress made in implementing new requirements relating to FATF Recommendations which have changed since the MER was adopted: R.5, R.7 and R.8. 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 a later follow-up assessment and, if found to be sufficient, may result in re-ratings of Immediate Outcomes at that time.

2. The 2018 assessment of Sri Lanka's request for technical compliance re-ratings and the preparation of this report were undertaken by the following experts:

- Ms Lim Hsin Ying Bank Negara Malaysia.
- Mr Lindsay Chan, APG Secretariat

3. The draft FUR was distributed to the global network for review on 15 June 2018 prior to its consideration by the APG Mutual Evaluation Committee on 22 July 2018 and adopted by the APG Plenary on 25 July 2018.

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

### II. FINDINGS OF THE MUTUAL EVALUATION REPORT

5. The MER rated<sup>1</sup> Sri Lanka as follows:

IO 1	IO 2	IO 3	IO 4	IO 5	IO 6	IO 7	IO 8	IO 9	IO 10	IO 11
Mod	Low	Low	Low	Low	Low	Low	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	PC	LC	PC	C	LC	NC	PC	LC	NC
R 11	R 12	R 13	R 14	R 15	R 16	R 17	R 18	R 19	R 20
LC	NC	NC	NC	PC	NC	NC	PC	NC	C
R 21	R 22	R 23	R 24	R 25	R 26	R 27	R 28	R 29	R 30
C	NC	PC	NC	NC	PC	C	NC	PC	C

<sup>1</sup> There are four possible levels of technical compliance: compliant (C), largely compliant (LC), partially compliant (PC), and non-compliant (NC).

R 31	R 32	R 33	R 34	R 35	R 36	R 37	R 38	R 39	R 40
LC	PC	PC	PC	PC	LC	PC	PC	LC	PC

6. Given these results, Sri Lanka was placed in enhanced follow-up (expedited) in July 2015<sup>2</sup>. In September 2016 the APG plenary agreed: (i) to upgrade the following nine Recommendations to LC: R.2, R.10, R.12, R.13, R.15, R.16, R.17, R.18 and R.19; and (ii) that there had been sufficient progress for Sri Lanka to exit enhanced follow-up (expedited) and to be placed on enhanced follow-up. Sri Lanka did not seek re-ratings in 2017.

### III. OVERVIEW OF PROGRESS TO IMPROVE TECHNICAL COMPLIANCE

#### 3.1 Progress on Recommendations which have changed since adoption of the MER

7. Sri Lanka has made progress to address the technical compliance deficiencies identified in the MER in relation to Recommendations: R.1, R.22, R.23, R.29, R.33 and R.34 which were rated NC/PC.

8. As a result of this progress, Sri Lanka has been re-rated on all six Recommendations to C or LC: R.1, R.22, R.23, R.29, R.33, and R.34. The APG also welcomes the steps that Sri Lanka has taken to improve its technical compliance with FATF Recommendations 5, 7 and 8; however, insufficient progress has been made to justify a re-rating of Recommendations 7 and 8. Recommendation 5 was rated C in the MER.

#### *Recommendation 1 (Originally rated PC, re-rated LC)*

9. Sri Lanka was rated PC with R.1 in its 2015 MER. The MER found that Sri Lanka lacked clear mechanisms for the dissemination of the NRA results; absence of national level risk-based approach to allocating resources and implementing measures to mitigate ML; and gaps in preventive measures for reporting entities concerning institutional risk assessment and the application of risk based approach.

10. Sri Lanka has now circulated its NRA, updated its findings and issued revised and new AML/CFT regulations to address gaps for FIs and DNFBPs in 2016 and 2018 respectively (see below on R.22-23). The additional requirements include implementation of a risk based approach and for RIs to undertake institutional risk assessments.

11. Sri Lanka has addressed most of the deficiencies relating to R.1 identified in its MER. However, minor deficiencies remain including the conduct of a risk assessment of legal persons and arrangements. On this basis, R.1 is now re-rated to LC.

#### *Recommendation 22 (Originally rated NC, re-rated LC)*

12. The MER rated Sri Lanka NC on R.22, finding that the requirements in the Financial Transactions Reporting Act No. 6 of 2006 (FTRA) did not cover the scope of CDD required under R.10, nor did it set thresholds for CDD by casinos or dealers in precious metals and stones (DPMS). There were no detailed KYC/CDD rules issued for all DNFBPs, and no enforceable requirements in place with respect to PEPs, new technologies or reliance on third parties.

13. The issuance of the Designated Non-Finance Business (CDD) Rules, No. 1 of 2018 has largely addressed deficiencies identified. The legally enforceable rules apply to all DNFBPs,

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

prescribes thresholds for which casinos and DPMS must conduct CDD, and detailed requirements on dealing with PEPs, new technologies and reliance on third parties. Record keeping requirements are included at Rule 38, 39 and 40 and require the maintenance of records in accordance with R.11.

14. Every criterion in R.10 has been met, except for the remaining gap in relation to the need to reject new business, or terminate existing business relationship, if the customer fails to satisfactorily complete CDD. Instead, the new Rule 27 states that in such circumstance, “the relationship with such customer shall be treated as a relationship posing a high risk and be subject to enhanced CDD measures”, which falls short of what is required under criterion 10.19<sup>3</sup>.

15. All the criteria except for c. 22.1 are now fully met. On this basis, R.22 is now re-rated to LC.

#### *Recommendation 23 (Originally rated NC, re-rated C)*

16. Sri Lanka was rated NC in the 2015 MER, with the report highlighting that gaps in relation to imposing obligations on internal controls and foreign branches, and higher-risk countries also applied to DNFBPs.

17. With the issuance of the DNFBP (CDD) Rules, No. 1 2018, all these deficiencies have been adequately addressed.

18. All the essential criteria for this Recommendation are now met. On this basis, R.23 is now re-rated to C.

#### *Recommendation 29 (Originally rated PC, re-rated to LC)*

19. Sri Lanka was rated PC with R.29 in its 2015 MER. The MER found that, (i) the FTRA only provided for requests for additional information from reporting entities that have made a report(s), or have given information to the FIU, and not from reporting entities that have not filed a report(s); (ii) the FIU did not access the widest possible range of information, in particular police information, to undertake its analytical functions; (iii) only preliminary strategic analysis on certain areas of ML typologies was conducted; and (iv) there was no provision under the FTRA for the FIU to disseminate upon request from law enforcement.

20. As reported by Sri Lanka in its latest progress report, the FIU has signed MOUs with the Police, Inland Revenue, Registration of Persons and Immigration to provide the FIU access to information held by those agencies, and for the Police to request information from the FIU. Sri Lanka has further clarified the FIU’s ability to access information under Section 15(1)(b) of the FTRA from reporting entities, even in the absence of any STR report. Sri Lanka has begun to conduct strategic analysis including the publication of case studies based on STRs, analyzing trends relating to STRs in the FIU Annual Report, and conducting outreach to financial institutions on new trends and typologies identified by the FIU. However, the FIU is still in the process of developing and improving its strategic analysis capabilities.

21. The FIU is still in the process of developing its strategic analysis capabilities. However, Sri Lanka has addressed most of the deficiencies relating to R.29 identified in its MER. On this basis R.29 is re-rated to LC.

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<sup>3</sup> Following adoption of the FUR by the APG Plenary, Sri Lanka identified that Section 3 of the FTRA may address the remaining deficiency identified in R.22. As the report had already been adopted, this was not assessed by the review team.

*Recommendation 33 (Originally rated PC, re-rated to LC)*

22. Sri Lanka was rated PC with R.33 in its 2015 MER. The MER found that statistics were not sufficiently comprehensive on matters relevant to the effectiveness and efficiency of Sri Lanka's AML/CFT system, particularly property frozen, seized and confiscated; and mutual legal assistance or other international requests for cooperation made and received.

23. Sri Lanka has made continued progress to improve its statistical collection, including providing regular updated statistics since 2016 on STRs, international cooperation and to a lesser extent confiscation information. It has also established a case management system for MLA/Extradition which will provide for more timely and accurate statistics. There are still gaps in confiscation, but deficiencies are being rectified.

24. Sri Lanka has addressed most of the deficiencies relating to R.33 identified in its MER. On this basis R.33 is re-rated to LC.

*Recommendation 34 (Originally rated PC, re-rated to LC)*

25. The 2015 MER rated Sri Lanka PC with R.34, and found that other than on UNSCRs 1267 and 1373, there were limited supervisory instructions provided in the form of guidelines or guidance to all reporting entities. The guidelines and circulars were limited to FIs. The FIU had also not provided any substantive feedback on STR reporting to FIs.

26. Sri Lanka has embarked on various initiatives to address these deficiencies. The FIU has issued (i) detailed CDD Rules for FIs (Rule No. 1 of 2016) and DNFBBs (Rule No. 1 of 2018); (ii) Guidelines for AML/CFT compliance obligations for MVTS providers were issued in January 2017; (iii) Regulation on Suspicious Transactions Report for FIs and DNFBBs were issued and publicised in April 2017; and (iv) Guidelines for ML/TF Risk Management for FIs were issued in January 2018. In addition, since August 2017 the FIU has commenced monthly forums with compliance officers from FIs towards increasing their awareness on new developments, typologies and ML/TF trends. A series of awareness programmes were also held for key FIs, casino, DPMS and real estate sectors to raise awareness of AML/CFT obligations and CDD Rules.

27. The May 2018 ICRG progress report notes at length the number of awareness raising outreach programmes that authorities of Sri Lanka have engaged in, and articulates over 15 different meetings and workshops from January to April 2018 with a range of sectors.

28. Furthermore, the FIU issued the following guidelines in April 2018:

- a. Guideline on AML/CFT Compliance Obligations for Casino and Gambling Houses No. 2 of 2018 dated 18 April 2018.
- b. Guideline on AML/CFT Compliance Obligations for Dealers in Real Estate and Precious Metals, Precious and Semi-precious Stones No 3 of 2018 dated 18 April 2018.
- c. Guideline for Financial Institutions on Identification of Beneficial Ownership No 4 of 2018 dated 19 April 2018.

29. The review team acknowledges the on-going efforts by the FIU to enhance AML/CFT compliance through the issuance of detailed guidelines and in conducting greater outreach to FIs and DNFBBs that were assessed as posing higher risks, that is, FIs, MVTS, casinos, DPMS and real estate sectors. The FIU should prioritize the issuance of further guidelines for FIs and DNFBBs in relation to the one preventive measure that remains at NC. Weighing up the deficiencies and the considerable progress Sri Lanka has made in conducting outreach and guidance to a range of DNFBB and FIs, the review team considers Sri Lanka is now at a level of LC with R.34.

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

30. Recommendations 5 and 8 have been amended since the adoption of Sri Lanka's MER. Since that time Sri Lanka has:

- drafted amendments to the Voluntary Social Service Organizations (VSSO) Act No. 31 of 1980, but these have not yet been passed;
- made plans to undertake a risk assessment of the NPO sector.

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

31. In addition to progress on R.7 and R.8, Sri Lanka has made continued progress on the following:

32. R.7: Sri Lanka issued a targeted financial sanctions regulation on UNSCR 1718 (DPRK) in 2017 and has commenced work to prepare a regulation on UNSCR 1737 / 2231 (Iran Sanctions);

33. R.14: The FIU issued Guideline on AML/CFT Compliance obligations for Money or Value Service Providers No. 1 of 2017 on 20 January 2017. Rule 84-88 of the CDD Rule No 1 of 2016 impose obligation relating to AML/CFT on MVTs providers.

34. R.24: The ML/TF risk associated with legal persons and arrangements will be assessed with the update of the existing NRA in 2018.

35. R.25: Amendments to Trust Ordinance were Gazetted on 10 November 2017 and Parliament passed these amendments on 28 March 2018.

36. R.26: The FIU is undertaking an on-going programme of risk based supervision. The offsite supervision tool, which was developed with the assistance of IMF, is being used to assist with offsite supervision of banks and finance companies. The FIU issued on 11 January 2018 the Guideline of ML/TF Risk Managements of FIs.

37. R.37-38: In addition to introducing a case management system, Sri Lanka is in the process of amending the Mutual Assistance in Criminal Matters Act to rectify the deficiencies highlighted in the MER.

## IV. CONCLUSION

38. Overall, Sri Lanka has made good progress in addressing the technical compliance deficiencies identified in its MER and has been re-rated on six Recommendations. On the basis of progress made by Sri Lanka, Recommendations 1, 22, 29, 33 and 34 have been re-rated to LC, and Recommendation 23 has been re-rated to C.

39. Taking into account Sri Lanka's progress confirmed in APG follow up reports since 2016, Sri Lanka's technical compliance with the FATF Recommendations has been re-rated 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	NC	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	<b>LC</b>	<b>C</b>	NC	NC	PC	<b>C</b>	NC	<b>LC</b>	C
R 31	R 32	R 33	R 34	R 35	R 36	R 37	R 38	R 39	R 40
LC	PC	<b>LC</b>	<b>LC</b>	PC	LC	PC	PC	LC	PC

40. At the 2018 APG Annual Meeting members adopted the Sri Lanka FUR and decided that 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.

August 2018