

# NATIONAL MONEY LAUNDERING AND TERRORIST FINANCING RISK ASSESSMENT OF SRI LANKA

2021/2022



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## DISCLAIMER

The National Money Laundering and Terrorist Financing (ML/TF) Risk Assessment of Sri Lanka has been conducted as a self-assessment by Sri Lankan Authorities, using the National ML/TF Risk Assessment Tool that has been developed and provided by the World Bank. The World Bank team's role was limited to delivery of the tool; providing guidance on technical aspects of it and review/feedback to assist with the accurate use of it. The data, statistics, and information populated into National ML/TF Risk Assessment Tool templates, and any other finding, interpretation, and judgment under the scope of National ML/TF Risk Assessment process completely belong to the Sri Lankan authorities and the sectoral participants, and as such, the findings do not reflect the views of the World Bank, its Board of Executive Directors, or the governments they represent. Nothing herein shall constitute or be considered to be a limitation upon or waiver of the privileges and immunities of the World Bank, all of which are specifically reserved.

## LIST OF ACRONYMS

AAT	- Association of Accounting Technicians of Sri Lanka
ACCA	- Association of Chartered Certified Accountants
AF	- Asset Forfeiture
AGD	- Attorney General's Department
AML	- Anti-Money Laundering
APG	- Asia Pacific Group on Money Laundering
APIS	- Advance Passenger Information System
BASL	- Bar Association of Sri Lanka
BO	- Beneficial Ownership
BOD	- Board of Directors
BSD	- Bank Supervision Department
BSU	- Border Surveillance Unit
CAs	- Competent Authorities
CBSL	- Central Bank of Sri Lanka
CBDCs	- Central Bank Digital Currencies
CBT	- Criminal Breach of Trust
CCPA	- Code of Criminal Procedure Act, No. 15 of 1979
CDASL	- Condominium Developers' Association of Sri Lanka
CDD	- Customer Due Diligence
CDS	- Central Depository System
CEFTS	- Common Electronic Fund Transfer Switch
CEO	- Chief Executive Officer
CERT	- Computer Emergency Readiness Team
CFT	- Countering the Financing of Terrorism
CIABOC	- Commission to Investigate Allegations of Bribery or Corruption
CID	- Criminal Investigation Department
CIDA	- Construction Industry Development Authority
CIMA - UK	- Chartered Institute of Management Accountants of the United Kingdom
CITES	- Convention on International Trade in Endangered Species of Wild Fauna and Flora
CMA	- Condominium Management Authority
CMA – Sri Lanka	- Certified Management Accountants of Sri Lanka
CNI	- Chief of National Intelligence
CRIB	- Credit Information Bureau of Sri Lanka
CSS	- Co-operative Societies
CSE	- Colombo Stock Exchange
CSTFA	- Convention on the Suppression of Terrorist Financing Act, No. 25 of 2005
CTID	- Counter Terrorism Investigation Division
CTRs	- Cash Transaction Reports
DCD	- Department of Co-operative Development
DCS	- Department of Census and Statistics
DFE	- Department of Foreign Exchange
DNFBPs	- Designated Non-Finance Businesses and Professions

DPMS	- Dealers in Precious Metals and Precious Stones
DPS	- Drugs and Psychotropic Substance
DRC	- Department of Registrar of Companies
DRP	- Department for Registration of Persons
DSNBFI	- Department of Supervision of Non-Bank Financial Institutions
EFTs	- Electronic Fund Transfers
EMS	- E-Money Service
ENV-NR	- Environmental and Natural Resource
ESW	- Egmont Secure Web
EU	- European Union
EXBS	- Export Control and related Border Security
FATF	- Financial Action Task Force
FBA	- Finance Business Act, No. 42 of 2011
F&CCID	- Financial and Commercial Crime Investigation Division
FEA	- Foreign Exchange Act, No. 12 of 2017
FIIs	- Financial Institutions
FIU	- Financial Intelligence Unit
FLA	- Finance Leasing Act, No. 56 of 2000
FTRA	- Financial Transactions Reporting Act, No. 6 of 2006
GDP	- Gross Domestic Product
GTI	- Global Terrorism Index
GWP	- Gross Written Premium
IAID	- Illegal Assets Investigation Division
IBSL	- Insurance Board of Sri Lanka
ICs	- Insurance Companies
ICASL	- Institute of Chartered Accountants of Sri Lanka
ICO	- Initial Coin Offerings
ICRG	- International Cooperation Review Group
ICT	- Information and Communication Technology
IEC	- Initial Exchange Offerings
IGP	- Inspector General of Police
IMs	- Investment Managers
IMF	- International Monetary Fund
IMLs	- Informal Money Lenders
INGOs	- International Non-Governmental Organizations
IOM	- International Organization for Migration
IPBs	- Informal Pawn Brokers
IRA	- Inland Revenue Act, No. 24 of 2017
IRCSL	- Insurance Regulatory Commission of Sri Lanka
IRD	- Inland Revenue Department
IPG	- Internet Payment Gateway
ISIL	- Islamic State of Iraq and Levant
IUU	- Illegal, Unreported and Unregulated
JSC	- Judicial Service Commission
KYC	- Know Your Customer
LBs	- Licensed Banks

LCBs	- Licensed Commercial Banks
LEAs	- Law Enforcement Agencies
LFCs	- Licensed Finance Companies
LKR	- Sri Lankan Rupee
LMFCs	- Licensed Microfinance Companies
LSBs	- Licensed Specialized Banks
LSD	- Lysergic Acid Diethylamide
LTTE	- Liberation Tigers of Tamil Eelam
ME	- Mutual Evaluation
MER	- Mutual Evaluation Report
MFA	- Microfinance Act, No. 6 of 2016
MFIs	- Microfinance Institutions
ML	- Money Laundering
MLA	- Mutual Legal Assistance
MOD	- Ministry of Defence
MOU	- Memorandum of Understanding
MOJ	- Ministry of Justice
MVTS	- Money or Value Transfer Service
NCB	- Non-Conviction Based
NCC	- National Coordinating Committee
NFIS	- National Financial Inclusion Strategy
NGJA	- National Gem and Jewellery Authority
NGOs	- Non-Governmental Organizations
NPOs	- Non-Profit Organizations
NSNGO	- National Secretariat for Non-Governmental Organizations
NIC	- National Identity Card
NRA	- National Risk Assessment
NSC	- National Security Council
P2P	- Peer-to-Peer
PDs	- Primary Dealers
PEPs	- Politically Exposed Persons
PMLA	- Prevention of Money Laundering Act, No. 5 of 2006
PNB	- Police Narcotic Bureau
PSD	- Payments and Settlements Department
PSSA	- Payment and Settlement Systems Act, No. 28 of 2005
PTA	- Prevention of Terrorism Act, No. 48 of 1979
QPC	- Quoted Public Company
RBA	- Risk-Based Approach
RBC	- Risk-Based Capital
RDs	- Restricted Dealers
RGD	- Registrar General's Department
RIs	- Reporting Institutions
RII Act	- Regulation of Insurance Industry Act, No. 43 of 2000
SAARC	- South Asian Association for Regional Cooperation
SBs	- Stockbrokers
SDA	- Special Deposit Account

SEC	- Securities and Exchange Commission of Sri Lanka
SIS	- State Intelligence Service
SLAAS	- Sri Lanka Accounting and Auditing Standards
SLAASMB	- Sri Lanka Accounting and Auditing Standards Monitoring Board
SLAuSs	- Sri Lanka Auditing Standards
SLCs	- Specialized Leasing Companies
SLIPS	- Sri Lanka Interbank Payment System
SLJI	- Sri Lanka Judges' Institute
SME	- Small and Medium Enterprise
SRB	- Self-Regulatory Body
STO	- Security Token Offerings
STRs	- Suspicious Transaction Reports
TBML	- Trade-Based Money Laundering
TCSPs	- Trust and Company Service Providers
TF	- Terrorist Financing
TFS	- Targeted Financial Sanctions
TISL	- Transparency International Sri Lanka
TRO	- Tamil Rehabilitation Organization
UAE	- United Arab Emirates
UK	- United Kingdom
UMFIs	- Unregulated Microfinance Institutions
UN	- United Nations
UNSCRs	- United Nations Security Council Resolutions
UNODC	- United Nations Office on Drugs and Crime
USA	- United States of America
USD	- United States Dollar
UTs	- Unit Trusts
V2V	- Virtual-to-Virtual
VAs	- Virtual Assets
VASPs	- Virtual Assets Service Providers
VCs	- Virtual Currencies
VSSO Act	- Voluntary Social Services Organizations (Registration and Supervision) Act, No. 31 of 1980
WB	- World Bank
WCO	- World Customs Organization
WMD	- Weapons of Mass Destruction
WGs	- Working Groups

## EXECUTIVE SUMMARY

Money Laundering (ML) threat levels emanating from each major predicate offence are listed below with the rating.

- i. Drug trafficking - **Medium High**
- ii. Bribery and Corruption - **Medium High**
- iii. Customs related offences including laundering of trade-based proceeds - **Medium High**
- iv. Fraud (including offences in relation to fraud - scams, criminal breach of trust, cheating or criminal misappropriation, or any combination thereof) - **Medium**
- v. Robbery (includes housebreaking, extortion, and theft) - **Medium**
- vi. Environmental and Natural Resource (ENV-NR) crimes - **Medium**
- vii. Illegal, Unreported and Unregulated (IUU) fishing and related unlawful activities (trafficking and smuggling) - **Medium Low**
- viii. Human smuggling/ trafficking - **Medium Low**
- ix. Tax offences - **Medium Low**
- x. Counterfeiting of currency - **Low**

The overall ML threat and vulnerability of Sri Lanka has been assessed as **Medium** and the ML risk level in the country has been rated as **Medium**. Similarly, Terrorist Financing (TF) risk also has been rated as **Medium** after identifying the TF threat and TF vulnerability at **Medium** level.

As per the below grid using left-hand side colours for low scales and right-hand side colours for high scales ML threat, vulnerability and risks can be identified as follows.



**Low**                    **Medium**                    **High**

**Table 1: Sectoral Money Laundering Threat, Vulnerability and Risks**

Sector		ML Threat	ML Vulnerability	ML Risk
Banking		Medium High	Medium	Medium High
Other Financial Institutions Sector	Finance Companies	Medium High	Medium	Medium High
	Money or Value Transfer Service (MVTs) Providers	Medium	Medium	Medium
	Informal (Hawala/Hundi) Remitters	High	High	High
Securities	Stockbrokers	Medium Low	Medium	Medium
	Primary Dealers	Medium	Medium	Medium
Insurance		Medium Low	Medium Low	Medium Low
Designated Non-Finance Businesses and Professions (DNFBPs)	Casinos	Medium	Medium	Medium
	Real Estate Agents	Medium High	Medium	Medium High
	Dealers in Precious Metals and Precious Stones (DPMS)	Medium	Medium	Medium
	Lawyers	Medium Low	Medium	Medium
	Notaries	Medium		
	Accountants	Medium Low	Medium Low	Medium Low
	Trust and Company Service Providers (TCSPs)	Medium Low	Medium Low	Medium Low

Figure 1: Money Laundering Threat

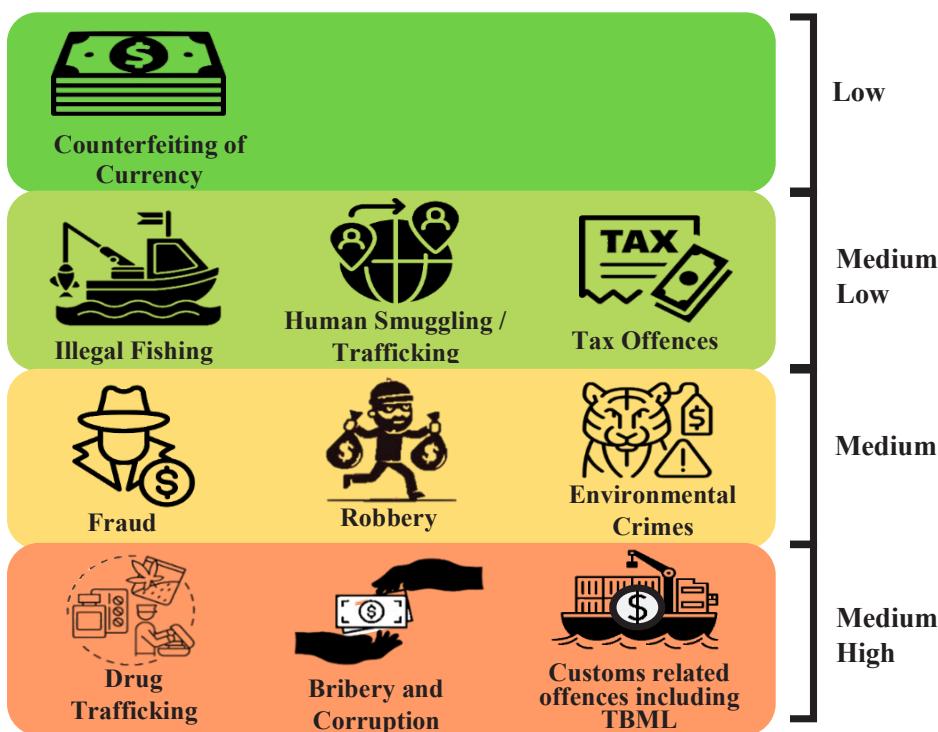
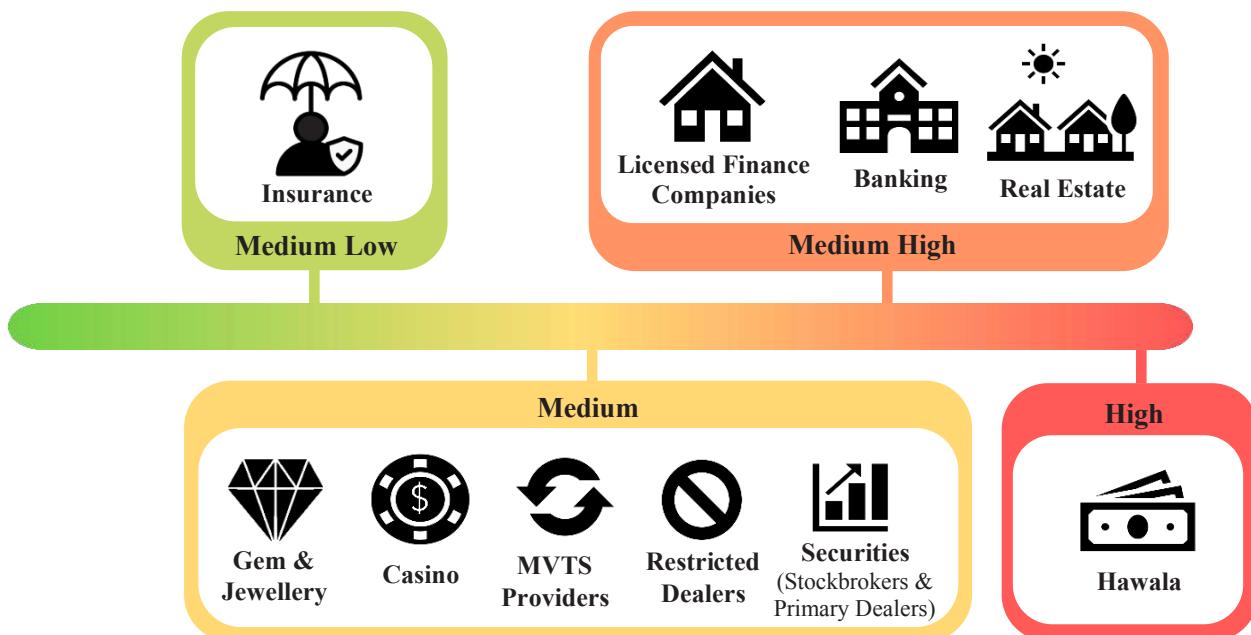


Figure 2: Sectoral Risk to Money Laundering



# PART I

## RISK ASSESSMENT OVERVIEW

## 1. INTRODUCTION

National Risk Assessment (NRA) on Money Laundering and Terrorist Financing (ML/TF) is a comprehensive process of identifying, analyzing and understanding the main sources and drivers of the ML/TF risk of the country. The purpose of NRA is to develop risk-based Anti-Money Laundering and Countering the Financing of Terrorism (AML/CFT) actions and facilitate allocation of available resources in the most effective way to control, mitigate and eliminate the identified risks.

The Recommendation 1 of the Financial Action Task Force (FATF) requires countries to identify, assess and understand the ML/TF risk and apply a Risk-Based Approach (RBA) to ensure that the measures to prevent/mitigate ML/TF risks commensurate with the risks identified. The RBA is the basis for all measures to prevent ML/TF by public authorities and Reporting Institutions (RIs).

Sri Lanka's NRA is an activity carried out with the cooperation of the state and private sectors aiming to reach a better understanding of the ML/TF risks faced by the country. The Financial Intelligence Unit (FIU) of Sri Lanka, as the AML/CFT regulator in the country coordinated the NRA process. Accordingly, stakeholders representing key government and private sector institutions participated in the NRA. The NRA was conducted under the ambit of the AML/CFT National Coordinating Committee (NCC) which comprises senior government officials chaired by the Governor, Central Bank of Sri Lanka (CBSL).

Accordingly, Sri Lanka conducted the first ever NRA on ML/TF in 2014, immediately after the revision of FATF Recommendations in February 2012 and was subjected to second Mutual Evaluation (ME) subsequently. The second NRA was conducted in 2021/22, with the available information during the period from 2015 to 2022. In certain instances where information was not available, the data collection period has been limited.

This report details the findings from the Sri Lanka's NRA on ML/TF risk, conducted based on a self-assessment by Sri Lankan authorities, using the ML/TF Risk Assessment Tool developed and provided by the World Bank (WB). The NRA was carried out over a period of 18 months from July 2021 to December 2022 amidst the COVID-19 pandemic and the economic turbulence that prevailed within the country.

## 2. OBJECTIVES

The objectives of the NRA were to:

- Understand the ML/TF threat posed by criminals, terrorist groups, ML/TF activities, proceeds of crime generated through predicate offences and funds aimed at terrorism that could cause harm to the society and economy;
- Identify the factors that represent weaknesses in the Sri Lankan AML/CFT systems and controls, features of the country including features of particular sectors of Financial Institutions (FIs) and Designated Non-Finance Businesses and Professions (DNFBPs), financial products and type of services that make them attractive for ML/TF purposes in order to assess ML/TF vulnerability;
- Identify Sri Lanka's ML/TF risk resultant from the identified ML/TF threat and weaknesses in the AML/CFT regime after considering the impact or harm (consequences) of ML/TF;
- Facilitate the allocation of available resources in the most effective ways to control, mitigate and eliminate the identified high risks areas;
- Determine the weaknesses of other sectors such as Legal Persons, Non-Profit Organizations (NPOs), Virtual Assets and Virtual Assets Service Providers (VAs and VASPs) and Environmental and Natural Resources (ENV-NR) for them being abused for ML/TF;
- Evaluate ML/TF risks stemming from financial inclusion products (existing, emerging, or new) offered in Sri Lanka to effectively facilitate financial inclusion while mitigating potential risks of ML/TF.

### **3. ASSESSMENT METHODOLOGY**

The WB methodology defines the ML risk as a combination of national ML threat and national vulnerability. TF risk is also defined in a similar manner. The WB methodology, which is identified as the "Structure of the NRA Tool", consists of 13 modules given in Annex I to this report.

#### **1) National Money Laundering Threat**

The ML threat in Sri Lanka is analyzed on the primary assumption that the ML threat is a function of criminal proceeds in terms of the predicate offending type. In this process, systematically collected and compiled data on the criminal offences to identify the offending's origin and the sector, to which, such offending is closely affiliated.

#### **2) National Money Laundering Vulnerability**

The national vulnerability to ML in Sri Lanka is assessed considering the combating ability of the country for exposed vulnerabilities of different sectors arriving at overall sectoral vulnerability and national combating ability. It measures how well the domestic legal framework and Law Enforcement Agencies (LEAs) are equipped to tackle ML. This included assessing the legal framework, levels of training, integrity, and resources in these institutions as well as how these institutions are cooperating with one another and other institutions in addition to understanding overall sectoral vulnerability to ML.

#### **3) Banking Sector Vulnerability**

Assessed the vulnerability arising from the banking sector by looking at the AML general controls and the product specific variables which included volume, average transaction size, client profile, other vulnerable features, and the controls specific to the products.

#### **4) Securities Sector Vulnerability**

Assessed the vulnerability arising from the securities sector by analyzing the AML general controls of institutions consisting of Primary Dealers (PDs), Stockbrokers (SBs), Unit Trusts (UTs) and Investment Managers (IMs). Product specific variables were not considered as the securities sector in Sri Lanka predominantly consists of equity products and does not have many products on offer unlike in other developed markets.

#### **5) Insurance Sector Vulnerability**

Assessed the vulnerability arising from the insurance sector by analyzing the AML general controls and the product specific variables which included volume, average transaction size, client profile, other vulnerable features, and the controls specific to the products.

#### **6) Other Financial Institutions Vulnerability**

Assessed the vulnerability arising from other financial sector which includes Licensed Finance Companies (LFCs), Specialized Leasing Companies (SLCs), Money or Value Transfer Service (MVTS) Providers, E-Money Service (EMS) Providers, Licensed Microfinance Companies (LMFCs), Restricted Dealers (RDs), Co-operative

Societies (CSs) and Samurdhi Banks included in the regulated category and Informal Money Transfer Systems (Hundi/Hawala), Informal Pawn Brokers (IPBs), Informal Money Lenders (IMLs) and Unregulated Microfinance Institutions (UMFIs) in the unregulated/informal/under-regulated category.

#### **7) Designated Non-Finance Businesses and Professions Vulnerability**

Analyzed the vulnerability of DNFBPs which included Casinos, Real Estate Agents, Dealers in Precious Metals and Precious Stones (DPMS), Notaries Public, Lawyers, Accountants and Trust and Company Service Providers (TCSPs).

#### **8) Terrorist Financing Risk**

Analyzed the overall TF risk and vulnerability of the country through TF threat, sectoral TF risk and how well the domestic legal framework and LEAs are equipped to tackle TF.

#### **9) Financial Inclusion Product Risk**

Analyzed the ML/TF risks stemming from current and emerging financial inclusion products in order to make recommendations to facilitate risk-based ML/TF preventive measures which promote inclusive financial integrity.

#### **10) Environmental and Natural Resource Crimes Risk**

Focused on identifying main ENV-NR crime threats in the Sri Lankan context, assessing vulnerabilities to financial crimes, and developing recommendations to strengthen ENV-NR crimes related ML controls in order to reduce vulnerabilities to ML in the related sectors.

#### **11) Non-Profit Organizations Risk**

Focused on identifying the categories of NPOs at risk of abuse for TF.

#### **12) Legal Persons, Legal Arrangements and Beneficial Ownership-related Risk**

Focused on identifying the ML related risk of legal structures, created or operating in Sri Lanka.

#### **13) Virtual Assets and Virtual Assets Service Providers Risk**

Focused on assessing the VAs and VASPs related ML/TF threats, vulnerabilities, and mitigating measures.

Similar to the past practice and as required by the WB tool, Sri Lanka established Working Groups (WGs) representing all AML/CFT related stakeholders in Sri Lanka. Accordingly, the WGs comprised senior officials / representatives from several government/private institutions and the departments of the CBSL having expert knowledge on relevant fields in addition to the officials from the FIU. All stakeholder institutions of the WGs are given in Annex II to this report. Participants were assigned to 13 WGs, each WG for each module of the NRA tool, based on their professions, specializations, and background, in order to carry out assigned tasks and to

focus on specific areas of each NRA module.

The NRA was carried out amidst the COVID-19 pandemic, and the economic crisis prevailed in the country. Groundwork to formulate WGs for the NRA modules was commenced in April 2021. Under the leadership of NRA National Coordinator and Assistant Coordinator, 13 WGs were formulated with the participation of 151 experts representing governmental organizations, private sector institutions, the CBSL and the FIU. Thirteen senior officers of the FIU were appointed as Coordinators for 13 NRA modules. The inauguration session of the NRA was conducted virtually by the FIU on July 07, 2021 by addressing all the NRA WG members providing them with an overall understanding of the NRA process and detailing the expected contribution by the WG members.

The NRA process was carried out in three stages; the first stage was the technical assistance sessions, conducted by the WB NRA experts from July 15, 2021 to September 30, 2021 where they discussed the NRA concepts, introduced NRA tools and explained the assessment methodology and the use of the NRA tool.

The second stage required the WGs to collect data from their institutions and relevant parties and use them as the inputs for the NRA tool for analysis. This longest phase involved time consuming data collection, compilation, assessment, analysis and drafting. At this stage, another series of technical assistance sessions was carried out by the WB virtually to review the progress and subsequent to these sessions, WGs were able to finalize the ratings and they drafted the detailed version of reports for their respective modules. The final stage of the NRA process included another virtual technical assistance session on November 15, 2022. This session provided an insight for the finalization of the detailed NRA report, as well as the sanitized version.

Once the NRA was finalized, on May 30, 2023 the findings were presented to the NCC chaired by the Governor of the CBSL participated by key stakeholders from Attorney General's Department (AGD), Department of Legal Draftsman, Ministries of Defence, Justice, Finance and Foreign Affairs, other Departments, namely, Immigration and Emigration, Import and Export Control, Excise, Inland Revenue, other institutions such as Registrar of Companies, Sri Lanka Accounting and Auditing Standards Monitoring Board (SLAASMB), National Secretariat for Non-Governmental Organizations (NSNGO), National Dangerous Drug Control Board, Securities and Exchange Commission of Sri Lanka (SEC), Sri Lanka Police, and the Central Bank including Department of Foreign Exchange (DFE). The progress of the NRA and summary of its findings were also presented to the Monetary Board of the CBSL on June 27, 2023.

The WB technical assistance team provided preliminary comments to the draft report, and the Module Coordinators of the FIU had a virtual concluding meeting with the WB team on July 05, 2023 to discuss the manner in which the comments were addressed and the way forward for the next stages of the NRA being discussed among the relevant stakeholders. The members of the WGs and the FIU are thankful for the efforts of the team of resource persons from the WB in assisting Sri Lanka in the second NRA.

## PART II

# THE ASSESSMENT

## 1. MONEY LAUNDERING THREAT ASSESSMENT

### 1.1 Introduction

The ML/TF threat assessment for Sri Lanka focuses on the primary assumption that the ML threat is a function of the criminal proceeds. The WG carried out its analysis on the ML/TF threat in Sri Lanka, by identifying money laundering threats and origins in terms of the predicate offending type, the sector to which such offending is closely affiliated, on proceeds of crime generated and several new trends of predicate offences. The offending reported to law enforcement authorities and other relevant authorities for the period from 2015 to 2022 were considered in this assessment.

The overall ML threat for Sri Lanka is identified as **Medium**.

### 1.2 Main Crimes that Generate Proceeds of Crimes

All unlawful activities listed within the Prevention of Money Laundering Act, No. 05 of 2006 (PMLA), amended by Act, No. 41 of 2011 are considered by the WG in analyzing the ML threat faced by Sri Lanka.

ML threat levels emanating from each major predicate offence considered in the assessment are listed in Table 1.

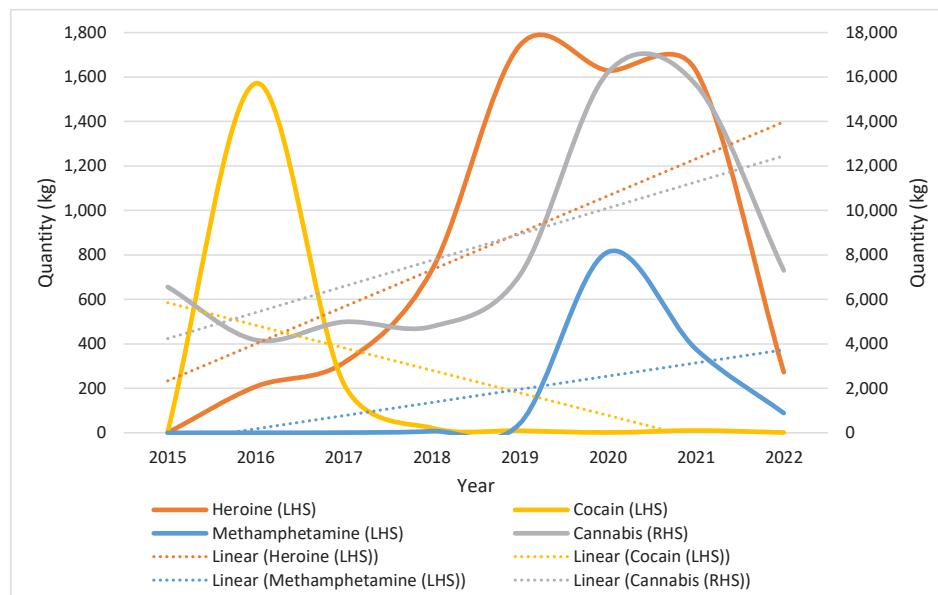
**Table 1: Major Money Laundering Threats**

	Major Money Laundering Threat	Rating
1	Drug trafficking	Medium High
2	Bribery and Corruption	Medium High
3	Customs related offences including laundering of trade-based proceeds relating to such offending	Medium High
4	Fraud (including criminal misappropriation, criminal breach of trust (CBT), cheating and its variants, scams, prohibited schemes, payment devices fraud, internet frauds, etc.)	Medium
5	Robbery (includes housebreaking, extortion, and theft)	Medium
6	Environmental and Natural Resource crimes	Medium
7	Illegal, Unreported and Unregulated (IUU) fishing related unlawful activities including drug trafficking and smuggling	Medium Low
8	Human smuggling/ trafficking	Medium Low
9	Tax offences	Medium Low
10	Counterfeiting of currency	Low

### 1.2.1 Drug Trafficking

WG identifies Drugs and Psychotropic Substance (DPS) trafficking as the most significant unlawful activity that generates criminal proceeds in Sri Lanka based on arrests, seizures, and prosecutions. This is similar to the 2014 NRA finding. However, usage of drugs has widened from heroine and cannabis to several new types of narcotic drugs and psychotropic substances such as Lysergic Acid Diethylamide (LSD), Crystal Methamphetamine (Ice), and cocaine in view of several instances of high value detections during the period assessed.

**Figure 1: Quantity of Drugs/Psychotropic Substances by Type (2015-2022)**



Sources: Police Narcotic Bureau  
National Dangerous Drugs Control Board

Figure 1 shows the drug type and quantity detected during investigations. As of November 2022, the street value of drug types showed that on average, annually, Rs. 42 billion of heroine had been detected from the arrests compared to Rs. 11.52 billion seen during the previous NRA. Similarly, annually an average value of Rs. 11.8 billion of cocaine, Rs. 1.02 billion of cannabis (Kerala Ganja) and Rs. 0.82 billion of cannabis (domestic variant) have been detected. An increasing trend concerning LSD /Ice usage shows that proceeds generated on average amounts to around Rs. 5.67 billion. These values reconfirm the WG observation of the offending as a significant level of ML threat emanating offence in Sri Lanka.

Sri Lanka is identified as a transshipment point for drug trafficking via the “Southern Route”<sup>1</sup>. Large detections of high-end narcotics such as cocaine, increased recreational drug detections observed lately reflecting the increased threat exposure. Lack of detections on outward movement of DPS is identified as a significant concern in view of the “transshipment” theory. Although incidents of outward movements of DPS are not detected, as identified average consumption of heroine per annum is approximately 4,964 kg<sup>2</sup>, it is inferred that Sri Lanka is used as a transshipment point by traffickers.

Considering the proceeds generated during the period and other salient features observed for this type of offending, the ML threat is rated as **Medium High**.

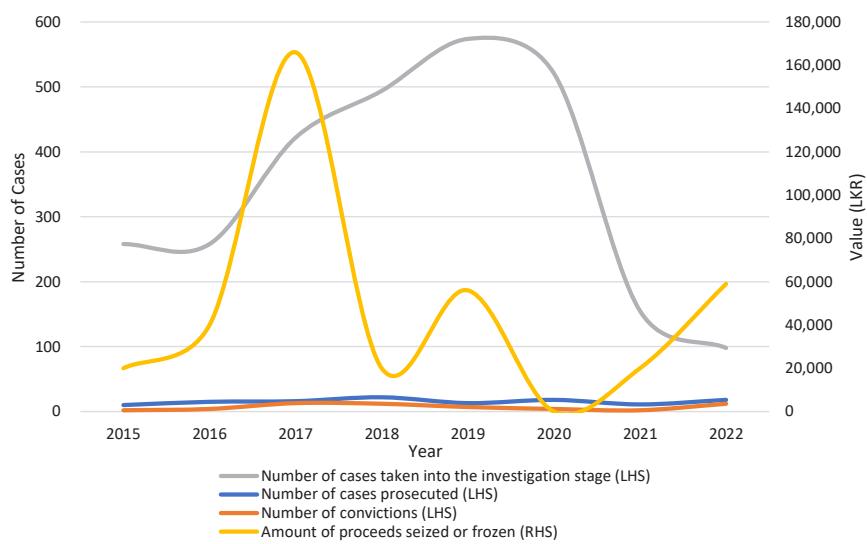
1 World Drug Report 2016, United Nations Office on Drugs and Crime (UNODC)

2 Source – National Dangerous Drugs Control Board

### 1.2.2 Bribery and Corruption

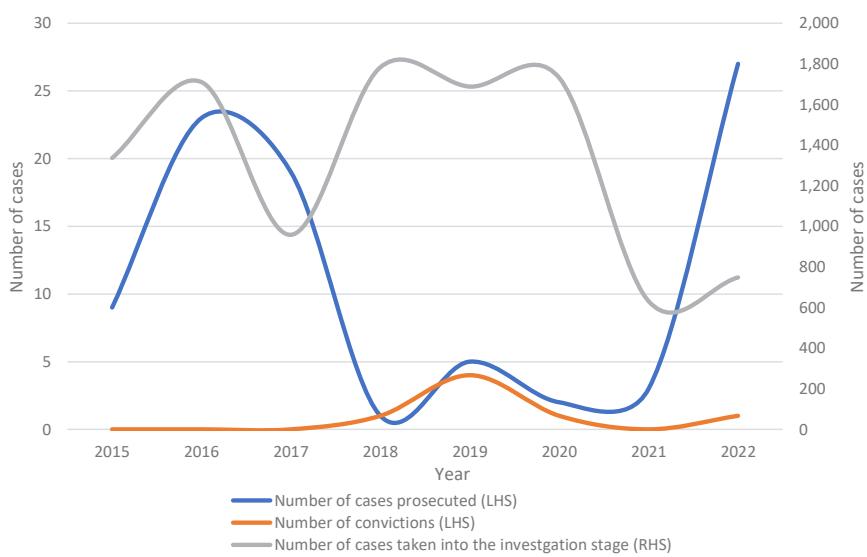
The offence of bribery and corruption is identified as the second most significant unlawful activity that generates criminal proceeds in Sri Lanka. In 2014, bribery and corruption ranked at fifth place. Bribery and corruption offences and statistics on raids reported to WG have been shown in Figures 2, 3 and 4, respectively.

**Figure 2: Investigations on Bribery (2015-2022)**



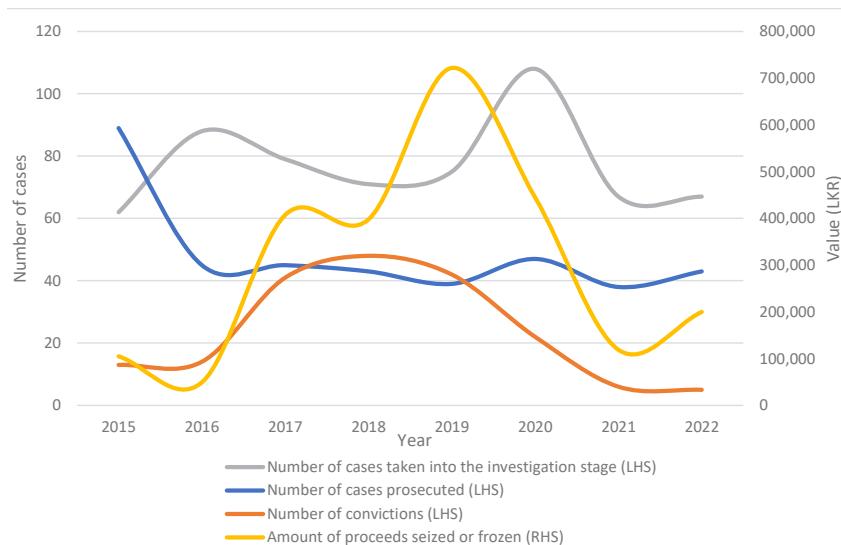
Source: Commission to Investigate Allegations of Bribery or Corruption

**Figure 3: Investigations on corruption (2015-2022)**



Source: Commission to Investigate Allegations of Bribery or Corruption

**Figure 4: Investigations Linked to Raids (2015-2022)**



Source: Commission to Investigate Allegations of Bribery or Corruption

During the assessed period, apparent scenarios of grand bribery and corruption events are not adequately reflected in the statistics of investigations carried out. Although the incidents reported (complaints) were high, the raids and investigations subsequently carried out result in a much lower number of prosecutions. Due to the absence of ML investigations, no ML cases are reported linked to bribery and corruption offences. WG was also challenged by the fact that corruption cannot be directly quantified to criminal proceeds as there is no direct measurable value involved in most instances due to components of misuse of power and abuse of authority linked with majority of cases. However, this aspect is deemed as inconclusive as indirectly a comparable value variable may be identified from abandoned or attempted incidents of corruption.

During the assessed period, 10 Mutual Legal Assistance (MLA) requests sought information from foreign jurisdictions on possible offences of bribery and corruption involved with ML being indicated in the MLA. Therefore, potential of ML related bribery/corruption offending indicates that threat of ML is prevalent among the investigated incidents.

Having considered the proceeds generated during the period, Suspicious Transaction Reports (STRs), MLA requests, and of the unsubstantiated yet widely accepted belief of high corruption level in the country, the ML threat has been rated as **Medium High**.

### **1.2.3 Customs related Offences including Laundering of Trade-Based Proceeds relating to such Offending**

Customs related offences are identified as the third most significant unlawful activity that generates criminal proceeds in Sri Lanka. Penalties and goods forfeiture by Sri Lanka Customs during 2015-2021 are shown in Table 2.

**Table 2: Penalties and Goods Forfeiture by Sri Lanka Customs (2015-2021)**

Year	Investigations finalized by Customs	Total Penalties imposed / Rs.	Forfeiture of Goods /Rs.	Sale Proceeds of Goods Forfeited / Rs.	Additional entry to recover state's dues
2015	1,491	1,580,553,306.26	617,706,497.00	483,384,959.36	111,111,571.94
2016	2,615	2,764,167,997.12	1,804,671,427.68	970,857,447.05	302,311,459.77
2017	2,899	2,517,459,470.24	1,295,323,499.30	1,201,467,600.70	320,942,984.00
2018	2,131	742,271,416.36	2,485,471,695.80	2,286,008,088.29	480,339,120.00
2019	1,613	356,721,057.59	2,232,464,190.19	1,313,070,723.92	231,541,698.84
2020	2,504	411,331,784.95	2,396,652,208.34	993,741,415.40	150,924,341.00
2021	731	189,007,570.06	863,283,050.00	1,148,145,552.56	117,978,776.93
<b>Total</b>	<b>13,984</b>	<b>8,561,512,602.58</b>	<b>11,695,572,568.31</b>	<b>8,396,675,787.28</b>	<b>1,715,149,952.48</b>

Source: Sri Lanka Customs (2021)

Customs data during the period of assessment report highlights penalties summing up to nearly Rs. 8.5 billion (approx. Rs. 2.9 billion in value of goods detected) and Rs. 11.6 billion worth forfeitures of goods by SL Customs. Further, it can be presumed for the assessed years trade related activities would have generated around Rs. 14.5 billion in illegal proceeds.

High number of incidents that has invoked Sri Lanka Customs penalties indicates a large value trade-based goods movement that has violated customs laws and detected by Sri Lanka Customs. Due to trade-based instruments such as Letters of Credit and Open Account terms (mis)used in international trade indicate significant involvement of the banking sector. The WG observes that significant challenges faced by the foreign exchange market and the managed exchange rate since 2019 has increased the activity related to informal money value remittances (hawala and undial), both inward and outward. These are potent indicators of large value criminal proceeds and a likely presence of ML precursors. Furthermore, SL Customs' lacked ML investigation expertise, which coupled with gaps in the scope of legal jurisdiction and limited referrals to LEAs makes this threat a fairly significant new entrant.

Having considered the proceeds generated during the period, the ML threat has been rated as **Medium High**.

**1.2.4 Fraud (including offences in relation to fraud - scams, criminal breach of trust, cheating or criminal misappropriation, or any combination thereof)**

In the period assessed, WG observed a large number of incidents relating to offences of fraud reported in low value detections. High number of bank account related freezing and FI related investigations were also observed. Summary of Investigations related to cheating is depicted in Table 3.

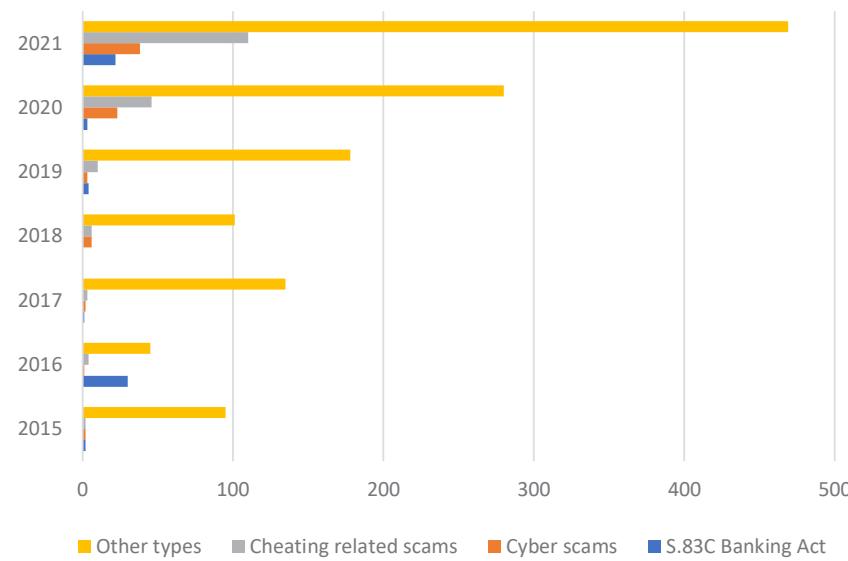
**Table 3: Summary of Investigations Related to Cheating**

Year	Number of cases detected or investigated	Number of cases prosecuted	Number of convictions (cases)
2015	5,532	1,806	164
2016	5,472	1,914	274
2017	6,192	1,934	106
2018	6,090	2,247	92
2019	5,251	1,608	54
2020	2,891	882	37

Source: Sri Lanka Police

Large number of investigations linked to scams commenced during the Pandemic lockdown period that may be a result of substituting loss of livelihood during COVID-19 travel restrictions via proceeds generated from fraud related criminal activities. Summary of the investigations related to scams based on STRs during 2015-2021 are shown in Figure 5.

**Figure 5: Suspicious Transaction Reports based on Fraud Type and Scams**



Source: Financial Intelligence Unit – Sri Lanka

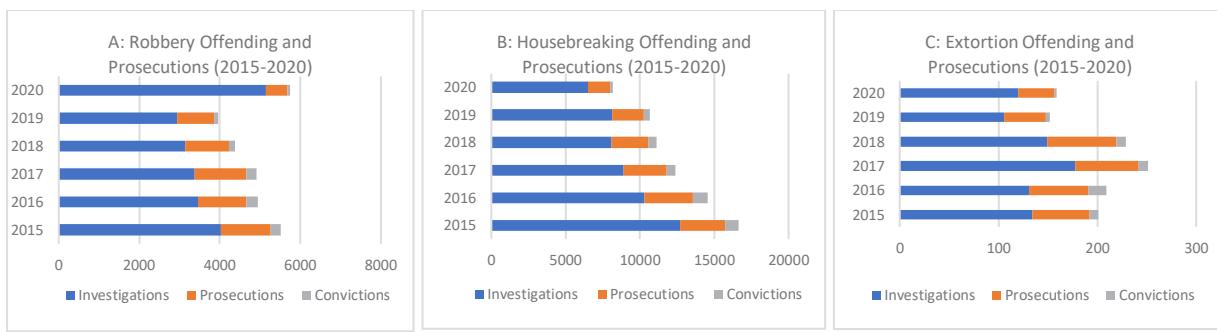
Having considered the proceeds generated during the said period, the ML threat has been rated as **Medium**.

### 1.2.5 Robbery

The offending of Robbery is viewed by the WG as an unlawful activity that generates significant amount of criminal proceeds in Sri Lanka. Among many variations of the offending relating to robbery, house breaking (or breaking and entering with the intent to commit robbery) is viewed as the most prevalent type of robbery.

A decreasing trend of robbery offending is observed since 2015. However, in 2020, this trend had reversed, and the spike in robberies maybe an indication that the criminal activities may be the means to sustain livelihoods lost due to COVID-19 pandemic related limitation in outdoor activities.

**Figure 6: Offending and Prosecutions: Robbery, Housebreaking, Extortion**



Source: Sri Lanka Police

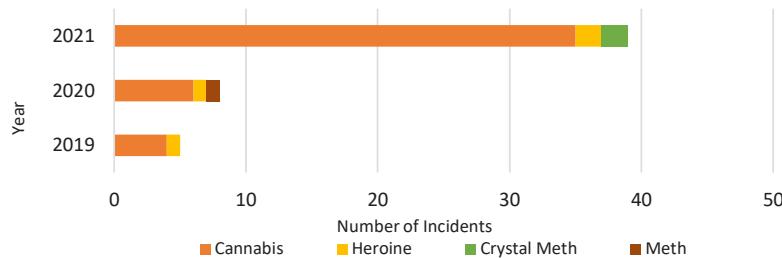
Having considered the proceeds generated during the said period, the ML threat has been rated as **Medium**.

### 1.2.6 Illegal, Unreported and Unregulated Fishing related Unlawful Activities including Drug Trafficking and Smuggling

The region for ML threats on IUU Fishing is observed as the Bay of Bengal<sup>3</sup> in the Indian Ocean along the coastal areas of Sri Lanka. Apart from direct IUU activities generating criminal proceeds, the WG strived to identify other types of criminal activities<sup>4</sup> linked to IUU activities, such as smuggling of contraband goods, drugs, and psychotropic substances.

ML threats in IUU fishing are not reflected in available statistics. However, considering the proximity to the Indian sub-continent, visible links to criminal proceeds observed during detections in the forms of trafficking and smuggling and related offending.

**Figure 7: Drug Smuggling linked to Illegal Unreported and Unregulated Fishing**



Source: Indian Monthly Maritime Security Update, (IFC-IOR, 2021)

3 Bay of Bengal comprises of 2,172 million km<sup>2</sup> area of maritime zones impacting the South Asian region countries.

4 Illegal unreported, and unregulated fishing, drugs and psychotropic substance trafficking, trafficking of persons, smuggling of contrabands, migrants etc.

Contraband smuggling and trafficking of Kerala ganja and other forms of narcotics (Figure 7) via illegal and unauthorized fishing vessels had been observed for a prolonged period with no identified pattern indicating a seasonal trend. However, no incidents are linked to ML investigations as at the period of assessment. Having considered the proceeds generated during the period, the ML threat has been rated as **Medium Low**.

#### **1.2.7 Human Smuggling and Human Trafficking**

This type of offending has had links with IUU fishing related activities where the fishing vessels are used as means of transportation to reach foreign shores. 29 STRs have been reported to the FIU on human smuggling linked to fishery sector and several incidences were reported from the Northwestern part of Sri Lanka on irregular migration including asylum seekers from Myanmar and Bangladesh seeking temporary shelter until they reach fairer shores. Single indictment has been presented to the High Court of Negombo based on the predicate of organized human trafficking where unlawful activity entailed violation of Section 45C of the Immigrants and Emigrants Act. Furthermore, LEA investigations relating to the possible offending of this type has reported seized funds and frozen property to the value of Rs. 12.8 million and Rs. 28.3 million approximately during 2021.

Compared to 984 cases reported during the assessed period for 2014 NRA, the present assessment has identified 296 cases investigated by the Criminal Investigation Department (CID) that has resulted in 98 convictions over the period of 2015-2021. Outreach measures adopted through assistance received by foreign governments including Australia and India, active engagement of the Sri Lankan Coastguard and Navy along with LEAs, and COVID-19 related health concerns may have acted as a deterrent during the period. Although the offending seems to be on a decreasing trend, the possible ML threat cannot be downplayed. Further, WG observed a rapid increase during the later period of the assessment on outward trafficking, which can be attributed to the objective of escaping economic hardships prevailing in Sri Lanka. However, several international studies and literature show Sri Lanka as a Tier 2 country<sup>5</sup>, used as a transit point for trafficking to Middle East and elsewhere, while no ML footprint is linked to Sri Lanka by these literary sources. Having considered the low level of proceeds generated during the period, the ML threat has been rated as **Medium Low**.

#### **1.2.8 Money Laundering Risk in Tax Offences**

Since 2014 to date, tax evasion or other tax offences are not identified in the PMLA as unlawful activities. Furthermore, the Inland Revenue Act does not recognize tax offences' tendency to be a vehicle for ML. However, 2017 amendments to the Inland Revenue Act have introduced the offence of tax evasion with strong, dissuasive penalties. The number of cases scrutinized by tax authorities are as follows:

<sup>5</sup> Tier 2 refers to a jurisdiction not fully compliant but making significant efforts to be compliant to minimum standards to eliminate severe forms of trafficking of persons.

**Table 4: Taxation Related Activity and Offending (2015-2021)**

Description	2016	2017	2018	2019	2020	2021
Number of tax audits	7,709	1,221	5,685	9,470	788	1,477
False tax declarations	33	253	148	2	16	5
Penalties imposed (false declarations) (Rs. million)	1.6	2.9	21.1	0.1	116.9	-

Source: Inland Revenue Department

The threat emanating from the tax offending is deemed lower due to the low numbers reflected above. However, WG observes this as an inconclusive finding that may require an update once a full range of data is available. Having considered the low proceeds reflected by the available data for the assessed period and taking into consideration the perceived level of threat observed by the tax authorities being low, the WG deems this offending as having a threat level of **Medium Low**.

### 1.3 Criminal Proceeds Related to Threat Analysis

The LEAs have suspended proceeds amounting to Rs. 3.03 billion at various stages of ML investigations. The full description of the suspended assets is listed under Table 5.

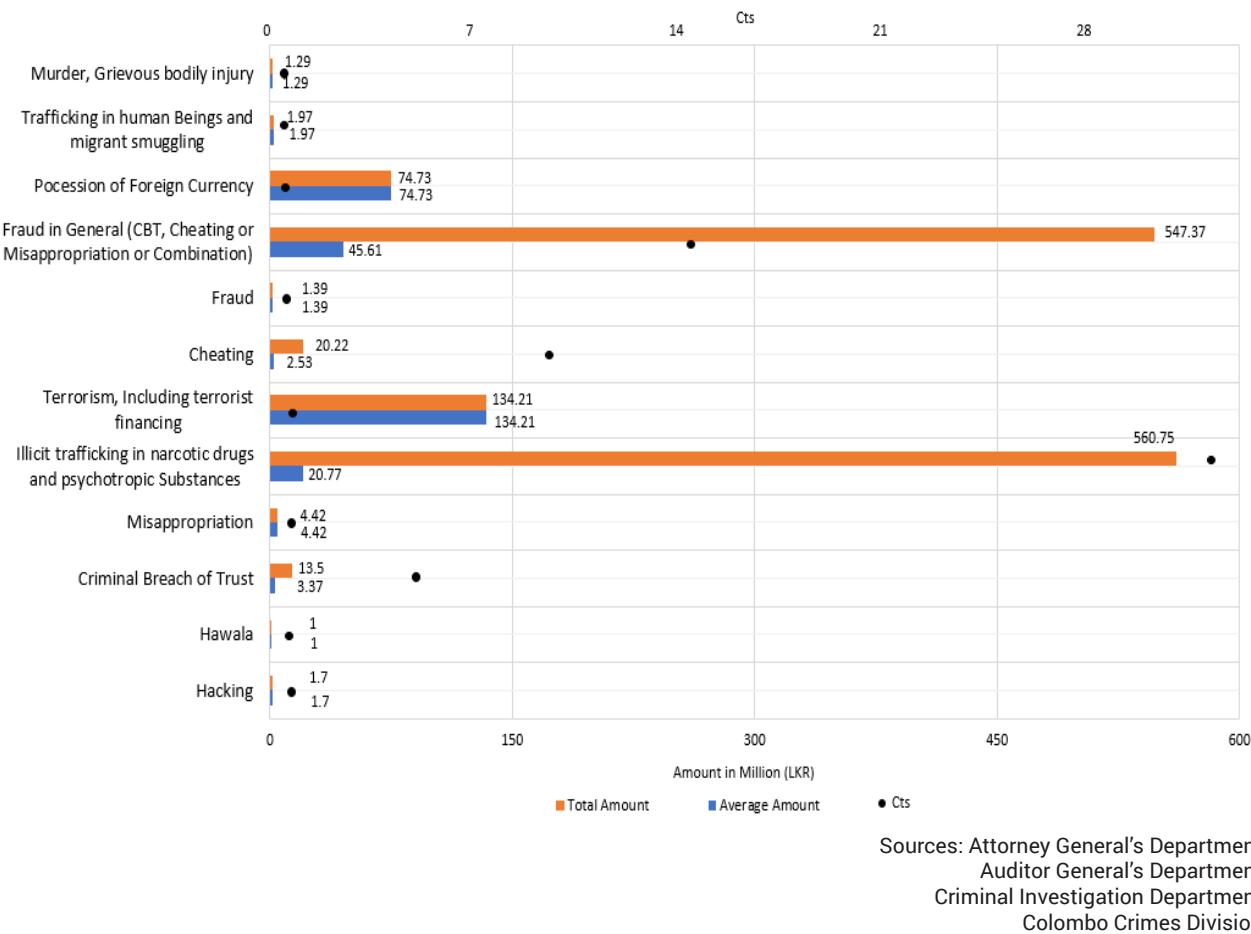
**Table 5: Criminal Proceeds and Assets Suspended under the Prevention of Money Laundering Act**

Asset	CID		IAID	
	Quantity	Value (Rs million)	Quantity	Value (Rs million)
Lands & houses	87	1,122	Acres – 29.11, Houses - 05, Shops - 02	684
Vehicles	31	211	37	469
Fishing Crafts	7	16		
Gold			6.32 kg	105
Bank Accounts	401	88	113	169
Money		35	Rs. 84.5 million (in LKR) Rs. 37.5 million (in USD)	122
Other				7
<b>Total</b>		<b>1,472</b>		<b>1,556</b>

Sources: Illegal Assets Investigations Division  
Criminal Investigation Department

Most proceeds generating offence has been illicit trafficking in narcotic drugs and psychotropic substances. According to the latest data, the value of laundered investigated proceeds stands at Rs. 560.75 million with average case amounting to Rs. 20.77 million laundered proceeds. Figure 8 illustrates the money distribution among typologies.

**Figure 8: Money Distribution Among Typologies by Number of Cases (Cts) (2015-2021)**



**Table 6: Stages of Money Laundering Investigation/Prosecutions by Agency**

Department	Stage	Number
Auditor General Department to LEAs	Investigated	8
CID-FIU 2	Investigated	17
Colombo Crimes Division	Investigated	1
Attorney General's Department	Prosecuted	32
Attorney General's Department	Convicted	1
<b>Total</b>		<b>59</b>

Sources: Attorney General's Department  
Auditor General Department  
Criminal Investigations Department  
Colombo Crimes Division

Information received from competent authorities and LEAs depict the amount generated from illicit funds are around Rs. 1,440,845,000 and the total amount seized, frozen, or confiscated is around Rs. 78,405,000. Table 7 shows the estimated detected amounts and seized, frozen, or confiscated amounts according to each category of unlawful activity.

**Table 7: Estimated / Seized, Frozen, or Confiscated Amounts by Unlawful Activity**

Unlawful Activity	Detected amount (Rs. million)	Seized, frozen, or confiscated amount (Rs. million)
Hacking	1.70	0
Hawala	1.00	1.57
Criminal Breach of Trust	13.50	0.35
Misappropriation	4.42	7.12
Illicit trafficking in narcotic drugs and psychotropic Substances	560.75	8.52
Terrorism, Including terrorist financing	134.12	0
Cheating	20.22	1.10
Fraud	1.39	0
Fraud in General (CBT,Cheating or Misappropriation or Combination)	547.37	0
Procurement of Foreign Currency	74.73	59.73

Sources: Attorney General's Department  
Auditor General Department  
Criminal Investigations Department  
Colombo Crimes Division

## 1.4 Sectoral Threat Analysis

Table 8 depicts the sectoral threat levels, which will be discussed in detail below.

**Table 8: Sector-wise Money Laundering Threat Perception**

	Sector		Threat Level (a combination of perceived threat level and consequences)
1	Banking		Medium High
2	Other Financial Institutions Sector:	Finance Companies MVTs providers Informal (Hawala/ Hundi) Remitters	Medium High Medium High
3	Securities:	SBs PDs	Medium Low Medium
4	Insurance		Medium Low
5	DNFBPs:	Real Estate Agents Casinos Notaries DPMS Accountants TCSPs Lawyers	Medium High Medium Medium Medium Medium Low Medium Low Medium Low

#### 1.4.1 The Banking Sector

The WG identifies 26 ML cases remaining at advanced stages of investigation carried out by LEAs in the sector threat analysis. Out of these, 8 cases have been subject to government audits and investigations stemming as a result of the focused audits where investigation is referred to LEAs (Table 9). From the 54 ML/TF indictments that have been sent out by the Attorney General's Department (AGD) (two are pending appeals to the sentence and convictions), during the assessed period, the WG observed 28 indictments as having ML charges and 3 forming TF charges (linked to bank accounts). From the information received on 33 indictments out of the 54 cases, 28 cases (52 per cent out of overall number of indictments, 85 per cent out of indictments where information about specific charges have been received) are linked to either to banking institutions, bank accounts and/or other financial products offered by the banking sector.

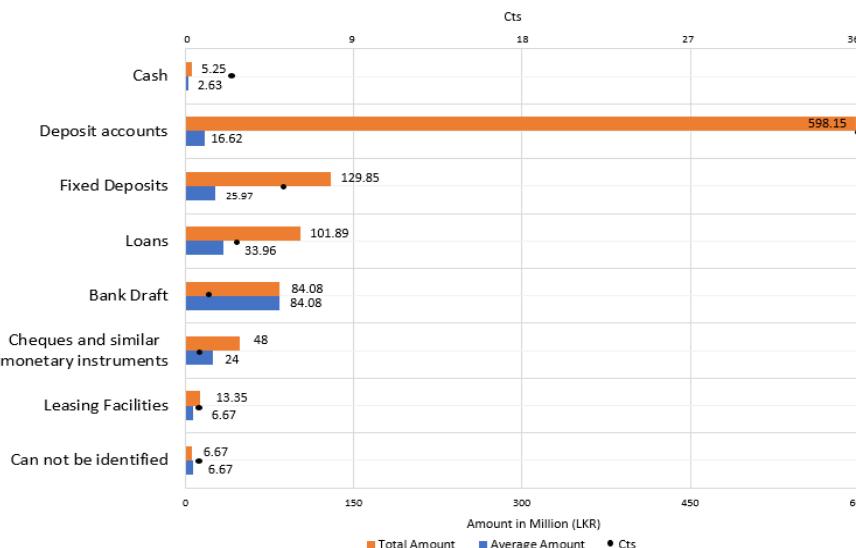
**Table 9: Sector Involved Based on the Money Laundering Charges in the Indicted Money Laundering Cases**

Sector	No. of Indictments
Banking Sector	26
Other Financial Sector (Finance Companies)	5
Securities Sector	0
Insurance Sector	0
Legal persons other than FIs	1
Real Estate	5
Notaries	0
Other (NPOs, Lease Financing and Self laundering)	8

Source: Attorney General's Department

As generally anticipated from a jurisdiction where the financial sector is dominated by the banks, Sri Lanka's ML threat most frequently involves banking sector products. Figure 9 depicts the most frequently used financial products found in ML investigations.

**Figure 9: Financial Product Most Frequently Used – Based on the Money Laundering Prosecutions, Investigations Concluded (Cts) (2015-2021)**



Sources: Attorney General's Department / Auditor General's Department / Criminal Investigation Department / Colombo Crimes Division

WG also considered statistics relating to the suspension of accounts as a result of possible nexus of ML seen in the related transaction or linked with bank or in relation to another suspicious account/ transaction. Furthermore, Table 10 refers to the statistics where suspensions are carried out by the LEAs under the PMLA section 7 read together with sections 3 and 4, as amended. Table 10 also identifies the large presence of banking accounts.

**Table 10: Financial Intelligence Unit Directed Suspensions  
(Up to 31.10.2022)**

Institution	No. of Accounts
Banks	1,318
Finance Companies	60
Colombo Stock Exchange	10
Insurance Companies	3
<b>Total</b>	<b>1,391</b>

Source: Financial Intelligence Unit – Sri Lanka

Based on these assumptions and on the fact that the banking sector reflects the largest aggregated financial assets within the jurisdiction, WG deems the ML threat emanating on the banking sector as **Medium High**.

#### **1.4.2 Other Financial Sector**

Among the 12 categories considered for the Other Financial Sector, WG identified three categories of institutions, the LFCs, MVTS Providers and Informal money remitters (Hundi/ Hawala) as subjected to the ML threat in significant level.

##### **1.4.2.1 Licensed Finance Companies**

As the second largest sector in the financial system, LFCs are presumed to considerably impact the financial system and the economy. In the recent past, several LFCs have failed due to internal frauds, malpractices by company directors and senior management, mismanagement, and integrity breaches of the staff. Furthermore, several drug trafficking offending have led the criminal proceeds being laundered through finance companies including leasing of assets using part criminal proceeds. Fixed deposit facilities, followed by leasing facilities and pawn broking were among the most abused products by indicted launderers. Several instances of unregulated, unlicensed deposit taking were reported via companies formed, which signified presence of Ponzi schemes where regulator has frozen the assets and had taken regulatory actions against the directors and the top management under the Finance Business Act, No. 42 of 2011 (FBA). During the assessed period, LFCs have been involved in, directly or indirectly, with 5 ML indictments filed by the Attorney General. The sector has reported a considerable number of STRs to the FIU, while the FIU suspended 60 accounts maintained with the LFCs under the Financial Transactions Reporting Act, No. 6 of 2006 (FTRA). Furthermore, the analysis shows appreciable number of predicate offending via unauthorized finance companies. Considering these factors, the ML threat emanating from the non-bank financial sector (other financial institutional sector) is identified as **Medium High**.

#### 1.4.2.2 *Informal Money Remitters*

This category poses a more dominant ML threat, largely based on foreign exchange market pressures observed since 2019 and the significant depreciation in the LKR/USD exchange rate observed in March 2022. It is also identified as a conduit for informal fund transfers from trade-based activities. Therefore, the sector threat emanating into the national economy is viewed as significant. Due to absence of verifiable data, the size of this sector cannot be determined. Considering the high number of STRs received during latter part of the period assessed, large number of identified and suspended accounts, and the LEAs' identified and suspended accounts it was apparent that large amount of proceeds are in circulation in this sector. Hence, in view of the degree of ML threat associated with the sector, coupled with the absence of legal measures to counter the threat, the ML threat emanating from the informal money remitters (Hundi/Hawala) is deemed as **High**.

#### 1.4.2.3 *Money Value Transfer Service Providers*

There are only 3 formal MVTS Providers in the country: 2 mobile money operators and one non-mobile MVTS Provider. Although the mobile operators have policies and mechanisms in place, many incidents identified link this sector and its agents to predicate offending such as drug trafficking, fraud, scams and other MVTS linked abuses, which are reported by LEAs as involving MVTS agents retained by the mobile service providers. The agents sell multiple sim cards without adhering to Customer Due Diligence (CDD) processes or abuse the process to suit their motives. For the above reasons and the nature of the products delivered by MVTS Providers, the ML threat is identified as **Medium**.

#### 1.4.3 *Securities Sector*

The WG considered the ML threat in relation to the SBs and the PDs sub sectors. There are 28 SB companies in the equity sector. Total market capitalization of around 14 per cent of the national Gross Domestic Product (GDP).

Most importantly, stockbrokers are not identified as a sector that has carried out ML related activities. However, although there are significant number of STRs reported to the FIU in relation to share trading, no indication of involvement of stockbroking company could be seen. No ML cases were reported leading to indictments. Regulatory sanctions and compounding of penalties had been on shareholders and market manipulators and not by stockbrokers. Predicate offending linked proceeds that may have entered the share market via stockbrokers are presumed as relating to corruption, fraud, and scam related proceeds, however, no direct links have transpired during the assessed period. Investigations linked to PD activities had led to 10 suspensions of Central Depository System (CDS) accounts directed by the FIU under FTRA provisions. The complexity of the share market and the attention drawn by CDD may have limited the involvement of the sector to white collar offending. Although ML threat is not immediately visible, WG deems the sector to have consequences far reaching should there be cases that link with the ML predicate offending. The potential ML threat is categorized as **Medium Low** for the Stockbrokers.

PDs by its size, is around 0.3 percent of the total financial sector assets by 2021 (CBSL). The dealers are limited to 6 License Commercial Banks (LCBs) and 7 PD companies. There are several cases at present pending prosecution before the High Court, indicted for insider dealing including the infamous "bond scandal" related

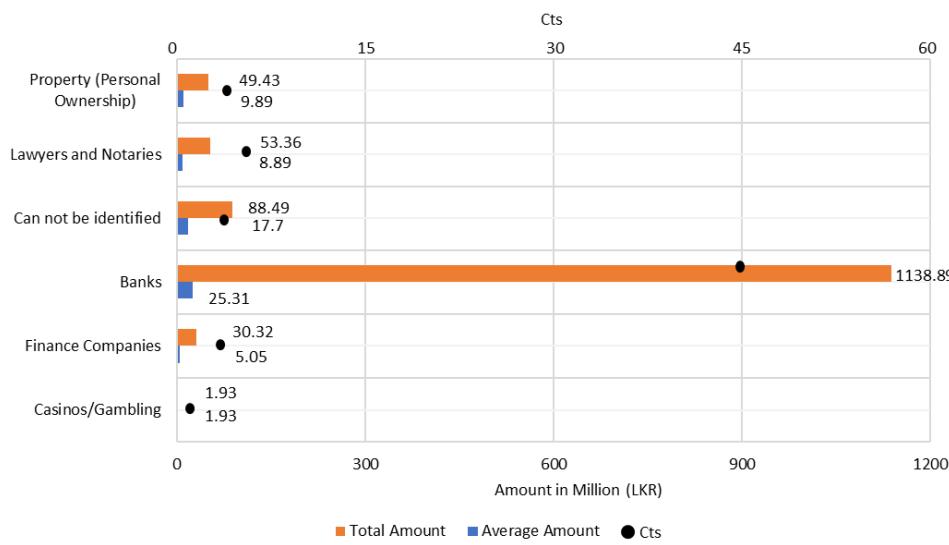
prosecutions implicating former officials of the Central Bank and primary dealerships as having colluded with market participants and price setters. Two participants, a bank and a standalone primary dealership had been suspended following the bond scandal related investigations. WG is guided by the much-publicized evidence gathered and the conclusions arrived at by a Presidential Commission of Inquiry during the assessed period. WG also identifies this sector as prone to ML threats where proceeds from the offending of corruption, fraud and scams could enter. The consequences of such would cause a decline in market activities, erode investor confidence and value fundamentals, further contributing to adverse economic conditions. Therefore, considering the consequences, the threat level for this sector is deemed as **Medium**.

#### 1.4.4 Insurance Sector

The insurance sector represents 3 percent of the total assets of the financial sector in Sri Lanka. In line with FATF Recommendations, WG has focused on identifying possible ML threat risk emanating from the longer-term insurance products that involve a one-time premium or multiple premia. In this context, a large segment of the products utilized in Sri Lankan insurance sector consist of life insurances. For the assessment, WG looked at the number of cases reported, involvement of insurance agents and brokering services, and linkages to predicate offending. Considering the limited range of longer-term products, and the limited ML threat exposure sans investigations/prosecutions, this sector is deemed as posing a **Medium Low** ML Threat.

#### 1.4.5 Designated Non-Finance Business and Professions

**Figure 10: Estimated Money Laundering Proceeds in Financial Sector and DNFBPs - Based on the Money Laundering Prosecutions, Investigations Concluded (Cts) (2015-2021)**



Sources: Attorney General's Department  
Auditor General's Department  
Criminal Investigation Department  
Colombo Crimes Division

##### 1.4.5.1 Casinos

From the DNFBPs, casinos and gambling sector showed criminal offending that links to ML threat and its estimated proceeds are around Rs. 1.93 million as shown in Figure 10. The AML/CFT supervision is carried out by the FIU. Although legislation to regulate the sector - the Casino Business (Regulation) Act, No. 17 of

2010 - was in place, the effective mechanism by way of Regulations was not in place until August 2022. The regulation of casinos is now vested with the Ministry of Finance and four casinos have been obtained licenses under the Casino Business (Regulation) Act as at end 2022. However, creating a unique situation in Sri Lanka, a large levy has been extracted from the casinos although license was not issued prior to 2022. Considering the low transaction values of the players, perceived exposure to foreign participants and presence of one LEA investigation resulting in ML prosecution (albeit a low number of STRs are received by the FIU) the WG places the level of ML threat emanating from the casino sector as **Medium**.

#### 1.4.5.2 *Dealers in Precious Metals and Precious Stones*

The National Gem and Jewellery Authority (NGJA) established under the National Gem and Jewellery Authority Act, No. 50 of 1993, regulates a large part of this sector. The FIU is ensuring the AML/CFT supervision and outreach activities take place. Presence of large value merchandise, transportability in small quantities, the presence of hawala and hundi activities, absence of ML reported cases and limited number of STRs reported albeit possibility of high value marked items being moved across the border, indicate potent ML threat factors. In view of these, the sector is rated as posing a **Medium** level ML threat.

#### 1.4.5.3 *Real Estate Agents*

The real estate sector is unregulated and poses as a conduit for drug trafficking and other fraud based criminal activities to launder proceeds of crime. Sector ML/TF risk is supervised to a limited extent by the FIU. However, the presence of reported cases linked with ML, predicates linked to drug trafficking, significant presence of cash intensive transactions, LEA originated suspensions related to ML investigations under PMLA provisions, questionable proceeds that do not match the known income of the suspects, multiple cases where assets are traced to organized criminal gangs involved in the sector, and inadequate CDD measures being engaged by the Notaries place this sector at a **Medium High** level of ML threat.

#### 1.4.5.4 *Notaries*

The Notaries carry out notarial execution of deeds and prepare related documentation within their capacity as gatekeepers in property transactions. WG observes that in several indicted cases for ML offending had involved deeds and notarial executed documents in purchase of real estate. However, no ML charges are framed against Notaries in these indictments. It is observed that Notaries sector is in a position to play a supporting role in carrying out property transactions that are widely deemed as a more famous mode of laundering of proceeds. Furthermore, the Registrar General's Department (RGD) records depict a large number of deeds registered annually during the assessed period, and where CDD on the transacted parties are not strictly being adhered, there is an increasing likelihood of the sector being misused. Accordingly, this sector threat element is deemed as **Medium**.

#### 1.4.5.5 *Accountants Engaged in Covered Activities*

The accountants are not charged in any ML case specifically, and the large audit firms have a robust presence and healthy regard towards practicing AML/CFT safeguards in the profession. In view of the lack of cases and the conditional engagement in the auditing practice absolving the burden of criminal association with the accountants place the sector as **Medium Low**.

#### 1.4.5.6 *Trusts and Company Service Providers*

The TCSPs are not identified in separate STRs nor the ML investigations during the assessed period. Due to the indirect component involved with formation of legal persons and legal arrangements and the fact that no case has been reported of their involvement, the TCSP sector is identified as forming a **Medium Low** level of ML threat.

#### 1.4.5.7 *Lawyers Engaged in Covered Activities*

Predicate offences relating to the sector have linked ML investigations to property transactions carried out by lawyers in their capacity as notaries and trust and company services providers. Information relating to direct involvement of Attorneys-at-Law in ML cases is not visible. Accordingly, the sector is viewed as having a **Medium Low** threat level.

### 1.5 Origin of the Money Laundering Threats

The strategic geographic location of Sri Lanka in the Indian Ocean, and its close proximity to India and Maldives and the southern trade routes to the Asian region countries pose as a significant ML threat. When considering the direct external threat relating to drug trafficking as a major predicate offence generating ML threat, the threat emanates from ports being used as onboarding/offloading points for transshipments from coastal locations in Afghanistan, Pakistan, Bangladesh, India, and from several Middle Eastern ports, where the narcotic hauls are transported via Sri Lanka for onward destinations.

The trade flow patterns and Foreign Direct Investment flows were reviewed by the WG to observe possible direction and size of foreign flows that may lead to indicate money laundering stemming from foreign destinations. According to statistics compiled by the Economic Research Department of the CBSL, trade flows and Foreign Direct Inflows during the period 2015-2021 show largest inflows related to trade arriving from the European Union (EU) group of countries, USA, UK, and India. Foreign Direct Inflows stem from India, UK, UAE, Canada, Australia, and USA. Largest outflows in terms of trade have gone to the jurisdictions of India, the EU Group, UAE, USA; while outward investments stemming from Sri Lanka were largely directed to India, Australia, and Bangladesh. The values related to trade and FDI are not significant and stretch over a period around the same geographical locations that are deemed as low ML threat destinations by literature and having strong ML controls in place.

However, direction of the ML threat is not fully conclusive due to absence of significant level of data on ML fund flows. TBML flows may determine some sense of direction and source countries. However, it is also not a conclusive source of evidence for direction of ML flows. DPS trafficking related activities detected show external factors controlling origin and direction remaining as an outflow of funds gained from sale of trafficking. Recent patterns of outward remittances, increased presence of hawala and hundi operators, weak laws and limited investigative scope affirm possibility of the outward-bound direction of ML proceeds.

## Figure 11: Money Laundering Threat Assessment



## 2. NATIONAL VULNERABILITY ASSESSMENT

### 2.1 Introduction

Sri Lanka has structured the AML/CFT regime of the country to combat possible national-level vulnerabilities in order to protect the financial system from being misused. This national vulnerability assessment focusses on evaluating the current AML/CFT regime as a defensive and reactive mechanism for combating ML.

Sri Lanka identifies the importance of assessing ML/TF risk periodically to strengthen the AML/CFT regime of the country in accordance with a sound risk-based approach in order to cater policy changes in local as well as global context due to technological innovations and ever-increasing growth of financial crimes. Therefore, NRA 2021/22 is used as an opportunity to identify national vulnerabilities and come up with strategies to combat ML through a proactive new strategy.

National vulnerability assesses the overall exposed vulnerability for ML which comes from the national combating ability as well as the vulnerability of different sectors of the economy in Sri Lanka. There is a possibility for criminals to abuse the institutions in these different sectors for their intended activities. The availability of a sound control mechanism to combat ML is vital in respect of individual institutions. Accordingly, different types of financial sectors i.e., banking, insurance, securities, other FIs as well as each segment of DNFBPs were considered for the assessment. The overall vulnerability assessment was conducted to achieve the following main objectives.

- Identify the overall vulnerability of Sri Lanka to ML.
- Identify the weaknesses and gaps in the ability of Sri Lanka to combat ML.
- Prioritize actions that will improve the ability of Sri Lanka to combat ML by strengthening AML controls at national level.

The overall national vulnerability level of Sri Lanka was determined at a **Medium** level. This is a slight decrease from the overall national vulnerability level of the previous assessment. The WG understands this improvement as a result of the various measures taken by Sri Lanka to address deficiencies which were identified in the Mutual Evaluation Report (MER) of Sri Lanka – 2015. This progressive trend is also reflected in the overall sectoral vulnerability.

The overall sectoral vulnerability has moderated in comparison to the previous NRA, due to quality of AML/CFT enhancements arising out of institutional compliance with the issuance of CDD Rules for FIs<sup>1</sup>, DNFBPs<sup>2</sup>, and Insurance industry<sup>3</sup>. Further, Circulars<sup>4</sup> and Guidelines<sup>5</sup> issued as and when necessary, increased awareness and implementation of an effective risk-based AML/CFT supervision also contributed to the decreased level

1 The Financial Institutions (Customer Due Diligence) Rules, No.1 of 2016

2 The Designated Non-Finance Business (Customer Due Diligence) Rules, No.1 of 2018

3 The Insurers (Customer Due Diligence) Rules, No. 1 of 2019

4 Circular 01/2021 (Implementation of AML/CFT measures on parties involved with online payment platforms), Circular 03/2021 (Additional measures to mitigate the emerging Money Laundering/Terrorist Financing risks during the third wave of the COVID-19 pandemic), etc.

5 Guidelines for Financial Institutions on CCTV Operations for AML/CFT Purposes (No.02 of 2021), Guidelines on Identification of Politically Exposed Persons (No.03 of 2019), etc.

of sectoral vulnerability. On the other hand, the national combating ability has declined marginally. The overall combating ability of the assessed areas is shown in Annex III. The WG believes that this marginal decline may be due to the limited improvements in the law enforcement process. Therefore, expeditious measures are to be taken to further strengthen the AML/CFT regime of Sri Lanka by implementing proposed amendments to the PMLA, FTRA, and the Convention on the Suppression of Terrorist Financing Act, No. 25 of 2005 (CSTFA). However, it is noteworthy that Sri Lanka has been able to maintain both the sectoral vulnerability and combating ability at a **Medium** level despite the slight changes in sectoral vulnerability and ML combating ability during the assessment period.

## 2.2 Assessment of National Combating Ability

### 2.2.1 Quality of Anti Money Laundering Policy and Strategy of Sri Lanka

The first national AML policy of the country was formulated following the results of NRA 2014 which was effective from 2015 to 2020. Sri Lanka has adopted the RBA in 2016 and has taken measures to reflect the NRA findings in the AML policy 2015-2020. Accordingly, new rules on customer due diligence have been introduced. In addition to the NRA, the FIU, SEC, and Insurance Regulatory Commission of Sri Lanka (IRCSL) conduct ML/TF risk assessments of each institution that come under their purview, in order to allocate resources for the risk-based examinations, while FIs and DNFBPs are required to undertake enterprise-wide risk assessments and take measures to identify and mitigate ML risks.

The NCC for AML/CFT which consists of 21 members representing relevant key ministries and institutions of the country provides necessary guidance for preparing the AML/CFT Policy of the country, and the NCC is chaired by the Governor of the CBSL. The NCC engages in policy related matters and effectively coordinates with the stakeholders. The WG is of the view that given the importance of participation of all the stakeholders in the national level coordination, a sound mechanism should be established assigning responsibilities for each member of the NCC. Establishment of a regulatory subcommittee and law enforcement subcommittee may enhance the effectiveness of NCC as well as AML regime of the country. The results of the 2021/22 NRA will provide the guidance to draft a new policy for 2023-2028 which will guide the efforts of Sri Lanka, strengthening the AML regime.

Considering the above, the quality of AML Policy and strategy of the country has been rated as Medium High.

### 2.2.2 Effectiveness of Money Laundering Crime Definition

The criminalization of ML is covered under the provisions of PMLA as amended by Act, No. 40 of 2011. Section 35 of PMLA provides a list of serious offences which are applicable for the crime of ML. The WG observed that Sri Lanka needs to expand the list of unlawful activities by including some of the predicate offences of FATF Recommendations. For example, the offences under the Inland Revenue Act, No. 24 of 2017 (IRA) are not included in the list, to be considered as an unlawful activity. Further, insider dealing has not been recognized as an unlawful activity in PMLA. These deficiencies will be addressed in the proposed amendments to the PMLA.

#### 2.2.2.1 *Penalties for Money Laundering*

The PMLA provides a wide range of dissuasive penalties for ML offences where a sentence is set out in section 3(1) of the PMLA. The High Court of Sri Lanka is vested with the exclusive jurisdiction to hear the cases under PMLA. According to above section if an accused is convicted for an offence of ML, High Court can impose a fine which shall be not less than the value of the property in respect of which the offence is committed and not more than three times the value of such property, or to rigorous imprisonment for a period of not less than five years and not exceeding twenty years, or to both such fine and imprisonment. The criminal penalties for ML offences in Sri Lanka are regarded as proportionate when compared to penalties for other serious offences.

Value of total penalties for ML cases is Rs.7.56 million and 1 imprisonment for the year 2022.

#### 2.2.2.2 *Applicability of Criminal Penalties*

Sri Lanka has a comprehensive mechanism to impose criminal penalties for both natural and legal persons. In most of the legislations, other than the natural persons, body corporates also have been made liable with a provision in case such body corporate is also concerted to commit the offence. In such an instance, the Board of Directors and other relevant officers of that company shall be made liable for the offence committed along with the body corporate, as the body corporate cannot form a mental element and it was the Board of Directors that should take decisions on behalf of the body corporate. Therefore, deeming provision has provided for such persons to absolve from that responsibility by proving at the trial that the offence was committed without their knowledge. There are two types of penalties available in the penal law of Sri Lanka which include imprisonment period and fine. In some legislations, the imprisonment period has been made mandatory and the court has no discretion in giving a lesser sentence. Another sentence is the death penalty, and the death penalty can only be imposed upon very limited offences in Sri Lanka. However, the death penalty is being converted to a sentence of life in prison.

#### 2.2.2.3 *Sentencing Tools for Judges*

The availability of a wide range of sentencing tools is useful to improve the quality of judgements. Therefore, a sentencing guideline which amalgamates the unlawful activities given in PMLA, could be issued which could enhance the understanding of Judges on sentencing ML offenders. This initiative will provide an opportunity to the courts to maintain a uniformity in sentencing. However, it has been observed during the assessment that unavailability of a sentencing tool has not affected the judgement.

Considering the above, the effectiveness of ML crime definition has been rated as Very High.

#### 2.2.3 *Comprehensiveness of Asset Forfeiture Laws*

A comprehensive set of Asset Forfeiture (AF) laws is a prerequisite of an effective investigation. This will enable the Competent Authorities (CAs) of a country to seize, freeze and forfeit proceeds and instrumentalities of crime. Therefore, AF laws should extend to the proceeds and instrumentalities of ML and its predicate offences as well as provide relief for *bona fide* third parties and ensure such parties are safeguarded. The AF procedure of Sri Lanka is set out in sections 7 to 16 of the PMLA, and those sections should be read with sections 3 to 4 of the PMLA. The profits derived from predicate offences are also subjected to AF within the scope of PMLA.

The LEAs have been provided with a legal basis to identify and trace the proceeds or property under the PMLA. This includes carrying out rapid provisional measures, such as seizing or freezing, to prevent the transfer or disposal of the proceeds. These measures include a range of AF tools, including criminal forfeiture, enforcement of foreign Non-Conviction Based (NCB) orders, and administrative forfeiture, consistent with domestic law. Further, Section 124 of the Code of Criminal Procedure Act, No. 15 of 1979 (CCPA) provides that Magistrate can assist investigations in this respect. Accordingly, Section 124 of the CCPA requires every Magistrate to whom the application is made on that behalf shall assist the conduct of an investigation by making and issuing appropriate orders and processes of the court, and may, in particular hold, or authorize the holding of, an identification parade to ascertain the identity of the offender, and for such purpose require a suspect or any other person to participate in such parade, and make or cause to be made a record of the proceedings of such parade. The above fact reveals that the AF framework of the country covers broader scope including proceeds, instrumentalities, profits, and property of corresponding value in order to provide a sound regime for the law enforcement authorities.

Further, the legal framework provides relief for *bona fide* third parties and such parties are safeguarded as well. After a comprehensive investigation is over, the investigating authorities can make an application according to the provisions set out in the PMLA and CCPA to court by conceding to uplift the freezing orders, if such property is found no longer required for any prosecutions.

Considering the above, the comprehensiveness of AF laws has been rated as Very High.

#### **2.2.4 Quality of Financial Intelligence Unit Intelligence Gathering and Processing**

The FIU is housed within the CBSL and is having sufficient operational independence and autonomy in accordance with international standards, and it is free from any undue political, government or industry influence or interference, to carry out its functions freely. The FIU has adopted a comprehensive mechanism to maintain the integrity of the staff. The potential candidates are screened before they are recruited and once the staff is allocated to the FIU, such staff members are screened using the screening tool used by the FIU. Once it is confirmed that the staff is free from negative/criminal records, they are required to sign a secrecy declaration form (confidentiality agreement) before the director, FIU. In order to improve and maintain expertise on ML and TF, the FIU staff frequently participates in specialized training/discussions conducted both locally and internationally.

**Table 1: Training/Discussions Attended by the staff of Financial Intelligence Unit**

	2018	2019	2020	2021	2022
Foreign Trainings/Discussions	30	20	13	19	20
Local Trainings/Discussions	10	16	3	10	7

Source: Financial Intelligence Unit – Sri Lanka

##### **2.2.4.1 Intelligence Management Process**

The FIU gathers financial information from RIs in terms of Sections 6 and 7 of the FTRA. The information comprises the periodical threshold-based Cash Transaction Reports (CTRs) and Electronic Fund Transfer

(EFT) reports and STRs. The RIs are required to submit STRs when such an institution has reasonable grounds to suspect that any transaction or attempted transaction may be related to the commission of any unlawful activity or any other criminal offence. Further, the FIU receives reactive STRs for which the FIU shares information with the requesting parties, to facilitate the investigations.

**Table 2: Suspicious Transaction Reports Reported to Financial Intelligence Unit and Information Requests made by Agencies**

	Category	2018	2019	2020	2021	2022
STRs received from RIs and Public	Reporting Institutions	775	1,434	1,963	3,713	1,444
	Public Complaints	20	89	93	112	37
STRs based on information requests by Stakeholders	LEAs, Intelligence Agencies and Competent Authorities <sup>(a)</sup>	227	1,281	1,561	871	500
<b>Total</b>		<b>1,022</b>	<b>2,804</b>	<b>3,617</b>	<b>4,696</b>	<b>1981</b>

(a) LEAs consist of CID, F&CCID, IAIID, CTID, etc.,  
Intelligence Agencies consist of SIS, CNI, etc.

Source: Annual Reports, Financial Intelligence Unit – Sri Lanka (2018 - 2022)

The FIU has implemented internationally recognized “goAML” system developed by the United Nations Office on Drugs and Crimes (UNODC) since February 2022 and functioned parallelly with the locally developed “LankaFIN” system in order to improve the quality of the intelligence management process. Further, by the end of 2021, the FIU had entered into Memoranda of Understanding (MOUs) with 12 domestic agencies<sup>6</sup> to exchange information thereby providing timely access to databases of other domestic agencies and commercial sources, including cross-border currency declarations. These databases are used for the analysis of reports submitted to the FIU. Further, based on the STRs received to the above systems the FIU continuously develops typologies and red flag indicators and shares with RIs for their awareness. Some of such typologies developed during the period from 2021-2022 are given in Annex IV and Annex V.

The Intelligence Management Division of the FIU analyses the reported STRs and refer to LEAs such as CID of Sri Lanka Police, Police Narcotic Bureau (PNB), Sri Lanka Customs, etc., as per the provisions of the FTRA. Such STRs being disseminated, include intelligence analysis reports prepared by the FIU.

**Table 3: Referring/Dissemination of Suspicious Transaction Reports during 2018-2022**

	2018	2019	2020	2021	2022
Law Enforcement Agencies (LEAs)	256	1,465	2,800	1,081	369
Regulatory Authorities (RAs)	61	9	80	92	68

Source: Financial Intelligence Unit – Sri Lanka

RIs have been submitting the threshold reports (CTRs and EFTs) and STRs to the FIU online through the “LankaFIN” system during the assessed period.

6 LEAs and Competent Authorities

**Table 4: Statistics on Periodical Threshold-based Cash and Electronic Fund Transfer Reports (Mn)**

Year	2017	2018	2019	2020	2021	2022
No. of CTRs (million)	5.62	5.74	5.25	4.61	5.72	7.64
No. of EFTs (million)	5.34	6.38	7.17	7.33	9.20	10.76
<b>Total (million)</b>	<b>10.96</b>	<b>12.12</b>	<b>12.42</b>	<b>11.94</b>	<b>14.92</b>	<b>18.40</b>

Source: Financial Intelligence Unit – Sri Lanka

Considering the above, the quality of FIU intelligence gathering, and processing has been rated as Very High.

### **2.2.5 Capacity and Resources for Financial Crime Investigations**

CID of Sri Lanka Police is the main investigator of ML, associated predicate offences and AF in the country. At the beginning of the assessment period, the Criminal Investigation Range was the only investigator for ML matters. However, Sri Lanka Police has taken measures to restructure the operations of the Criminal Investigation Range of the Sri Lanka Police by segregating into divisions, where five divisions namely CID, Counter Terrorism Investigation Division (CTID), PNB, Financial and Commercial Crime Investigation Division (F&CCID) and IAID, currently carry out investigations related to ML.

Considering the capacity and resources of the investigators, specific subjective training programmes, seminars, workshops and discussions have been regularly organized by the Sri Lanka Police, FIU and other local and international institutes to provide a sound knowledge of financial products, processes and financial crime and ML typologies and AF. Due to the COVID-19 pandemic situation prevailed in the country, all in-person training and public gatherings were cancelled by health authorities during that time. Therefore, officers participated in online training sessions. Further, the newly established divisions; F&CCID and IAID are in the process of developing the capacity of newly appointed officers in the divisions and providing resources for financial crime investigations.

#### **2.2.5.1 Identification of Assets**

Investigators have established a mechanism to identify assets without prior notice to the owner. This mechanism is used to identify assets of identified suspects and their related parties, at instances of suspected narcotics, human trafficking, fraud, cybercrime, etc. According to the powers vested under Section 12 of the PMLA, ML and AF investigators have powers to use compulsory measures to produce records for the search of persons and premises, for taking witness statements, and for the seizure and obtaining of evidence by obtaining a court warrant. Further, the investigators may access the records held by FIs through a court order or the direction of FIU.

#### **2.2.5.2 Investigations on Asset Forfeiture and Money Laundering**

The ML investigative agencies such as CID, F&CCID and IAID are aware of the work of ML investigators as well as AF investigators. However, the WG suggests improving the coordination among the different divisions of Sri Lanka Police and provide adequate training to improve the effectiveness of handling cases. Statistics on ML cases handled by different divisions of the CID are mentioned in the below table.

**Table 5: Progress of Investigations (2018-2022)**

No. of STRs disseminated to LEAs by FIU	1,664
No. of cases opened by LEAs	1,175
Investigations closed without further action	203
No. of indictments	12
No. of cases referred for prosecution	8
Investigations concluded and referred for action other than prosecution	21
No. of convictions	1

Source: Criminal Investigation Department

According to the World Justice Project, during 2022, the timeliness and effectiveness of criminal adjudication system has been below the regional and global average. The WG observed that there were low convictions during the assessment period, since the cases in the High Court have not been concluded due to the complexity of the cases and thereby delays in court process as well as the impact of COVID-19 pandemic situation.

The details on the portion of traced assets that were subsequently frozen during the assessment period are as follows.

**Table 6: Criminal Proceeds and Assets Suspended under the Prevention of Money Laundering Act**

Asset	CID		IAID	
	Quantity	Value (Rs million)	Quantity	Value (Rs million)
Lands & houses	87	1,121.5	Acres – 29.11, Houses - 05, Shops - 02	684
Vehicles	31	210.6	37	469
Fishing Crafts	7	16		
Gold			6.32 kg	105
Bank Accounts	401	87.8	113	169
Money		34.7	Rs. 84.5 million (in LKR) Rs. 37.5 million (in USD)	122
Others				7
<b>Total</b>		<b>1,470.6</b>		<b>1,556</b>

Sources: Criminal Investigation Department  
Illegal Assets Investigation Division

**Table 7: Asset Forfeiture Investigations in relation to Different Divisions of the Criminal Investigation Department during the Assessment Period**

Division	Number of Investigations
F&CCID	7
CID	45
IAID	9

Source: Criminal Investigation Department

Considering the above, the capacity and resources for financial crime investigations including AF, has been rated as High.

#### **2.2.6 Integrity and Independence of Financial Crime Investigators**

The Inspector General of Police (IGP) closely administers the conduct of investigators using Circulars. The responsible officer can initiate an investigation independently. Therefore, they conduct investigations into possible ML cases without political interference, social pressure, corruption, intimidation, or abuse of office. The AF processes are also instituted or terminated without interference, political or social pressure, corruption, intimidation, or abuse of office. Further, according to the World Justice Project, the effectiveness of the criminal investigation system, and the levels of lack of corruption and improper government influence in the criminal system, are above the regional average for 2022.

However, Transparency International Sri Lanka (TISL) is concerned that the lack of urgency in addressing allegations against police officers investigating major corruption cases, could have a detrimental impact on public trust in the justice system. Past incidents, including unwarranted contact between politicians and investigators, illustrate that interference by political authorities undermines the impartiality and credibility of investigations (TISL, 2022). Handbook on Police Accountability, Oversight and Integrity notes that "A culture, valuing loyalty over integrity, facilitates misconduct by keeping it concealed. Any attempt to enhance police integrity needs to be accompanied by measures to enhance transparency and stimulate a culture of openness" (UNODC, 2011). On the other hand, 73 per cent of the public had either a fair amount or a great deal of trust in the judiciary, whereas, in the case of the police, the figure was 57 per cent (Transparency International, 2019) which raises serious concern over the independence of the investigator. Sri Lanka was rated 102<sup>nd</sup> place on Transparency International's Corruption Perceptions Index with a score of 37 in 2021 (Transparency International, 2021).

Considering the above, the integrity and independence of financial crime investigators have been rated as Medium High.

#### **2.2.7 Capacity and Resources for Financial Crime Prosecutions**

The AGD functions as the prosecutor for ML and associated predicate offences, and AF cases in Sri Lanka. The main functions of the AGD have been divided into four divisions which include civil, criminal, state attorneys, and other divisions with a total number of around 200 staff members who are legal professionals and out of this total number, 30 number of staff members have been allocated to the ML unit of AGD. As at the date of

this report, there are over 58 on going ML cases handled by the AGD, which includes ML stand-alone cases as well as ML cases coupled with other offences. Further, as per the records maintained by the AGD, 58 indictments have been filed in relation to ML cases as of 31<sup>st</sup> December 2022.

#### *2.2.7.1 Access to Necessary Information*

The officers of the AGD can access all necessary documents, information, witnesses and/or other relevant individuals for the purpose of prosecution. In terms of the provisions of the CCPA, the Prosecution has a right to access all documents which ought to be produced in the trial. Further, the Prosecutors have the skills and knowledge to understand the flow of proceeds of crime and present such cases to the court. The provisions of the CCPA enable the Prosecutor to conduct consultations with the investigating officers before the commencement of the trial.

The provision in the law for the Prosecutor to get assistance of experts necessary to support the case is limited. In terms of the Section 393 of the CCPA, Prosecutors are not allowed to participate in the investigation processes and shall only give advice for the investigations. Therefore, there are no provisions in Sri Lankan law that the Prosecutors can directly assign the work to any forensic expert. Nevertheless, in terms of the CCPA, Prosecutors can assist the investigators and recommend assigning a forensic expert where necessary, to support the case. Therefore, this limitation will not affect the effectiveness of the investigation.

Considering the above, the capacity and resources for financial crime prosecutions have been rated as Medium High.

#### *2.2.7.2 Integrity and Independence of Financial Crime Prosecutors*

The Prosecutors of AGD act free from undue influence since they enjoy sufficient operational independence and autonomy, display high professional standards and act with integrity. According to the provisions set out in the CCPA, Prosecutors are not allowed to have consultations or meetings with any lay witnesses. Therefore, there is no capability of interfering with the integrity of the Prosecutors regarding any trial with this limited exposure to the witnesses in cases. However, some reports question the independence of the Prosecutor. For example, Centre for Policy Alternatives (2020) shows in a context where the existing framework places the AGD in constant contact with Politically Exposed Persons (PEPs), the functioning of the office will always be open to criticisms of political bias, regardless of the character or integrity of individual holders of the office. This happens due to the critical role played by the AGD as the legal advisor to the government. However, the professionalism of the staff of AGD will balance the allegations.

According to the World Justice Project, Sri Lanka's score for criminal justice has remained between 0.42 to 0.49 during the period from 2015 to 2022. In 2022, Sri Lanka's score for criminal justice was 0.42 which is above the regional average of 0.36 and the country was ranked second place in the region.

Considering the above, the integrity and independence of financial crime Prosecutors have been rated as Medium High.

## **2.2.8 Capacity and Resources for Judicial Process**

ML prosecutions are carried out in the High Courts. The High Court judges who conduct ML and associated predicate offences, and AF cases can function effectively in Sri Lankan context because the judicial function is adequately structured, funded, and staffed by persons with appropriate educational background, training, and skills in order to deliver a fair judgment. The support staff of the judges, the registrar and the staff are appointed considering their skills, qualifications, and experience, by the Judicial Service Commission (JSC) which is an independent commission in Sri Lanka.

The financial, technical, and other resources to perform the functions of the judges are facilitated by the Ministry of Justice in collaboration with the JSC.

### **2.2.8.1 Money Laundering Case Proceeding before the Court**

ML cases are tried before the High Court in terms of the provisions of the PMLA and CCPA. It is important to note that Sri Lanka has a victim-centric prosecutorial system. Accordingly, an indictment is served on the accused and if he pleads not guilty the Prosecutors prosecute him and if found guilty, the accused is sentenced in terms of Section 3(1) of the PMLA.

Currently, ML cases in relation to ML offences such as drugs, fraud, theft, criminal breach of trust, cheating, etc., are being heard in the court. However, the WG observed the lack of ML cases related to bribery and corruption being heard in the court.

### **2.2.8.2 Specialization in Financial Crimes**

In terms of the provisions of the Judicature Amendment Act, No.9 of 2018, permanent High Court at Bar was established to hear, try and determine matters in respect of financial and economic offences including ML, conspiracy and abetment to commit ML, bribery, offences under the CSTFA, and a wide array of offences such as theft, dishonest misappropriation of property, criminal breach of trust, dishonestly receiving stolen property, cheating, forgery, counterfeiting, falsification of accounts all of which are listed in the Schedule 6 to the above Act.

Three judges are nominated by the Chief Justice from judges of the High Court to hear these cases. The permanent High Court at Bar has jurisdiction in respect of offences committed in Sri Lanka as well as outside the territory of Sri Lanka. The Minister of Justice by order published in the Gazette, with the concurrence of the Chief Justice can designate permanent High Court at Bar for any province. The purpose of establishing the permanent High Court at Bar is to hold and conclude complex cases pertaining to grave financial crimes expeditiously. Also, under exceptional circumstances, these cases will be heard day-to-day to ensure expeditious disposal.

### **2.2.8.3 Skills of Judges**

The judges in Sri Lanka maintain the necessary skills and experience to adjudicate ML cases. An Attorney-at-Law can enter the judiciary as a Magistrate with a minimum of 5 years of active practice and higher education (Master's degree in Law) and they should pass a competitive examination to join the service. The judicial officers are being trained by Sri Lanka Judges' Institute (SLJI). Further, the Judges have participated for the following trainings conducted by SLJI, which focuses specifically on ML.

**Table 8: Money Laundering Related Training Programmes Organized by Sri Lanka Judges' Institute**

Year	No. of ML related training programmes held	Participants
2018	02	All High Court Judges
2019	01	All High Court Judges
2020	01	85 District Judges and Magistrates

Source: Ministry of Justice

Considering the above, the capacity and resources for Judicial processes have been rated as High.

#### **2.2.9 Integrity and Independence of Judges**

The Constitution of Sri Lanka of 1978 and the Judicature Act provide a comprehensive framework for protecting judicial independence and integrity. The Constitution also provides for the creation of the JSC, an independent institution vested with powers of administration over Courts of First Instance. Interference with the decisions or members of the JSC is a punishable offence, and members of the JSC are granted immunity for acts done in good faith in the performance of their duties (S.L. Const. Art. 111(K), 111 (L)).

Therefore, the Judges are able to act free from political or social influence and they enjoy sufficient judicial independence and autonomy, display high professional standards and act with integrity in delivering justice. Therefore, safeguards are in place to preserve the integrity of the judges.

Considering the above, the integrity and independence of Judges have been rated as Medium High.

#### **2.2.10 Quality of Border Controls**

Sri Lanka has identified some borders which are known as routes for smuggling trade goods, people, drugs, arms, etc., and can also be abused for smuggling cash. Certain instances have revealed that vessels have been involved in exchanging Kerala Marijuana from India and Sri Lanka sea borders. Due to the COVID-19 pandemic in India, Sri Lankans who were residing in India have arrived in Sri Lanka.

Sri Lanka has established a strong border control system to prevent illegal border passes. Illegal border passing is experienced in either sea-borne or air-borne modus centered on Sri Lanka. Sea-borne methods using fishing vessels have drastically dropped for years. The border control system has prevented a couple of instances of people being smuggled into Canada, EU, Australia, etc., during the past. Sri Lanka coast guard and Navy have successfully discouraged such attempts. Air-borne smuggling with fake documents has been significantly dropped with the establishment of new investigation units (Border Surveillance Unit, Risk Assessment Centre) adhered to the Department of Immigration and Emigration.

Sri Lanka Customs has intensified its surveillance on increasing foreign currency smuggling amidst the country's worsening forex crisis. Below are a few examples of instances where assets being carried were discovered and seized during border crossing.

- Sri Lanka Customs on December 24, 2021 seized foreign currency, including US Dollars, Euros and Sterling Pounds, worth over Rs. 65 million from seven individuals at the Bandaranaike International Airport.

- On January 29,2022, five Sri Lankans were arrested by the Narcotics Division for trying to smuggle foreign currency consisted of USD 95,000, Euro 18,000 and Saudi Riyal 37,000 out of the country to Dubai.
- On January 20, 2022, Customs arrested five more suspects for the attempted smuggling of foreign currency worth Rs. 42 million to Dubai, UAE. The currency consisted of USD 22,300, Euro 63,500, Saudi Riyal 292,000, Sterling Pound 8,725 and UAE Dirham 75,000 hidden inside luggage.
- A businessman had been taken into custody on November 23, 2021 when he attempted to smuggle foreign currency valued at over Rs. 14 million to Dubai, from the Bandaranaike International Airport. Rs. 10 million in Sri Lankan currency and USD 25,000 were recovered from the hand luggage of the suspect.
- Considering the above, the quality of border controls has been rated as Medium.

#### ***2.2.11 Comprehensiveness of Customs Regime on Cash and Similar Instruments***

Sri Lanka has established a mechanism where passengers entering/leaving Sri Lanka are required to declare their baggage in the Passenger Baggage Declaration Form, where currency, Travelers' Cheques, Drafts, etc., in their possession exceed a certain threshold. Such declaration of the currency and negotiable bearer instruments in the said Passenger Baggage Declaration is subject to regulation 2213/39 of 03.02.2021 published under the Foreign Exchange Act, No.12 of 2017 (FEA) which defines the threshold.

In an instance a passenger does not make a declaration or makes a wrong declaration as required above, it will be considered a violation of Section 107A of the Customs Ordinance and the currency and negotiable bearer instruments can be forfeited under the same Section.

There is an established requirement where every person importing/exporting goods to/from Sri Lanka has to make a Customs Declaration (CusDec) as specified in Customs Notification published in Extraordinary Gazette No. 1786/10 of 29.11.2012 issued under section 47 and section 57 of the Customs Ordinance. Failure to do so will be considered a violation of Section 107 of the Customs Ordinance and the goods can be forfeited under the same Section.

There are no specific provisions in the Customs Ordinance to stop or restrain currency and bearer negotiable instruments that are suspected to be related to ML. However, in terms of Section 12 read with Schedule B of the Customs Ordinance any article the importation/exportation of which is restricted or prohibited under any other law can be intercepted by Sri Lanka Customs and action can be taken either under the Customs Ordinance or under the law where the restriction/prohibition is made. Further, Section 25 of the FTRA provide for an authorized officer to seize and, detain any cash or negotiable bearer instruments which is being imported into, or exported from Sri Lanka in any form or manner, which is suspected to be derived from or intended to be used in the commission of an unlawful activity as set out in the FTRA.

The present practice of importing and exporting gems has been identified as a high-risk area in the transfer of foreign exchange from and to Sri Lanka. It is necessary to review the current procedure and the directions issued on the "Gem Declaration Fee" to avoid any abuse of facilitations offered to promote the international trading of precious stones.

The WG is of the view that a proper system has to be established for coordinated monitoring of the cross-border movement of foreign currency, precious stones and metals from and to Sri Lanka. Further, a more comprehensive and stronger legal framework must be established to enable Sri Lanka Customs to take necessary action in implementing AML/CFT law.

Considering the above, the comprehensiveness of Customs regime on cash and similar instruments has been rated as Medium.

#### **2.2.12 Effectiveness of Customs Controls on Cash and Similar Instruments**

Sri Lanka has taken various measures and procedures to inform all the passengers regarding any limitations on cash transportation, their relevant declaration/disclosure duties, and the legal consequences of any violation. The awareness related to limits of foreign currency and negotiable bearer instruments and the legal responsibility to make a declaration to Customs is given to the departing and arriving passengers by the following methods.

- Publishing relevant regulations in the government gazette.
- Displaying the relevant legal provisions at the key places of the airport.
- Announcing the relevant legal requirements in the aircraft just before landing during arrivals.
- Placing Passenger Baggage Declaration forms along the pathway of passenger movement.

According to the present legal provisions, the passenger is legally obliged to make a declaration to the Sri Lanka Customs where required. The Custom officers deployed at the airport use the available documents such as the passenger list submitted by the airlines and the flight details to screen passengers.

Sri Lanka Customs has sufficient human resources to screen and physical search passengers. For arriving passengers, Sri Lanka Customs has its baggage scanning machines and body scanning machine. At the departure area, Sri Lanka Customs is sharing the scanners operated by the airport security staff. Therefore, the WG is of the view that Sri Lanka Customs has to acquire technology and more equipment to detect unauthorized/illegal cash transportation by persons.

Sections 24 to 26 of the FTRA provide for currency reporting at the borders. These provisions include seizure or detention of cash and negotiable bearer instruments. Related offences and applicable punishments have been set out in Section 27 of the FTRA. However, the FEA does not identify offences. Therefore, it is observed that the controls imposed by the FEA cannot be effectively enforced by Sri Lanka Customs. Section 107A of the Custom Ordinance describes the controls on incoming and outgoing passengers that are to be implemented. Sections 47 and 57 of the Customs Ordinance also contain provisions related to the controls on the import and export of commercial goods.

Considering the above, the effectiveness of Customs controls on cash and similar instruments has been rated as Medium.

### 2.2.13 Effectiveness of Domestic Cooperation

The domestic cooperation mechanism of the country is developed around the NCC. The national-level issues are discussed at the NCC. The FIU meets regularly with Sri Lanka Police to share information to assist in investigations. The FIU also conducts external STR review meetings regularly with the nominated officers of AGD to share financial intelligence with LEAs. A separate unit of the CID has been placed within the CBSL premises under the FIU, to strengthen the coordination between the FIU and the LEAs. The FIU has entered into MOUs in terms of Section 15 (1) (r) of the FTRA with some domestic stakeholders to strengthen the domestic cooperation. As at the end of 2022, the FIU had entered into 11 such MOUs with domestic stakeholders as mentioned in the table below.

**Table 9: MOUs with Domestic Agencies as at 31.12.2021**

No.	Year	Institution	Signed date
01	2010	Sri Lanka Customs	14.05.2010
02	2016	Department of Immigration and Emigration	27.09.2016
03	2016	Department of Inland Revenue	19.10.2016
04	2017	Department for Registration of Persons	11.01.2017
05	2017	Sri Lanka Police	13.12.2017
06	2018	Securities and Exchange Commission of Sri Lanka	19.06.2018
07	2018	Insurance Regulatory Commission of Sri Lanka	01.08.2018
08	2018	Department of Motor Traffic	01.11.2018
09	2019	Condominium Management Authority	28.08.2019
10	2019	National Gem and Jewellery Authority	28.08.2019
11	2019	INTERPOL National Central Bureau for Sri Lanka	11.10.2019

Source: Financial Intelligence Unit – Sri Lanka

Sri Lanka does not have an established legal framework that allows for joint investigations by relevant investigative units. However, such investigations are undertaken by LEAs, where required. The main investigator of the country is Sri Lanka Police. However, in respect of the investigations which are conducted by different units of Sri Lanka Police, these units interact with each other within the institutional framework.

Other authorities such as Sri Lanka Customs, Child Protection Authority/Women and Child Bureau, CIABOC, etc., which conduct investigations on predicate offences, also cooperate when and where necessary. The FIU has established an effective cooperation between the FIU, reporting entities and investigators by introducing the internationally recognized “goAML” reporting system. Further, the AGD, investigators and the FIU collaboratively attend ML cases and the FIU shares information with Inland Revenue Department (IRD) and other regulatory authorities as and when necessary. Moreover, Sri Lanka Police obtains necessary information from relevant stakeholders to carry out investigations, by way of court orders. Pandora papers case is one of the well-known cases where effective domestic cooperation had been portrayed.

Considering the above, the effectiveness of domestic cooperation has been rated as High.

#### 2.2.14 Effectiveness of International Cooperation

Sri Lanka has established an active and effective mechanism to maintain international cooperation in relation to ML, associated predicate offences, related financial crime investigations and prosecutions and AF matters. The Secretary to the Ministry of Justice is the central authority responsible for MLA. The Ministry of Foreign Affairs acts as a conduit for the transmission of information. Requests for MLA are usually received by the Ministry of Foreign Affairs or directly from foreign missions. The legal regime pertaining to providing MLA in criminal matters in Sri Lanka was enacted initially in the year 2002 in terms of Mutual Assistance in Criminal Matters Act, No. 25 of 2002 and subsequently amended by Act, No. 24 of 2018.

**Table 10: Summary of Mutual Legal Assistance Requests**

Year	2016	2017	2018	2019	2020	2021
Requests received	25	26	5	12	6	12
Requests made	64	63	27	17	7	2

Source: Ministry of Justice, Prison Affairs and Constitutional Reforms

On the other hand, the FIU utilizes Egmont Secure Web (ESW) and has entered into 44 MOUs (as of August 2023) with foreign counterparts for information and intelligence sharing. Further, all the information requests sent to the FIU Sri Lanka by foreign FIUs, are being prioritized and responded with relevant information.

**Table 11: Information Sharing through Egmont Secure Web**

Year	2016	2017	2018	2019	2020	2021	2022
Requests received	27	50	24	40	15	33	27
Requests made	36	54	70	58	35	21	35

Source: Financial Intelligence Unit – Sri Lanka

The FIU also functions as a key stakeholder in helping LEAs in international cooperation in ML investigations. Further, Sri Lanka police cooperates with INTERPOL, ARIN-AP network, and the foreign Diplomatic missions in Sri Lanka.

Considering the above, the effectiveness of international cooperation has been rated as High.

#### 2.2.15 Availability of Independent Audit

Sri Lanka has established a sound regime of independent auditing practices by enacting the Sri Lanka Accounting and Auditing Standards (SLAAS) Act, No. 15 of 1995. The SLAAS requires auditors to conduct the audit and report to shareholders in accordance with Sri Lanka Auditing Standards (SLAuSs) and that all reporting entities are required to prepare the financial statements and present them in accordance with Sri Lanka Accounting Standards (LKASs/SLFRSs). The LKASs/SLFRSs represent the international financial reporting standards in the local context. Further, Section 154 of the Companies Act, No.7 of 2007 requires appointing an auditor and submitting the financial statements and audit report to shareholders annually for all limited liability companies. The mechanism established in Sri Lanka regarding the rotation of auditors is determined by the Code of Ethics issued by ICASL. Accordingly, Sections 290 and 149 state that in respect of

an audit of a public interest entity, an individual shall not be a key audit partner for more than seven years. After such time, the individual shall not be a member of the engagement team or be a key audit partner for the client for two years. During that period, the individual shall not participate in the audit of the entity, provide quality control for the engagement, consult with the engagement team or the client regarding technical or industry-specific issues, transactions or events or otherwise directly influence the outcome of the engagement.

The directions issued by the CBSL to the LBs state that the engagement of the audit partner shall not exceed five years and that the particular audit partner is not re-engaged for the audit before the expiry of three years from the date of the completion of the previous term. On the other hand, LFCs and auditors are required to adhere to the provisions of Corporate Governance Direction No.5 of 2021 issued under the FBA. Section 10.2 (d) (ii) of the direction states that the engagement of an audit partner shall not exceed five years and that the particular audit partner is not re-engaged for the audit before the expiry of three years from the date of the completion of the previous term. Further, LFC shall not use the service of the same external audit firm for not more than ten years consecutively. However, there is no provision to rotate independent auditors and audit firms every 5-7 years in the Sri Lankan context other than rotating the audit partner periodically in terms of the above-discussed guidelines/regulations.

The integrity breaches by independent auditors/audit firms are dealt with by the code of conduct of the Institute of Chartered Accountants of Sri Lanka (ICASL) through the Professional Conduct (Ethics Committee) of ICASL. Further, if any violations/breaches of accounting /auditing standards are identified by the SLAASMB, they will be reported to the Professional Conduct Committee which will deliberate each incident and propose the action plan to the Council of Chartered Accountants of Sri Lanka. The SLAASMB evaluates the disclosures of audited entities and independent auditors. The details on enforcement actions made by the SLAASMB is as mentioned in the table below.

**Table 12: Enforcement Actions made by the Sri Lanka Accounting and Auditing Standards Monitoring Board**

Year	No. of letters of warning	No. of cases referred to Attorney General	Letters issued for non-compliance
2017	2	3	185
2018	2	-	12
2019	2	-	15
2020	-	1	4
2021	1	1	12

Source: Sri Lanka Accounting and Auditing Standards Monitoring Board

Considering the above, the availability of independent audit has been rated as Close to Excellent.

#### **2.2.16 Level of Financial Integrity**

Sri Lanka has developed a comprehensive mechanism to maintain a high level of financial integrity. Accordingly, business entities and professions are required to adhere to practices of good corporate governance, tax compliance and a generally high level of business ethics, as evidenced by appropriate codes of conduct.

On the other hand, revenue officers are also required to follow a code of conduct such as responsibility, personal behaviour, rules and regulations, official duties, and non-discriminations. The tax framework of the country is developed assigning responsibilities to Sri Lanka Customs, Excise Department, and IRD under the relevant statutes. IRD is the main entity responsible for handling the inland revenue of the government.

The tax regime of the country requires a high level of tax transparency which requires natural and legal persons to provide extensive information about their income and assets to the IRD. Section 91 of the IRA requires a person who expects to derive an assessable income during a year of assessment to submit a statement of estimated income tax payable to the Commissioner General on the 15<sup>th</sup> of August every year. Further, as per Section 93, subject to Section 94, every person shall file with the Commissioner General a return of income for a year of assessment on the 30<sup>th</sup> of November of every year. Sections 35 and 189 of the IRA deals with tax avoidance and tax evasion. Sections 135(2), 166(1) and 180 deal with tax fraud.

Serious financial crimes including false tax declarations, failure to adhere to the codes of conduct, misleading financial records, and the existence of different books of accounts for tax purposes are dealt with in the provisions of IRA. Section 181 and 190 of the IRA deals with the false tax declarations and sanctions available to deal with such declarations.

**Table 13: Number of Serious Financial Crimes Identified by the Inland Revenue Department**

Description	2016	2017	2018	2019	2020	2021
False tax declarations	33	253	148	2	16	5

Source: Inland Revenue Department

**Table 14: Sanctions Imposed on Identified Serious Financial Crimes (Rs. million)**

Description	2016	2017	2018	2019	2020	2021
False tax declarations	1.6	2.9	21.1	0.1	116.9	-

Source: Inland Revenue Department

Financial crimes are offences in Sri Lanka. However, tax evasion is not a predicate offence under the AML/CFT regime of Sri Lanka. Therefore, LEAs do not have the power to access information held by the IRD when they investigate crimes related to ML.

Further, the SEC conducts investigations into any alleged violation on contravention to the provisions of the Securities Exchange Commission Act, No. 19 of 2021, and any regulation, rule, directive or instruction given thereunder. The SEC is responsible for taking necessary steps for ensuring the integrity of the securities market. Accordingly, the following actions have been taken by the SEC for non-compliance during the period from 2017 to 2022.

**Table 15: Actions taken by the Securities and Exchange Commission of Sri Lanka for non-compliance during the period 2017 - 2022**

Offense	Enforcement Action
Insider Dealing	6 Warning Letters
Market Price Manipulation	3 Warning Letters 3 Compounding
Failure to immediately disclose material information	1 Compounding 1 Conviction
Submission of false/fictitious financial statements to the SEC	1 Compounding
Other	4 Warning Letters

Source: Securities Exchange Commission of Sri Lanka

Considering the above, the level of financial integrity has been rated as Medium.

#### **2.2.17 Effectiveness of Tax Enforcement**

IRD has been given adequate resources to enhance its capacity. Sri Lanka has established a comprehensive legal framework, including the provision of adequate powers for obtaining information and an appropriate regime of sanctions to deter and penalize non-compliance with tax laws. Section 123 of the IRA provides a wide range of powers to the IRD to obtain information from taxpayers and Section 176 of the IRA provides a wide range of powers to the IRD to impose sanctions and penalties for non-compliance.

**Table 16: Tax Collection Efficiency of the Inland Revenue Department**

Description	2016	2017	2018	2019	2020	2021
Cost of Collection per 100/-	0.63	0.52	0.46	0.44	0.86	0.72
Cost of Collection per 100/-, excluding Value Added Tax, Nation Building Tax and Economic Service Charge on import	0.84	0.67	0.58	0.54	1.03	0.90

Source: Performance Report (2020), Inland Revenue Department

The IRD conducts tax audits regularly in order to improve voluntary compliance by detecting and distinguishing those who do not pay the right amount of tax. Such detection ensures the integrity of a self-assessment tax system.

**Table 17: Details of Tax Audits and Integrity of Tax Officers**

Description	2016	2017	2018	2019	2020	2021
Number of tax audits	7,790	1,221	5,685	9,470	788	1,477

Source: Inland Revenue Department

The IRD is empowered to take action for noncompliance with the provisions of the legal framework. Sections 35 and 189 of the IRA deals with tax avoidance and tax evasion. Sections 135(2), 166(1) and 180 deal with tax fraud.

**Table 18: Details of Fines and Penalties imposed by the Inland Revenue Department for False Declarations**

Description	2016	2017	2018	2019	2020	2021
Fines and Penalties (Rs. million)	1.6	2.9	21.1	0.1	116.9	-

Source: Inland Revenue Department

Considering the above, the effectiveness of tax enforcement of the country has been rated as Medium High.

#### **2.2.18 Formalization Level of Economy**

The economy of Sri Lanka has been structured in a way that the informal sector contributes a sizable portion of employment. WB (2020) reveals that around 70 per cent of the workforce of Sri Lanka is informally employed and there are generally three reasons to be concerned about high informality namely poverty, productivity, and public finance. International Labour Organization (2022) also states that almost two-thirds of total employment in Sri Lanka is in the informal sector. Department of Census and Statistics (DCS) (2021) also reveals that the total employment contribution to the informal sector in Sri Lanka in 2021 is 58.4 per cent. On the other hand, the DCS (2021) further adds that the Households and Non-Profit Institutions Serving Households sector has contributed 41.1 per cent of the gross value added of the economy in 2021. There is a limitation of laws and regulations requiring the formalization of economic activities of an informal economy.

Considering the above, the formalization level of the economy has been rated as Close to Nothing.

#### **2.2.19 Availability of Reliable Identification Infrastructure**

The Department for Registration of Persons (DRP) is the only institution vested with the authority to establish a National Persons Registry as an electronic data system and issue National Identity Cards (NICs). The DRP has been established under the Registration of Persons Act, No. 32 of 1968. DRP has a fully comprehensive national identification system which is primarily based on the demographic data of citizens who are of the age 15 years or above. A birth Certificate is the most convenient document to get the information for issuing the NIC. Basic information should get certified through the *Grama Niladari* Divisional Secretary and be fed to DRP main system. DRP is working towards introducing a new identity card with highly secured characteristics, called the Interim National Identity Card of International Civil Aviation Organization Standards soon to establish the identity of Sri Lankan citizens.

DRP also facilitates checking identity card details through the “NIC LOOK UP” to verify the authenticity of the NICs issued by the DRP. This system can be accessed by FIs for their CDD purposes. However, the FIs believe that the current system and practices are not ideal for their intended purposes due to the below reasons.

- Limitations in available information due to the system not being updated regularly.
- Automation is not possible due to the non-availability of Application Programming Interface in the DRP system.
- Limitations in accessibility to the DRP system due to lack of capacity of the system.
- Non-availability of direct links to access databases of Government Authorities such as IRD, Department of Immigration and Emigration, Department of Motor Traffic, Sri Lanka Customs, SEC, Department of Registrar of Companies (DRC), etc., which are relevant to conducting comprehensive CDD and verification by Banks.

- Issuance of a unique identification number at birth will build very accurate databases with useful history records while building confidence among citizens.

Considering the above, the availability of reliable identification infrastructure has been rated as Medium High.

#### **2.2.20 Availability of Independent Information Sources**

Sri Lanka has established a mechanism to make available independent and reliable information to RIs. Credit Information Bureau of Sri Lanka (CRIB) was established by the Credit Information Bureau of Sri Lanka Act, No. 18 of 1990 in order to facilitate shareholder lending institutions. The CRIB is engaged in collecting and collating, credit, and financial information on borrowers of lending institutions and providing credit information on request to shareholder lending institutions and simultaneously to borrowers to whom such information relates and to instill credit discipline in the financial sector. However, access to the information held by CRIB has been limited and RIs have limited reliance on the said information system.

Further, RIs can obtain information from the employer of their customers and can request customers to provide utility bills. The CDD rules which were issued to FIs, DNFBPs, and Insurance Companies (ICs) require the relevant institutions to verify the address of the customer if the residential address differs from the permanent address, with a utility bill, not over three months old or any other reliable proof of residence. The RIs also have subscribed to commercially available databases which can be used to strengthen the CDD process.

Considering the above, the availability of independent information sources has been rated as Medium.

#### **2.2.21 Availability and Access to Beneficial Ownership Information**

Registrar of Companies is responsible for incorporating legal persons (companies) in terms of the provisions of Companies Act, No. 7 of 2007. Accordingly, the incorporated companies under Section 120 require making available specified records for public inspection which include a certificate of incorporation, articles of association, share register, register of directors and secretaries, and particulars of the registered office. The records on shareholders, directors and secretaries and such information need to be up-to-date and accurate. The information so recorded can be obtained under Section 483 of the Act.

However, a comprehensive central depository is not available to collect information on Beneficial Ownership (BO) in Sri Lanka. During the CDD process RIs are required to obtain BO information. The FIU has issued the following guidelines to the RIs on the identification of beneficial ownership.

- Guidelines on Identification of Beneficial Ownership for Financial Institutions No. 04 of 2018.
- Guidelines for Designated Non-Finance Businesses on Identification of Beneficial Ownership, No. 02 of 2019.

Accordingly, several incidents of non-compliance have been identified during the assessment period in relation to the aforementioned Guidelines.

Despite the limitation of a central depository, LEAs and regulators have been able to obtain information on BO from the DRC to facilitate investigations as and when required. However, a mechanism is being implemented to obtain the BO information of corporations by reporting institutions and professions, to facilitate their customer due diligence requirements.

Trust Ordinance (Amendment) Act, No. 06 of 2018 introduced amendments to the Trust Ordinance, to include beneficial ownership information register for express trust maintained within Sri Lanka. The register is to be kept with the Registrar General and updated every three months to the greatest extent possible.

Considering the above, the availability and access to BO information has been rated as Medium High.

## 2.3 Sectoral Vulnerability

The overall sectoral vulnerability for ML was assessed considering the vulnerability of different financial and non-financial sectors of the economy. The overall sectoral vulnerability for ML has come down in 2022 because of various measures taken by Sri Lanka to improve institutional compliance. Accordingly, the sectoral vulnerabilities to ML as per sectoral assessments, are shown below.

**Table 19: Sectoral Vulnerability**

Sector	Rating
Banking	Medium
Security Stockbrokers	Medium
Security Primary Dealers	Medium
Security Units Trusts & Investment Managers	Medium Low
Insurance Sector	Medium Low
Casino	Medium
Real Estate	Medium
Gem and Jewellery	Medium
Accountants	Medium Low
TCSPs	Medium Low
Lawyers and Notary Public	Medium
Other Financial Institutions- MVTS Providers	Medium
Other Financial Institutions - EMS Providers	Medium
Other Financial Institutions – RDs	Medium
Other Financial Institutions - LFCs	Medium
Other Financial Institutions - SLCs	Medium Low
Other Financial Institutions - LMFCs	Medium Low
Other Financial Institutions – CSs	Medium Low
Other Financial Institutions – Samurdhi Banks	Medium Low
Other Financial Institutions - Unregulated Financial Institutions -MFIs	Medium
Other Financial Institutions - Unregulated Financial Institutions -Hawala/Hundi	High
Other Financial Institutions - Unregulated Financial Institutions -IPBs	Medium Low
Other Financial Institutions - Unregulated Financial Institutions - IMLs	Medium

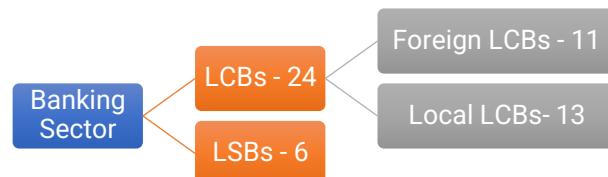
Figure 1: National Money Laundering Vulnerability



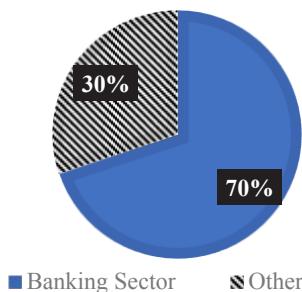
### 3. BANKING SECTOR VULNERABILITY ASSESSMENT

**Figure 1: Highlights of the Banking Sector Vulnerability Assessment (as at 31.12.2022)**

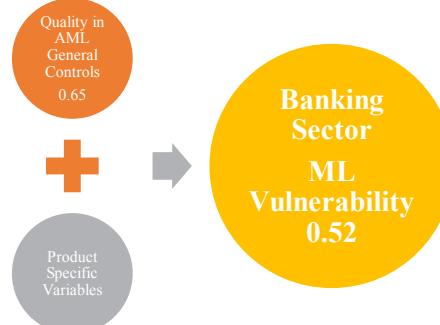
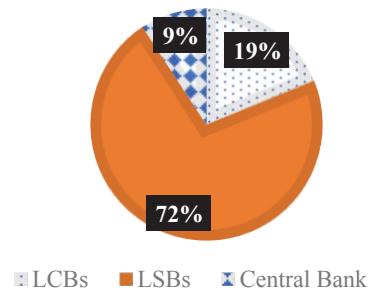
Composition of the Banking Sector



Composition of Assets of the Financial System



Composition of Assets in the Banking Sector



**Quality in AML General Controls (0.65)**



**Product Specific Variables**



### 3.1 Introduction

The banking sector of Sri Lanka is regulated by the Bank Supervision Department (BSD) of the CBSL and, it comprises LCBs and Licensed Specialized Banks (LSBs). The banking sector dominates the financial system of the country, and it accounts for the highest share of the total assets in the financial system. As per Central Bank Annual Report 2022, as of end 2022, the total assets of the banking sector is 61.9 per cent of total assets of the financial system. By end of 2022, the banking sector comprised 30 banks, i.e., 24 LCBs including 11 branches of foreign banks, and 6 LSBs.

### 3.2 Overall Sector Assessment

ML vulnerability of the banking sector is assessed based on the variables provided by the tool i.e., AML general control variables and product specific variables. Accordingly, the ML vulnerability encompasses weaknesses in AML general controls and product<sup>1</sup> specific controls. The general AML controls apply to the entire banking sector and the variables were assessed at sector level. This type of input variables relates to the quality and effectiveness of general AML controls, and therefore affects the vulnerability of all the products being assessed. Whereas the product specific variables affect only particular product. They therefore only impact the vulnerability of the product they are related to.

Accordingly, weaknesses and deficiencies in the areas of quality of the CDD framework arising from a low level of availability of independent information sources and BO information were identified. Further, enforcement of criminal sanctions is observed to be lower.

Considering the overall vulnerability of the products/ services offered by the banking sector, despite the lower prevalence in Sri Lankan banking system, private banking has been identified as the most vulnerable product. This is followed by foreign currency accounts, deposit products, correspondent accounts and electronic fund transfers, all having a medium level of vulnerability.

Accordingly, the overall banking sector vulnerability to ML is rated **Medium**.

### 3.3 Information Collection Methodology

Primary data capture for the assessment primarily involved the use of questionnaires, which were distributed to all banks. Secondary information was gathered from examination reports, supervisory findings, and other reports submitted by banks to the BSD. The assessment was carried out with the assistance of the BSD and representation from Banks.

### 3.4 Quality of Anti Money Laundering General Controls of the Banking Sector

The assessment of AML general controls' quality took into account of 13 general input variables, which are summarized in Table 1 below. A higher rating indicates stronger controls. These variables also impact the vulnerability of all banking sector products and the overall vulnerability of the sector as a whole.

1 The assessment includes products (e.g., deposit accounts), services (e.g., asset management), or channels (e.g., electronic banking). For simplicity, this document will subsequently refer only to products. This reference should be understood as products, services, or channels.

The ratings assigned to the aforementioned 13 AML general input variables are elaborated in detail below.

**Table 1: Anti Money Laundering General Input Variables – Banking Sector**

Banking Sector	Assessment Rating
A. GENERAL INPUT VARIABLES	
Availability and Effectiveness of Entry Controls	High
Comprehensiveness of AML Legal Framework	High
Effectiveness of Supervision Procedures and Practices	High
Availability and Enforcement of Administrative Sanctions	High
Availability and Enforcement of Criminal Sanctions	Medium
AML Knowledge of Banks' Staff	High
Integrity of Banks' Staff	Medium High
Effectiveness of Compliance Function	High
Level of Market Pressure to Meet AML Standards	Very High
Effectiveness of Suspicious Activity Monitoring and Reporting	High
Availability and Access to Beneficial Ownership Information	Medium
Availability of Reliable Identification Infrastructure	Medium High
Availability of Independent Information Sources	Medium

### **3.4.1 Availability and Effectiveness of Entry Controls**

The Monetary Board of the CBSL is the licensing body of banks as per the Banking Act, and through BSD, CBSL effectively carries out its licensing and entry control duties. CBSL and BSD have a clear and comprehensive framework for the licensing of banks including a fit and proper test designed to prevent criminals or their associates holding significant managerial positions in banks. Further, pre-employment vetting is conducted for all bank staff prior to recruitment. These conditions have not changed during the economic crisis period in 2022. Nevertheless, appropriate educational and professional certification for key directors and senior management and availability of adequate AML compliance control requirements are not included in the banking sector licensing framework. Further, availability of a convenient tool for BSD to carry out background checks on key directors and senior management is also lacking in the licensing process and there is no substantial difference in entry controls between foreign banks and domestic banks. Although there are controls in place, considering the above weaknesses, the availability and effectiveness of entry controls was rated as medium.

### ***3.4.2 Comprehensiveness of the Anti-Money Laundering Legal Framework***

Financial Institutions (Customer Due Diligence) Rules, No. 1 of 2016 (CDD Rule) which was issued by the Extraordinary Gazette No. 1951/13 dated January 27, 2016, focusing LBs and LFCs is the main rule on CDD aspect. The FIU also has issued directives, circulars, guidelines as per Section 2(3) of the FTRA to the banking sector to ensure its compliance. Accordingly, the comprehensiveness of the AML legal framework was rated as high.

### ***3.4.3 Effectiveness of Supervision Procedures and Practices***

In order to assess if the banks are complying with relevant legal and regulatory requirements, AML/CFT supervision is carried out by the FIU jointly with the regulator of banks, the BSD, according to the risk based on-site examination plan. The following year's risk based on-site examination plan is drafted based on the outcome of the ML/TF risk assessment conducted by the FIU on all licensed banks annually. The ML/TF risk assessment is conducted using the risk tool developed by the FIU with the technical assistance of International Monetary Fund (IMF). As conducting risk-based supervision examination on banks was initiated in 2016, it was not factored in the NRA 2014. Further, the FIU has taken initial steps to conduct AML/CFT consolidated supervision. In addition, FIU conducts AML/CFT related spot examinations and thematic examinations on banks. Supervisory authorities, i.e., BSD and FIU have well-trained and highly skilled examiners to ensure a high level of AML compliance in the banking sector. Based on the above facts, the effectiveness of AML supervision was rated as high.

### ***3.4.4 Availability and Enforcement of Administrative Penalties***

Section 19 of the FTRA provides for the imposition of penalties relating to non-compliances with AML obligations. Accordingly, the FIU has imposed penalties worth of Rs. 11,750,000 on banks during the year 2022 for violations of provisions of the FTRA and Rules issued thereunder. In instances where shortcomings were identified, such as inadequate AML/CFT enterprise-wide risk assessment, lapses in transaction monitoring systems and CDD process, banks were warned and required to take corrective actions to rectify the deficiencies identified. Subsequently, follow-up examinations were carried out to ensure implementation of recommended corrective actions. Considering the aforementioned facts, the availability and enforcement of administrative penalties was rated as high. Further, as per the feedback received from WG members including compliance officers, it can be determined that administrative sanctions are sufficient to positively influence bank management and staff behaviour.

### ***3.4.5 Availability and Enforcement of Criminal Sanctions***

It can be considered that Sri Lanka has a legal framework that has comprehensive criminal penalties in case of non-compliance with AML Laws and Regulations, as Section 28 of the FTRA prescribes criminal penalties for non-compliance with the FTRA and AML-related offences including offences such as corruption and collusion, and Subsection 3(2) of PMLA contains appropriate criminal penalties for ancillary offences. Based on the feedback received from WG members including compliance officers of banks, it can be concluded that criminal sanctions are effective and sufficiently dissuasive and have a positive influence on the response

and approach of top management of banks. Although banks have not been indicted on ML offences, there are cases where the bank's staff are the main witnesses to prove ML offences. On such instances the bank staff has shown heightened awareness of the penalties that the authorities would impose on violation of PMLA provisions. Further, due to the strict penalties, all banks do take proactive measures to prevent such situations including increased ML/TF training for their staff. Therefore, the availability and enforcement of criminal sanctions with regard to the banking sector was rated as medium.

#### ***3.4.6 Anti-Money Laundering Knowledge of the Bank's Staff***

The banks have developed extensive training programmes (both online and classroom) covering AML and CFT laws, policies, and procedures. The frequency of such training programmes can be varied from annual to multiple times during a year based on the size and the requirements of different banks and these programmes are conducted to different categories of bank's staff. Further, most banks have online E-learning platforms, where staff members are required to undertake continuous assessments to update their knowledge on AML/CFT. Also, the staff members have a good knowledge of and are regularly updated on domestic and transnational money laundering typologies, including those involved in the misuse of banks, their products and services. Further, the FIU has been conducting training and awareness programmes for all sectors, specifically for banks consistently to enhance specialized knowledge and skills of their staff. Considering the above facts, the AML knowledge of the bank's staff was rated as high.

#### ***3.4.7 Integrity of Bank's Staff***

Comprehensive training programmes have been developed and conducted by the respective banks to uplift the fraud awareness knowledge of the staff members. Disciplinary actions are taken on staff members who are involved in fraud or policy breaches in line with the relevant banks' internal policies. Further, the banks have reported 196 instances of internal theft and fraud to BSD for the year 2022. Loss amount of these reported events amounted to Rs. 1,364.12 million of which Rs. 1,061.22 million has been recovered by the respective banks as at 30.06.2023.

The FTRA contains sufficient provisions to deal with tipping-off, confidentiality and protection from civil and criminal liability. Further, the FTRA provides necessary protection to institutions (reporting entity and supervisory authority) and natural persons (auditor, director, partner, officer, employee, or agent) from criminal and civil liability in relation to any action carried out in terms of the Act or regulations, rules or directions issued thereunder, in good faith.

Also, banks have now implemented speak up platforms for employees and have created an environment where employees feel comfortable in speaking up regarding any issues or concerns. Further, mechanisms have also been created to ensure that staff are able to raise "whistleblowing" cases which are independently assessed and reviewed.

Therefore, considering the developments that have taken place since the last NRA, the integrity of bank's staff was rated as medium high.

### ***3.4.8 Effectiveness of Compliance Function of the Banking Sector***

Requirements under Section 14 of the FTRA facilitates that Sri Lanka has a sound and necessary regulatory framework to support AML compliance function. Accordingly, all LBs have an independent officer, mostly at the senior management level as the compliance officer. Further, the knowledge level of the compliance officer and the compliance staff are at a good level and the staff has received both internal and external training. Also, banks have developed internal controls to take disciplinary actions on staff members who breach AML policies and procedures.

Internal AML audits are performed in all banks in line with the existing legislation to test the procedures and systems for AML compliance in line with the provisions of the FTRA. Internal auditors also participate in the awareness sessions conducted by the FIU and separate awareness sessions are also conducted by the FIU for external auditors that help to enhance their knowledge on the FTRA and focus on their responsibilities.

At the same time, representing the entire sector, the banks have formed an Association of Compliance Officers of Banks aiming at ensuring a more effective compliance culture. It is evident that the banks attempt to establish fair and equal market conditions, “a level playing field” for all market players which will in turn support good compliance function of the banking sector.

Considering the above facts, the effectiveness of the compliance function of the banking sector was rated as high.

### ***3.4.9 Effectiveness of Suspicious Activity Monitoring and Reporting***

When assessing the effectiveness of suspicious activity monitoring and reporting which was rated as high, it was observed that all banks have implemented transactions monitoring mechanisms systematically, semi systematically or manually in compliance with the CDD Rules. As per CDD Rules, banks are required to monitor all business relationships carried out with their customers on an ongoing basis in order to ensure that all transactions conducted are consistent with the economic profile, risk profile and source of funds of the customer. Accordingly, customer information and transaction details are collected, recorded and monitored through the systems, and there are processes in place to create alerts which would assist banks in detecting suspicious transactions.

Further, the STR reporting process is well established at all banks and the STR scope is covered in training programmes conducted to banks' staff which enhances the awareness among all staff members. Additionally, the FIU provides red flags to banks, which encompass new typologies, enabling them to detect any suspicious transactions. Prevailing provisions of the FTRA provides protection for all staff members who file STRs which encourage the culture of submitting STRs.

### ***3.4.10 The Level of Market Pressure to Meet Anti Money Laundering Standards***

The level of market pressure to meet AML standards was rated as very high as in most instances banks are required to uplift their AML standards mainly due to pressure from its commercial partners such as correspondent banks at the time of establishing business relationships and on an ongoing basis. Furthermore, pressure from rating agencies, international lending institutions, foreign investors and most importantly industry pressure also contribute to the upliftment of the AML standards of banks. Further, certain overseas

clients may also require banks to uplift their AML standards prior to establishing business relationships with the investors and also in maintaining the relationships. The Banks' supervisor confirmed that checks and assessments of correspondent banking relationships are conducted based on specific requirements and when the need arises.

Also, all banks are concerned of the reputational risk and loss of business that may arise due to non-compliance with AML standards both locally and internationally, and therefore continue to invest and enhance the AML standards. Since 2020, FIU has been periodically publishing press releases that provide detailed information about penalties imposed for non-compliance with FTRA provisions. Considering the feedback from WG, discussions at the Banks' Chief Executive Officer's and Chairman's meeting with the supervisor, feedback from Financial System Stability Committee meeting, queries that FIU received periodically based on the press release on penalties imposed by the FIU and face to face progress review meetings between high-level officials of banks and the FIU, it can be stated that this initiative has increased reputational damage forcing banks to avoid non compliances.

#### ***3.4.11 Availability and Access to Beneficial Ownership Information***

As per the CDD Rules, banks are required to identify and take reasonable measures to verify the identity of the BOs of their customers, if any. Core Banking Systems used by banks have been updated to capture and maintain BO details. Banks collect BO details through self-declarations obtained at the time of establishing business relationship. Further, banks identify/verify BO details utilizing documents relevant to company incorporations<sup>2</sup> submitted by the account holders. Few institutions such as SEC and Registrar of Companies maintain shareholder details. Banks have access to such databases, however, dedicated access portal to such databases would be convenient.

Awareness has been given to all staff members of banks on the requirement of obtaining BO details. However, instances were noted where the knowledge/awareness among staff on this requirement is varied. Based on the above facts, availability and access to BO information was rated as medium.

#### ***3.4.12 Availability of Reliable Identification Infrastructure***

As per CDD rules, banks are required to identify and verify the identity of their customers. In this regard, banks collect information of an official personal identification or any other identification document that bears a photograph of the customer such as the NIC/valid driving license from citizens of Sri Lanka and a valid passport from foreign nationals. From legal persons information on Business Registration Certificate/Incorporation Certificate is obtained. Since 2021, banks have a process to check the customer information via dedicated web portal provided by DRP. In case of inconsistencies, access to DRP is available for banks to verify information.

Furthermore, it is observed that arrangements are proposed to provide access to databases of Department of Motor Traffic and the Department of Immigration and Emigration for verification of authenticity of Driving License and Passport, respectively.

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<sup>2</sup> Form 1, Form 40, Form 20, etc. under the Companies Act No. 7 of 2007.

Based on the above facts, availability of reliable identification infrastructure was rated as medium high.

#### **3.4.13 Availability of Independent Information Sources**

Although a reliable independent information source is available through CRIB, obtaining that information to verify the transaction patterns of customers is restricted as information can only be obtained in compliance with CRIB Act. It was also observed that if infrastructure is put in place to provide easy access for banks to independent and reliable information sources to enable them to verify the transaction patterns of customers, it would have a positive effect on customer information databases maintained at banks.

Considering the above facts, the availability of independent information sources was rated as medium.

### **3.5 Quality of Bank Operations and Internal Anti Money Laundering Policies and Procedures**

Based on the tool, the quality of bank operations and internal AML policies and procedures, which are pivotal in determining the overall effectiveness of AML general controls in the banking sector, can be influenced by a combination of 13 AML general control variables discussed above and intermediary variables<sup>3</sup>. These factors collectively impact the quality of AML general control in the banking sector.

Internal AML policies and procedures appear to be more robust compared to actual bank operations due to the direct involvement of the board of directors as well as top management in formulating policies and procedures. Although, the direct involvement of the top management could assist the maintenance of the quality of banking operations at a consistent high level, it is important to note that these operations can be influenced by various internal and external factors, unlike the internal policies and procedures which remain relatively unaffected.

Accordingly, considering both quality of internal AML policies and procedures and bank operations, the quality of AML general controls of the banking sector was rated as medium high with a score of 0.65.

### **3.6 Product/Service Vulnerability**

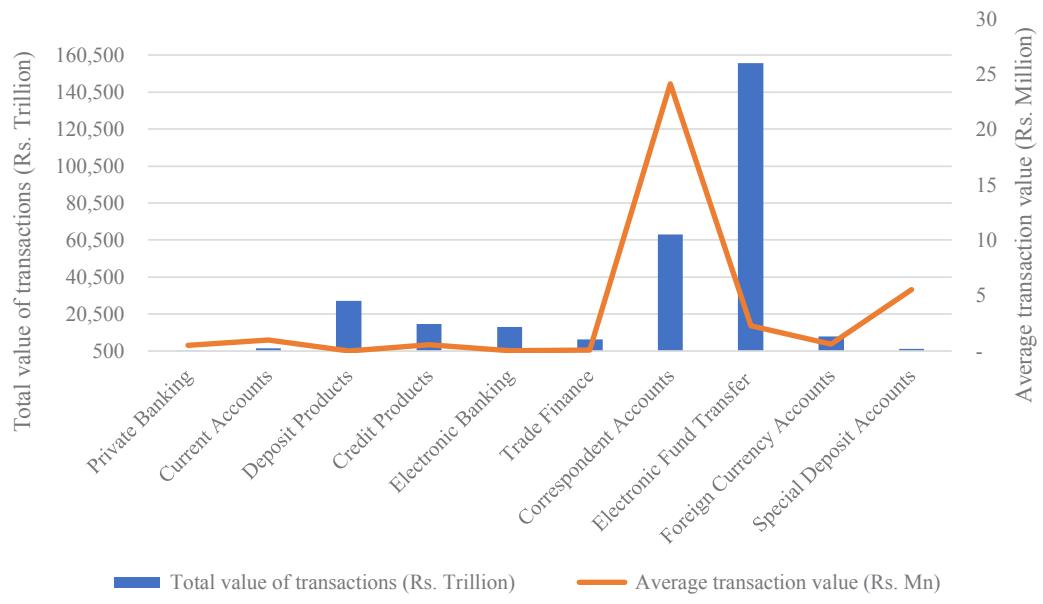
ML vulnerability emanating from products or services in the banking sector was assessed considering 13 product specific variables<sup>4</sup>. The sample consists of highest vulnerable products as per the previous NRA, to maintain consistency and the new product introduced to the banking sector, special deposit account. Accordingly, the sample included 10 products ranging from private banking, foreign currency accounts, deposit products, electronic fund transfers, correspondent accounts and special deposit accounts. All products other than private banking were offered by banks to its customers.

3 Intermediate variables are broad and high-level factors that cannot be assessed directly. They, therefore, need to be disaggregated into their constituent parts in order to be assessed. The module determines intermediate variables automatically, based on the ratings entered for the input variable.

4 Total size/value, Average transaction size, Client base profile, Existence of investment/deposit feature, Level of cash activity, Frequency of international transactions, Anonymous/omnibus use of the product, Existence of ML typologies on the abuse of the product, Use of the product in fraud or tax evasion schemes, Difficulty in tracing the transaction records of the product, Non face to face use of the product, Other factors such as delivery of the product through agents, Availability of product specific AML controls.

Private banking, foreign currency accounts, deposit products, EFTs, correspondent accounts and special deposit accounts were identified as products that are most vulnerable in the ML context and these products ranged around medium level vulnerability. Electronic banking, credit products and current accounts were identified as least vulnerable products in the ML context. These products ranged around medium low vulnerability. Figure 2 below shows the total value of transactions and average transaction size of the product sample during 2016 January - 2021 September.

**Figure 2: Total Value and Average Transaction Size of Products of the Banking Sector during 2016 - 2021**



Source: Licensed Banks

The following section provides a detailed discussion of the products that exhibit a medium or higher level of vulnerability, as derived from the sample.

### **3.6.1 Private Banking**

Private banking product is identified as priority banking in Sri Lanka, entails preferential rates, services and reward programmes. It is different from the context of its international banking business in Sri Lanka and it was identified as the most vulnerable product at medium level considering the inherent vulnerability endowed by the tool, high likelihood of PEP remaining among the client base and the amount of cash activity involved in the product. Also, the transaction volumes are comparatively higher irrespective of the low number of customers. However, all private banking customers are subject to normal CDD for which all other customers are subject to and there is no product specific additional CDD measures. Further, enhanced CDD is conducted on high-risk customers including PEP or if any possible ML/TF related risk factor is identified.

### **3.6.2 Foreign Currency Accounts**

Considering the facts explained below, the vulnerability of foreign currency account product was rated as medium. Based on the responses received from banks, the volume of transactions of foreign currency accounts is identified as medium level, the average transaction size as low level and the client profile of foreign

currency accounts is identified as a mix of high ML risk clients and low ML risk clients including employees working abroad (non face-to-face), making the client base of medium risk. Further, special mechanisms such as enabling banks to access NIC database, providing banks to get written confirmations from DRP where required, have been established to conduct CDD in respect of non-face to face Sri Lankan customers who are living or employed abroad.

### ***3.6.3 Deposit Products***

The deposit products are composed of a mixed clientele, since it caters to the mass market of individual customers, sole proprietorships, large corporates, associations, and clubs. Some are from various jurisdictions. Hence, the client base was rated as high risk in general and the potential for clients using this product to engage in ML does exist but limited. It has a high level of volume compared with the rest of the products in the sample. However, the average transaction size is found to be lower. Therefore, the vulnerability of deposit product was rated as medium.

### ***3.6.4 Electronic Fund Transfers***

Considering the below facts, the vulnerability of EFTs was rated as medium. Based on the responses received from banks, the volume of EFTs is found to be high due to the implications of mobility restrictions during COVID-19 pandemic forcing clients to engage in internet banking, average transaction size is found to be medium low in line with the spending pattern of the country and the client profile of the product is identified to be of medium risk. The product involves prominently non face-to-face transactions where customers can instruct banks in writing or electronically to transfer funds to a different account or bank. The small value transactions can mainly be done through Sri Lanka Inter Bank Payment System (SLIPS) and Common Electronic Fund Transfer Switch (CEFTS) systems, and this is mainly used by many institutions for the payment of salaries to their employees. These value transfers are retail in nature.

Further, there are several MVTS providers operating in Sri Lanka such as Western Union, MoneyGram, etc. These MVTS providers have formed partnerships with banks to utilize banks as their remitting partners. When the banks act as the money remitting partners, their licensing requirement is covered under the banking license and Know Your Customer/Customer Due Diligence (KYC/CDD) rules issued to LBs are applicable for the remittance service as well.

### ***3.6.5 Correspondent Accounts***

Most of the banks have correspondent relationships with other banks which have strong AML/CFT procedures and systems. All the banking transactions are subject to normal KYC/CDD regulations. Therefore, before establishing the business relationship, CDD is carried out. Enhanced CDD is carried out when dealing with correspondent banks that pose a higher risk, such as those owned by PEPs or banks from high-risk countries. Further, ongoing due diligence is carried out on these relationships. Similarly, banks in other countries carry out CDD on Sri Lankan banks when establishing correspondent banking relationships with them. Further, the average transaction size of correspondent accounts is found to be high, see the Figure 2 above. Considering the above factors, including the comprehensive CDD measures carry out, the correspondent accounts product was rated as medium.

### ***3.6.6 Special Deposit Accounts***

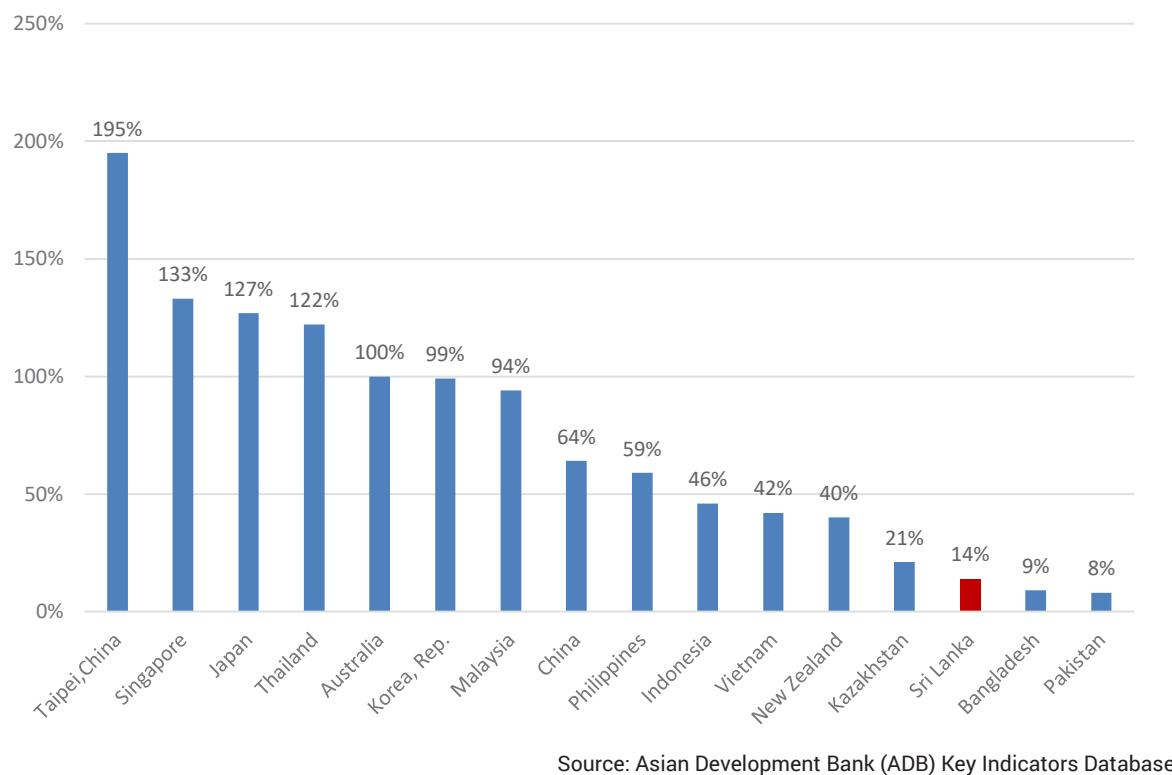
Special Deposit Account (SDA) which was rated as medium was introduced as a means of bringing foreign currency held by Sri Lankans in foreign countries to Sri Lankan banking system. A favourable tax system was introduced for SDA. However, normal CDD measures applicable to foreign currency accounts are applicable to SDAs as well. Accordingly, enhanced CDD is conducted on high-risk customers including PEPs or if any possible ML/TF related risk factor is identified.

## **3.7 Ranking of Priority Areas**

The assessment tool ranks the general input variables with respect to their impact on the AML controls and consequently the sector vulnerability. Accordingly, areas have been identified from the assessment that need to prioritize in implementing to strengthen AML controls within the banking sector and those are “Availability and Enforcement of Criminal Sanctions”, “Integrity of Banks’ Staff”, “Availability of Reliable Identification Infrastructure”, “Availability and Access to BO Information” and “Availability of Independent Information Sources”.

## 4. SECURITIES SECTOR VULNERABILITY ASSESSMENT

Figure 1: Market Capitalization of Securities Sector (as a % of GDP) of the Region in 2022



Source: Asian Development Bank (ADB) Key Indicators Database

### 4.1 Introduction

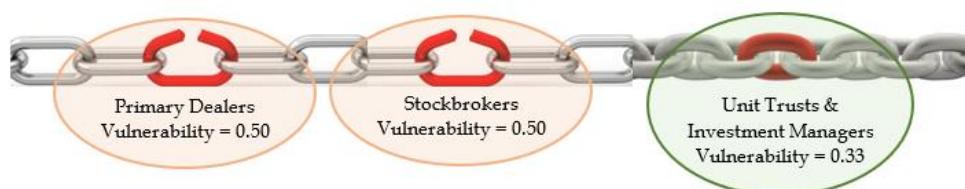
The securities sector of Sri Lanka is regulated by the SEC with the Colombo Stock Exchange (CSE) as its only licensed stock exchange. The CSE's Market Capitalization of USD 11.9 billion stood at 14 per cent of the GDP according to September 30, 2022, figures, which is low compared to those of most other emerging markets in the region (Figure 1). There are 3 main product types available to investors on the CSE, namely, equity, debt, and units of closed end funds. An analysis of the total volume of trading in all types of securities shows that around 99 per cent of the turnover is generated from equities, and the majority of the remaining 1 per cent from debt. Accordingly, SBs, PDs and Unit Trusts and Investment Managers (UTs and IMs) were selected for the risk assessment of the securities sector.

### 4.2 Sector Overall Assessment

The securities sector of Sri Lanka does not have many products on offer (e.g., Derivatives, etc.) compared to other developed markets. Even though Institution types such as Investment Managers, Wealth Managers, Unit Trusts, etc., are emerging in the securities sector compared to 2014 situation, the complex products they offer are not significant in value, compared to the value of predominant products in the securities sector which are equity and debt. Therefore, the vulnerability of the sector is mainly related to the quality of the general AML controls, compared to the inherent vulnerability.

The overall capital market vulnerability to ML is rated **Medium** (0.50) for PDs and SBs. For UTs and IMs assessed together, the overall vulnerability to ML is rated **Medium Low** (0.33). This assessment is also in line with the low number of ML convictions related to the securities sector in the country.

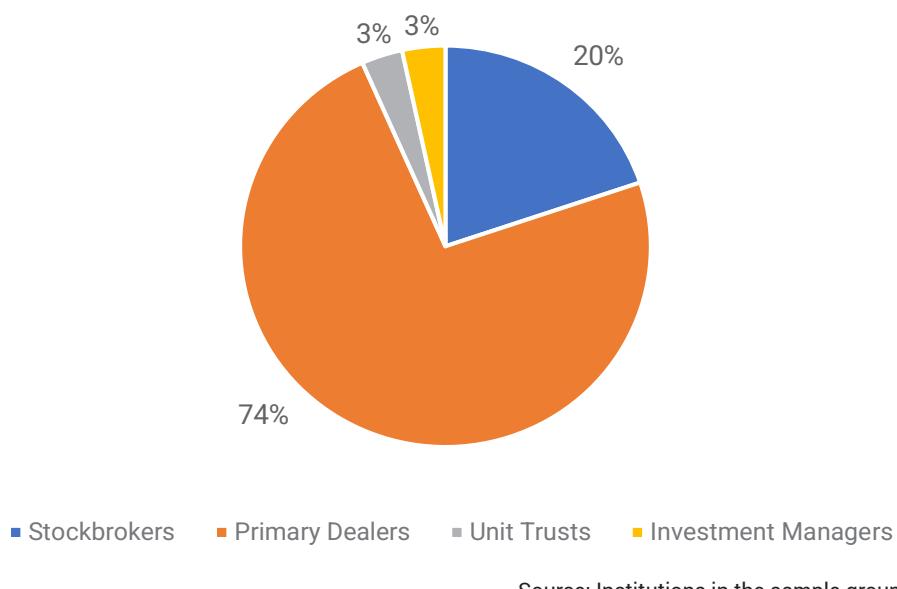
**Figure 2: Highlights of the Securities Sector Vulnerability Assessment**



### 4.3 Data Collection Methodology

A detailed questionnaire was used to gather data from a sample of 20 institutions which comprised of 8 SBs, 8 PDs, 2 UTs and 2 IMs, to assess 25 variables in the WB Risk Assessment Tool for assessing the quality of AML controls and inherent vulnerability of each Institution type. The sample was selected considering the portfolio value, annual holdings and Assets Under Management and it represented more than 64 per cent of the total turnover levels of the market (as of end 2021). The other required information on the regulatory framework, supervision and enforcement actions were collected from the SEC and CBSL (BSD and Department of Supervision of Non-Bank Financial Institutions (DSNBFI).

**Figure 3: Representation of Assets Under the Management of Securities Sectors in the Sample Group**



## 4.4 Quality of Anti-Money Laundering Controls

There is a high level of awareness and conformity by the securities sector Institutions on the AML legal and regulatory framework in Sri Lanka, which primarily comprises of following legal instruments:

- Prevention of Money Laundering Act, No. 5 of 2006 (PMLA)
- Financial Transactions Reporting Act, No. 6 of 2006 (FTRA)
- CDD Rules for FIs and other Rules and Regulations issued under the FTRA

In the Securities and Exchange Commission Act, No. 19 of 2021, SEC is identified as the licensing and supervising authority for SBs. In the Registered Stock and Securities (Primary Dealers) Regulations, No. 01 of 2009 (as amended) and the Local Treasury Bills (Primary Dealers) Regulations, No. 01 of 2009 (as amended), DSNBFI and BSD are identified as the relevant authorities for Non-Bank PDs and Bank PDs, respectively. FTRA provides AML regulatory powers to the FIU for SBs, PDs, and UTs and IMs under the definition of Institutions. There are adequate administrative and criminal sanction provisions available in the FTRA and other legislations applicable for all Institutions ranging from warning letters to imposing penalties and suspension of businesses.

The incidents of integrity failures involving securities firm staff is low, and there are appropriate mechanisms in place to protect the securities firm's staff regarding the reporting of STRs to the FIU and other actions relating to compliance with AML obligations. The AML knowledge of the staff at SBs and Bank PDs is at a reasonable level. However, the engagement of UTs and IMs with SEC on AML specific matters is minimum resulting in a low level of AML knowledge of the staff in that sector. SBs are engaged with FIU more than other Institution types due to their threshold and STR reporting process. Therefore, the compliance function of SBs is regularly reviewed by the FIU making its effectiveness high. Furthermore, Bank PDs benefit from the effective compliance function of their Banks. The compliance function of the UTs and IMs is less effective since they are not under the reporting purview of the FIU due to their relatively low footprint in the financial sector.

Most PDs have specialized AML monitoring systems which support risk profiling of customers. However, during 2015–2022, PDs have reported only 1 STR. SBs report monthly compliance reports to the SEC and CSE and have reported 16 STRs to the FIU during 2015-2022. UTs and IMs are currently not reporting STRs to the FIU and confirm certain information to the SEC through the monthly compliance reports. Bank PDs have systems for transaction/client profile recording and monitoring, automated systems to monitor transactions for AML screening, but SBs, UTs and IMs have less effective automated systems. Most Institutions have manual/automated systems for PEP monitoring and sanction screening, reviewed by Compliance Officer and subject to internal audit.

On a sector-wise analysis as per WB tool's model, overall vulnerability to ML is rated **Medium** for PDs and SBs, with a rating of medium for the quality of general AML controls and inherent vulnerability for both sectors. However, the WG is of the view that SBs had a slightly better rating for the general AML controls compared to PDs, but a slightly higher rating for the inherent vulnerability compared to PDs.

The key contributing factors for the above ratings are:

- Medium high level of comprehensiveness of AML legal framework for both PDs and SBs.
- Medium level of effectiveness for suspicious activity monitoring, reporting and compliance function for both sectors, where SB ratings are slightly higher than PDs.
- Medium level of availability and effectiveness of entry controls, quality of AML supervision, AML knowledge and integrity of staff for both sectors, where quality of AML supervision for SBs is rated better than PDs.
- Medium level of effectiveness of supervision procedures and practices, and availability and enforcement of administrative sanctions for both sectors, where SBs are rated better than PDs.
- For both sectors, availability and enforcement of criminal sanctions is rated as medium low, indicating an area to be improved. The enforcement actions taken by the SEC ranged from warning letters to suspensions, compounding, and convictions, which were mainly against insider dealing, market/price manipulation, and violation of SEC rules. The SEC has also imposed an administrative penalty of Rs. 500,000 on a Stockbroker for having contravened the provisions of the SEC Act.

For UTs and IMs, quality of AML controls is rated as medium, even though their ratings for effectiveness of suspicious activity monitoring and reporting, and effectiveness of compliance function are rated as medium low. However, as they are having medium low inherent vulnerability due to their low footprint in terms of total managed assets, final vulnerability of UTs and IMs is rated as **Medium Low**.

#### 4.5 Deficiencies / Gaps Identified and Proposed Actions to Rectify the Issues

1. AML/CFT related provisions could be incorporated in following regulatory instruments to enhance the coverage of AML/CFT supervision for the securities sector.
  - Securities Exchange Commission Act, No. 19 of 2021
  - Registered Stock and Securities Ordinance
  - Code of Conduct for Primary Dealers (2003)
  - Direction on Customer Charter for Primary Dealers and their Customers dated November 07, 2013
2. As the AML/CFT supervisor, FIU's supervision of the securities sector should be enhanced by providing adequate resources to the FIU (especially human resources). Also, knowledge of prudential supervisors (SEC / BSD / DSNBFI) should be increased to cover AML/CFT aspects during their supervisions. The possibility of undertaking the supervision of UTs and IMs by the CSE needs to be assessed.
3. Licensing and supervision of PDs were initially handled by the Public Debt Department of CBSL, and it was later assigned to DSNBFI in June 2016. Then in May 2018 it was further divided as Bank and Non-Bank PDs and assigned to BSD and DSNBFI, respectively. This segregation created a lack of attention for supervision of PDs in non-prudential areas like AML/CFT among BSD and DSNBFI.

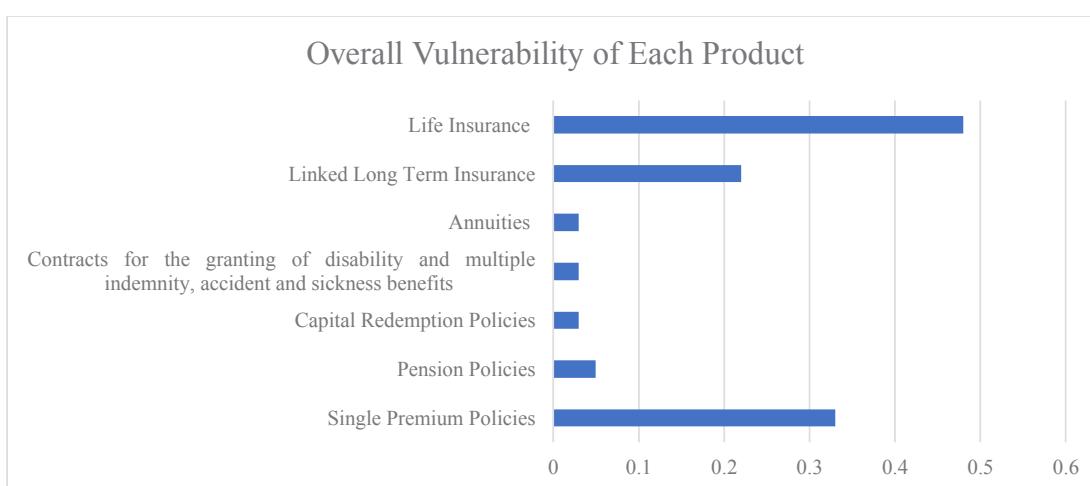
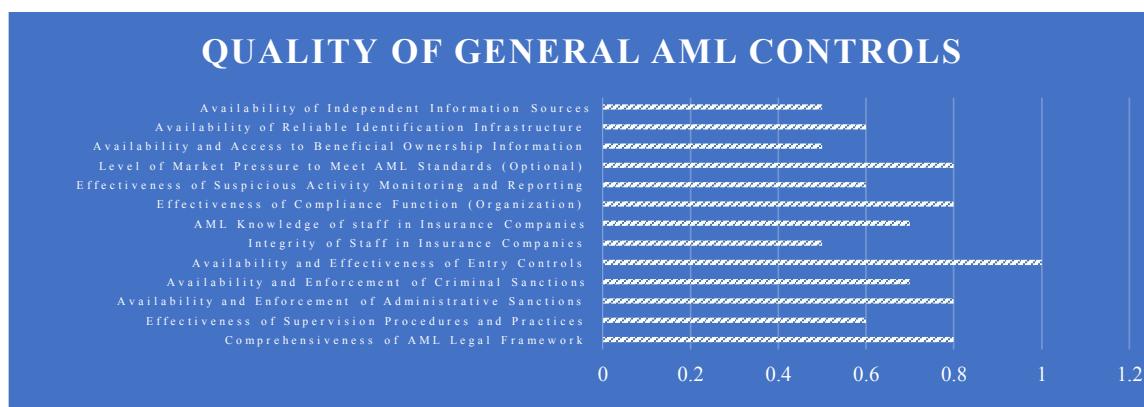
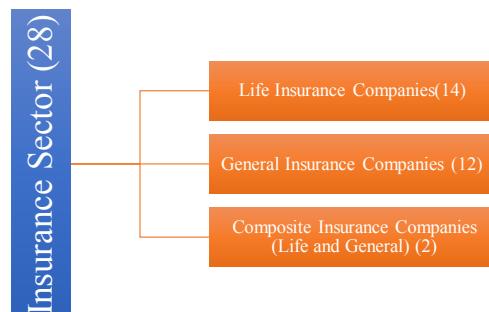
4. Administrative sanctions provisions in relation to non-compliances with obligations pertaining to AML/CFT could be included in the sector supervisors' legal framework, and enforcement of administrative sanctions could be increased by the sector supervisors BSD and DSNBFI.
5. Even though the supervision is segregated among BSD and DSNBFI for PDs within CBSL, licensing for new PDs is not clearly set out in the relevant regulations.
6. There is a considerable gap between Bank PDs and Non-Bank PDs in the effectiveness of compliance functions due to operating structure (Bank PDs being more compliant than Non-Bank PDs).
7. Specialized systems to identify suspicious transactions must be implemented and relevant staff should be trained in the securities sector to increase the effectiveness of suspicious activity monitoring and reporting.
8. With the perceived low risk of the securities sector, cost of conducting KYC and requirement to promote investments to the country, the possibility of applying simplified KYC process for the securities sector Institutions could be considered.
9. Inclusion of securities sector Institutions in the shared KYC project would also reduce the cost and effort of conducting KYC for the customer onboarding, thereby allowing the Institutions to attract more customers and investments.

#### **4.6 Challenges in Data Collection and Actions for Better Analysis in Future**

The main challenge in collecting the data was the unavailability of statistics in the securities sector according to the classification required by the assessment tool/methodology. The systems available with the Institutions are mainly for trading purposes. Hence, the data available could not be directly mapped with the requirement of conducting the assessment.

## 5. INSURANCE SECTOR VULNERABILITY ASSESSMENT

Figure 1: Highlights of the Insurance Sector Vulnerability Assessment



Quality of General AML Controls	0.6
<b>INSURANCE SECTOR VULNERABILITY</b>	<b>0.39</b>

## 5.1 Introduction

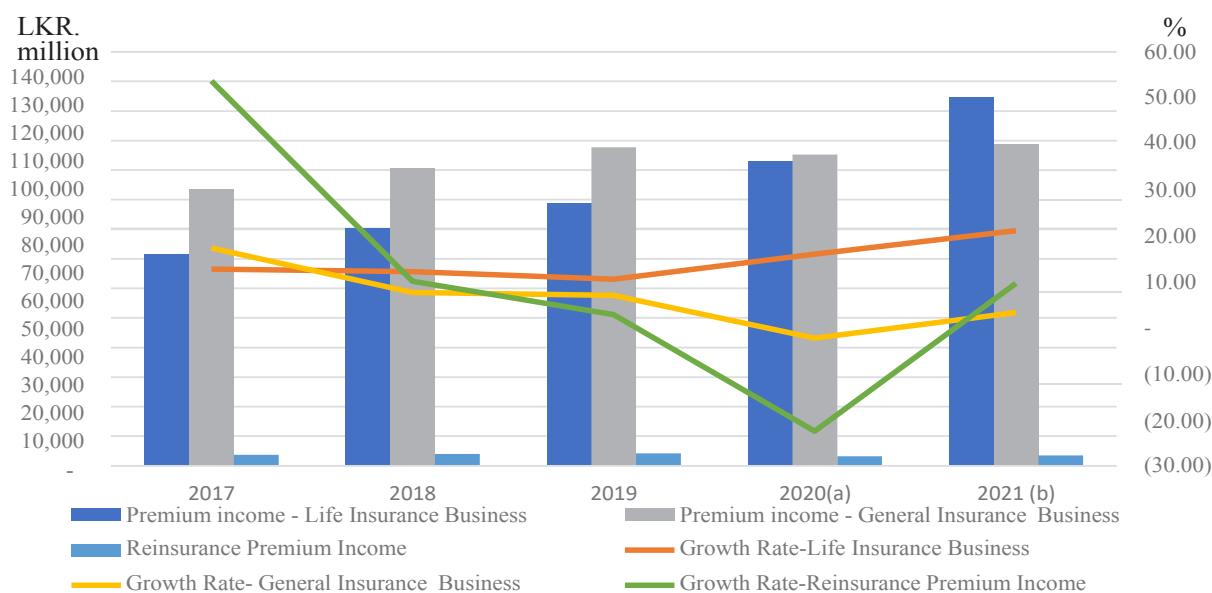
IRCSL is responsible for the development, supervision and regulation of the insurance industry in Sri Lanka under Regulation of Insurance Industry Act, No. 43 of 2000, (RII Act) as amended by Act, No. 23 of 2017. At end of 2022, the insurance industry of Sri Lanka consisted of 28 insurance companies with 14 life insurance companies, 12 general insurance companies and 2 composite insurers carrying on both life insurance business and general insurance business. The National Insurance Trust Fund also comes under the purview of IRCSL. By the end of 2022, 77 insurance brokering companies were operating in the market.

The total asset portfolio of the insurance industry amounted to Rs. 888,377 million in 2021 which is only 3.4 per cent of the total assets of major financial sectors of Sri Lanka.

Total Gross Written Premium (GWP) generated by the insurance industry amounted to Rs. 257,580 million in 2022 and demonstrated a growth rate of 10 per cent compared to 2021. Life insurance business recorded GWP of Rs. 135,367 million and industry grew by 9 per cent. GWP of the general insurance industry recorded an increase of 12 per cent with a premium income of Rs. 122,212 million during 2022 against the premium income of Rs. 108,760 million recorded in 2021.

Insurance penetration which is expressed by the GWP as a percentage of GDP stood at 1.39 during 2021. The penetration of life insurance business and general insurance business were 0.74 and 0.65 respectively. Insurance density, which is stated as the ratio of premium to total population has increased from Rs. 9,502 in 2020 to Rs. 10,539 in 2021.

**Figure 2: Premium Income and Growth Rate of the Insurance Industry**



Source: Statistical Review 2021, Insurance Regulatory Commission of Sri Lanka

IRCSL implemented the Risk-Based Capital (RBC) regime in 2015. Insurers started to fully adopt the regime in 2016 and must maintain a minimum RBC ratio. The regulator also mandates the compulsory segregation of life insurance and general insurance businesses and for all insurers to list on the local stock exchange to improve transparency, except those whose parent companies are listed on a recognized stock exchange. However, few insurers are yet to fully comply with this regulation.

For the assessment of insurance sector's vulnerability to money laundering, only life insurance sector/products were considered due to the close to non-existent exposure to ML/TF risk posed by general insurance products.

## 5.2 Methodology used for Information Collection

A questionnaire was used to collect information from all insurance companies. Accordingly, all insurance companies provided the requested information and information was collated by the IRCSL for the assessment.

## 5.3 Overall Sector Assessment

The following product categories have been considered for AML control variables and inherent vulnerability variables:

- Life Insurance Products
- Linked Long Term Insurance
- Annuities
- Contracts for the Granting of Disability and Multiple Indemnity, Accident and Sickness Benefits
- Capital Redemption Policies
- Pension Policies
- Single Premium Products

The overall ML vulnerability for the insurance sector was assessed as **Medium Low** with a score of 0.39. NRA - 2014 considered both life products and non-life insurance products, however, only life insurance products were considered for the NRA 2021/22.

### 5.3.1 Quality of General Anti-Money Laundering Controls

#### 5.3.1.1 Comprehensiveness of Anti-Money Laundering Legal Framework

Insurers (Customer Due Diligence) Rules, No. 1 of 2019<sup>1</sup> - Extraordinary Gazette No. 2123/14, May 13 of 2019 was issued for the insurance sector covering ML and TF risk management which includes controls and policies, compliance, audit and training, foreign branches and subsidiaries, using new technologies, CDD including CDD in general, timing of verification, enhanced CDD, on-going CDD, existing customers, CDD for legal persons and legal arrangements, Non-Governmental Organisations (NGOs), NPOs or charities, customers from high risk countries, PEPs, reliance on third-parties, record keeping, customer screening, etc. Further, FTRA has

<sup>1</sup> Under the powers given by the FTRA, the FIU initially issued "KYC – CDD Rules for insurance industry" during 2008/09. In 2019, it was repealed and Insurers (Customer Due Diligence) Rules, No. 1 of 2019 - Extraordinary Gazette No. 2123/14, was issued on May 13 of 2019.

provisions regarding CDD, record keeping, STRs, tipping-off and confidentiality, etc. Considering the above areas covered by CDD Rules and FTRA and additional provisions of PMLA and CSTFA, comprehensiveness of AML legal framework was rated very high.

#### *5.3.1.2 Effectiveness of Supervision Procedures and Practices*

FIU provides resource/technical assistance to conduct joint supervision for the insurance sector as per the annual supervision plans prepared by IRCSL. Although the risk of ML/TF of the sector is very minimal compared with other financial sectors, the supervision process for the insurance industry needs to be much more improved with more onsite inspections.

**Table 1: Summary of Joint Supervisions and Prudential Supervisions on Insurance Companies with/conducted by Insurance Regulatory Commission of Sri Lanka**

	2014	2015	2016	2017	2018	2019	2020	2021	2022
Joint Supervisions with IRCSL					01	03	02 (01 Remote)	03	03
Prudential Supervision by IRCSL	07	02	05	03	03	03	01 (Remote)	02 (Remote)	01

Sources: Insurance Regulatory Commission of Sri Lanka  
Financial Intelligence Unit – Sri Lanka

Therefore, effectiveness of supervision procedures rated medium high.

#### *5.3.1.3 Availability and Enforcement of Administrative Sanctions*

FTRA provides for administrative sanctions including imposing penalties and suspension of businesses and IRCSL is empowered to issue directions, warnings letters to insurance companies, suspension of license, cancellation of license, etc., in the event insurers violate the provisions of RII Act, rules, determinations, and circulars.

**Table 2: Suspensions and Warnings issued by Insurance Regulatory Commission of Sri Lanka**

2022	<ul style="list-style-type: none"> <li>No suspension was imposed by IRCSL during 2020. However, the suspension imposed on a takaful insurance company, in year 2009, continued during 2022.</li> <li>The Commission decided to warn the Principal Officer of an insurer for violating Direction #18 by writing back unpresented claim cheques in the year 2019. In terms of Direction # 18, dated 22nd February 2019, all insurers carrying on long-term insurance business are prohibited from transferring unclaimed benefits to shareholders, with effect from the financial year ended 31st December 2018.</li> <li>The Commission decided to warn the Chief Financial Officer of an insurer for neglecting his duties as the Chief Financial Officer by allowing/approving payments of dividend which was prohibited by the Commission.</li> </ul>
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2021	<ul style="list-style-type: none"><li>The suspension imposed on a takaful insurance company in year 2009 continued throughout the year 2021. Although the said insurance company has settled all claims, other than few claims which are the subject matter of litigation, the claim settlement process could not be concluded in view of such court cases.</li></ul>
2020	<ul style="list-style-type: none"><li>No suspension was imposed by IRCSL during 2020. However, the suspension imposed on a takaful insurance company, in year 2009, continued during 2020.</li></ul>
2019	<ul style="list-style-type: none"><li>After considering the deteriorating financial status of an insurance company, where its financial viability was in serious doubt suspended its registration to carry on both Long Term and General Insurance Businesses, from 20th July 2017 till 2nd April 2019.</li><li>An insurer continued with a reinsurer with ratings below IRCSL prescribed ratings, therefore, IRCSL issued a Warning to the said insurer for non-compliance with the aforesaid Reinsurance Terms and Conditions.</li><li>An insurer which has been already directed to refrain from obtaining facilities from Banks without the prior written approval of IRCSL in 2012 has carried out two transactions with regard to obtain loan facilities without IRCSL's approvals. Therefore, IRCSL issued a warning to the company for the above two violations.</li></ul>
2018	<ul style="list-style-type: none"><li>IRCSL has issued a Direction, in year 2015, to an insurer prohibiting them from obtaining services from any related party without obtaining prior written approval from the Commission. However, as the company has obtained such services without first seeking approval of the Commission, a warning was issued to all Directors and the Principal Officer of the company.</li></ul>
2017	<ul style="list-style-type: none"><li>IRCSL has issued a Direction to an insurer requiring them to furnish Monthly Returns with effect from August 2017 within 21 days from the end of each month. However, the company has continued to not submit the same and IRCSL warned the company for violating the provisions of the Act, particularly the direction issued.</li></ul>
2016	<ul style="list-style-type: none"><li>An insurance company was suspended from 25th July 2016 to 15th August 2016 since the company failed to demonstrate compliance with the required solvency margin amount.</li><li>The Insurance Board of Sri Lanka (IBSL)* has suspended another insurance company, from 4th October 2016 to 25th October 2016, for failing to fulfill the requirements set out by IBSL and to demonstrate compliance with Solvency Margin (Risk Based Capital) Rules, segregation requirements etc.</li></ul> <p>* <i>The Insurance Board of Sri Lanka (IBSL) changed its name as the IRCSL from 2017 onwards.</i></p> <ul style="list-style-type: none"><li>IBSL has warned the members of IBSL of an insurance company for providing false and inaccurate information in their quarterly returns submitted to IBSL.</li><li>In terms of Section 57 of the Act, IBSL has issued a Direction to an insurer in 2015, requiring them to furnish Monthly Returns within a period of 15 days from the end of each month. However, the company has failed to submit same for the month of April 2016 and IBSL has warned the company for violating the provisions of the Act, particularly the direction issued previously.</li></ul>

2015	<ul style="list-style-type: none"><li>No suspension was imposed by IBSL during the year. However, the suspension imposed on a takaful insurance company, in year 2009, continued during 2015.</li><li>A warning has been issued to an insurance company for entering into a facultative reinsurance arrangement with a reinsurer violating the compulsory cession requirement specified in Section 31 (1A) of the Act.</li><li>IBSL has issued several Directions to an insurer with regard to winding up.</li></ul>
2014	<ul style="list-style-type: none"><li>No suspension was imposed by IBSL during the year. However, the suspension imposed on a takaful insurance company, in year 2009, continued during 2014.</li><li>Directions were issued by IBSL to two insurance companies in terms of Section 57 of the Act, for violating Solvency Margin Rules and these companies were required to furnish returns monthly in addition to the Quarterly Returns.</li><li>IBSL warned an insurance company for violating a previous Direction issued by the Board by incorporating a subsidiary company without the prior written approval of IBSL. IBSL once again warned the same insurance company for violating two Directions issued previously, one such warning is for incorporating a subsidiary company without the prior written approval of the Board and the second warning is for issuing insurance policies to persons within the group of companies of the insurer without having received the full premium as at the commencement date of cover.</li></ul>

Source: Annual Reports 2014-2021, Insurance Regulatory Commission of Sri Lanka

Therefore, availability and enforcement of administrative sanctions was rated very high.

#### 5.3.1.4 Availability and Enforcement of Criminal Sanctions

Availability and enforcement of criminal sanctions was rated medium high mainly due to the provisions available in the PMLA, CSTFA and insurance legal framework for effective criminal sanctions including imprisonment and penalties. But no criminal sanctions have been taken to date.

#### 5.3.1.5 Availability and Effectiveness of Entry Controls

A company wishing to conduct insurance business in Sri Lanka is required to obtain a license from IRCSL prior to carrying on business. The RII Act and rules have set out criteria for registration of insurers.

Further, the applicant company has to submit shareholder details to IRCSL, and any further changes made to its shareholding (even after granting license) shall also be informed to IRCSL.

**Table 3: Summary of New Registrations of Insurance Companies and Brokers**

	2014	2015	2016	2017	2018	2019	2020	2021	2022
New Registration of Insurance Companies Applications	12	4	-	-	-	-	1	-	1
New License of Insurance Companies Granted	8	3	-	-	-	-	-	-	1
Registration of New Insurance Brokering Companies	-	1	5	9	4	4	10	10	7
Registration of New Insurance Brokering Companies Granted	-	1	3	5	4	4	3	10	7

Source: Annual Reports 2014-2021, Insurance Regulatory Commission of Sri Lanka

Therefore, availability and effectiveness of entry controls was rated medium high as the provisions of RII Act and other rules highly control the entry to the insurance sector<sup>2</sup>.

#### 5.3.1.6 Integrity of Staff in Insurance Companies

Even though IRCSL will peruse the details provided by directors and key management personnel such as Principal Officer and Specified Officer to ascertain whether they are fit and suitable to discharge their duties, all insurance companies do not carry out a vetting process for all staff when recruiting. But insurance companies carry out disciplinary actions on any staff members involved in fraud or policy breaches in line with their internal policies. During 2021, IRCSL has revised a Direction directing persons registered under the RII Act (insurers, brokers and loss adjusters) to refrain from employing persons, in any capacity of employment, whose services have been terminated on the grounds of financial misappropriation or fraud. However, in the event of termination of a person is carried out by an insurer, broker, loss adjuster, such persons are required to follow due process, especially follow the principles of Natural Justice prior to such decision to terminate is taken.

2 A person who wishes to carry on insurance business in Sri Lanka is required to obtain a license from IRCSL prior to carrying on business. RII Act and rules have set out criteria for registration of insurers. Further, the applicant company has to submit shareholder details to IRCSL, and any further changes made to its shareholding (even after granting license) shall also be informed to IRCSL. IRCSL is empowered to issue directions, warnings to insurance companies, suspension of license, cancellation of license etc. in the event insurers violate the provisions of the RII Act, rules, determinations and circulars.

**Table 4: List of Actions Regarding Key Management Personnel by  
Insurance Regulatory Commission of Sri Lanka**

2022	-
2021	<p>The Commission after having examined show cause letters issued to an insurer was of the firm view that the said insurer has failed to satisfactorily justify/reason as to why the Chief Executive Officer (CEO) of the said insurer should not be removed from his prevailing position based on the allegations against him, in terms of Section 57 of the RII Act. In view of the above, the Commission directed the insurer to immediately remove the said CEO from the said position.</p> <p>In a similar situation, the Commission has directed another insurer in terms of Section 57 of the RII Act to remove its Specified Officer from the said post with immediate effect as he had been acting without due care, neglecting his statutory role in terms of Sections 94 and 32 of the RII Act while functioning as the Principal Officer/Specified Officer</p>
2020	-
2019	IRCSL observed that an insurer has been conducting its affairs in a manner that is detrimental to the national interest and prejudicial to the interests of its policyholders, IRCSL issued Directions to the insurer under Section 57 of the Act, out of which one Direction was issued in respect of removal of its Principal Officer and the Chief Financial Officer.

Source: Annual Reports 2014-2021, Insurance Regulatory Commission of Sri Lanka

Also, insurance companies regularly update a list of “black-listed” insurance agents maintained at Insurance Association of Sri Lanka for which all insurers have access.

Considering above factors, integrity of staff in insurance companies was rated medium high.

#### *5.3.1.7 Anti-Money Laundering Knowledge of Staff in Insurance Companies*

Majority of insurance companies have developed and conducted training programmes covering AML and CFT laws, policies, procedures. The training material is available to the staff to refer when carrying out their work. In addition, FIU regularly conducts training and awareness programmes for the financial sector. Therefore, AML knowledge of staff in insurance companies was rated medium high.

#### *5.3.1.8 Effectiveness of Compliance Function (Organization)*

All insurance companies have a documented internal compliance policy which has considered the levels of risks such as volume, nature of products, client base, clients' profiles, cross border transactions under the CDD Rules. Further, all insurance companies have appointed a senior management level officer as the AML/CFT compliance officer and are provided competent supporting staff and all insurance companies are required by the regulator to conduct internal and external audits. In addition to the above, compliance policy of insurance companies has provisions for actions on their staff for breaching the compliance policy. Therefore, effectiveness of compliance function (organisation) was rated very high.

#### 5.3.1.9 Effectiveness of Suspicious Activity Monitoring and Reporting

Compared with other financial institutions, STRs reporting by insurance companies are minimal.

**Table 5: Suspicious Transaction Reports submitted by the Insurance Sector**

	2018	2019	2020	2021	2022
No. of STRs reported by Insurance Sector	-	11	11	27	3

Source: Financial Intelligence Unit - Sri Lanka

The importance of raising STRs is continuously communicated to the insurance companies through awareness and training programmes. Therefore effectiveness of suspicious activity monitoring and reporting were rated medium.

#### 5.3.1.10 Level of Market Pressure to Meet Anti-Money Laundering Standards

Expectations of foreign reinsurers for insurance companies to meet international AML standards and the importance of an insurance company's reputation in a sector which has a low penetration have prompted insurance companies to meet AML standards in the market. Therefore, level of market pressure to meet AML standards were rated very high.

### 5.4 Product Inherent Vulnerability

For the assessment of inherent vulnerability, WG categorized life insurance sector's products in to seven categories, namely, life insurance (individual & group), linked long term insurance, annuities, contracts for the granting of disability and multiple indemnity, accident and sickness benefits, capital redemption policies, pension policies, single premium products and used seven inherent variables<sup>3</sup> to assess and compare product vulnerability.

<sup>3</sup> Inherent vulnerability factors include total value/size of the product, use of agents, client base profile of the product, availability of investment type policy, level of cash activity, availability of cross-border use of the product, other vulnerable factors of the product.

**Table 6: Summary of Inherent Variable Factors for each Product**

	Life Insurance	Linked Long Term Insurance	Annuities	Contracts for the granting of disability	Capital Redemption Policies	Pension Policies	Single Premium Policies
Size of the sector/industry	High			Low			Medium low
Use of Agents	High			Low	Medium low	Low	
Percentage of customers who pose higher risk	Low risk			Very low risk			Medium risk
Availability of investment type Policy	Available and prominent	Available		Not available			Available
High cash intensive product/services				Medium low			
Frequency or % of international transactions				Low			
Anonymous/Omnibus use of the product				Not available			
Existence of ML typologies on the abuse of the product	Exist but limited			Does not exist		Exist but limited	
Use of the product in insurance fraud or tax evasion schemes				Does not exist			
Difficulty in tracing the transaction records of the product				Easy to trace			
Non face-to-face use of the product				Not available			
Others				Does not exist			

Life insurance product category is the largest contributor of the life insurance sector. Even though the statistics analyzed during the assessment indicated high level cash intensiveness, majority of the life insurance products are regular premium policies with low exposure to PEPs, non-residents and high-risk jurisdictions. Therefore, the product inherent vulnerability of life insurance products (individual and group) was rated medium. Even though single premium products have higher susceptibility to be used for money laundering, due to the low level of cash intensiveness and minimal number of transactions with PEPs, non-residents and trusts, single premium policies' product inherent vulnerability was rated medium low. Product inherent vulnerability of linked long-term insurance products was rated medium low as there were no international transactions, minimal level of cash intensiveness and minimal number of transactions with PEPs, non-residents and high-risk jurisdictions. Product inherent vulnerability of other product categories: annuities, contracts for the granting of disability and multiple indemnity, accident and sickness benefits, capital redemption policies and pension policies, were rated low mainly due to low volumes compared with the other products, low level of cash intensiveness and minimal amount of transactions with PEPs, high net-worth customers and high-risk jurisdictions.

**Table 7: Summary of Product Inherent Vulnerability for each Product**

Product	Vulnerability of each product
Life Insurance Products (Individual and Group)	Medium
Linked Long Term Insurance	Medium Low
Annuities	Low
Contracts for the granting of disability and multiple indemnity, accident and sickness benefits	Low
Capital Redemption Policies	Low
Pension Policies	Low
Single Premium Products	Medium Low

## **5.5 Priority Areas Identified from the Assessment**

- Although the risk of ML/TF of the insurance sector is minimal, the effectiveness of supervision procedures and practices need to be much more improved with more onsite supervisions conducted by the FIU and the IRCSL.
- Improve the effectiveness of suspicious activity monitoring and reporting by increasing the number of training and awareness programmes to emphasize the importance of raising STRs and to provide typologies to identify the areas where the insurance sector could be used by money launderers.
- Increase the number of training and awareness programmes to, improve the AML knowledge of insurance staff, identify the areas where the insurance sector could be used by money launderers, conduct KYC / CDD process properly.
- A vetting process be introduced for the staff of insurance sector, not limiting to key management personnel, to enhance the integrity of the staff of insurance companies and to develop a mechanism to ensure staff members as secure from corruption by criminals.

## 6. OTHER FINANCIAL INSTITUTIONS VULNERABILITY ASSESSMENT

### 6.1 Introduction

The module covers the vulnerability of FIs operating in Sri Lanka in 2 broader categories, i.e., regulated FIs and unregulated/informal/under-regulated FIs. The regulated category consists of LFCs, SLCs, MVTS Providers, EMS Providers, LMFCs, RDs, CSs and Samurdhi Banks while unregulated/informal/under-regulated category consists of Informal Money Transfer Systems (Hundi/Hawala), Informal Pawn Brokers (IPBs), IMLs and Micro Finance Institutions (MFIs).

Total asset of the other financial institutions as at the end of 2022 was as follows.

Table 1: Total Assets of Financial System

Financial Institution Type	Rs. billion/ USD million
Licensed Finance Companies (Rs. million)	1,610.2
Specialized Leasing Companies (Rs. million)	1.0
Money or Value Transfer Service Providers (Rs. million)	425
E-Money Service Providers (Rs. million)	424.52
Licensed Microfinance Companies (Rs. million)	9.9
Restricted Dealers <sup>(a)</sup> (USD million)	170.3
Co-operative Societies (Rs. million)	220.8

(a) Performance (Amount deposited into banking system + Amount of USD sold by RDs)

Sources: Annual Report 2022, Central Bank of Sri Lanka  
Annual Report 2022, SLTMobitel  
Financial statements as at 31.12.2022 Dialog  
Axiata PLC, MMBL Money Transfer (Pvt) Ltd.

According to the above figures, it is obvious that the LFCs are the main player of the other FIs sector.

### 6.2 Sector Overall Assessment

In the regulated category, MVTS Providers, LFCs, EMS Providers and RDs have a **Medium** level of vulnerability for ML, among which MVTS Providers have the highest vulnerability. Further, SLCs, LMFCs, CSs and Samurdhi Banks have **Medium Low** level of vulnerability for ML, among which CSs and Samurdhi Banks have the lowest vulnerability for ML. On the other hand, in the unregulated/informal/under-regulated category, informal money transfer systems (Hawala/ Hundi) have the highest vulnerability for ML which is assessed as **High** followed by IMLs and UMFIs having **Medium** level of vulnerability for ML while IPBs have **Medium Low** vulnerability for ML.

### 6.3 Methodology used for Information Collection

A questionnaire was used to collect information relating to regulated category while research, articles and mini projects assigned to WG members were used to collect information for the unregulated category.

## 6.4 Regulated Sector

### 6.4.1 Licensed Finance Companies

By the end of 2022, there were 36 LFCs licensed by the Monetary Board of the CBSL under the FBA. All LFCs are subjected to the supervision and regulation by the DSNBFI of CBSL under the powers vested by FBA. Compared to the other FIs, LFCs are the major player in the sector.

Most of the products offered by LFCs are savings accounts, fixed deposits, loans, and leasing while most of the customers of the LFCs perform cash deposits, cash withdrawals and fund transfers. LFCs are high cash intensive institutions performing domestic transactions predominantly over cross border transactions. Apart from FBA, all LFCs are subjected to the AML/CFT requirements. During the last 5 years, there were some instances where LFCs have identified several incidents of integrity failures. There are some lapses identified relating to training such as inadequate training conducted for the employees in the compliance function even though those employees directly correspond with the customers. Absence of procedures to identify unusual and suspicious transactions, inadequate trainings carried out on suspicious transaction reporting leads to the ineffectiveness of the process and hence number of STRs reported by LFCs is low (2020 – 16 STRs, 2021 – 21 STRs, 2022 – 26 STRs). Based on the above, ML vulnerability of LFCs was rated as **Medium** which is similar to the vulnerability assessed in 2014 NRA.

### 6.4.2 Money Value Transfer Service Providers

MVTS providers are mainly Bank/Finance Company related and Non-Bank MVTS Providers. This sub-sector only covers Non-Bank MVTS Providers. This includes 2 mobile money operators who are predominately offering domestic money transfer services and one FI (hereinafter referred to as “non-mobile MVTS provider”) which acts as the representative of Western Union, Money Gram, and Ria money transfer services.

This is also a high cash intensive sector performing a considerable volume of cross-border transactions which include remittances. Apart from remittances, cash deposits, cash withdrawals, fund/value transfers are also offered by the MVTS Providers. All MVTS Providers are subjected to the AML/CFT requirements. During the last 5 years, there were no incidents of integrity failures of the 3 institutions. All MVTS Providers have provided training to their employees including agent/sub-agents, new recruits based on the job role in a periodic manner. However, limited training has been conducted for Board of Directors (BOD) and senior management of MVTS Providers. Based on the above, ML vulnerability of MVTS Providers was rated as **Medium**.

### 6.4.3 E-Money Service Providers

There were two EMS Providers operating in the country via mobile devices. Payment and Settlement Systems Act, No. 28 of 2005 (PSSA) and Payment Cards and Mobile Payment Systems Regulations, No. 1 of 2013 vest prudential supervisory powers on Payments and Settlements Department (PSD) of the CBSL on EMS Providers. Section 17 of the PSSA states that the Minister may make regulations with respect to any matter required by the PSSA. Accordingly, the Payment Cards and Mobile Payment Systems Regulation was issued for the supervision of payment cards and payment systems.

EMS Providers offer the service through nearly 190 outlets in all districts in the country via agents or sub-agents numbering approximately 240. These institutions provide mobile or value transfer services and digital/virtual wallet services facilitating cash deposits, cash withdrawals, and intra fund/value transfer, receive funds or value from abroad, Internet Payment Gateway (IPG) transactions, peer to peer transactions, and business-to business transactions, Lanka QR transactions, utility and institute bill payments and agency banking services. This is also a high cash intensive sector whose customers perform high value and volume of cash transactions. As per the Payment and Settlement Systems Circular No. 8 of 2019, basic customer wallet limit is Rs. 10,000 while enhanced wallet limit is Rs. 50,000 of both EMS Providers per day as at May 2023. Compared to the domestic transactions, international transactions are very low, which is 1 per cent. This sector is also subject to the AML/CFT requirements. Both e-money service providers provide AML/CFT training to the relevant employees including agent/sub-agents, new recruits, senior management based on the job role in a periodic manner. However, limited training has been conducted for BOD. Both EMS Providers have an effective compliance function enriched with sufficient resources and independent audit function. Based on the above, ML vulnerability of EMS Providers was rated as **Medium**.

#### **6.4.4 Restricted Dealers**

There were 59 money changing companies, 6 finance companies and 14 hotels who operate as restricted dealers in the country at the end of 2022 (permits were issued to 59 companies which include 69 money changing outlets/branches. Out of these 69 outlets, 58 were permitted to buy and exchange foreign currency, while the remaining 11 were permitted to buy, sell and exchange foreign currency). FEA vests prudential supervisory powers on DFE of the CBSL on RDs. Accordingly, DFE has powers to issue directions and guidelines, conduct investigations on RDs, and impose administrative sanctions on non-compliances with the provisions of the FEA, and regulations, orders, directions and guidelines, issued under FEA.

In order to reduce the impact of COVID-19 pandemic and economic crisis on foreign currency status of the country, DFE has issued Regulations No. 3 of 2021 published in the Extraordinary Gazette Notifications No. 2213/36 dated 03 February 2021, under Section 22 of FEA which is subjected to the renewal in every 6 months.

This is a high cash intensive sector, and their international transactions are low. The AML knowledge of the staff is also at a low level. Staff of RDs are lacking awareness in respect of the Directions issued to RDs in relation to customer identification and reporting suspicious transactions. All RDs are subject to the AML/CFT requirements. Based on the above, ML vulnerability of RDs was rated as **Medium**.

#### **6.4.5 Specialized Leasing Companies**

By the end of 2022, there was 1 SLC whose asset value was nearly Rs. 1 billion. At the beginning of NRA in 2021, there were 3 SLCs out of which 2 companies were granted finance company licenses under the non-bank financial institutions sector consolidation plan of CBSL.

The SLCs are subjected to supervision and regulation by the DSNBFI of the CBSL under the powers vested by the Finance Leasing Act, No. 56 of 2000 (FLA). FLA vests the prudential supervisory powers on DSNBFI in respect of SLCs.

Mostly offered products by the SLCs are loans and leasing. Apart from that, hire purchasing, trade financing, factoring and margin trading are also offered by SLCs. SLCs are also a high cash intensive sector but cash intensiveness is less than that of the LFCs sector. SLCs in Sri Lanka do not perform cross-border transactions. Some of the lapses observed by DSNBFI in relation to AML/CFT knowledge include inadequate training conducted for the employees in the compliance function. Main lapses observed during the on-site examinations of certain companies are, lack of dedicated compliance officers, inadequate allocation of human and technological resources to the function, lapses in the policies and procedures related to compliance risk management, absence of comprehensive information systems to capture data on testing the compliance levels. Some of the lapses observed by DSNBFI relating to AML/CFT monitoring and raising STRs include absence of procedures to identify, obtain and examine information on unusual and suspicious transactions, inadequate trainings carried out for all employees of SLCs. Considering the above, ML vulnerability of SLCs was rated as **Medium Low**.

#### **6.4.6 Licensed Microfinance Companies**

In the Micro-Finance Institutions sector of the country, there are LMFCs, NGO MFIs (registered under the NSNGO) and unregulated MFIs. However, in this assessment, only the LMFCs are considered. There were 4 LMFCs as at the end of 2022. Microfinance Act, No. 6 of 2016 (MFA) and Directions and Rules issued thereunder vest prudential supervisory powers on the DSNBFI with respect to LMFCs. Operations carried out by LMFCs are covered within the finance businesses defined under FTRA.

LMFCs offer products and services including savings accounts, loans, micro-financing as well as cash deposits. The number of active customers of LMFCs is comparatively low. Cross-border transactions are also negligible. The majority of customers of LMFCs are low-income earners and micro entrepreneurs. LMFCs are required to always be in the position of a net lender and are only permitted to accept limited saving deposits only from their borrowers, as a collateral, where the total deposits of a LMFC shall not be more than 60 per cent of its total performing loans, limiting the deposits that can be acceptable from a depositor. The AML knowledge of the staff is relatively low. LMFCs have implemented procedures and processes to identify violations of the internal code of ethics and code of conduct as well as they have developed specific actions that should be taken against such violations. Integrity failures and compliance breaches have been identified only in 3 LMFCs during the recent past. All LMFCs have computer-based systems that facilitate monitoring and recording of client profiles and transactions. Considering the above, ML vulnerability of LMFCs was rated as **Medium Low**.

#### **6.4.7 Co-operative Societies**

In the Co-operative Societies sector, there are 2,333 Co-op Rural Banks, more than 6,000 Sanasa Societies (Primary), 13 Co-op Rural Banks Federations, 40 Co-op Sanasa Federations and other CSs. At the end of 2022, total assets of CSs were Rs. 220.8 billion which is 0.7 per cent of share of the financial system. All CSs are subjected to supervision by the Department of Co-operative Development (DCD) under Cooperative Societies Act, No. 05 of 1972<sup>1</sup> and its amendment as well as Provincial Charters<sup>2</sup> applicable for different provinces.

CSs perform high level/frequency of cash transactions. But cash intensiveness is lower than that of the LFCs. This sector has no international transactions. CSs have implemented procedures and processes to identify violations of the internal code of ethics and code of conduct as well as developing specific actions that should be taken against such violations. There was lesser number of instances where the CSs have removed employees due to integrity failures during recent past. As operations of CSs are covered under the finance businesses within the FTRA, CDD Rules are also applicable to CSs. Accordingly, CSs should design and implement suitable AML training programmes for relevant employees. However, AML knowledge of its business staff is comparatively low. Some CSs have compliance officers/department to perform compliance function. And there are CSs which do not have such a function. However, most CSs have internal and external audit functions which conduct respective audits at regular intervals. Monitoring and reporting of suspicious transactions is also not effective as only some of the CSs have computer-based systems that facilitate monitoring and recording of client profile and transactions. Considering the above, ML vulnerability of CSs was rated as **Medium Low**.

#### **6.4.8 Samurdhi Banks**

As at the end of 2018, there were 1,073 community-based banks and 331 community-based banking societies operating in all districts. The share capital of Samurdhi Banks has grown to Rs. 15,848 million in 2018 from Rs. 11,791 million in 2016. The number of deposits has grown to 8,177,216 (amounting to Rs. 55,627.64 million) in 2018 from 7,417,540 (amounting Rs. 43,716 million) in 2016. As per the Divineguma Act, No. 1 of 2013 (Samurdhi Act) and Divineguma (Amendment) Act, No. 2 of 2017, Samurdhi Development Department who is accountable to Auditor General of Sri Lanka has powers to supervise, manage, monitor and audit Samurdhi Community Based Banks and Samurdhi Community Based Banking Societies.

Samurdhi Banks have relationships mostly with individual customers. Savings accounts, fixed deposits, loans and micro-financing are the most accessed products by customers while most customers perform cash deposits and withdrawals. The Banks limitedly use non face-to-face channels including SMS, telephone and email. Samurdhi Banks are not maintaining relationships with walking customers and foreign customers. Some Samurdhi Banks employ agents for their operations and perform moderate level of cash transactions. Further, the banks do not perform international transactions. AML knowledge of business staff is at a low level. The banks have implemented procedures and processes to identify violations of the internal code of ethics

1 Applicable to Line Department, Northwestern Southern, North and Eastern Provinces.

2 Co-operative Societies Charter No. 03 of 2007 of the Sabaragamuwa Provincial Council, Co-operative Societies Charter No. 05 of 2009 of the North Central Provincial Council, Co-operative Societies Charter No. 03 of 2011 of the Uva Provincial Council, Co-operative Societies Charter No. 03 of 1998 of the Western Provincial Council, Co-operative Societies Charter No. 06 of 2018 of the Central Provincial Council.

and code of conduct as well as developing specific actions that should be taken against such violations. There were limited instances where the Samurdhi Banks have removed employees due to integrity failures during the recent past and have taken disciplinary actions against staff due to compliance breaches. According to the sample, a smaller number of Samurdhi Banks have a Compliance Officer/ department to perform compliance function. Average monthly transactions of Samurdhi Banks are between Rs. 1 million – Rs. 10 million. All Samurdhi Banks have internal and external audit functions which conduct their respective audits at regular intervals. Some Samurdhi Banks have computer-based systems that facilitate monitoring and recording of client profiles and transactions. By considering the above, ML vulnerability of Samurdhi Banks was rated as **Medium Low**.

## 6.5 Unregulated/ Informal/ Under-Regulated Sector

Due to the absence of a comprehensive legal framework for supervision, registration, documentation and other requirements, quality of AML controls is low in this sector. Accordingly, ML vulnerability of the sector totally depends on the inherent vulnerability of each individual sector.

### 6.5.1 *Informal Money Transfer Systems (Hundi/ Hawala Dealers)*

There are no restrictions for the establishment of an agency to conduct transactions through informal money transfer systems. Informal money transfer systems are trustworthy, and they maintain minimal documentation. It is observed that criminals take advantage of the anonymity of the systems to move the proceeds of illegal activities. Since the documentation involved in such deals is minimal, it makes the system vulnerable to being abused for ML. There is still limited knowledge of these systems and therefore they are more likely to operate for illegal purposes including ML.

External oversight of Hawala transactions is limited and detection of risk is minimal. This makes them susceptible to abuse by individuals and groups transferring proceeds of crimes or funds to finance illegal activities. On the other hand, when the formal financial sector has been subjected to oversight or supervision under a well-established legal framework, the Hawala system will provide opportunities for criminals to transfer proceeds. Considering these facts, at present informal money transfer system in Sri Lanka is more vulnerable to ML. Accordingly, ML vulnerability in the informal money transfer sector has been rated as **High**.

PSD of CBSL is in the process of issuing a regulation in order to introduce registration requirement for the sector.

### 6.5.2 *Informal Money Lenders*

Unlike LBs, LFCs, LMFCs, Microfinance NGOs, Co-operative Rural Banks and Thrift and Credit Co-operative Societies, and Samurdhi Community-Based Banks, IMLs are not regulated or supervised. These IMLs operate in the form of individuals, sole proprietors, partnerships or companies. Though the absence of regulatory framework causes various malpractices and customer harassments in the money lending businesses, lack of collaterals in the informal financial sector and low financial literacy increases the popularity of informal money lending. As informal money lenders are not reporting information, collecting information on the sector is difficult. Informal money lending is popular amongst close knit communities (e.g., plantation community)

due to word-of-mouth marketing. There are various instant online cash loans offering within Sri Lanka such as "OnCredit", "Loanme", "Lotus Loan", "Credit ONE", "CashX", "Cashwagon", "Cashray", etc. These types of loans create negative consequences to borrowers which include unaffordable repayments, high interest rates and fees and late repayments owing to poverty and other serious social issues. Accordingly, ML vulnerability of the sector was rated as **Medium**.

In order to address the above stated issues, CBSL has proposed the enactment of the Microfinance and Credit Regulatory Authority Act and it will enable the establishment of Microfinance and Credit Regulatory Authority which is mandated to regulate both unregulated MFIs and informal money lenders. The draft of the proposed Act has been approved by the Monetary Board of the CBSL and forwarded to the Ministry of Finance on 23.11.2021.

#### **6.5.3 Unregulated Micro Finance Institutions**

UMFIs mostly offer micro-financing and loans facilities to rural customers for house repairing, small businesses, education, agriculture, consumption, etc. As per the interviews conducted with the MFIs, use of these loans granted are continuously monitored by the field officers of the relevant MFIs. There are 200 – 400 UMFIs possessing a lending market share of 10 per cent - 15 per cent. UMFIs mostly have relationships with individuals/sole proprietorships, partnerships and corporates. These institutions do not have relationships with high-risk customers such as foreign customers and walking customers. UMFIs perform low level of cash transactions and do not perform international transactions. Non face-to-face channels such as SMS, telephone and email are used by customers of UMFIs to conduct transactions. As this sector is unregulated in Sri Lanka, required control measures relating to AML have not been implemented. Awareness of ML in this industry is also at a low level. Market entry has been controlled to a certain extent by the existing industry players. Accordingly, ML vulnerability of the sector was rated as **Medium**.

#### **6.5.4 Informal Pawn Brokers**

Similar to the other informal sectors, IPBs are also not subjected to supervision by the banking and monetary authorities, as they are not registered. IPBs often do not comply with bookkeeping standards and are not reflected in official statistics.

IPBs charge interest rates higher than the formal pawnbrokers which make customers pay for the extra risk involved in informal pawn broking since the risk of loan default is high. As there is a trend to pawn stolen items by the borrowers who do not have any intention to redeem them, there is a ML risk in relation to the informal pawn brokers' sector. However, IPBs are closer to the clients than formal ones, as their needs are met at any time of the day with easy and simple procedures. Lending conditions and applicable interest rates in the informal pawning transactions can vary from borrower to borrower depending on the evaluation of the value of pawned article, creditworthiness, and the degree of relationship the borrower has with the lender. The informal pawning industry is carried out on a cash basis. Since the regulated formal pawning institutions are largely scattered in the country, attractiveness of informal pawning sector is low. It caters mostly to the local poor families who are financially illiterate. Accordingly, ML vulnerability of IPBs was rated as **Medium Low**.

## 6.6 Deficiencies and Gaps Identified with the Sector and Proposed Actions to Rectify the Issues.

After completing the assessment, the tool provided by the WB has generated the priority ranking for the AML control variables for each FI. Accordingly, priority ranking for the regulated FIs are shown in Table 2 (The lower the ranking, the more priority the item has).

**Table 2: Priority Ranking for Anti Money Laundering Controls of Regulated Financial Institutions**

	MVTS	LFCs	EMSs	RDs	SLCs	LMFCs	CSs	Samurdhi Banks
Comprehensiveness of AML Legal Framework						4	6	6
Effectiveness of Supervision/Oversight Activities	2			3		6	2	2
Availability and Enforcement of Administrative Sanctions				7		8	8	8
Availability and Enforcement of Criminal Sanctions	4	4	3	6	4	7	7	7
Availability and Effectiveness of Entry Controls				8			9	9
Integrity of Business/Institution Staff	3	2	2	4	2	3	5	5
AML Knowledge of Business/Institution Staff	1	1	1	1	1	1	1	1
Effectiveness of Compliance Function (Organisation)	5	5	4	2	5	4	3	3
Effectiveness of Suspicious Activity Monitoring and Reporting	6	3	5	5	3	2	4	4
Availability and Access to Beneficial Ownership information	8	7	7	10	7	10	11	11
Availability of Reliable Identification Infrastructure	7	6	6	9	6	9	10	10
Availability of Independent Information Sources	9	8	8	11	8	11	12	12

Accordingly, in summary followings are highlighted with respect to regulated FIs;

- Steps need to be taken to enhance the awareness relating to ML/TF risks in the other financial sector, especially, in RDs, LMFCs, CSs and Samurdhi Banks.
- Prudential supervisors of the respective sector should expand the AML/CFT supervision in relation to regulated FIs. In that case, consider amending the respective regulations (discussed in above sections) to include the AML/CFT aspects.
- Enhance the scope of entry controls by including AML controls implemented by FIs. Further, enhance the fulfillment of fit and proper criteria in relation to major shareholders when applying for the license or renewal of license of LFCs and SLCs.
- LFCs should increase the effectiveness of reporting STRs to the FIU.

Priority ranking for the unregulated/informal/under-regulated FIs are shown in Table 3.

**Table 3: Priority Ranking for Anti Money Laundering Controls of Unregulated/Informal Financial Institutions**

	Hundi/ Hawala	IMLs	UMFIs	IPBs
Comprehensiveness of AML Legal Framework	9	9	9	7
Effectiveness of Supervision/Oversight Activities	2	2	2	2
Availability and Enforcement of Administrative Sanctions	7	7	7	9
Availability and Enforcement of Criminal Sanctions	8	8	8	8
Availability and Effectiveness of Entry Controls	4	4	4	5
Integrity of Business/Institution Staff	6	5	6	6
AML Knowledge of Business/Institution Staff	1	1	1	1
Effectiveness of Compliance Function (Organisation)	3	3	3	3
Effectiveness of Suspicious Activity Monitoring and Reporting	5	6	5	4
Availability and Access to Beneficial Ownership information	11	11	11	11
Availability of Reliable Identification Infrastructure	10	10	10	10
Availability of Independent Information Sources	12	12	12	12

In summary, followings are recommended with respect to the unregulated/informal/under-regulated FIs;

- Strengthening the regulatory framework for the unregulated/ informal/ under-regulated FIs in order to enhance the effectiveness of supervision, enforcement of sanctions, monitoring and reporting of the transactions.
- Necessary actions are required to undertake to improve formal money lending facilities and formal money transfer systems by financial institutions in order to discourage the informal sector, especially, informal money lending activities and hundi/hawala businesses in the country.

**Figure 1: Highlights of the Assessment of Vulnerability of Other Financial Institutions**

### VULNERABILITY OF OTHER FINANCIAL INSTITUTIONS

#### Regulated FIs

FI type	Inherent Risk	AML controls	Final vulnerability
LFCs			
SLCs			
MVTS			
EMS			
LMFCs			
RDs			
CSs			
Samurdhi Banks			

*In the regulated category, MVTS Providers possess the highest vulnerability due to the nature of product (money transfer services and digital wallet services) offered via agents and associated with cross border transactions.*

#### Unregulated/Informal FIs

FI type	Inherent Risk	AML controls	Final vulnerability
Hawala			
IPBs			
IMLs			
UMFIs			

*In the unregulated/informal category, Hawala possess the highest vulnerability as they are highly associated with cross border transactions and more susceptible to abuse by individuals and group transferring proceeds of crimes or funds to finance illegal activities.*

High Medium High Medium Medium Low Low

## 7. DESIGNATED NON-FINANCE BUSINESSES AND PROFESSIONS VULNERABILITY ASSESSMENT

### 7.1 Introduction

Casinos, Real Estate Agents, DPMS, and when engaged in defined activities the Lawyers and Notaries, Accountants, and TCSPs are identified as DNFBPs<sup>1</sup> in Sri Lanka. The FIU has the authority to verify institutional compliance of its RIs which includes these DNFBPs<sup>2</sup>. The FIU established a separate division to monitor the compliance of DNFBPs and started issuing Rules, Guidelines and Directives for DNFBPs during 2018 to rectify the deficiencies identified at the 1st NRA conducted in 2014. Since then, the FIU closely co-ordinates with relevant sector licensing, regulatory, self-regulatory bodies, or associations in introducing and promoting AML/CFT requirements among DNFBPs in Sri Lanka. As of today, the following number of DNFBPs are being monitored by the FIU under the RBA.

**Table 1: Composition of the Designated Non-Finance Businesses and Professions registered with the Financial Intelligence Unit as at 31.12.2022**

	DNFBP sector	No. of DNFBPs registered with FIU	Regulator/ Self-Regulatory Body cooperates with the FIU
1.	Casinos	03	Finance Ministry
2.	Real Estate Agents	161	Condominium Management Authority
3.	Dealers in Precious Metals and Precious and Semi-Precious Stones	187	National Gem and Jewellery Authority
4.	Lawyers and Notaries	16	Supreme Court/Bar Association/ Registrar General's Department
5.	Accountants	08	Institute of Chartered Accountants
6.	Trust and Company Service Providers	06	Registrar General's Department/ Department of Registrar of Companies

At the time of conducting Sri Lanka's 1st NRA, the DNFBPs were not properly integrated into the AML/CFT framework in Sri Lanka. This was identified as one of core deficiencies at the ME conducted in 2015 as well as it became one of core action items in the International Cooperation Review Group (ICRG) process. Considering the level of non-compliance as well as the threat that could bring by these segments into the Sri Lankan financial sector, in 2018, FIU initiated a programme to include them into AML/CFT framework with the issuance of CDD Rules<sup>3</sup> for DNFBPs. For the 2nd NRA conducted in 2021/22, a working group was created including the private sector DNFBPs and their regulators/self-regulatory bodies and associations. It was collectively decided to consider the assessment period for DNFBP sectors from 2018-2022, as there were no prior data, especially on many AML control variables for DNFBPs in Sri Lanka.

1 Refer Section 33 of the FTRA

2 Refer the requirements set out in the FTRA as per Section 15 (1) (e), read with Section 18 of the FTRA.

PL 000861 (E) Financial Transactions PDF,p65 ([fiusrilanka.gov.lk](http://fiusrilanka.gov.lk))

3 Designated Non-Finance Business (Customer Due Diligence) Rules, No. 1 of 2018. - Extraordinary Gazette No 2053/20, January 10 of 2018

Difficulties in obtaining information from unregulated business sectors in DNFBPs, non-availability of comprehensive databases on the institutions operating in some DNFBP sectors, and lack of information on local, global typologies and case studies on ML/TF related to all DNFBP sectors were the other challenges faced when conducting the DNFBPs vulnerability assessment.

Inherent ML vulnerabilities of each DNFBP sector and the quality of AML controls of DNFBP sectors which were assessed at the NRA conducted in 2021/22 are presented below.

## 7.2 Casinos

### 7.2.1 Inherent Vulnerability of Business

Casino industry in Sri Lanka is a small business sector of country's entertainment industry which consists of only 3 physical, land-based businesses located in the city of Colombo and no island wide branch network is available. Also, there are no foreign branches available in high-risk jurisdictions as per FATF closely monitored standards. However, 2 casinos have 5 offshore branches in Mozambique, Zambia, Madagascar, Malavi and Nepal.

The casinos were not fully functioning during the assessment period as the number of their main target customers i.e., foreign gamblers were considerably low from 2019 to 2021 period due to several adverse conditions faced by the country. The brutal Easter Sunday bomb attack in 2019, closure of businesses, interruptions, and travel restrictions for foreigners due to COVID-19 pandemic during 2020/21 and prevalent economic crisis of the country were such adverse conditions. Due to these factors, casinos were making continuous losses during the period of 2019-2021 and identified as loss-making institutions for the income tax payments as well. However, in 2021, average revenue of the Casino sector was recorded as Rs. 1.8 billion.

When considering the games available in Sri Lankan casinos, there is no wider range of selection for table games or slots, compared to the casinos in foreign destinations. There is only a limited number of common tables and slot games available for gamblers in Sri Lanka<sup>4</sup>. The number of gaming tables available in 3 casinos ranges between 41 and 100 whereas the number of slot machines ranges between 28 and 150. Further, the minimum and maximum betting limits for the games available in casinos are depicted in both LKR and USD terms in the below table.

**Table 2: Betting Limits for Games**

Name of the Game	Minimum Betting Limit of the Sector		Maximum Betting Limit of the Sector	
	LKR	USD <sup>5</sup>	LKR	USD <sup>5</sup>
Baccarat	1,000	3.12	1,000,000	3,125
Blackjack	1,000	3.12	10,000	31.25
Roulette	100	0.31	20,000	62.50
03 Card Poker	1,000	3.12	20,000	62.50
05 Card Poker	1,000	3.12	20,000	62.50
Texas Poker	100	0.31	10,000	31.25

Source: Casinos

<sup>4</sup> Products available at 03 casinos as per the information obtained from the onsite examinations conducted during year 2019 and from the periodic information gathered from Compliance Officers of those casinos include Baccarat, Blackjack, Roulette, 03 Card Poker, 05 Card Poker and Texas Poker.

<sup>5</sup> At the exchange rate of Rs. 320 per 1 USD

The above table denotes that the games in Sri Lankan casino sector have less vulnerability due to insignificant betting limits where only the maximum limit of Baccarat marginally exceeds the financial transaction threshold of USD 3,000 applicable for casinos. Considering the above and other factors applicable, the total size/volume of the business has been rated as low among other variables.

The level of cash activity associated with the casino business has been assessed as medium high among the inherent vulnerability variables, recording a comparatively high vulnerability. This was due to cash being the main method to buy chips while other methods of payments such as electronic fund transfers, debit/credit cards, etc., are also available. Additional financial services such as safety lockers, currency exchange services, cheque cashing, lending, or pawning are not available in these business premises.

The risk of client-base profile of the casino business was recorded as medium among other variables due to the factors discussed herein. The membership base of all casinos is less than 2,000 and membership cards are granted physically by seeing the customer in-person. Walk-in customers are allowed to enter casino premises after granting membership. Casinos obtain copies of identity verification documents when granting memberships and records are properly retained with the easy access to retrieve as and when such records are demanded by an authority<sup>6</sup>. Further, all customers are screened against sanction lists when granting memberships<sup>7</sup> and screening tools for PEP identification such as Accuity are also available within these casinos. In addition, the customers are rated while assigning risk scores as per the AML/CFT policies. If a PEP is a member, he/she is rated at high risk to closely monitor their transactions<sup>8</sup>. However, during the assessment, it was observed that no membership was granted to customers from high-risk jurisdictions and no designated persons have been detected while screening their memberships against designated lists.

Risk arising from using agents in the casino business was also recorded medium as there is no involvement of outsourced companies/ agents or third parties in casino operations. As per the information provided by the casinos during the assessment, the use of agents or other professional intermediaries to deliver the casino product is at a low level. Even, the entertainment events are handled by casinos themselves and no outsourced/agent services are obtained. However, there are mediators such as marketing groups of hotels for recommending and directing, especially the foreign customers to Sri Lankan casinos. These mediators are not providing any other services to gamblers instead of the marketing activities. Further, the memberships introduced via such mediators are also subject to routine screening procedure of the casinos and the CDD requirements.

While considering the non-face-to-face use of the casino products, non-face-to-face issuance of membership is limited only for virtual membership granting mechanism started due to COVID-19 pandemic. As casino businesses were closed during the COVID-19 pandemic, customers of casino businesses have been facilitated with live stream gaming facilities launched by the casinos in Sri Lanka. However, the conduct of CDD measures and the screening procedures were followed when granting online memberships. Sri Lankan casinos operate

6 This process is carried out by casinos in order to comply with the Rule 10 of the Designated Non-Finance Business (CDD) Rules No. 01 of 2018.

7 This process is carried out by casinos in order to comply with the Rule 42 of the Designated Non-Finance Business (CDD) Rules No. 01 of 2018.

8 This process is carried out by casinos in order to comply with the Rule 24 of the Designated Non-Finance Business (CDD) Rules No. 01 of 2018.

online at a small scale compared to large scale operations of other online gaming by casino sites in other destinations.

Close monitoring of customer transactions is done by the casinos at the time of encashing the winnings, but it is difficult to trace all the records relevant to each gaming activity the customer engaged in as there are no tracking systems. Further, the existence of ML typologies was assessed as exist but limited considering the previous ML cases involving foreign PEPs related to casino gaming in Sri Lanka. The use of the business in fraud or tax evasion schemes was also assessed as exist but limited based on the availability of cases and adverse media records both in Sri Lankan and international context.

Anonymous use of the product in the casino business was assessed as not available as this is not possible within any of the 3 casinos in Sri Lanka because no person can enter the casino premises or play online without a verified membership.

#### ***7.2.2 Quality of Anti Money Laundering Controls***

There are 2 core legal enactments relating to Sri Lankan betting and gaming industry. One is the Betting and Gaming Levy Act, No. 40 of 1988. According to the provisions of this Act, a levy is imposed every year on the person who carries out gaming business in Sri Lanka. The other is the Casino Business (Regulation) Act, No. 17 of 2010. Under the Regulation Act, a casino shall only be operated under a valid license subject to terms and conditions and within an area designated by the relevant Minister. The Regulation Act was effective from January 1, 2012. However, on August 31, 2022, nearly after 12 years of its enactment, the Minister of Finance has issued Casino Business Licensing Regulation, No. 1 of 2022 ("Regulation") giving effect to the provisions of the Regulation Act. These regulations set out a comprehensive licensing process. An existing operator must apply for a license within 60 days of the date of the Regulation, and an application for the renewal of a license must be made six months prior to the expiry of the license. The fee for a new license or renewal of a license for a period of five years is Rs. 500,000,000. Also, all licensees are required to appoint a Compliance Officer to ensure that the casino complies with all applicable laws, terms and conditions of the license, mandate stringent book-keeping requirements, and stipulate certain employee requirements. All 3 existing casinos have obtained the license from the Ministry of Finance for the year 2023 after paying the above license fee and no new entrants have applied for licenses to date. Considering the above, though the AML/CFT framework applicable for casinos is monitored by the FIU, Ministry of Finance acts as the licensing authority for the industry attributing more formality and regularity to the sector.

Effective entry controls can also be seen in the sector due to several reasons such as considerable capital expenditure needed for the investment in new casinos, huge licensing fee, higher taxation rates for the sector, etc. Further, there are some other culturally influential facts such as majority of the population being Buddhists, working as a barrier for the government to expand the business activities of the industry. Hence, this industry is expected to be retained at the same size and volume with no expansion in near future.

Further, since January 2018, FIU undertakes AML/CFT on-site supervision under the RBA for the casino sector. In addition, off-site ML/TF risk assessment is conducted annually in every November-December and thematic reviews were also conducted for the sector. Following are the statistics of onsite, off-site examinations, and thematic reviews conducted for the casino sector during the assessment period.

**Table 3: Risk-Based Supervision/Meetings for Casinos**

Year	Number of Examinations				Number of Meetings
	Progress Review Visits		On-site Examinations	Off-site Examinations	
2018	3	-	-	-	2
2019	-	3	1	-	6
2020	-	-	1	-	1
2021	-	-	1	2 <sup>9</sup>	1
2022	-	-	1	1 <sup>10</sup>	1

Source: Financial Intelligence Unit - Sri Lanka

Further, the FIU conducts regular AML/CFT awareness/training programmes to enhance AML knowledge of the staff members of the sector and to enhance the effectiveness of the compliance function. Accordingly, front office staff engaged in customer handling, accounts section and managers of the gaming floors are continuously equipped with the training on AML/CFT in addition to the Compliance Officers. The awareness/training programmes conducted by the FIU in collaboration with the management of the casinos during the assessment period are as follows.

**Table 4: Awareness/Training Sessions**

Year	No. of Training Programmes
2018	2
2019	4
2020-2022 <sup>11</sup>	-

Source: Financial Intelligence Unit – Sri Lanka

AML/CFT compliance function is directly handled by the senior management of the businesses and good rapport is maintained with the FIU for the development and maintenance of AML/CFT policies and procedures. In addition to the above, the integrity of the staff of the casinos has been established through intense screening procedures carried out by the management when hiring employees to the business.

However, the number of STRs submitted by the casinos during the assessment period was low considering the casino business closure and interruptions to operations due to previously explained reasons.

#### **7.2.3 Deficiencies/Gaps Identified during the Vulnerability Assessment of Casinos**

- Non-availability of records relevant to each gaming activity the customer engaged as there is no tracking systems within the casinos.

<sup>9</sup> Due to the travel restrictions and curfew situations resulted from COVID-19 pandemic, on-site examinations were not conducted during the year 2021 and hence, 2 thematic reviews were conducted.

<sup>10</sup> Due to the travel difficulties arisen from the fuel crisis of the country, on-site examinations were not conducted and hence, a thematic review has been conducted specifically focusing on online gaming.

<sup>11</sup> Due to the casino business closure and interruptions to operations resulted from COVID-19 pandemic, fuel crisis and the current economic condition of the country, no new trainings have been conducted for the sector since 2020. However, the same market players remain to date where they have already been trained on AML/CFT requirements applicable for them. However, FIU continuously communicated with 3 market players virtually and instructions were provided as and when necessary.

- Non-availability of fit and propriety requirements for the beneficial owners and persons holding a senior management position of casinos.
- Although, policies are in place for suspicious activity reporting, effectiveness of reporting is low considering the reported number of STRs.

Accordingly, the overall vulnerability of the Casino sector was assessed at **Medium**.

## 7.3 Real Estate Agents

### 7.3.1 Inherent Vulnerability of Business

Real estate sector is a large business sector compared to other DNFBP sectors in Sri Lanka. Real estate market comprises several diverse market segments such as condominium properties, residential housing properties, commercial properties, agricultural lands, residential lands, etc. DNFBPs include real estate agents when they are involved in transactions for their clients in relation to the buying and selling of real estate, as defined in the FTRA. As per the survey conducted by FIU to collect details of real estate operators in Sri Lanka in 2018, it was revealed that most of the country's leading real estate companies are operated and based in the Western Province. The real estate companies operated in the other provinces are the branches, subsidiaries, or groups of companies of these leading real estate companies located in the Western Province in most cases. The details of real estate businesses were collected from the official business directories. Details of operators in other provinces were also collected through Regional Offices of the CBSL. However, the total number of such institutions operating in the whole real estate sector is not traceable from a single source due to the non-availability of a centralized database for the sector. Hence, entire market operators for each segment cannot be identified and the total size of the segments cannot be accurately estimated with this gap.

Nevertheless, the condominium developers which is the prime segment of the sector has established an association known as Condominium Developers' Association of Sri Lanka (CDASL) for their administrative matters and 35 condominium developers including the key developers have obtained the membership of this association as of March 2022. Further, every condominium developer shall obtain a clearance certificate from the Condominium Management Authority (CMA) prior to initiating a development project where CMA can be considered as an authority only for the condominium developers' segment in Sri Lanka. CMA has issued around 1,500 clearance certificates from 2005 to 2022<sup>12</sup>, but the number of developers in Sri Lanka massively differs from the number of certificates issued by them as it includes certificates issued for the same developer for different projects, certificates issued to government projects and certificates belonging to individuals mainly developing units only for the purpose of renting out or personal use who are not covered under the FTRA. Further, the database of condominium developers maintained by the CMA is not sufficiently comprehensive. It was noticed that the contact details of condominium developers who got registered at the early stages were not available in this database. However, such details of newly registered developers are available in the database as they are now obtained at the registration. Apart from CMA, Construction Industry Development Authority (CIDA) operating under the Ministry of Urban Development and Housing, has already taken initial steps to register property developers and issue a "Certificate of Registration". However, they have only registered 15 property developers as of April 2022. In addition, CBSL conducts a condominium market survey every quarter where only 17 condominium developers have participated in the Q3, 2022 survey.

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12 As per the information provided by the CMA.

Based on the above information deficiencies and gaps in the sector, FIU focused on the 161 real estate agents who have been registered with the FIU as of December 2022 for the assessment. Hence, the survey questionnaire for the sector was distributed among them. Around 90 per cent of the sample constituted the condominium developers and residential housing developers as the condominium properties/residential properties represent a larger segment of the real estate market based on their higher value and their considerable attractiveness among domestic, expatriate, and foreign buyers. Further, the period of assessment was impacted from COVID-19 pandemic, resultant travel restrictions, fuel crisis and the adverse economic condition of the country where the construction and the real estate sector experienced severe downturns by these conditions.

Size and volume of the sector has been rated as medium high under the assessment considering the large volume transactions associated with the sector and the increase of real estate volume related statistics discussed herein. Other than institutional property transactions, individual property transactions are also registered at the Land Registries of the country and the details of the same can be obtained from them. The number of deeds registered with the 45 Land Registries in Sri Lanka during year 2019 and 2020 are 1,128,508 and 864,105 respectively<sup>13</sup> (this includes different categories of deed registrations including deeds of transfer, mortgages, leases, gifts, declarations, and other deed registrations such as Title Registrations. Among these, deeds of transfer are the deeds prepared when a property owned by one person is sold to another). Further, the value of the property, mortgages, multiple transfers of a single property with the title changes, geographical location of the property, assets under the local authorities, information of notary public, stamp duty details, etc., can be identified through the Land Registries. This information can be obtained, if any competent authority or LEA requests the same from the Land Registries. In addition, to understand the market size of the real estate activities, the value of the real estate sector could be derived through contribution of real estate activities (including ownership of dwelling) to the Gross Domestic Product which was at Rs. 920,883 million in 2020 and Rs. 1,006,056 million in 2021 as per the reports of DCS. Foreign Direct Investment by Board of Investment companies for housing, property development and shop office sector as per the CBSL annual reports was USD 256.1 million in 2020 and USD 201.5 million in 2021. Further, the Condominium Property Volume Index<sup>14</sup> has increased significantly during Q4, 2021 with a notable increase of 49.0 per cent compared to Q4, 2020. According to the condominium market survey as at end of Q4 2021, 49 per cent of sales occurred in the 0-25 million range, 29 per cent of sales occurred in the 25-50 million range while 12 per cent of sales occurred in the 50-75 million range and 10 per cent in the above 75 million range.

Risk arising from the client-base profile of the real estate business was rated medium due to several reasons. According to the condominium market survey as at end of Q4, 2021<sup>15</sup>, around 85 per cent of the condominium buyers were Sri Lankan residents. Further, number of clients who are domestic/international PEPs, high net-worth individuals, non-residents particularly from higher-risk jurisdictions, corporates, NGOs and NPOs was insignificant among the client bases of real estate agents participated in the assessment survey.

13 As per the information obtained from Registrar Generals' Department.

14 Condominium Property Volume Index is compiled to capture the variations in market activities by way of number of sales transactions reported for the reference period. (Base period: Q3, 2017 = 100).

15 [https://www.cbsl.gov.lk/sites/default/files/cbslweb\\_documents/statistics/real\\_estate\\_market\\_analysis\\_2022\\_q1.pdf](https://www.cbsl.gov.lk/sites/default/files/cbslweb_documents/statistics/real_estate_market_analysis_2022_q1.pdf).

The use of agents in the real estate business has also been ranked as having a medium risk. Around 55 per cent of the real estate respondents have not allowed the use of agents or other professional intermediaries in delivering the product in their business. But in some instances, real estate agents use the service of an intermediary institution or an individual in reaching buyers, for a professional fee. On the other hand, the variable “level of cash activity associated with the business” was assessed as having a medium low risk as 81 per cent of the real estate respondents has recorded zero to medium low level of cash usage in their business.

When considering the availability of ML cases on the abuse of real estate business, there have been cases in Sri Lanka as well as in the global context as per the open-source information and the information obtained from LEAs and hence, the variable was ranked as exist. In Sri Lankan context, there were ML cases relating to the funds obtained from drug trafficking, bribery and corruption being invested in property market in condominiums, individual housing properties and lands. Further, there were 6 indictments with related to such ML cases on the abuse of real estate business. Use of the real estate business in fraud or tax evasion schemes also exists but a limited number of cases were reported on such fraudulent activities.

Further, based on the survey responses, non-face-to-face use of the product in the business was ranked as available but limited and anonymous use of the product was not available within the business. Moreover, the transaction records were easily traceable and retrievable in the business as per the information obtained from the real estate agents through the questionnaire and discussions.

### ***7.3.2 Quality of Anti Money Laundering Controls***

Sri Lanka has a number of laws in relation to the segmented real estate sector where different authorities have diverse roles. These laws help the government to manage the real estate markets, ownership of property, lease of property, buying and selling property and collection of taxes in relation to property, etc. There are several government authorities such as Urban Development Authority, Urban Councils, National Housing Development Authority, Pradeshiya Sabha, CMA, Land Registries and CIDA established under these legal enactments to implement the provisions therein. While considering the different roles of these entities, a regulatory role for the whole sector cannot be identified from any entity other than the CMA which only covers the condominium property developers, which is the main stakeholder group under the real estate market.

CMA is established under the Apartment Ownership (Amendment) Act, No. 39 of 2003 and the Common Amenities Board (Amendment) Act, No. 24 of 2003. Accordingly, the CMA has setup a requirement of appointing a Compliance Officer for the purpose of AML/CFT compliance function of the condominium property developers, when applying for the “Preliminary Planning Clearance Certificate” from the CMA. Further, the CMA has a continuous information sharing policy with the FIU as per the MOU signed between them during 2019. CMA shares the number of final clearance certificates, provisional certificates and semi certificates issued by them on an annual basis with the FIU as an outcome of this MOU. Breakdown of the certificates issued by the CMA during 2019-2021 period is given below.

**Table 5: Breakdown of the Certificates Issued by the Condominium Management Authority**

Year	Final Clearance Certificates	Provisional Certificates	Semi Certificates
2019	153	13	5
2020	56	4	2
2021	44	-	-
2022	63	7	3

Source: Condominium Management Authority

In addition, as per Section 13 (k) of the Construction Industry Development Act, No. 33 of 2014, the CIDA shall provide for the registration of property developers<sup>16</sup> and to grade them under financial and marketing capabilities which has been initiated by CIDA only after the issuance of the Construction Industry Development (Registration of Property Developers) Regulations of 2020. However, CIDA currently has no grounds to act as the real estate regulator as per AML/CFT requirements. Hence, the FIU continued its attempts in establishing a regulatory authority for the sector and has prepared a concept paper on formation of a regulatory environment for the real estate sector in view of complying with both national and international AML/CFT requirements and submitted the same to the Ministry of Finance where the matter was further referred to the Hon. Attorney General by CIDA in 2021. Accordingly, the CIDA has agreed to make necessary amendments to the CIDA Act covering the real estate agents coming under the FTRA and the relevant changes are suggested to process through the Ministry of Urban Development and Housing at present. After that mechanism to register the institutions engaged in the real estate business with CIDA will be carried out until a separate regulatory framework is established in the future.

The FIU follows up the process of identifying new institutions operating as real estate agents and enhancing the number of Compliance Officers appointed by such identified Institutions. New Institutions are identified through newspaper advertisements, associations, regional offices of the CBSL, etc. The FIU has issued the Designated Non-Finance Business (Customer Due Diligence) Rules, No. 01 of 2018 (CDD Rules for DNFBPs) in 2018 which are applicable to real estate agents when they are involved in transactions for their clients in relation to buying and selling of real estate.

Since January 2018, FIU has undertaken AML/CFT on-site supervision of DNFBPs under the RBA for real estate agents. In addition, off-site ML/TF risk assessment is conducted annually in every November-December and thematic reviews were also conducted for the sector. Following are the statistics on risk-based supervision for the real estate sector during the assessment period.

<sup>16</sup> In terms of the Construction Industry Development Act, No. 33 of 2014, “property developer” means an entrepreneur who promotes any project in the construction industry, specially in the housing sector which are either physically or conceptually developed by the gain of inputs of lands, land ownership, financing, marketing, or any other required expertise.

**Table 6: Risk-Based Supervision of Real Estate Agents**

Year	Number of Examinations					Other Supervisory Actions Taken by the FIU	
	Progress Review Visits	On-site Examinations	Off-site Examinations	Follow-up Examinations	Thematic Reviews	Warning Letters	Letters Informing Deficiencies
2018	11	-	-	-	-	40	-
2019	-	6	1	5	-	89	-
2020	-	7	2	2	-	-	8
2021	-	-	1	-	2 <sup>17</sup>	-	-
2022	-	9	1	-	-	-	9

Source: Financial Intelligence Unit – Sri Lanka

Further, the FIU conducts AML/CFT awareness/training programmes to enhance AML knowledge of the staff members of the sector and to enhance the effectiveness of the compliance function. Some of the programmes were conducted for the sector in collaboration with the CMA and LEAs. The CMA continuously shares informative brochures relating to AML/CFT in their website as well. The details of the awareness/training programmes conducted by the FIU during the assessment period are as follows.

**Table 7: Awareness/Training Sessions**

Years	2018	2019	2020	2021	2022
No. of Training Programmes	11	6	1	1	1

Source: Financial Intelligence Unit – Sri Lanka

AML/CFT compliance function of real estate businesses is usually handled by the senior management and the Compliance Officers have the required knowledge and understanding to implement the AML/CFT policies and procedures within these Institutions. In addition, the integrity of the staff of the real estate sector has been established through the employee screening processes commonly carried out by the management when hiring employees to the business. A police report or a Grama Niladari certificate is normally obtained from every employee by the businesses as a practice and a background or a reference check is also done to screen employees.

However, the number of STRs submitted by the real estate sector during the assessment period was low and the entry controls of the sector has also been identified at a low level under the assessment considering the non-availability of a single regulatory authority for the sector, informality, and largely diversified segments of the sector.

<sup>17</sup> Due to the travel restrictions and curfew situations resulted from COVID-19 pandemic, on-site examinations were not conducted during the year 2021 and hence, 2 thematic reviews were conducted.

### 7.3.3 Deficiencies/Gaps Identified during the Vulnerability Assessment of the Real Estate Sector

- Non-availability of a regulatory authority to grant licenses/registrations to real estate sector in Sri Lanka and no comprehensive database of Institutions and individuals operating in the sector.
- Lack of transparency and accountability resulting in increased malpractices.
- Although, policies are in place for suspicious activity reporting, effectiveness of reporting is low considering the reported number of STRs.

Accordingly, the overall vulnerability of the Real estate sector was assessed at **Medium**

## 7.4 Dealers in Precious Metals and Precious and Semi-Precious Stones

### 7.4.1 Inherent Vulnerability of Business

DPMS includes, but not limited to, dealers in metals and stones covered by the National Gem and Jewellery Authority Act, No. 50 of 1993 (NGJA Act), and they come under the AML/CFT purview when engaging in cash transactions with a customer, equal to or above the prescribed threshold which is currently USD 15,000<sup>18</sup>. The NGJA regulates the DPMS in Sri Lanka. Based on different activities carried out by individuals in the value chain, they are required to obtain a license from the NGJA to carry out the business legally. Accordingly, the details of licenses issued/renewed by the NGJA during the period from 2020-2022 are provided in the table given below.

**Table 8: Breakdown of the Licenses Issued/Renewed by the National Gem and Jewellery Authority**

Year	Gem Mining Licenses	Gem Dealing Licenses	Jewellery Shop Registration Certificates
2020	4,666	3,481	1,125
2021	4,434	3,628	840
2022	5,322	7,193	1,434

Source: National Gem and Jewellery Authority

Gem miners were excluded from the assessment as they cannot engage in dealing unless they obtain a gem dealer license separately. Further, the gem dealers include the exporters, gem manufacturers, whole-sellers, retailers, etc. The dealing license is issued by the NGJA based on the gross value of the stock of gems expected to be kept to a maximum during the year. For stock values ranging from Rs. 50,000 to Rs. 100,000,000, the license fee ranges between Rs. 5,000 and Rs. 100,000. On the other hand, the jewellery sellers must obtain jewellery shop registration certificates to engage in jewellery dealing and if they are willing to conduct gem dealing in the shop premises, they need to obtain a separate gem dealer license for that. Considering the scattered segments of the gem dealers, non-availability of data with the NGJA on sub-classification of the gem dealers such as exporters, gem manufacturers, whole-sellers, retailers, etc., and wide dispersion of the

18 As per FATF Recommendation 22 and Section 33 of the FTRA.

sector all over the country including Colombo, Ratnapura, Beruwala, Kandy, Galle and other geographical areas and their reachability issues, the registrations of the DPMS with the FIU was considerably low during past period which accounted to 187 as of December 2021.

Gem and jewellery dealers are considered as DNFBPs under the FTRA only when they engage in cash transactions with a customer, equal to or above the prescribed threshold which is currently USD 15,000 (around Rs. 4.8 million)<sup>19</sup>. As the whole-sellers and exporters mainly conduct bank transactions depending on the nature and volume of their business, retail gem dealers and jewellery shops were primarily considered for the assessment by the WG since they have a possibility of conducting cash transactions above the threshold. In order to obtain an accurate picture of the whole population, a sample of 300 of gem and jewellery dealers was selected with the assistance of the NGJA, including exporters, whole-sellers, retail gem dealers and jewellery shops. However, around 90 per cent of the sample constituted with retail gem dealers and jewellery shops. Also, as disclosed by them, most of these businesses are passed down through successive generations. Moreover, a substantial number of individuals in their clientele are personally acquainted with them as such individuals have been purchasing gold or gems from them consistently across multiple generations. The period of assessment was impacted from COVID-19 pandemic resultant travel restrictions, fuel crisis, country visit barriers and the adverse economic condition of the country where the DPMS sector was adversely affected by these conditions.

As per the annual reports of the CBSL, exports of gems, diamonds and jewellery details are given below. A significant improvement in exports of gems, diamonds and jewellery can be seen during the year 2022 which was due to the efforts on streamlining and strengthening the procedures relating to the export of gems.

**Table 9: Exports of Gems, Diamonds, and Jewellery**

Year	USD million	Share of Total Exports
2018	278	2.3%
2019	305.7	2.6%
2020	181.5	1.8%
2021	276.7	2.2%
2022	450.6(a)	3.4%(a)

(a) Provisional

Source: Annual Reports, Central Bank of Sri Lanka

Apart from the above volume related information of the DPMS sector, results of the survey conducted among DPMS was considered for the ranking of size and volume of the sector as medium. The number of employees, branch network within the country, foreign branches, existence of subsidiaries and affiliations, annual turnover, etc., of the institutions were considered for the given ranking.

The client-base profile of the business was also considered as having a medium risk as expatriates and foreign citizens can be identified as customers in this business sector in addition to domestic customers. Further, the client bases of DPMS consist of corporate customers, domestic/international PEPs, and high net-worth individuals. However, business transactions with NGO or NPO customers are at a very low level. Further, the

19 At the exchange rate of Rs. 320 per 01 USD.

level of cash activity involved in the business has been rated as having a medium risk exposure considering that around 73 per cent of the respondents recorded from zero to low level of cash usage in their business. Banking transactions, debit/credit cards, old gold exchanges, etc. are used by the customers as main payment methods in this sector.

The existence of ML typologies related to the abuse of the business was ranked as exist because there was open-source information on such cases, even though reliable statistics on cases or indictments were not available. However, there are typologies available in the global context related to the abuse of the business. The use of the business in fraud or tax evasion schemes have been identified as exist but limited considering the “Custom Ordinance” related violations that may lead to fraud/tax evasion schemes. On the other hand, the export of gemstones and jewellery is closely monitored by the NGJA and Sri Lanka Customs. All the gem exporters and suppliers of Sri Lanka requires a valid official gem dealer license issued by the NGJA and the exports are monitored by the “Gem Unit” of the Sri Lanka Customs.

The risk of non face-to-face use of the product in the business was ranked as available but limited as there are limited instances where gemstones or jewellery can be purchased via online platforms. However, the online purchases were mainly conducted during the COVID-19 period in low volumes and the DPMS conducts online CDD when such purchases are made. Further, due to the reason of CDD requirements are being properly adhered by the DPMS which was revealed through the supervisory activities of the FIU, the anonymity is not allowed by the DPMS. The risk arising from the use of agents in the business was also ranked low as around 76 per cent of the DPMS respondents have mentioned that they do not use agents or other professional intermediaries to deliver their products. Moreover, the transaction records were easily traceable and retrievable in the businesses as per the information obtained from the DPMS through the questionnaire and discussions.

#### ***7.4.2 Quality of Anti Money Laundering Controls***

In 1993, Sri Lanka enacted the NGJA Act to establish the NGJA for the development, regulation and promotion of the gem and jewellery industry. Accordingly, the licensing body for the DPMS has been clearly identified in the said law and the licensing criteria and regulations for the sector have been set up to control the entry to the sector. The NGJA carries out its licensing and entry control duties effectively in line with the criteria for granting, revoking, and renewing licenses established under the above Act. The FIU has submitted proposals on amending the NGJA Act to incorporate the AML/CFT obligations to be complied by the DPMS, fit and proper requirements for the sector, etc. The NGJA has drafted the required changes and currently the NGJA is in the process of getting the NGJA Act amended.

The NGJA has the required understanding and appreciation for the ML risks in the sector where they have participated in the awareness sessions and meetings conducted by the FIU time to time in this regard. The knowledge and information sharing process between NGJA, and the FIU continues with the MOU signed between two organizations in the year 2019.

The FIU has issued CDD rules for the DNFBPs sector in 2018 which are applicable to DPMS when they engage in cash transactions with a customer, equal to or above the prescribed threshold. Since January 2018, FIU has undertaken AML/CFT on-site supervision of DNFBPs under the RBA for DPMS. In addition, off-site ML/TF risk

assessment is conducted in November/ December every year, and thematic reviews were also conducted for the sector. NGJA provides their support in sharing and collecting the annual ML/TF off-site risk assessment questionnaires from the DPMS, and they have allocated their supervision officers to conduct joint AML/CFT onsite examinations with the FIU on DPMS. Following are the statistics on risk-based supervision for the DPMS sector during the assessment period.

**Table 10: Risk-Based Supervision of Dealers in Precious Metals and Precious Stones**

Year	Number of Examinations					Other Supervisory Actions Taken by the FIU	
	Progress Review Visits	On-site Examinations	Off-site Examinations	Follow up Examinations	Thematic Reviews	Warning Letters	Letters Informing Deficiencies
2018	13	-	-	-	-	47	-
2019	-	16	1	6	-	81	-
2020	-	4	2	5	-	-	9
2021	-	-	1	-	2 <sup>20</sup>	-	-
2022	-	8	1	-	-	-	8

Source: Financial Intelligence Unit – Sri Lanka

Further, the FIU conducts AML/CFT awareness/training programmes to enhance AML knowledge of the staff members of the sector and to enhance the effectiveness of the compliance function. Some of the programmes were conducted for the sector in collaboration with the NGJA, Sri Lanka Customs and LEAs. In addition to the assistance given for the AML/CFT trainings, the NGJA separately conducts sector related trainings/ awareness for the DPMS time to time. The NGJA continuously shares informative brochures relating to AML/ CFT on their website as well. The details of the awareness/training programmes conducted by the FIU during the assessment period are as follows.

**Table 11: Awareness/Training Sessions**

Year	2018	2019	2020	2021	2022
No. of Training Programmes	11	7	1	1	1

Source: Financial Intelligence Unit – Sri Lanka

AML/CFT compliance function is directly handled by the senior management, partners or owners of the businesses, and the Compliance Officers have the required knowledge and understanding to implement the AML/CFT policies and procedures within the Institutions. In addition, the integrity of the staff of the DPMS sector has been established through the employee screening processes usually carried out by the management/owners/partners when hiring employees to the business. A police report or a Grama Niladhari certificate is normally obtained from every employee by the businesses as a practice.

<sup>20</sup> Due to the travel restrictions and curfew situations resulted from COVID-19 pandemic, on-site examinations were not conducted during the year 2021 and hence, 02 thematic reviews were conducted.

However, the number of STRs submitted by the DPMS sector during the assessment period was low considering the business closure and interruptions to operations due to previously explained reasons.

#### **7.4.3 Deficiencies/Gaps Identified during the Vulnerability Assessment of the DPMS Sector**

- Lack of knowledge on ML/TF vulnerability of the sector and AML/CFT controls, especially within the businesses located outside the Colombo city such as Kandy, Beruwala, Ratnapura, and Galle areas.
- Although, policies are in place for suspicious activity reporting, effectiveness of reporting is low considering the reported number of STRs.

Accordingly, the overall vulnerability of the DPMS sector was assessed at **Medium**.

### **7.5 Lawyers and Notaries**

#### **7.5.1 Inherent Vulnerability of Profession**

Lawyers and notaries sector is one of the largest professional sectors in Sri Lanka and to practice law in Sri Lanka, one must be admitted and enrolled as an attorney-at-law of the Supreme Court of Sri Lanka. The legal profession in Sri Lanka is divided into two as official and unofficial bar. The official bar consists of state counsels serving in the AGD while unofficial bar consists of legal professionals engaged in private practice. A person who is qualified as an attorney has different career opportunities to work as a judge, President's Counsel, law officer in private or government entities or justice of peace, notary, company secretary or unofficial magistrate, etc. Attorneys are authorized to engage as notaries and company secretaries in Sri Lanka. Further, to practice as a notary public in Sri Lanka, a notarial license shall be obtained from the RGD and the license can only be applied by articled clerks and lawyers sworn at the Supreme Court. Also, the Minister (Minister of Home Affairs) may appoint qualified persons as notaries as per Section 4 (1) of the Notaries Ordinance No. 1 of 1907. The notary warrant is cancelled, if any notary is lawfully convicted of any offence or removed from the office of attorney-at-law. As per the statistics given on the website of RGD, there are 5,174 practicing notaries as of the end 2022. Warranted notaries who render their service through the legal firms may engage in defined activities as per FATF recommendations. Hence, FIU closely works with such notaries in appointing Compliance Officers and other related AML/CFT requirements who practice through the legal firms.

The professional body of the attorneys-at-law is the Bar Association of Sri Lanka (BASL) which can be considered as a Self-Regulatory Body (SRB) for the sector. Lawyers' profession has a dual controlling system where the profession is liable to the highest legal authority, the Supreme Court of Sri Lanka and the BASL also involves in support activities to the Supreme Court in managing the sector. However, there is no mandatory requirement to obtain BASL registration by every attorney-at-law whereas the number of members of the BASL has a discrepancy from the number of actual attorneys enrolled into the profession through the Supreme Court. There are around 25,000 registered lawyers in Sri Lanka according to the statistics of Supreme Court. As per the annual reports of the BASL, summary of their membership for the assessment period are as follows.

**Table 12: Membership of Bar Association of Sri Lanka**

Category	2018	2019	2020	2021
Life Membership	15,509	15,965	16,577	16,956
Ordinary Membership	4,970	4,788	5,055	5,474
<b>Total Membership</b>	<b>20,479</b>	<b>20,753</b>	<b>21,632</b>	<b>22,430</b>

Source: Bar Association of Sri Lanka

Lawyers and notaries are coming under the purview of the FTRA only when they prepare for or carry out transactions for their clients in relation to defined activities under the FTRA<sup>21</sup>. However, the BASL has no data on the activities carried out by their members and due to this data limitation, the individual lawyers engaged in defined activities cannot be traced. Further, considering the nature and volume of defined activity related transactions in Sri Lanka and the gathered information from sector experts in the WG, legal and notarial firms engaged in conducting defined activities were only considered for the assessment. In selecting the sample for the assessment, geographical location of the firm, number of employees, transaction volumes, etc. were considered. Accordingly, 16 firms with large to medium scale operations centered in Western province and registered with the FIU were selected for the sample. These 16 firms were considered for the assessment as they had declared that they are engaged in defined activities as per FATF recommendations.

Considering the above, the rating was given as medium high for total size/volume of the profession. The rating was primarily based on the fact of non-availability of information on the defined activities conducted by the profession in Sri Lanka. Existence of ML typologies on the abuse of the profession was ranked as exist but limited considering the available ML cases in Sri Lanka as well as in the global context. Also, there were 06 indicted cases for ML offending had involved deeds and notarial executed documents on purchasing real estates. However, no ML charges were framed against lawyers/notaries in these indictments. Further, the use of the profession in fraud or tax evasion schemes was ranked as exist but limited. Although there were no recorded number of instances for fraud/tax evasion by lawyers, there are occasional media records which leads to possibility of malpractices.

Non face-to-face use of the service is possible but in a limited level within the profession as there is a possibility for online service obtaining. According to the survey on the legal and notarial firms registered with the FIU, it was evident that the number of domestic/foreign PEPs, high-net-worth domestic as well as foreign individuals were low and hence, the risk of client-base profile of the profession was considered low in the assessment. Cash, cheques, debit/credit cards, bank drafts and wire transfers are collectively used as the transaction modes in the profession. Around 78 per cent of the respondents indicated a zero to low level of cash activity associated in their profession and hence, the variable was ranked low risk in the assessment. As per 89 of per cent legal and notarial firms participated in the survey, there is a low usage of agents in their profession.

21 Defined activities applicable for lawyers, notaries, and accountants include (i) buying and selling of real estate; (ii) managing of client money, securities, or other assets; (iii) management of bank, savings, or securities accounts; (iv) organization of contributions for the creation, operation, or management of companies; and (v) creation, operation or management of legal person or arrangements and the buying and selling of business entities.

Furthermore, the anonymous use of the service in the profession was ranked as not available since beneficial owner of the transaction is identified and verified through identification document verification and adhering to CDD requirements, and hence the real clients are always known by the profession.

#### ***7.5.2 Quality of Anti Money Laundering Controls***

The legal profession in Sri Lanka was recognized by the Charter of Justice in the year 1802. Prior to 1974, the legal profession consisted of two branches namely the Advocates of Sri Lanka and the Proctors of Sri Lanka. The “Bar Council of Sri Lanka” represented the Advocates in Sri Lanka, and the “Law Society of Sri Lanka” represented the Proctors in Sri Lanka in all matters affecting their respective practices. With the enactment of the Administration of Justice Law, No. 44 of 1973, the said two branches were amalgamated into a single group of legal practitioners named as attorneys-at-law. Further, the legal professionals in Sri Lanka are governed with higher standard professional ethics under the controls of the Constitution, provisions of the Judicature Act, No. 02 of 1978, the Supreme Court (Conduct and Etiquette for Attorneys-at-Law) Rules, 1988. In addition, the notaries conduct is governed by the Notaries (Amendment) Act, No. 31 of 2022 (Notaries Ordinance). A registry of notaries is maintained by the RGD.

There were instances that revoked and temporary ceasing of license to practice as attorneys in Sri Lanka. Further, the following entry controls have been established to protect the integrity of the profession.

- Foreign entities cannot enter this profession.
- Legal professional service outsourcing is not possible.
- Foreign citizens cannot be employed.
- Attorney has to be a Sri Lankan citizen, enrolled by the Supreme Court as a qualified attorney.

Following special facts were also found regarding the integrity of the profession.

- Supreme Court is the regulating body for attorneys in Sri Lanka.
- Supreme Court Conduct of Etiquette for attorneys issued in the gazette of 7th December 1988 by the Supreme Court.
- Disciplinary actions will be taken for conducts outside the professional sphere.
- Suspension for unethical conduct is available.
- Section 42 of the Judicature Act states that attorneys shall be guilty of any malpractices or offences will be suspended from practice or revoke from office by 3 judges of the Supreme Court sitting together.
- Bar Association also has a role to play in ethical conducts of attorneys. BASL has a disciplinary committee.
- Lawyers' conduct should abide by the Supreme Court rules.

The CDD Rules for DNFBPs issued by the FIU are applicable to lawyers and notaries who are engaged in defined activities. Further, the FIU has drafted and in the process of issuing the “Guidelines on AML/CFT Compliance Obligations for Lawyers and Notaries”. The FIU started conducting off-site examinations for the sector in 2020 despite the fact that the number of firms registered with the FIU was low as many firms are

not engaged in providing defined activities. Off-site monitoring covered the compliance with main AML/CFT requirements stipulated by the FTRA and the CDD Rules based on the tool developed with the assistance of the IMF. The tool covers risks arising from inherent factors and the available AML controls of an Institution. A risk score is calculated as per the risks arising from the above factors to decide the ML/TF related risk level of the Institution.

Further, the FIU conducts AML/CFT awareness/training programmes to enhance AML knowledge of the members of the sector and to enhance the effectiveness of the compliance function. AML/CFT compliance function is directly handled by the senior management /partners of the firms. Some of the programmes were conducted for the sector in collaboration with the BASL. The BASL continuously provides support relating to the proper implementation of AML/CFT measures within the sector and to strengthen the AML/CFT regime. The details of the awareness/training programmes conducted by the FIU during the assessment period are as follows.

**Table 13: Awareness/Training Sessions**

Years	2018	2019	2020	2021/22
No. of Training Programmes	6	2	1	1

Source: Financial Intelligence Unit - Sri Lanka

Further, the number of suspicious activity/transactions reports reported by lawyers and notaries is at a very minimum level and therefore, suspicious activity monitoring and reporting requires improvement.

Accordingly, the overall vulnerability of the Lawyers and Notaries sector was assessed at **Medium**.

## 7.6 Accountants

### 7.6.1 Inherent Vulnerability of Profession

Several professional bodies offer professional accounting qualifications and serve as SRBs for their respective members, such as the Institute of ICASL, Chartered Institute of Management Accountants of the United Kingdom (CIMA-UK), Association of Chartered Certified Accountants (ACCA), Association of Accounting Technicians of Sri Lanka (AAT) and Certified Management Accountants of Sri Lanka (CMA-Sri Lanka). There are government accountants serving in the public sector apart from the members of the bodies stated above. Therefore, quantifying the number of accountants and size of the sector is a cumbersome process as they provide services in a wide array of businesses and no single database to gather information on the same. However, ICASL which was founded in 1959 is considered as the largest professional accountancy body in the country. ICASL is the only accredited authority that formulates Accounting and Auditing Standards in Sri Lanka. Further, many accountants have dual or more accounting qualifications from the aforesaid professional bodies where quantification of the sector is not possible.

However, as per the information obtained from ICASL, number of active members for the assessed period are as follows.

**Table 14: Active Members of the Institute of Chartered Accountants of Sri Lanka**

	2018	2019	2020	2021	2022
Resident	4,405	4,561	4,566	4,582	4,480
Non-Resident	1,210	1,382	1,332	1,367	1,590
<b>Total</b>	<b>5,615</b>	<b>5,943</b>	<b>5,898</b>	<b>5,949</b>	<b>6,070</b>

Source: Institute of Chartered Accountants of Sri Lanka

There are large, medium and small-scale accounting and auditing firms in Sri Lanka. Most of these firms are in bookkeeping, payroll and financial advisory services to small to medium-sized businesses. However, the large-scale accounting and auditing firms are into specified activities as per FATF recommendations.

Most of the individual professional accountants belonging to all above accounting bodies serve in private or government companies, do not prepare for, or carry out transactions in relation to defined activities coming under the FTRA<sup>22</sup>. Defined activities are generally offered by the accounting/auditing firms on behalf of their clients. Establishment of accounting and auditing firms are permitted only for the professional members of ICASL in Sri Lanka. As per the information collected from ICASL, the total number of such audit firms were 619 and 608 respectively for the years 2019 and 2020. Considering these facts and as there is no single source to identify the volume of the accountants' sector, overall assessment was limited to the established accounting and auditing firms under the authority of ICASL. Hence, the survey questionnaire was circulated among 30 selected institutions registered with the ICASL. Around 98 per cent of the audit firms belong to small to medium size category with less than 5 partners. Considering these facts, the rating for total size/volume of the sector was assigned as medium.

Existence of ML typologies on the abuse of the profession and the use of the profession in fraud or tax evasion schemes were ranked as exist but limited. The accountants are not directly charged against ML cases in Sri Lanka. However, there are several investigations and indictments which relate to some involvement of the auditor/ accountant and the fraudulent practices leading to some cover up in the annual returns/financial statements etc.

Further, the non face-to-face use of the service in the profession was ranked as available but limited considering the limited possibility of obtaining online services to some extent. However, the anonymous use of the service in the profession was not available and the transaction records were easily traceable and retrievable.

More than 80 per cent of the accountants participated in the survey, had an insignificant number of domestic/international PEPs, high net-worth individuals, non-resident clients particularly from high-risk jurisdictions as clients. Hence, the risk arising from the client base of the sector has been ranked as low. Cash, cheques, debit/credit cards, bank drafts and wire transfers are collectively used as the transaction modes in the profession. However, the level of cash associated with the profession has been ranked as low based on the fact that

22 Defined activities applicable for lawyers, notaries, and accountants include (i) buying and selling of real estate; (ii) managing of client money, securities, or other assets; (iii) management of bank, savings, or securities accounts; (iv) organization of contributions for the creation, operation, or management of companies; and (v) creation, operation or management of legal person or arrangements and the buying and selling of business entities.

around 85 per cent of the respondents reported zero to low level cash utilization in the profession. Further, the risk arising from use of agents in the profession was also ranked as low in the assessment as 78 per cent of the respondents have indicated that they are not allowing use of agents in their profession.

#### **7.6.2 Quality of Anti Money Laundering Controls**

The members of the professional bodies are governed by the Acts, Regulations or by laws and code of ethics of each professional body. The SLAASMB is the mandated organization by the Sri Lanka Accounting and Auditing Standards Act, No. 15 of 1995, for monitoring the quality of the private sector financial reporting and auditing from a regulatory perspective. Further, the main SRB for the accounting professionals, the ICASL, has been established under the Institute of Chartered Accountants Act, No. 23 of 1959. Effective entry controls are maintained by all the SRBs including ICASL for the sector as they can cancel the membership for any misconduct in terms of applicable laws and code of ethics.

The CDD Rules for DNFBPs issued by the FIU in 2018 are applicable for accountants who are engaged in the defined activities. The FIU issued the Guidelines on AML/CFT Compliance Obligations for Accountants and TCSPs in 2020. The ICASL has also issued an AML/CFT guidance for their members in accordance with the Guidelines issued by the FIU in June 2020.

The FIU started conducting off-site examinations for the sector in 2020 despite the fact that the number of firms registered with the FIU was low as many firms are not engaged in providing defined activities. Off-site monitoring covered the compliance with main AML/CFT requirements stipulated by the FTRA and the CDD Rules based on the tool developed with the assistance of the IMF. The tool covers risks arising from inherent factors and the available AML controls of an Institution. A risk score is calculated as per the risks arising from the above factors to decide the ML/TF related risk level of the Institution.

Moreover, the FIU conducts AML/CFT awareness/training programmes to enhance AML knowledge of the members of the sector and to enhance the effectiveness of the compliance function. AML/CFT compliance function is directly handled by the senior management /partners/owners of the firms. Some of the programmes were conducted for the sector with the assistance and guidance of the ICASL. The ICASL works in collaboration with the FIU in raising awareness among their members on applicable AML/CFT requirements and in addition, they conduct separate programmes for profession related awareness. The details of the awareness/training programmes conducted by the FIU during the assessment period are as follows.

**Table 15: Awareness/Training Sessions**

Years	2018	2019	2020	2021/22
No. of Training Programmes	6	1	2	1

Source: Financial Intelligence Unit – Sri Lanka

Further, the number of suspicious activity/transactions reports reported by accountants is at a very minimum level and therefore, the effectiveness of suspicious activity monitoring and reporting require improvement.

Accordingly, the overall vulnerability of the Accountants was assessed at Medium Low.

## 7.7 Trust and Company Service Providers

### 7.7.1 Inherent Vulnerability of Profession

The TCSPs in the country mainly comprise legal professionals and chartered accountants, who provide secretarial functions to companies and trusts. The DRC acts as the regulator for Company Service Providers as per the provisions of the Companies Act, No. 7 of 2007. To act as a Company Service Provider, an individual should be registered with the DRC, satisfying the Registrar that the service provider is qualified. There are two types of service providers registered as secretaries and auditors. There are 13,928 individual secretaries and 588 secretary firms, as well as 1,702 individual auditors and 360 auditor firms registered with the DRC as of 2021. Additionally, legal professionals in the country primarily handle services related to trusts. There are less than 200 trusts registered under the Trust Ordinance, No. 9 of 1917. In general, most of the legal professionals do not have exposure to provide services related to trusts. The perception of the participants of the TCSPs group of the NRA was that only few institutions engage in the defined activities<sup>23</sup> such as formation of trusts. Considering the above, the total size/volume of the sector is rated as medium high.

The existence of ML typologies on the abuse of the profession and the use of the profession in fraud or tax evasion schemes were ranked as exist but limited as the TCSPs are not linked to any STRs or ML investigations during the assessed period. However, there are possible cases linking TCSPs on providing the service of formation of legal persons via DRC. Further, according to the FATF reports, criminals often seek out the involvement of legal professionals in their ML/TF activities because they may be required to complete certain transactions or provide access to specialized legal and notarial skills and services, both of which can assist the laundering of the proceeds of crime.

Non face-to-face use of the service is available but limited in the profession considering the possibility of obtaining the service via online platforms to a certain extent. However, TCSPs take controls to avoid providing services to clients who appear to be inexplicably avoiding face-to-face meetings or who provide instructions intermittently without legitimate reasons and are otherwise evasive or very difficult to reach. Anonymous use of the service in the profession is not facilitated. Most of the TCSPs do not use agents or other professional intermediaries to deliver their services.

Some TCSPs maintain transaction records in paper format and mostly the firms with large client bases use electronic systems to store the records which enables to trace them easily. Nevertheless, around 93 per cent of the respondents indicated that they have easily retrievable record keeping mechanism within their institutions.

About 70 per cent of the respondent TCSPs do not provide services to PEPs or high net worth individuals. Also, the number of non-resident clients particularly from high-risk jurisdictions, are reported at minimum in the sector. Considering this survey outcome, the variable on client base profile was rated at low risk in the assessment. Transaction modes such as cash, cheques and electronic fund transfers are commonly used in the sector. 65 per cent of the TCSP respondents mentioned a zero to medium low-level conduct of cash transactions within the sector where the level of cash activity was ranked low risk.

23 Defined activities applicable for TCSPs include (i) formation or management of legal persons (ii) acting as or arranging for another person to act as, a director or secretary of a company, a partner or a partnership or a similar position in relation to other legal persons (iii) providing a registered office, business address or accommodation, correspondence or administrative address for a company, a partnership or for any other legal person or arrangement Financial Transactions Reporting Act, No. 6 of 2006 33 (iv) acting as or arranging for another person to act as, a trustee of an express trust (v) acting as or arranging for another person to act as, a nominee shareholder for another person)

### 7.7.2 *Quality of Anti Money Laundering Controls*

As per the Extraordinary Gazette 471/6 dated 14 September, 1987 under the Companies Act, No. 17 of 1982, a person to be eligible to register under the DRC as a company secretary, he/she should be a citizen of Sri Lanka and be either an attorney-at-law, a member of the ICASL, a member of the Association of Chartered Secretaries and Administrators, a member of the CIMA-UK, a member of the CMA-Sri Lanka, or if the applicant is unable to meet the above qualifications, the applicant must have 20 years' experience in the company secretarial field. Although the Companies Act, No. 17 of 1982 was later repealed by the Companies Act, No. 7 of 2007, the eligibility criteria specified in the Extraordinary Gazette 471/6 dated 14th September, 1987 for registering as a company secretary, still remain in effect. Additionally, as per the provisions under Section 157 of the Companies Act, No. 7 of 2007, no person shall be eligible for appointment as an auditor of a company unless he is a member of the ICASL or is a registered auditor.

The availability and effectiveness of entry controls to the profession is identified as excellent and the integrity of the staff and the AML knowledge of the staff is given a higher rating considering the Acts, regulations, and directions issued by the regulators and the codes of ethics issued by the SRBs to which the members are expected to adhere with.

The FTRA and the CDD Rules for the DNFBP sector issued in 2018 are applicable to TCSPs when providing defined services to third parties. The FIU issued guidelines on AML/CFT Compliance Obligations for TCSPs in 2020. The FIU started conducting off-site examinations for the sector in 2020 despite the fact that the number of firms registered with the FIU was minimum as many firms are not engaged in defined activities. Off-site monitoring covered the compliance with main AML/CFT requirements stipulated by the FTRA and the CDD Rules based on the tool developed with the assistance of the IMF. The tool covers risks arising from inherent factors and the available AML controls of an Institution. A risk score is calculated as per the risks arising from the above factors to decide the ML/TF related risk level of the Institution.

Moreover, the FIU conducts AML/CFT awareness/training programmes to enhance AML knowledge of the members of the sector and to enhance the effectiveness of the compliance function. AML/CFT compliance function is directly handled by the senior management /partners/owners of the firms. Some of the programmes were conducted for the sector with the assistance of DRC. The details of the awareness/training programmes conducted by the FIU during the assessment period are as follows.

**Table 16: Awareness/Training Sessions**

Year	2018	2019	2020	2021	2022
No. of Training Programmes	5	-	1	-	1

Source: Financial Intelligence Unit – Sri Lanka

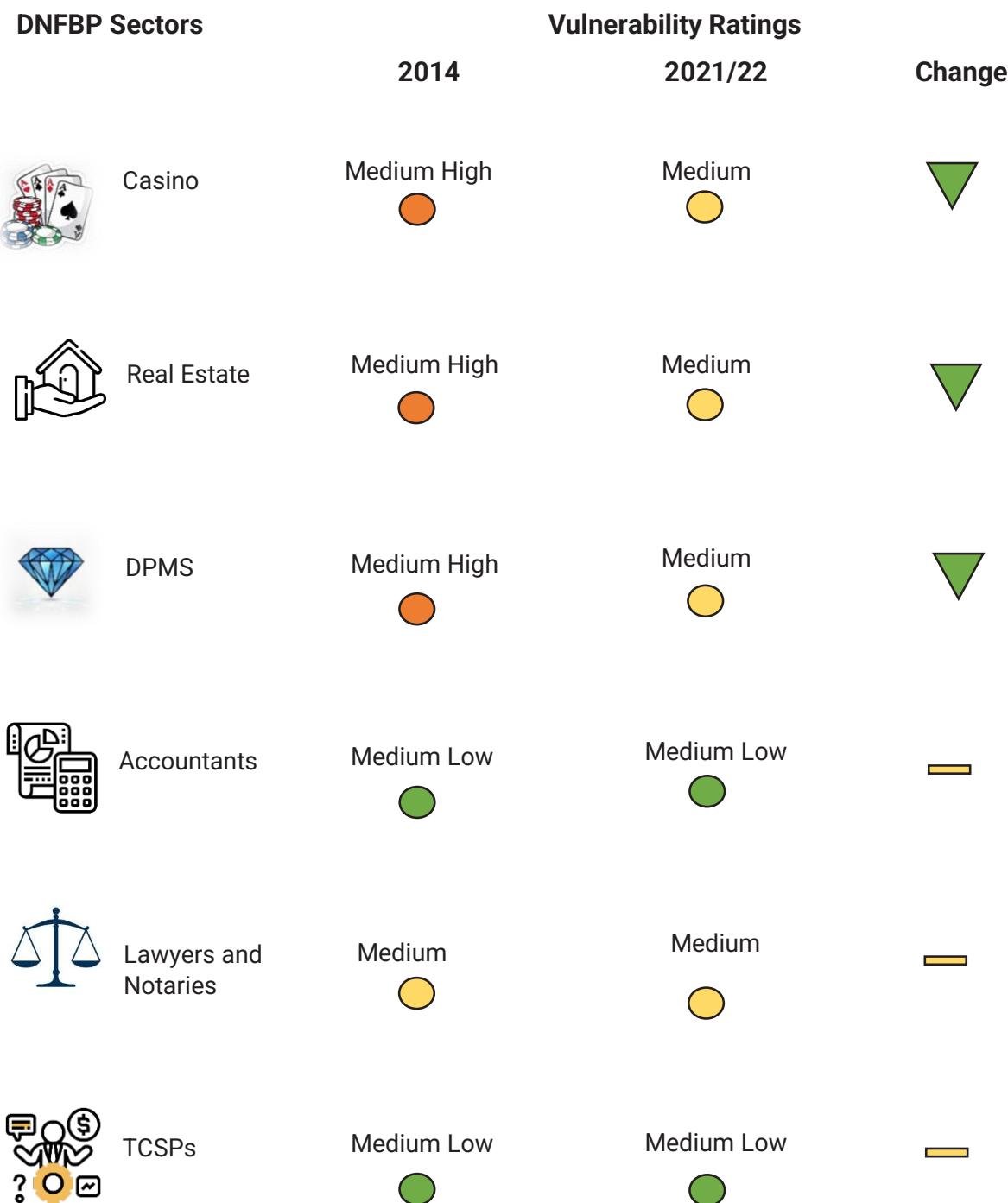
Further, the number of suspicious activity/transactions reports reported by TCSPs is at a very minimum level and therefore, the effectiveness of suspicious activity monitoring and reporting of TCSPs requires improvement.

Accordingly, the overall vulnerability of the TCSPs was assessed at **Medium Low**.

***7.7.3 Deficiencies/Gaps Identified in Lawyers and Notaries/ Accountants/ Trust and Company Service Providers***

- There was no data source to identify the individuals or firms engaged in captured activities specified in the FTRA.
- Although, policies are in place for suspicious activity reporting, effectiveness of reporting is low considering the reported number of STRs.

Figure 1: Key Changes from National Risk Assessment 2014



## 8. TERRORIST FINANCING RISK ASSESSMENT

TF risk is assessed as **Medium**. TF risk is derived based on TF threat, Sectoral TF risk, and TF vulnerability, which are further discussed in detail hereafter.

### 8.1 National Terrorist Financing Threat Assessment

The TF threat, which is considered under four elements: the domestic TF threat, outgoing TF threat, incoming TF threat and transit TF threat, is assessed as **Medium** based on six aspects as outlined below.

#### ***8.1.1 Terrorist Financing Threat which Stems from the Level of Active Terrorist Threat in the Country***

On Easter Sunday in 2019, Sri Lanka faced a sudden attack from an extremist group which was the most severe terrorist activity in Sri Lanka since the Liberation Tigers of Tamil Eelam (LTTE) was defeated militarily in 2009. Following the attack, the Sri Lankan authorities have initiated multiple measures from the lessons learned. The country's intelligence services have maintained continuous vigilance to detect any possible terrorist activities. For instance, as an immediate response, the government issued a gazette notification proscribing 11 extremist terrorist organizations.

The investigation into the TF aspects of the Easter Sunday attacks was conducted through various means, including financial intelligence gathering, tracing the financial transactions of the attackers, and cooperation with international counterparts. Sri Lanka's FIU, which is responsible for collecting, analyzing, and disseminating financial intelligence to combat ML, TF, and other financial crimes, played a crucial role in the investigation. The FIU worked closely with other law enforcement agencies, including the CID and the CTID, to identify and track the sources of funding for the attacks. This involved analyzing financial transactions, conducting forensic accounting, and tracing the movement of funds through various channels, including banks, informal money transfer networks, and other financial institutions. The investigation also involved international cooperation, as it was suspected that the attackers had received support from international terrorist networks. Sri Lanka sought assistance from foreign governments and international organizations in sharing intelligence, conducting investigations, and freezing assets linked to TF. This collaborative approach helped in identifying and disrupting the funding sources and networks that supported the attackers.

As a result of the investigations, several individuals and entities were identified and arrested in connection with the suspicion of TF related to the Easter Sunday attacks. Assets and funds suspected of having links to TF were frozen, and measures were taken to prevent the further flow of funds to terrorist networks. The investigation into the TF aspects of the Easter Sunday attack highlighted the importance of robust financial intelligence gathering, effective cooperation among LEAs, and international collaboration in CFT. It also underscored the need for ongoing efforts to monitor and disrupt the flow of funds to terrorist networks, both domestically and internationally, to prevent further attacks and dismantle their financial infrastructure.

However, no significant terrorist activity has been reported in the country since the Easter Sunday attack. This indicates that the trend of terrorism threat is decreasing. Further, the State Intelligence Service (SIS),

the intelligence units of the three forces (Army, Navy, and Air Force) and intelligence units attached to the Sri Lanka Police have constantly been initiated to look for terrorist activities. Also, the CTID attached to the Sri Lanka Police is conducting investigations based on information received regarding past terrorist activities and potential terrorist activities in the future. As a result of such activities carried out by these intelligence and investigation units, Sri Lanka has developed avenues to gain prior awareness of possible terrorist activities and to promptly take action upon them in the future.

In the intelligence agencies' view, the current terrorism threat level is low. Except for the Easter Sunday incident, the deaths caused by terrorist activities for the assessment period is extremely low, the level of ancillary activities to terrorist acts in the country in the last five years was identified at a low level, and there had been minimal reported terrorist activities in Sri Lanka over the past five years.

The Easter Sunday attack in 2019 caused Sri Lanka to move up 35 places in the Global Terrorism Index (GTI) ranking<sup>1</sup> for 2020, placing the country at 20 (Increasing the position of a country on the GTI Index indicates a high impact of terrorism). However, in 2021, the country was ranked 25, and in 2022 the country was ranked 29, which shows a decreasing threat of terrorism in the country.

Sri Lanka has established mechanisms to obtain advanced information on possible terrorist threats from other countries. There is no confirmed information on the presence of foreign terrorist fighters in Sri Lanka. Additionally, there are no deaths occurred in Sri Lanka due to cross-border terrorist activities.

### ***8.1.2 Terrorist Financing Threat Arising from Terrorist Persons, Groups, and Organizations***

Under the United Nations Security Council Resolution (UNSCR) 1373, 18 entities and 577 individuals have been designated during the assessment period (15 entities and 316 individuals as of August 01, 2022), and these entities and people are mainly related to the LTTE and other extremist groups that are banned in Sri Lanka. Over the last five years, the LTTE organization and 13 extremist groups have been identified as posing a threat to the country's national security and banned by the Prevention of Terrorism (Proscription of Extremist Organizations) Regulations, No. 2 of 2021 and Prevention of Terrorism (Proscription of Extremist Organizations) Regulations, No. 1 of 2019, which were issued under section 27 of the Prevention of Terrorism (Temporary Provisions) Act, No. 48 of 1979 in Sri Lanka.

#### ***8.1.2.1 The funding needs of LTTE were found to be low.***

There were some reported activities which were done to show that LTTE may still be active, such as purchasing vehicles, attempts to recover war equipment buried during the war, and possibly gathering people connected to LTTE in foreign countries, which may require funding.

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<sup>1</sup> The Global Terrorism Index (GTI) is a comprehensive study analyzing the impact of terrorism for 163 countries covering 99.7 per cent of the world's population.

The GTI report is produced by the Institute for Economics and Peace using data from Terrorism Tracker and other sources. The GTI produces a composite score so as to provide an ordinal ranking of countries on the impact of terrorism. The GTI scores each country on a scale from 0 to 10; where 0 represents no impact from terrorism and 10 represents the highest measurable impact of terrorism.

<https://www.visionofhumanity.org/maps/global-terrorism-index/#/>

*8.1.2.2 The funding needs of other extremist groups were found to be low.*

In terms of other extremist groups, before the Easter Sunday attack, some of these organizations conducted programmes and lectures to spread their ideology across the Island. They mainly needed money for planning, propagandizing, and training. However, after the Easter Sunday attack, no such activities were observed.

*8.1.2.3 The fundraising activity of LTTE was found to be minimum.*

According to investigations, there is no evidence of money being collected for LTTE activities in Sri Lankan territory.

*8.1.2.4 The fundraising activity of other extremist groups was found to be minimum.*

In relation to other groups – no fundraising activities have been identified after banning the extremist groups. However, possible grants from sympathizers, self-funding, and possible assistance from NGOs are suspected as possible fundraising sources before banning.

*8.1.2.5 The type of assets used by the LTTE was found to be limited.*

As per the intelligence information by SIS, during the post-war period, there have been attempts by the LTTE members to use drones.

*8.1.2.6 The type of assets used by the other extremist groups was found to be limited.*

Concerning other extremist groups, they have been observed using cash and some goods that may be strategic in nature in their operations before the Easter Sunday attack. As per the information by the SIS, chemicals such as nitric acid, sulfuric acid, sulphur, and urea were utilized by the Easter Sunday attack group to produce explosive devices. They also used drones<sup>2</sup> for reconnaissance. However, information about such activities was not reported after the attack.

*8.1.2.7 Channels used to transfer funds by the LTTE was found to be medium.*

Regarding the channels used to transfer funds, investigations have revealed some instances where LTTE activists in other countries have transferred money to banks and people in Sri Lanka who had connections with LTTE, using money remittance services.

*8.1.2.8 Channels used to transfer funds by other extremist groups were found to be medium.*

Concerning other extremist groups, following the banning of the extremist groups, the court suspended bank accounts suspected of being used by extremist groups. Further, there is no evidence that funds are currently being transferred in connection with terrorist activities.

Based on the above reasons, the domestic and cross-border TF threat posed by terrorist organizations, groups, and individuals who have been designated or for whom reasonable grounds exist to believe they are engaging in terrorist operations in the country is rated as medium and expected to remain same in the near future.

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<sup>2</sup> An unmanned aerial vehicle (UAV), commonly known as a drone, is an aircraft without any human pilot, crew, or passengers on board

### **8.1.3 Terrorist Financing Threat Associated with Sympathizers**

The Easter Sunday attack demonstrated that individual radicalization and extremist ideology were a threat in the country. According to SIS information, all of the suicide bombers involved in the Easter Sunday attack were Sri Lankan citizens affiliated with an extremist group that was banned after the attack. They had promoted an “Islamist State Ideology” to create a global jihadist movement in Sri Lanka. They had connections with international terrorist organizations and individuals who preached violent extremism. Further, they conducted workshops and training camps to educate military activities. However, with the security measures taken following the Easter attack, such activities have been reduced significantly within the country. As per CTID, there have been a number of investigations relating to possible TF-based suspicions. However, there have been no prosecutions or convictions initiated against any person or entity based on the findings of investigations regarding the financing of terrorists. There are currently no active terrorist geographical areas in Sri Lanka, and accordingly, inward remittances to a specific geographical area cannot be identified as suspicious. The domestic TF threat stemming from the persons in the Sri Lankan population that may be sympathetic to terrorist persons or ideology can be assessed as medium with a decreasing trend compared to past years. The cross-border threat can also be assessed as medium and expected to remain the same in the near future.

### **8.1.4 Terrorist Financing Threat Arising from Active Terrorist Threat in Neighbouring Countries**

According to information from the country's intelligence agencies, there is no information that Sri Lanka is experiencing terrorist threats from other countries in the region, including India, despite India being ranked 13th out of 163 countries as per the GT Index for the year 2022. As a result, incoming TF threat from the active terrorist threat of neighbouring jurisdiction is rated as medium while outgoing TF threat from active terrorist threat is rated as low, and both incoming and outgoing TF threat is expected to remain the same in the near future.

### **8.1.5 Terrorist Financing Threat Arising from being a Finance and Trade Hub**

TF threat arising from being a finance and trade hub is rated as medium, and the trend for this variable can be identified as increasing with the proposed Colombo Port City, which is expected to become a regional financial hub in the future. According to the latest statistics, it can be inferred that Sri Lanka does not function as an international or regional financial hub or as a significant trading jurisdiction. However, Sri Lanka can be considered a major transshipment hub. As per the statistics of the Sri Lanka Export Development Board, the Port of Colombo has reported transshipment volume accounted for more than 75 per cent of the total container quantity, which shows a significant level of transshipment (Transshipment incidence above 50 per cent is generally considered to be a significant level of transshipment). In addition, India, a neighbour in close proximity and a country with a higher terrorist threat as per the GT Index is a major trading partner of Sri Lanka. It is known that the volume of goods that flow through trade hubs generally makes enforcement against illicit activities and detection of suspicious activities harder. This may be of particular relevance if the Country, neighbouring countries, or major trading partners experience an active terrorist threat. Accordingly, as India is a major trading partner and neighbour of Sri Lanka, there might be a possibility for the country to face a TF threat emanating from India.

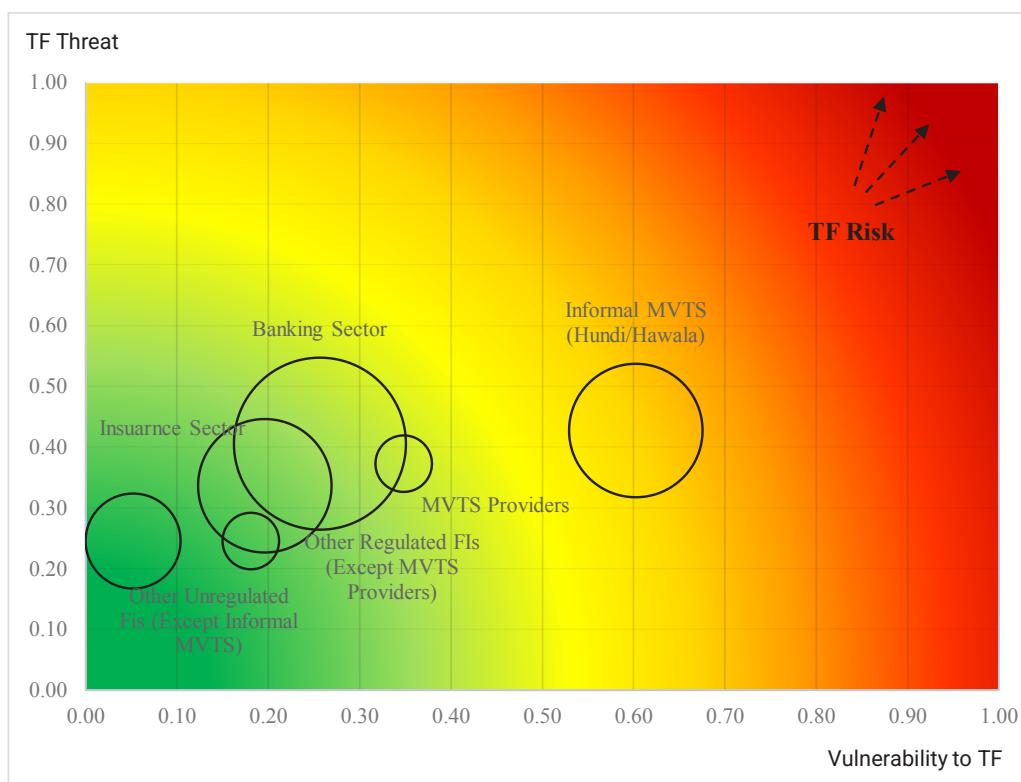
### 8.1.6 Terrorist Financing Threat Arising from Providing Strategic Goods and Services to Active Terrorist Threat Area

As per the information received from intelligence agencies, currently, there are no areas in Sri Lanka that have been identified as active terrorist threat areas since the military defeat of the LTTE, which had control of over 70 per cent of the landmass in the Northern and Eastern Provinces. Further, as per the information on the Sri Lanka trade information portal, before importing goods into Sri Lanka, importers should ensure that those goods do not fall into the category of prohibited goods. Prohibited goods cannot be imported, exported, transited, sold, or circulated in Sri Lanka. The Ministry of Defence (MOD) controls the import of firearms and ammunition for use by the armed forces, Police, and civil security. Further, certain military-related or dual-use items are prohibited or controlled. Furthermore, explosives and minerals in raw forms are under the items prohibited for export from Sri Lanka<sup>3</sup>. Hence, the impact of importing and exporting strategic goods and services to areas with an active terrorist threat on the domestic TF threat can be identified as low. The trend for this variable is expected to remain the same in the near future.

## 8.2 Sectoral Risk Assessment

The Sectoral risk assessment indicated the informal MVTS (Hundi/Hawala) sector as the highest possible TF risk sector in Sri Lanka. The most important sector is the Banking Sector. However, the TF risk level of the sector was found to be at a lower level. Additionally, the sectoral TF risk of the other sectors found to be low (Other Regulated FIs (except MVTS Providers), MVTS Providers, Other Unregulated FIs (except Informal MVTS), Security Sector and DNFBP sector).

Figure 1: Terrorist Financing Risk Heat Map of each Sector



<sup>3</sup> <https://www.srilankabusiness.com/pdf/export-procedure-21-10-2014.pdf>

**NPO Sector:** As per the final ratings of the module, no NPO category has exceeded the medium rating in respect of threat, where all six categories ranged between low to medium (vide Identifying the Categories of NPOs at Risk of Abuse for TF). Hence, NPO Sector is not considered in this TF Risk Assessment.

## 8.3 National Terrorist Financing Vulnerability of Sri Lanka

### 8.3.1 National Combating Ability

Sri Lanka has taken several measures to enhance its TF combating ability in recent years. The country has enacted legislation to criminalize TF and implement international standards for AML/CFT. In 2007, FIU was established under the CBSL to strengthen the country's AML/CFT regime. Sri Lanka has also strengthened its cooperation with international organizations, such as the FATF and Asia Pacific Group on Money Laundering (APG), to enhance its TF combating ability. The country has undergone two Mutual Evaluations to assess its AML/CFT regime's effectiveness and has made progress in addressing identified weaknesses. Moreover, Sri Lanka's financial sector has taken measures to prevent the misuse of the financial system for TF. FIs are required to implement customer due diligence procedures, including enhanced due diligence measures for high-risk customers, and report suspicious transactions to the FIU.

The national TF combating ability is assessed with 23 input variables that assess the legal and regulatory framework, institutional framework, financial system integrity, international cooperation, risk assessment and management, NPO regulation and public awareness and outreach.

Accordingly, following ratings were arrived at for the 23 variables that determine national combating ability:

**Very High:** Availability and Effectiveness of TF Asset Forfeiture and Confiscation.

**High:** Criminalization of Terrorism and Terrorist Financing, Effectiveness of International Cooperation.

**Medium High:** Quality of CFT Policy and Strategy, Effectiveness of Customs Controls on Cash and Similar Instruments, Quality of FIU Intelligence Gathering and Processing for TF, Capacity and Resources for Financial Crime Investigations, Capacity and Resources for Financial Crime Prosecutions, Integrity and Independence of Financial Crime Prosecutors, Capacity and Resources for Judicial Processes, Integrity and Independence of Judges, Effectiveness of Domestic Cooperation, Effectiveness of Targeted Financial Sanctions (TFS) Legislation, Availability of Independent Information Sources, Availability and Access to BO information, Availability of Reliable Identification Infrastructure.

**Medium:** Effectiveness of Border Controls on Goods (incl. military and strategic goods), Effectiveness of Immigration Controls, Integrity and Independence of Financial Crime Investigators, Quality of Other Intelligence Agencies' TF Intelligence Gathering and Processing, Comprehensiveness of TFS Legislation, Controls on Provision of Strategic Equipment, Goods and Services to Conflict Zones.

**Close to nothing:** Formalization Level of Economy.

Based on the combating ability, the assessment concluded the national vulnerability to TF under four categories, which is shown below in Table 1.

**Table 1: National Terrorist Financing Vulnerability of Sri Lanka**

Category	Vulnerability to TF
Domestic TF Risk	Medium
Outgoing TF Risk	Medium
Incoming TF Risk	Medium
Transit TF Risk	Medium

When arriving at the above vulnerabilities, analysis of some of these variables is identical to the ML vulnerability, and they are not detailed in this report *vide* ML vulnerability (integrity and independence of judges, effectiveness of customs controls on cash and similar instruments, effectiveness of international cooperation, formalization level of economy, availability of reliable identification infrastructure, availability of independent information sources, and availability and access to BO information).

#### *8.3.1.1 Quality of Countering the Financing of Terrorism Policy and Strategy*

The country has implemented a comprehensive legal and regulatory framework to combat TF, which includes the CSTFA, the PMLA and the FTRA. Sri Lanka is updating the national AML/CFT policy as the existing CFT Policy and Strategy expired in 2020. During the NRA, the TF risk borne by the banking sector, insurance sector, securities sector, DNFBP sector, and other FIs has been assessed to fully understand the national TF risk. Further, a separate NPO TF risk assessment was also carried out, however the results of which were not incorporated into the overall sectoral TF risk assessment as it did not meet the required risk levels to be incorporated. Additionally, the assessment is conducted with the participation of all relevant stakeholder institutions under the leadership of NCC and in coordination with the FIU.

In Sri Lanka, the National Security Council (NSC) acts as the apex body coordinating intelligence agencies and other agencies related to Terrorism and TF. As per the National Security Council Regulations, No. 1 of 1999, the NSC is the high-level inter-agency coordinating authority that maintains national security. The head of the NSC is the President of the country, who acts as the Commander-in-Chief of the armed forces. The NSC meets regularly on matters related to national security, which include Terrorism and TF. National policies and implementation programmes for terrorist de-radicalization is formulated and implemented through the NSC. The WG assessed the CFT policy and strategy quality as medium high.

#### *8.3.1.2 Effectiveness of Terrorist Financing Crime Definition*

The criminalization of TF in Sri Lanka is covered by the provisions of the CSTFA and its subsequent amendments in 2011 and 2013. While the law comprehensively defines TF, minor amendments are required to cover the full scope of individuals traveling abroad for the purpose of the perpetration, planning, or preparation of, or participation in, terrorist acts or the providing or receiving of terrorist training. Punishments for TF offences include a minimum of fifteen to a maximum of twenty years' imprisonment and a fine, without a specified limit.

Criminal penalties can be applicable to appropriate offences ancillary to the offence of TF and to both natural and legal persons. Since criminal penalties are available for legal persons, the Act does not provide for civil or administrative sanctions that can be applied to them. The penalties for TF are proportionate and dissuasive. The death penalty is prescribed in limited circumstances relating to offences against the State, Murder, serious offences involving narcotics, and offences under the Army, Navy, and Air Force Acts, respectively. However, in Sri Lanka, capital punishment sentencing practically converted to a life sentence of imprisonment. Other serious offences carry an imprisonment sentence of either description to a maximum of 20 years, with only certain offences containing a prescribed minimum mandatory sentence. A Fine is prescribed in respect of certain offences. Thus, in comparison, sentences prescribed for TF offences are relatively stringent.

However, due to the minimum mandatory term of imprisonment being laid down, the possibility of imposing suspended sentences is curtailed, *vide* Section 303(2)(a) of the CCPA. The Judges do have a wide range of sentencing tools (e.g., fines and imprisonments, the magnitude or tenure of which increases with the severity of the offence, number of offences and other factors). However, as per legal experts, there is no sentencing guidelines system in Sri Lanka. Specific guidelines on general sentencing are laid down in case law. The said guidelines may be adopted, considering the TF offences' unique nature. Sri Lanka does have a range of legislations to combat the phenomenon of TF. However, as observed above, some of the aspects may be improved. Further, as per CTID, the investigations conducted have not led to any instances where cases have been filed in the courts in the assessment period under this legislation. Therefore, these deficiencies should be addressed. Further, more action needs to be taken to effectively use the available laws in filing cases before the courts. Based on the above, the effectiveness of the TF crime definition is assessed as high.

#### *8.3.1.3 The Comprehensiveness of Asset Forfeiture Legislation*

In Sri Lanka, the following laws and gazettes are used to confiscate properties involved in terrorist activities.

1. Convention on the Suppression of Terrorism Financing Act, No. 25 of 2005 (CSTFA) [as amended by Act, No. 41 of 2011 and Act, No. 3 of 2013]<sup>4</sup>.
2. Prevention of Terrorism Act, No. 48 of 1979 (PTA)<sup>5</sup>.
3. Extraordinary Gazette No. 1721/02 dated 29.08.2011<sup>6</sup>.
4. Prevention of Terrorism (Proscription of Extremist Organizations) Regulations No. 1 of 2019<sup>7</sup>.
5. Prevention of Terrorism (Proscription of Extremist Organizations) Regulations No. 2 of 2021<sup>8</sup>.
6. Prevention of Money Laundering Act, No. 05 of 2006 (PMLA)<sup>9</sup>.

4 Section 5(1) of the CSTFA

5 Section 4 of the PTA

6 Section 6(1) under the conditions of banning the LTTE organization and Section 7(1) under the conditions of banning the Tamil Rehabilitation Organization of the said Gazette.

7 Section 7(1) of Extraordinary Gazette No. 2123/03 dated 13.05.2019 (Proscription related to Easter Sunday attack in 2019).

8 Section 7 of Extraordinary Gazette No. 2223/03 dated 13.04.2021 (Proscription related to Easter Sunday attack in 2019).

9 Section 7, Section 13(1) of the PMLA

The legislations and regulations above constitute the body of legislations that provides for the seizure, freezing, and forfeiture of assets used or intended to be used for TF. The CSTFA (as amended in 2011 and 2013) is the main law that deals with TF in Sri Lanka. However, the use of CSTFA for asset forfeiture was found to be very low. Following is the information with regard to the lands, buildings, vehicles and cash that have been confiscated as per the information revealed during the investigations carried out by CTID from 2014 to the time of the assessment.

**Table 2: Details of Confiscated Assets**

Asset Type	Details of the Assets
Land	1,896.18 perches (18 plots of land and 13 buildings on that land)
Vehicles	17 (includes 03 vans, 02 lorries, 08 motorcycles)
Cash	Rs.35,992,855.74 + USD 23,500

Source: Counter Terrorism Investigation Division

In conclusion, Sri Lanka has implemented a comprehensive legal framework for asset forfeiture to combat TF and other financial crimes. However, delays in the forfeiture process were found to be, in some instances, due to lacking resources and capacity within LEAs. The quality of asset forfeiture and confiscation mechanisms is assessed as very high.

#### *8.3.1.4 Quality of Terrorist Financing Intelligence Gathering and Processing*

This is an intermediate variable in which the impact of the following two variables is included.

##### (a) Quality of FIU Intelligence Gathering and Processing

FIU is well-structured, properly funded, and staffed with individuals who possess appropriate training and skills. The staff members of the FIU maintain high professional standards, and the institution is committed in maintaining and enhancing their capacity. It operates as an independent entity within the administrative structure of the CBSL. Moreover, the FTRA empowers the FIU to make autonomous decisions regarding the analysis, request for information, and/or dissemination of specific information.

- Suspicious Transaction Reporting

FIU received many STRs from RIs in relation to the 2019 Easter Sunday Bomb attack. In 2021, there was another spike in STRs related to ATM withdrawals and Debit card usage due to exchange rate disparities. Although initially suspected to be linked to TF, investigations revealed that these STRs did not have a TF element.

- Threshold Transaction Reports

RIs have been submitting CTRs, EFTs, and STRs online through the LankaFIN system. In 2021, more than 5.6 million CTRs and 9.2 million EFTs were received by the LankaFIN database from RIs. STRs are analyzed and disseminated to relevant LEAs or regulators for further investigation or regulatory action. The FIU is a member of the Egmont Group, and the FIU has the ability to detect cross-border activities.

- Analysis of Information and Dissemination of the Analysis Information to Law Enforcement Agencies

The financial data and information collected by RIIs are analyzed by the Intelligence Management Division to identify trends and incidents related to ML/TF. The STR analysis process involves several steps, and the outcome of the analysis is disseminated to relevant LEAs after necessary deliberation.

A summary of possible TF related STRs disseminated from 2017 to 2022 is given in Table 3 below:

**Table 3: Dissemination of Suspicious Transaction Reports related to Terrorist Financing**

Year	2017	2018	2019	2020	2021	2022
Number of Disseminations	03	02	104	07	36	49

Source: Financial Intelligence Unit - Sri Lanka

Information and statistics on the FIU's TF-related information and intelligence-sharing with foreign counterparts and other relevant authorities are as follows;

**Table 4: Terrorist Financing Related Information and Intelligence Sharing with Foreign Counterparts**

Year	TF-related information and intelligence-sharing with foreign counterparts
2017	1 information request from a foreign counterpart related to TF has been attended.
2018	8 STRs have been raised for individuals related to TF based on information received from foreign counterpart.
2019	-
2020	1 Information request related to TF has been attended, and information has been disseminated to foreign counterpart through ESW.
2021	FIU Sri Lanka has made 2 information requests related to TF from foreign counterparts through the ESW.
2022	1 information request has been received from foreign counterpart and 3 requests have been made by FIU – Sri Lanka from foreign counterparts.

Source: Financial Intelligence Unit – Sri Lanka

#### FIU has the capacity to detect cross-border activities

The FIU has access to a system via which requests can be made to call for information on details of border control due to the MOU it has with the Department of Immigration and Emigration. The FIU has requested information related to passports/border control from the Department of Immigration and Emigration. The information received for such requests has been used for STR analysis and other intelligence purposes. The statistics of such information requests are as follows:

**Table 5: Number of Requests to the Department of Immigration and Emigration**

Year	2017	2018	2019	2020	2021	2022
Number of requests	07	178	269	76	68	70

Source: Financial Intelligence Unit – Sri Lanka

FIU intelligence gathering, and processing quality is rated as medium high.

(b) Quality of Other Intelligence Agencies Terrorist Financing Intelligence Gathering and Processing

The Office of the National Intelligence Division serves as the umbrella organization for the national intelligence agencies. Additionally, it performs evaluations, conducts assessments, and prepares reports, and offers other advice to the Secretary of Defence on matters pertaining to the national intelligence community. In carrying out the role, the Chief of National Intelligence (CNI) provides directions and issues guidelines to be followed by the national intelligence community or particular agencies within the community, including SIS, Military Intelligence, Naval Intelligence, Air Intelligence and other investigation and intelligence branches under the Sri Lanka Police. Each of the aforementioned intelligence agencies has a clearly defined role and set of tasks which vary depending on that role.

Legal framework and powers vested to intelligence services to deal with Terrorist Financing

The Cabinet of Ministers has approved drafting a new "State Intelligence Act" to empower intelligence personnel to carry out their duties. The Bill is already drafted, and the enactment of the proposed State Intelligence Act will provide legal coverage and power for conducting intelligence operations and activities to ensure national security. The quality of other intelligence gathering, and processing is rated as medium.

*8.3.1.5 Quality of Terrorist Financing Investigation*

The impact of the following two variables is included in this intermediate variable.

(a) Capacity and Resources for Financial Crime Investigations (including Asset Forfeiture)

The Sri Lanka Police is responsible for investigating crimes in Sri Lanka, including terrorism-related crimes. The CTID is a specialized unit within the Sri Lanka Police that investigates terrorism-related crimes, including TF. The CTID has a separate division called the Terrorism Financing Investigation Unit, which is currently understaffed but plans to recruit more officers. The CTID conducts investigations based on information gathered on its own and from other institutions, including the FIU, SIS, tri-forces' intelligence units, and the instructions of the Inspector General of Police (IGP). Investigations to uncover information on TF are conducted by analyzing reports obtained from banks and other FIs, intelligence agencies, telecommunication service providers, the Department of Motor Traffic, the DRC, the NSNGO, etc. Furthermore, investigating officers conduct their investigations by interrogating and recording statements from numerous parties, as well as covert ground surveys and other methods. In terms of training, these investigators attend training courses both locally and internationally from time to time to improve their investigative skills.

The legal provisions in the CSTFA are used to investigate information received regarding the financing of terrorism. In addition, the Prevention of Terrorism (Temporary Provisions) Act, No. 48 of 1979 (PTA) and the Gazette Notifications issued on various occasions under Section 27 of the Act, the CCPA, and the Evidence Ordinance are used in investigations. Further, the PMLA and a few gazette notifications are applicable to the confiscation process in terrorist investigations.

Investigations into the financing of terrorism require obtaining reports and information from various agencies and seizing various items based on the lawsuits. In such cases, it is possible to seize property required for an investigation under Section 6 (1) of the PTA. Also, in some cases, court orders are obtained by reporting matters to the Magistrate's Court to get assistance from various institutions for investigations. In addition, assistance is obtained from the FIU in obtaining information from banks and other FIs. The INTERPOL police unit is also used to get assistance from police units of various countries. When considering what proportion of cases referred by investigators to prosecution, excerpts have been prepared and sent to the AGD for advice from the Attorney General regarding two investigations carried out by the Terrorism Financial Investigation Unit.

During the assessment period, the Colombo High Court suspended 41 bank accounts of 12 extremist organizations implicated in the CTID investigations.

Accordingly, this variable is rated as medium high.

(b) Integrity and Independence of Financial Crime Investigators (including Asset Forfeiture)

The CTID consists of 6 units, of which one deals specifically with TF, while the other divisions conduct terrorism-related investigations, and all units conduct AF depending on the circumstances of each case. TF and AF investigations are carried out independently by the investigators without influence. Investigators are required to respect human rights as laid down in the Constitution. If such limits are breached, the investigators are bound to be investigated and sued. Since 2015, the CTID has received 427 complaints regarding potential TF, of which 379 are still under investigation and 47 have already been completed. However, only two of the cases have been referred to the AGD for the Attorney General's instruction to proceed further. Additionally, no cases have proceeded to court yet. As per the CTID, the main reasons for such delays are staff issues in the CTID and delays in the prosecution due to the large number of cases AGD handles. It was also observed that there is no dedicated unit in the AGD to exclusively handle TF-related cases. AF is carried out by the Courts or MOD after a due investigation, and the CTID ensures that these assets are not forfeited without due process. Further, assets that have been forfeited are prevented from being misused. The WG noted that during the assessment period, the CTID initiated several investigations and proceeded to forfeit numerous assets.

As per the integrity of the TF investigator, there have been no incidents where investigators have been found guilty of issues with integrity. Considering the above reasons, this variable is rated as medium.

*8.3.1.6 Quality of Terrorist Financing Prosecution*

This intermediate variable includes the impact of the following two variables.

(a) Capacity and Resources for Financial Crime Prosecutions (including Asset Forfeiture)

Structure, human resources, and skills of the prosecution

In terms of prosecution, there had been issues related to structure and a vacuum of experienced staff due to various reasons. However, during the assessment period, various measures have been taken to improve this, which can be termed as work in progress. The AGD has around 200 staff working for the prosecution during

the assessment period. Further, the AGD has constituted a team headed by a very senior officer with extensive prosecutor experience and expertise in dealing with financial crimes. This unit consists of 13 officers who can advise on TF crimes. In terms of staff, there are plans to increase the number of prosecutors who handle the TF cases exclusively in future.

#### Accessibility to information

The prosecutor has sufficient access to the documents and statements of witnesses before the prosecution. In the investigations, investigators seek legal advice from the prosecutors on the admissibility of the evidence gathered by them. In such instances, the investigators are being directed to the Government Analyst, the Information and Communication Technology (ICT) experts, Sri Lanka Computer Emergency Readiness Team (CERT), the School of Computing at the University of Colombo, the IT Faculty at the University of Moratuwa, forensic auditors, etc. Accordingly, in the Tamils Rehabilitation Organisation (TRO) case, the University of Colombo School of Computing provided their expert opinion on the contents of the CDs recovered, which contained the amounts and the details of the funds disbursed.

#### Skills and knowledge of TF

The prosecutors in charge of TF cases in Sri Lanka are educationally and professionally qualified as Attorneys-at-Law. However, neither the local Universities nor Sri Lanka Law College offers the subject of TF or any related subject in their curriculum. They acquire knowledge through experience, capacity-building programmes, and training provided by foreign and local experts. Junior prosecutors are also being trained under experienced prosecutors to expand the number of prosecutors familiar with TF. Periodical training is conducted for capacity-building purposes. To overcome the challenges associated with TF prosecution, further and regular training is required.

Accordingly, this variable is rated as medium high.

#### (b) Integrity and Independence of Financial Crime Prosecutors (including Asset Forfeiture)

This variable is assessed in consultation with the ML Vulnerability WG and participants of the AGD. Prosecutors have been able to discharge their obligations free from political interference.

#### Safeguards for the integrity of prosecutors.

The recruitment process for prosecutors has stringent criteria and scrutiny, including a three-year probation period to assess competence and character. The AGD has a system of supervision and a work culture that focuses on upholding integrity and ethical conduct.

According to the provisions set out in the CCPA, prosecutors are not allowed to have consultations or meetings with lay witnesses other than the official witnesses such as investigating officers, public professionals, and forensic experts. Therefore, there is no capability of interfering with the integrity of the prosecutors regarding any trial with this limited exposure to the witnesses in cases. The State Counsel must observe general rules set by the Supreme Court relating to the conduct and etiquette of Attorneys-at-Law. A breach of such rules could potentially result in suspension or disenrollment. The department is also bound by the rules of the

Establishments Code, and the Attorney General may issue circulars to maintain the integrity of officers. A landmark judgment of the Supreme Court, i.e., LRC vs Grand Central [1981 (1) SLR 250] captures the unique constitutional role of the Attorney General and emphasizes the need to avoid a conflict of interest. This case is considered a guide to officers of the Attorney General's Department on the question of integrity and avoiding every apprehension of bias.

#### Prosecution of TF without interference

The general anxiety of the government to prosecute all aspects of terrorism has meant that prosecutors have been able to discharge their obligations free from political compulsion. The Sri Lankan AGD is not politically influenced in the prosecution of terrorism cases. The department does not delay or hasten cases for anyone's benefit but may prioritize contentious cases that cause public concern. Therefore, this variable is rated as medium high.

##### *8.3.1.7 Capacity and Resources for Judicial Processes (including Asset Forfeiture)*

The Judges who preside over TF cases can function effectively in Sri Lanka. Judges who oversee cases related to TF are High Court Judges, who are promoted to this position after gaining years of experience.

#### TF Case proceeding before Courts

TF is a criminal offence under the provisions of the CSTFA in Sri Lanka, and cases related to TF are tried in the High Court. The Criminal Procedure Code Act, No. 15 of 1979, governs the proceedings of TF cases in court. Sri Lanka has a victim-centric prosecutorial system. Accordingly, an indictment is served on the accused, and if he pleads not guilty, the prosecutors prosecute him, and thereafter, the lawyer of the accused can commence his case, and at the end of the trial, the judge decides whether the accused is guilty of the offence of terrorist financing or not. If guilty, the judge punishes the accused in terms of Section 3 of the CSTFA.

#### Specialization in financial crimes

As per the provisions of the Judicature Amendment Act, No. 9 of 2018, Permanent High Court at Bar was established to hear, try and determine matters in respect of financial and economic offences including offences under the CSTFA.

Three judges nominated by the Chief Justice from among the judges of the High Court sit together to hear these cases. The Permanent High Court at Bar has jurisdiction in respect of offences committed in Sri Lanka as well as outside the territory of Sri Lanka. The Minister by Order published in the Gazette with the concurrence of the Chief Justice can designate Permanent High Court at Bar for any Province.

#### Skills of Judges

The Sri Lankan judges maintain the necessary skills and experience to adjudicate TF cases. TF cases are heard by High Court Judges. An Attorney-at-law can enter the judiciary as a Magistrate with a minimum of 5 years of active practice and higher education (Master's degree in law). They should also pass a competitive examination. The judges are being trained by Sri Lanka Judges' Institute (SLJI). Considering their seniority,

integrity, skills, and knowledge, Magistrates can be subsequently promoted as District Court Judges and High Court Judges.

#### Training

All the judges and judicial officers, including High Court Judges, District Judges, and Magistrates, are subjected to workshops and seminars on financial crimes. SLJI organizes training programmes in collaboration with international institutions and organizations. Often, resource persons are superior court judges of Sri Lanka and judges and prosecutors of other countries, including the UK and USA. The programmes are usually conducted as residential workshops. Methodology of teaching includes discussions, group activities, studying of case scenarios, and mock trials. Materials are prepared in consultation with those institutions and the resource persons.

Additionally, there is no centralized database to gather information on what number of cases proceeded to trial and what number of these resulted in convictions. Therefore, the Ministry of Justice has prioritized implementing a project to automate the functions of the Court system. Certain pilot projects have commenced, such as the court records scanning project.

Accordingly, this variable is rated as medium high.

#### *8.3.1.8 Quality of Terrorist Financing Customs and Border Controls*

Impact of following three variables is included in this intermediate variable.

##### (a) Effectiveness of Immigration Controls

Sri Lanka is an island nation that lacks land borders, making immigration control easier. However, due to strict immigration controls and patrolling by the Sri Lanka Navy and Coast Guard, potential migrants who do not meet the requirements for legal entry or exit to their destination or transit country often seek the assistance of human smugglers. Irregular migration by air and sea is a huge profit-making venture for human traffickers. To combat human smuggling, Sri Lanka has conducted capacity building workshops for immigration officers in collaboration with international agencies such as the International Organization for Migration (IOM) and the UNODC. Several specialized units have also been established to strengthen formalities at borders, including the risk assessment center, the Border Surveillance Unit (BSU), the human trafficking prevention unit, and the document examination laboratory. These units have contributed to minimizing human smuggling, human trafficking, and the use of fraudulent documents.

Statistics on the detection of fraudulent travel documents identified by the BSU during the assessment period are as follows.

**Table 6: Statistics on the Detection of Fraudulent Travel Documents during 2019 (July) to 2022**

Inception Category	2019 (from July)	2020	2021	2022
Forged/Counterfeit/Visa	04	18	26	70
Forged/Counterfeit/Passports	11	12	07	35
Stolen blank Visa/passports	01	-	02	02
Impostor Visa/RP	01	-	-	08
Impostor passports	02	03	06	09
Fantasy Passport/visa	01	-	01	03
Forged seaman's books	-	01	04	01
<b>Total</b>	<b>20</b>	<b>34</b>	<b>46</b>	<b>128</b>

Source: Border Surveillance Unit, Department of Immigration and Emigration

Accordingly, the variable is rated at a medium.

**(b) Effectiveness of Border Controls on Strategic Goods**

Sri Lanka is in the process of finalizing list of strategic goods to be controlled in exporting, importing and transiting Sri Lankan borders. However, an enforcement framework to address any illegal import or export activities has been already established and it has been in operation since the start of Sri Lanka Customs. Further, an automated risk management system is in place for additional screening purposes. However, Sri Lanka Customs needs to establish capacity and acquire equipment for identifying strategic goods, once the strategic goods list is implemented. The US Department of State's Export Control and Related Border Security (EXBS) Programme and the World Customs Organization (WCO) trained 34 Customs Officials from Sri Lanka in strategic trade controls enforcement in 2017. The training provided knowledge, skills, and abilities to better screen shipments by identifying those that present a risk and targeting those that need to be physically inspected. EXBS aims to prevent the proliferation of Weapons of Mass Destruction (WMD) and their delivery systems and transfer of conventional weapons. Sri Lanka Customs has established the Central Intelligence Directorate as the focal point for exchanging intelligence with international agencies and customs administrations in other countries. They are also a user country of the Customs Enforcement Network system introduced by the World Customs Organization to report enforcement data among member countries. Mutual customs cooperation agreements have been established with several countries to assist in enforcing similar border controls. The rating for the effectiveness of the immigration control is assessed as medium.

**(c) Effectiveness of Customs Controls on Cash and Similar Instruments**

Sri Lanka has established a mechanism where passengers entering/ leaving Sri Lanka are required to declare their baggage in the Passenger Baggage Declaration Form, where Currency, Travelers' Cheques, Drafts, etc., in their possession exceed a certain threshold. Such declaration of the currency and negotiable bearer instruments in the said Passenger Baggage Declaration is subject to regulation 2213/39 of 03.02.2021 published under the FEA which defines the threshold.

In an instance a passenger does not make a declaration or makes a wrong declaration as required above, it will be considered a violation of Section 107A of the Customs Ordinance and the currency and negotiable bearer instruments can be forfeited under the same Section.

Sections 24 to 26 of the FTRA provide for currency reporting at the borders. These provisions include seizure or detention of cash and negotiable bearer instruments. Related offences and applicable punishments have been set out in Section 27 of the FTRA.

In terms of Section 12 read with Schedule B of the Customs Ordnance, any article the importation/exportation of which is restricted or prohibited under any other law can be intercepted by Sri Lanka Customs and action can be taken either under the Customs Ordinance or under the law where the restriction/prohibition is made. However, the FEA does not identify offences. Therefore, it is observed that the controls imposed by the FEA cannot be effectively enforced by Sri Lanka Customs.

The custom officers deployed at the airport use the available documents such as the passenger list submitted by the airlines and the flight details to target high-risk passengers. It is crucial in this scenario to have an APIS for identifying high-risk passengers. WG believes that Sri Lanka Customs has to acquire technology and more equipment to detect unauthorized/illegal cash transportation by persons. It is also necessary to have procedures and equipment to screen and detect unauthorized/illegal cash transportation in vehicles and shipping containers while entering or exiting the country.

The statistics on cases of bulk cash smuggling, failure to declare transportation of cash (and related instruments) and detected amounts which were forfeited during the assessment period are presented below.

**Table 7: Statistics on cases of Bulk Cash Smuggling, Failure to Declare Transportation of Cash (and Related Instruments) and Detected Amounts which were Forfeited during the Assessment Period**

Year	2017	2018	2019	2020	2021
Number of Cash (and related instrument) declaration failure incidents	106	114	58	39	20
Number of bulk cash smuggling cases	43	33	21	7	3
Number of bulk cash smuggling - Detected amounts (Rs. million)	516.4	205.1	159.1	58.6	40.8

Source: Sri Lanka Customs

Accordingly, this variable is rated at a medium high level.

#### *8.3.1.9 Quality of Targeted Financial Sanctions*

Impact of following four variables is included in this intermediate variable.

##### (a) Effectiveness of Domestic Cooperation

The NSC in Sri Lanka discusses national-level issues related to CFT and terrorism. The FIU regularly shares information with the SL-police and conducts external STR review meetings with AGD officers to share financial intelligence with LEAs. A separate unit of the CID of Sri Lanka Police has been placed within the Central bank premises under the FIU to strengthen coordination with LEAs. Additionally, the FIU has entered into 12

MOUs with some domestic stakeholders to enhance domestic cooperation which includes CFT and terrorism aspects. The main agencies involved in countering terrorism in Sri Lanka are MOD, CNI, SIS, intelligence services of tri-forces, CTID, CID, and FIU. They hold regular meetings at MOD to coordinate intelligence, and special committees are formed as needed to discuss specific matters. Two major terrorism incidents that have affected Sri Lanka are the war with LTTE that ended in 2009 and the Easter Sunday Bomb Attack in 2019. To address terrorism and TF threats, CTID maintains a close relationship with intelligence agencies and other entities and conducts joint missions with them to identify suspects and forfeit assets. CTID has held numerous meetings with intelligence agencies to share intelligence and gather information on methods of funding for terrorism activities. FIU works closely with CTID and SIS in TF investigations and gathering financial intelligence of suspected TF by sharing information and connecting FIs and other reporting entities with CTID for matters related to TF.

Sri Lanka currently lacks a legal framework for joint investigations by investigative units, and investigations are carried out on an as-needed basis. The Sri Lanka Police is the primary investigative agency, with specific divisions responsible for different types of crimes. However, the other agencies involved in predicate offence investigations (Sri Lanka Customs, CIABOC and etc.) may refer their findings in the predicate offence investigations to Sri Lanka Police for ML/TF investigation.

Additionally, the introduction of the goAML as a reporting and information sharing platform by the FIU has resulted in improved cooperation with reporting entities, regulators and LEAs.

Further, in addition to various TF related ad hoc committees and the TFS Committee, a working-level committee has been established to deal with matters related to TF to improve domestic cooperation among stakeholders who are involved in preventing Terrorism and TF in Sri Lanka. Accordingly, this variable has been rated as medium high.

#### (b) Effectiveness of International Cooperation

The country uses both formal and informal channels to strengthen international cooperation, operating through provisions of the Mutual Assistance in Criminal Matters Act and through relationships established through conventions, MOUs, and networks.

##### Mutual Legal Assistance

The Secretary to the Ministry of Justice (MOJ) in Sri Lanka is the central authority responsible for MLA. The Ministry of Foreign Affairs acts as a conduit for the transmission of information. Requests for MLA are usually received by various government agencies such as the MOD and the Ministry of Foreign Affairs. In such instances, government agencies receiving requests will forward them to the central authority.

The Mutual Assistance in Criminal Matters Act, No. 25 of 2002 was enacted to provide for MLA, and since then, it has been amended by Act, No. 24 of 2018, which expands its application to include countries that are parties to regional or international conventions, countries with bilateral agreements with Sri Lanka, and countries without such agreements, if the Minister determines that it is in the best interests of sovereign nations that Sri Lanka extends and obtains assistance on the basis of reciprocity. Additionally, intergovernmental organizations combatting corruption, ML, or TF may receive assistance on certain terms and conditions.

### Assistance via Egmont

The FIU uses the Egmont network which facilitates the exchange of financial intelligence between FIUs to combat ML and TF globally. As a member of the Egmont Group, the FIU has access to Egmont Secure Web and can send to and receive from other member countries, information and spontaneous disseminations.

This is supplemented in the FTRA under section 15(1)(i) where the FIU has the power to compile statistics, records, and disseminate information within Sri Lanka or internationally, as well as make recommendations based on received information. Additionally, the FIU assists LEAs in international cooperation on criminal matters and may provide necessary assistance when matters are referred to it by the Central Authority.

### Assistance via MOUs

The FIU can enter into agreements for the exchange of information with foreign institutions or agencies under the FTRA. The FIU has entered into 44 MOUs (as of August 2023) with foreign counterparts to exchange information on a regular basis, with the approval of the Minister of Finance. The information is shared based on necessity, as per the agreements between the counterparts.

### Assistance via INTERPOL

According to the INTERPOL's rules, data can be processed for various purposes such as searching for a wanted person, providing or obtaining information related to a criminal investigation, warning of criminal activities, identifying a person or a dead body, carrying out forensic analyses, security checks, and identifying threats and criminal networks.

Apart from the various information-sharing mechanisms mentioned above, the MOD participates in various committees with foreign counterparts to discuss matters related to terrorism and TF and provide assistance.

In terms of statistics, Sri Lanka has not received any NCB confiscations related requests as per the MOJ. The summary of incoming and outgoing MLA requests is depicted in the below table.

**Table 8: Summary of Mutual Legal Assistance Requests**

Year	2016	2017	2018	2019	2020	2021
Requests received	25	26	5	12	6	12
Requests made	64	63	27	17	7	2

Source: Ministry of Justice, Prison Affairs and Constitutional Reforms

According to the statistics available, during the last two years, there have been no incoming MLA requests related to TF and in relation to outgoing requests, there have been 3 MLA matters which are associated with TF.

With respect to the information sharing through ESW, details of the incoming and outgoing requests for the last five years are in Table 4.

As per INTERPOL Colombo, it has received 252 requests from its foreign counterparts in the year 2021 related to law enforcement issues, and 195 requests have been accommodated. Further, most of the un-responded requests are non-compliant with the INTERPOL Rules and local laws.

Accordingly, the effectiveness of international cooperation has been rated as high.

(c) The comprehensiveness of Legislation, Procedures and Mechanisms on Targeted Financial Sanctions related to Terrorism and Terrorist Financing

Sri Lanka has issued two principal regulations and two directives on implementation practices and enforcement obligations for both UNSCR 1373 and UNSCR 1267.

The United Nations Regulations, No. 01 of 2012 has been issued promulgating the UNSCR 1373 (2001, for local terrorists) designating individuals and entities related to terrorism and TF at the national level. The Regulation was amended on December 11, 2014, as per Extraordinary Gazette No. 1892/37.

The United Nations Regulations, No. 02 of 2012 issued by the Minister of Foreign Affairs promulgating the UNSCR 1267(1999) and the modifications and strengthening of the Resolution's sanctions regime by subsequent resolutions including 1526 (2004), 1617 (2005), 1735 (2006), 1822 (2008), 1904 (2009), 1988 (2011), 1989 (2011) and 2253 (2015) and any other subsequent resolution on Taliban (Islamic Emirate of Afghanistan), Islamic State of Iraq and Levant (ISIL, also known as Da'esh) and Al-Qaida, imposing upon member States of the United Nations a series of obligations to apply sanction measures to any natural or legal person, group or entity associated with Taliban, ISIL (Da'esh) or Al-Qaida. The Regulation was amended on December 11, 2014, as per Extraordinary Gazette No. 1892/37 and on November 04 of 2016, as per Extraordinary Gazette No. 1991/52.

The regulations cover the requirement for all natural and legal persons within the country to freeze, without delay and without prior notice, the funds or other assets of designated persons and entities. The mechanisms for communicating designations to the financial sector and DNFBPs immediately upon designations and providing clear guidance to them on their obligations in taking action under freezing mechanisms are also laid down in the above-mentioned regulations. As per the analysis, it was observed that the measures which protect the rights of bona fide third parties are not specifically mentioned in either of the regulations. However, the TFS Committee<sup>10</sup> frequently examines third-party claims.

Further, no specific clauses explain the procedure to unfreeze the funds or other assets of persons and entities that are de-listed. However, through awareness, training, and communications, the FIU and the competent authority have communicated to the FIs and DNFBPs to unfreeze funds or other assets if the name does not appear in the active designation list.

Comprehensiveness of Legislation, Procedures, and Mechanisms on TFS related to Terrorism and Terrorist Financing is rated as medium.

<sup>10</sup> Sri Lanka has formulated an inter-agency coordination mechanism identified as the "TFS committee" in 2018/19 with the participation of the relevant stakeholders including MOD, FIU, MOFA, AGD, CID, CTID and relevant financial regulators.

(d) Effectiveness of Implementation of Targeted Financial Sanctions related to Terrorism and Terrorist Financing

The Competent Authority for the implementation of the United Nations (UN) Regulations in Sri Lanka is the Secretary to the MOD. Additionally, Sri Lanka has formulated an inter-agency coordination mechanism with the participation of the relevant stakeholder, identified as the "TFS Committee" in 2018/19. The chairman of the Committee is the Secretary of Defence. Meetings of the TFS Committee are held routinely, and special meetings are held when required. The stakeholders of the Committee ensure that the institutions which are coming under their purview are aware of the regulatory requirements in relation to UNSCR resolutions and are implementing necessary procedures to comply with the same.

In Sri Lanka, the FIs and DNFBPs identify and freeze the funds of designated persons and entities without delay and ensure that no funds are made available to designated persons and entities. In the case of the other assets, they may be confiscated under PTA or CSTFA, as the subjects which are listed under UNSCR 1373 are mostly pursued also under PTA and/or CSTFA. As a result, while funds are being frozen in accordance with UNSCRs based on the listing, the designated person's assets are frozen in accordance with PTA and CSTFA provisions.

During the assessment period, there have not been any proposals from Sri Lanka for designations under the UNSCR 1267 regime. The designations are primarily done for UNSCR 1373 related to local terrorists.

Statistics on number of persons and entities subject to TFS under UNSCR 1373 are as follows;

**Table 9: Statistics on Number of Persons and Entities Subject to Targeted Financial Sanctions under UNSCR 1373**

Designation type	Number (as of August 01, 2022)
Individuals	316
Entities	15

Source: Financial Intelligence Unit – Sri Lanka

The procedures to de-list persons and entities that no longer meet the criteria for designation are laid down in the respective regulations. Based on a case-by-case basis, the competent authority is giving access to frozen funds or other assets which have been determined to be necessary for basic expenses, for the payment of certain types of fees, medical expenses and service charges, or for extraordinary expenses.

With regard to UNSCR 1373, from 2016 to 2021, new listings have been made through five gazettes<sup>11</sup> which designated a total of 577 individuals and 18 entities. Further, a gazette issued in 2022<sup>12</sup> de-listed 316 individuals and 6 entities, additionally, 55 individuals and 3 entities have been added to the list bringing the total to 316 individuals and 15 entities as per Table 9. During the assessment period, two requests to access the frozen funds have been made in 2022, however, subsequently, they were de-listed in 2022 following the due process.

11 No. 1992/25 dated November 09, 2016, No. 2076/18 dated June 20, 2018, No. 2124/32 dated May 23, 2019, No. 2140/16 dated September 09, 2019, No. 2216/37 dated February 25, 2021

12 No. 2291/02 dated August 01, 2022

As per the information received from the Ministry of Foreign Affairs, there are no requests received from other countries for designations based on UNSCR 1373 for the assessment period. Further, there are no requests sent to other countries and/or competent UNSC Committees proposing a designation for the assessment period.

FIU conducts awareness sessions and supervises reporting institutions such as FIs and DNFBPs to ensure compliance with the requirement of freezing funds without delay and reporting to competent authorities. The FIU communicates designations of individuals and entities subject to UN sanctions measures via email to reporting institutions and updates are immediately shared. The competent authority forwards updates to the designated list to various regulatory and supervisory authorities, and the FIU ensures compliance by conducting awareness sessions and supervision.

Statistics for the assessment period on amounts of assets frozen and transactions rejected are as follows;

**Table 10: Statistics for the Assessment Period on Amounts of Assets Frozen and Transactions Rejected**

Year	Amounts of assets frozen	Number of transactions rejected
2017	-	1 (Cheque deposit in relation to UNSCR 1373)
2018	-	-
2019	-	-
2020	-	-
2021	Rs. 5,633,125.42 (Account balance as of 28th March 2022)	1

Source: Licensed Banks and Finance Companies

Accordingly, effectiveness of Implementation of Targeted Financial Sanctions related to Terrorism and Terrorist Financing can be rated as medium high.

#### *8.3.1.10 Controls on Provision of Strategic Equipment, Goods and Services to Conflict Zones*

Sri Lanka has issued United Nations (Sanctions relating to Proliferation of Nuclear, Chemical or Biological Weapons) Regulations of 2017, in order to implement the provisions of UNSCR 1540. As per the regulation 5 of the UNSCR 1540 Regulation, “dealing with WMD related materials (dual use items) within Sri Lanka for peaceful purposes shall be done in accordance with relevant written law”. Further, as per the regulation 6 of the UNSCR 1540 Regulation, “export/ transit/ trans-shipment/ re-export of dual use items within Sri Lanka for peaceful purposes shall be done in accordance with relevant written law”. According to the said regulations, the country is required to formulate national laws relating to the exporting, re-exporting, migration and shipping of nuclear, chemical and biological weapons-related materials. Accordingly, in order to align the existing Import and Export Control Act with the implementation of Resolutions 1540 in Sri Lanka, a new Strategic Trade Management Act has been drafted by the Import and Export Control Department in the year 2020.

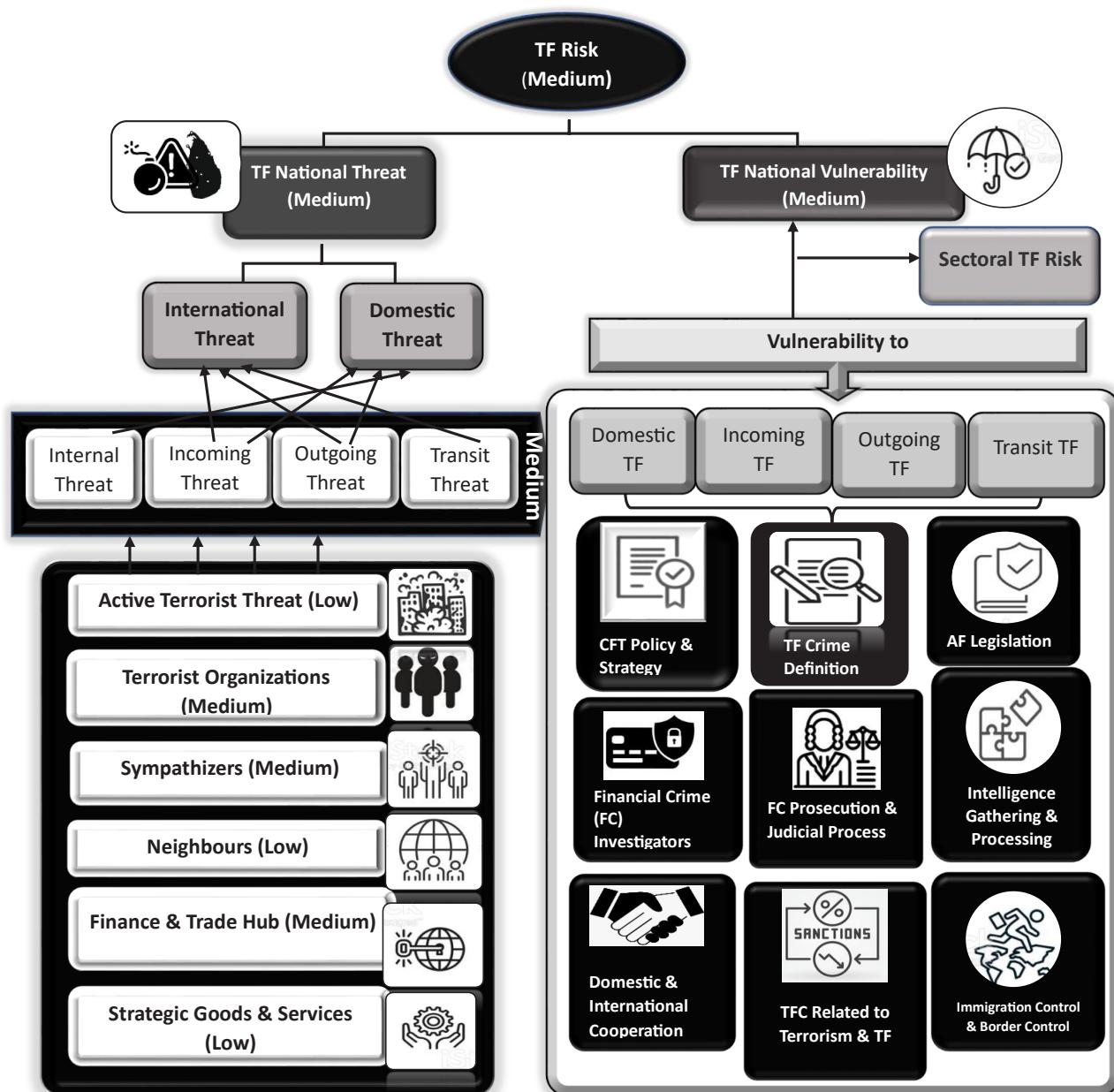
Currently, importation and exportation of dual usage items are subjected to the recommendation of a recommending authority identified by the Import and Export Control Department. However, policy approval has been granted by the Cabinet of Ministers in 2019 to prepare a National Strategic Product (Export) Control

List using the EU Military List and the EU Dual-Use Control List, which is suitable for Sri Lanka. Further, the Cabinet of Ministers has appointed two Cabinet Sub-Committees as Technical Committee and Legislative Committee for the implementation of the work relating to the new Strategic Trade Management Act and National Strategic Product Control list. Accordingly, the National Strategic Product Control List has been prepared and translated into Sinhala and Tamil languages on the advice of the technical committee. The new Strategic Trade Management Act is presently being reviewed by the legislative committee.

Since 2005, the Department of Imports and Exports Control, by the EXBS, is organizing local and international training and awareness programmes on item export control, on strategic actions for the government officers of the related agencies such as, MOD and Sri Lanka Customs. Five local and foreign training programmes were conducted for this purpose in the year 2019 and the Department of Import and Export Control takes necessary steps to ensure the participation of officials of other government institutions in these programmes.

Accordingly, Sri Lanka is still in the process of finalizing a list of strategic goods and services and identifying controls on provisioning the same to risky countries. Therefore, controls on provision of strategic equipment, goods, and services to conflict zones is rated as medium.

Figure 2: Highlights of the Terrorist Financing Risk Assessment



## 9. FINANCIAL INCLUSION PRODUCTS RISK ASSESSMENT

### 9.1 Introduction

Financial inclusion is about providing access to an adequate range of safe, convenient and affordable financial services to disadvantaged and other vulnerable groups, including low income, rural and undocumented persons, who have been underserved or excluded from the formal financial sector<sup>1</sup>.

### 9.2 Financial Inclusion Products Risk Assessment

The aim of the study is to evaluate ML/TF risks stemming from both existing and emerging/new financial inclusion products offered in Sri Lanka. This study entails the recognition of specific characteristics of the financial inclusion products, the risks and national priorities in the application of simplified AML/CFT measures and the flexibility of application of AML/CFT principles along with the financial inclusion products. The assessment will also inform policy formulation at the national level, meriting the objectives of National Financial Inclusion Strategy (NFIS). Financial Inclusion Products Survey 2021/22 was carried out covering the key financial sector organizations<sup>2</sup> which offer financial inclusion products in Sri Lanka. Two comprehensive questionnaires were developed mainly to focus on; 1. identifying products and product features, 2. identifying control measures used by the institutions.

Questionnaires were formulated in Microsoft forms in a user-friendly manner and sent to Compliance Officers or Chief Operating Officers of all the institutions surveyed. Survey post reconnoiter was done via focused meetings and discussions to provide proper guidance on the objective of the risk assessment. The questionnaires have been designed based on the guidelines of the WB, Financial Inclusion Product Risk Assessment Tool. The present assessment covered the formal and semi-formal sectors of the country's financial system, with a greater expansion towards semi-formal sectors comparative to the previous NRA. The NRA exercise surveyed a total of 105 institutions. The analysis is performed by deriving at responses for the variables in the module and the guidance questions.

### 9.3 Findings

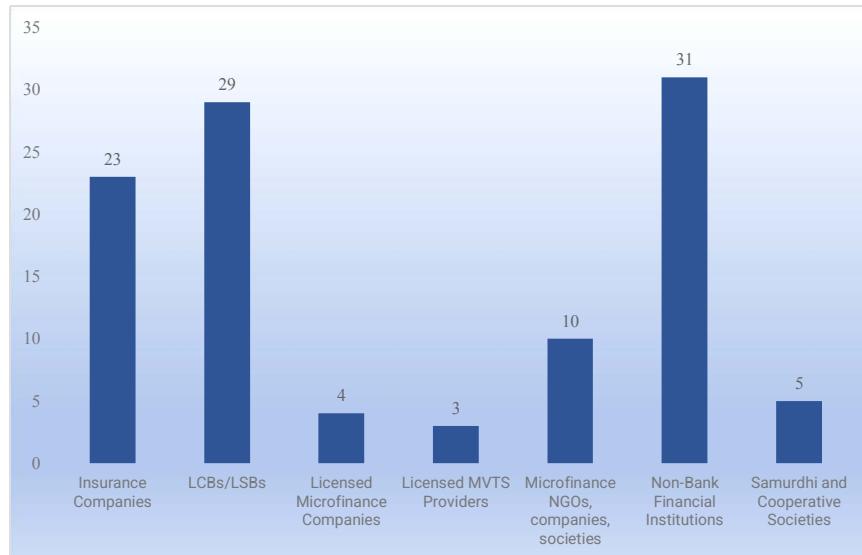
#### 9.3.1 Financial Inclusion Products in Sri Lanka

Of the responses received, it was observed that 75 (71 per cent) out of 105 institutions have financial inclusion products. There were 197 products offered by these 75 institutions which were qualified as financial inclusion products as per criteria. The said 197 financial inclusion products were grouped into 10 different categories based on their characteristics. The 10 categories were: 1) Regular Savings and/ or fixed deposits, 2) Micro loans, 3) Group Lending/Self-help groups products, 4) SME loans, 5) Deposit backed loan products/collateral savings, 6) Money or value transfer/ e – money services, 7) Microinsurance, 8) Finance leasing, 9) Pawning and 10) Remittances or Purchase/sale of foreign currency.

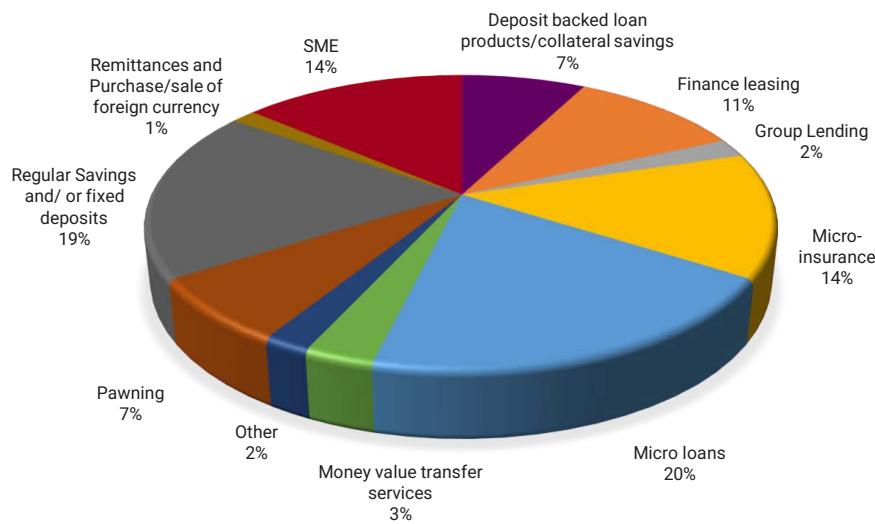
1 FATF guidance on Anti-money laundering and terrorist financing measures and Financial Inclusion

2 Banks, Finance Companies, Insurance Companies, MVTs and e-money service providers, Microfinance Companies (including NGOs), Cooperative Societies and Samurdhi Banks.

**Figure 1: Sector-wise Representation of the Total Responses Received from Institutions.**



**Figure 2: Availability of Financial Inclusion Products (Product wise Categorization)**



### **9.3.2 Overall Operating Environment**

According to the WB Global Findex 2021, 89 per cent of adults in Sri Lanka have accounts at a financial institution which is more than twice the average in South Asia (excluding India) of 38 per cent and higher than the average for developing countries which is recorded as 71 per cent. Sri Lanka benefits a broad physical access to financial services boasting bank branch density of 16.4 branches per 100,000 adults, nearly double the South Asian regional average of 9.4. However, despite having a high account ownership across all segments of the population, the actual account usage falls behind with many accounts being dormant. Sri Lanka has no significant gender gap in account ownership (18 per cent). Financial literacy of Sri Lanka is 57.9 per cent (Financial Literacy Survey of Sri Lanka 2021).

### **9.3.3 Regulatory Environment of the Financial Inclusion**

One of the key regulatory reforms introduced in the financial inclusion sector is the Microfinance Act, No. 6 of 2016. It was issued to license, regulate and supervise unregulated microfinance companies and microfinance NGOs of Sri Lanka by the Monetary Board of the CBSL. Only the financial institutions licensed by the CBSL are permitted to accept deposits from the general public in Sri Lanka. All regulated financial institutions that offer financial inclusion products are subject to the general AML/CFT requirements of the FIU. Therefore, they are required to establish an AML compliance function with competent officers on AML/CFT and to impart necessary awareness on AML/CFT to all levels of staff of the institutions. Financial Institutions (Customer Due Diligence) Rules, No. 1 of 2016 (CDD Rule), issued under Section 2(3) of the FTRA has prescribed the CDD requirements that should be applied by financial institutions including financial inclusion service providers who provide specific services as defined in the FTRA. The CDD Rules prescribe financial institutions on requirements relating to implementation of risk-based approach. Accordingly, when a financial institution is conducting transactions with a customer or a legal person, they are required to identify the risk and take measures and conduct ongoing due diligence commensurate with the risk. Product risk assessments need to be carried out before the launch of such products or new technologies. Institutions that come under CDD rules take necessary approvals from the regulator prior adopting such technological or product launch. The FIU has not issued regulations or guidelines specifically for financial inclusion products however, FIU has issued a guideline on ML and TF Risk Management for Financial Institutions, No. 1 of 2018 which stipulates the instances and possible measures of simplified CDD. Sri Lanka initiated to develop its national level policy framework for financial inclusion in early 2018 and the NFIS of Sri Lanka for 2021-2024 was launched in early 2021.

#### *9.3.3.1 Delayed Verification under Customer Due Diligence Rules*

CDD rules have provided for delayed verification in instances where the risk level of the customer is low and verification is not possible at the point of entering into the business relationship, the Financial Institution may, allow its customer and beneficial owner to furnish the relevant documents subsequent to entering into the business relationship and subsequently complete the verification<sup>3</sup> as soon as it is reasonably practicable but not later than fourteen working days from the date of opening of the account, the delay shall be essential so as not to interrupt the Financial Institution's normal conduct of business and no suspicion of money laundering or terrorist financing risk shall be involved<sup>4</sup>.

#### *9.3.3.2 Key Legislations and Rules that Govern Identification of Customers*

The FIU issued several regulations circulars and guidelines under the Section 3(2) of the FTRA in relation to the requirements of risk assessment, STR reporting, non face-to-face identification technologies, etc., further explaining AML/CFT responsibilities. All institutions under the FTRA are required to report suspicious transactions to the FIU. According to the rules and regulations in Sri Lanka, identification (passport, NIC, driving license, etc.), address verification, telephone/fax numbers, etc., must be obtained from potential customers to enable banks and other institutions to fulfill their KYC requirements.

<sup>3</sup> Rule 31 of Financial Institutions (Customer Due Diligence) Rules, No. 1 of 2016 (CDD Rule)

<sup>4</sup> Rule 32 of Financial Institutions (Customer Due Diligence) Rules, No. 1 of 2016 (CDD Rule)

Thus, as it stands at present, irrespective of the customer's ML/TF risk, the KYC requirements as stipulated in the rules are identical. Therefore, low-income groups i.e., low-income people, farmers, those involved in cottage industries, etc., who are generally low risk, are unable to furnish the above requirements and hence, get excluded from participating in the Financial Inclusion products.

#### **9.3.4 Risk Rating of Object Specific Products**

For 8 categories of products which are Micro Loans, SME Loans, Group lending/Self help groups, Regular savings/Fixed deposits, Microinsurance, Deposit backed loan products, Finance leasing, and Pawning, initial and final risk assessment arrived as Low risk. For MVTS and Remittances and sale/purchase of foreign currency, initial product risk assessment was medium and final risk assessment after considering risk mitigants, arrived at Low risk.

#### **9.3.5 Risk Assessment of Specific Product Categories**

##### **9.3.5.1 Microcredit**

The ML/TF risk for microcredit is Low, not only due to the size of the loan and the prescribed threshold amounts, but also due to clearly defined product features and existence of risk mitigants for the product. Anonymous use of the product is not possible since the institutions carry out customer identification prior to on-boarding. Loan products are availed of mainly by natural persons who are citizens residing in the country. The credit cooperatives, Samurdhi banks, MFIs and microfinance NGOs only lend to their members within the communities they serve. The value and number of loan transactions are limited, and the majority of products have threshold limits for value and frequency of transactions. There are no cross-border transactions. Non face-to-face account opening and transactions are allowed in some banking, finance leasing and MVTS micro credit products. Such microcredit facilities are disbursed and collected via established online platforms under monitoring of transactions, security (usernames, passwords and One Time Passwords, etc.) and the loans are disbursed after careful loan appraisals. Notably, there is no history or record of financial crimes. At instances where legal persons are entitled to use microcredit facilities, customer identification procedures are followed, and strict credit appraisal procedures are in place for granting loans. Agent banking is allowed, however, there is frequent interaction and close relationship between the service providers and agents as well as the clients.

##### **9.3.5.2 Small and Medium Enterprises Loans**

The ML/TF risk for SME loans is Low, mainly due to clearly defined product features, prescribed threshold amounts, and existence of risk mitigants for the product. Anonymous use of the product is not possible since customer identification or KYC procedures are carried out prior to customer on-boarding. Loan products are used only by citizens. These products are lent to their members within the communities they serve. Few products have threshold limits and the upper limit amounts to Rs. 500,000 which shows a low value facility. Therefore, the value of transactions is limited, and the number of loan transactions is also limited. For products which inward remittances are allowed, there is no possibility of having transactions from high-risk jurisdictions. Transactions are generally face-to-face and often conducted onsite (in or near clients' place of residence) by authorized loan officers. Some SME product facilities are allowed non face-to-face and in such instances, loan disbursements and repayments are carried out via established online platforms under

monitoring of transactions. There is no history or record of financial crimes. Legal persons are entitled to avail themselves of the SME facilities, and customer identification procedures are followed. Agent banking is allowed, however, there is frequent interaction and close relationship between the service providers and agents as well as the clients.

#### 9.3.5.3 *Regular Savings and/ or fixed deposits*

Despite the expansion of the functionalities of the regular savings and/ or fixed deposits, the ML/TF risk for regular savings and/ or fixed deposits remains to be Low. This is primarily due to the existence of risk mitigants, such as product is not typically available to individuals/entities other than the Bank's existing customers (not for walk-in customers), product typically creates a long-term obligation to the bank and the product significantly used by and/or marketed not towards customer types categorized as higher risk in regulatory or industry guidance. This product typically does not involve a high volume of transactions over a short period of time. The fact that deposit taking is allowed only for institutions which are licensed and supervised by the CBSL greatly contributes to the sustained low ML/TF risk. All the service providers of regular savings and fixed deposits are required to be compliant with the FTRA and CDD rules issued by the FIU for financial institutions. There are no thresholds on the number of transactions hence the number of transactions is unlimited. However, the average daily transactions must be monitored. Compliance is verified through supervision. This product is not offered to non-residents. Cross-border transactions are possible, however, due to strict compliance with the rules and regulations, there is no possibility of having transactions to and from high-risk jurisdictions. Further, transfers to microdeposit accounts by a third party are possible through electronic channels but the KYC aspect for the remitter is undertaken by remittance agents.

#### 9.3.5.4 *Microinsurance*

The ML/TF risk for microinsurance is generally Low due to clearly defined product features suited to the target market, and existing risk mitigants. It is not offered to non-residents, and anonymous use of the product is not possible. Microinsurance products do not allow transactions across borders. Anonymity cannot be possible because the products are offered to pre-identified customers. All insurance companies have to comply with IRCSL issued rules and regulations. The FIU had issued special CDD rules for the insurance sector in 2009, which were later repealed and replaced by the Insurers CDD Rules issued by the FIU in 2019. Accordingly, IRCSL has also issued AML/CFT regulations/guideline for their regulating insurance companies. Other financial institutions that offer insurance products need to adhere to CDD rules issued for FIs. Therefore, almost all insurance service providers have to comply with tightened AML/CFT rules. The value and the number of the transactions (per provider) are limited, and cross-border transactions are not allowed. Basic KYC, including face-to-face account opening, is required, although the process/documentation is simplified to accommodate the targeted low-income clients. Moreover, the product is generally offered to residents only. Of the surveyed products, 44.4 per cent has a threshold for value of transactions. Given the specific premiums and low frequency of payments, the transaction frequency is limited. It is generally offered to residents and citizens only. The usage of microinsurance products to perpetrate ML/TF activities is not known and there are not any reported cases that relate these products to financial crimes or activities. Given that there are strict procedures prior to the rolling out of these products and that the product caters to the low-income sector, possibility to commit fraudulent activities using the product is very low.

#### 9.3.5.5 *Pawning*

When compared with other loans, the value of transactions for this product is high, as generally a threshold is not provided. However, ML/TF risk is Low because the amount is based on weight of the gold article a customer possesses. Pawning loans are usually short-term, involving small amounts which are generally carried out by those from the low-income bracket, especially for urgent cash requirements. The customers typically carry out loans below Rs. 2 million. These products do not allow anonymity of the customers. These institutions which provide pawning services are supervised by the relevant regulatory authority. The ML/TF risk is also low due to the requirement of face-to-face transactions at the point of both pawning and settlement/redeeming stages. Although KYC is required, the process/documentation is simplified to fit the targeted low-income and small borrowers. Borrowers are natural persons. One identified risk in pawning is the issue of ownership of the personal property offered as collateral. These include instances where personal properties obtained through robbery or theft were pawned. Under the FTRA and CDD rules, financial institutions and DNFBPs are required to comply with explicit KYC procedures consistent with the requirements. The institutions following the practice of conducting the necessary due diligence to determine ownership of the item to be pawned and blacklisting those who pawn items which are found to be sourced from illegal activities is considered an effective risk mitigant.

#### 9.3.5.6 *Remittance Services and Purchase/Sale of Foreign Currency*

The ML/TF risks for remittance services are generally Low because thresholds have been placed on the amount of remittance and on the number of transactions. Due to the limits on the amount and number of transactions, in general, the amount of these remittances is relatively low. Some remittances also have regularity (i.e., once a month) with recipients already known to the institution. These remittance services are offered by financial institutions which are strictly adhered to AML/CFT requirements and supervision. The transaction monitoring and STR reporting is mandatory, indicating their ability to determine risks associated with transactions. Enhanced CDD needs to be conducted on remittances involving large amounts, especially, on cross-border transactions. Cross-border transactions with high-risk jurisdictions are very unlikely and closely scrutinized under the applicable laws and regulations. For enhanced measures for cross-border transactions, institutions take Visa information / dual citizenship copy/ source of income details, confirmation from correspondence agent and monitor transactions through separate monitoring rules available to cross border transactions and large remittances.

#### 9.3.5.7 *Money or Value Transfer Services/E-Money*

The ML/TF risk for e-money and MVTS is Low because of low value threshold, transaction monitoring and existence of risk mitigants. These service providers are required to ensure compliance with AML/CFT requirements. They provide training for individual retailers who are agents of the MVTS providers, and they have implemented the AML/CFT requirements of the CDD including maintaining a directory of agents and providing training. For non face-to-face account opening, the threshold of transactions per month is as low as Rs. 10,000. Also, whenever a customer cashes in and out in the e-money system, required CDD procedures are performed. The number of STRs filed by the sector is relatively low, as against the other financial sectors. Nonetheless, potential exposure to financial crimes and abuse of the product for scam purposes remains a

concern that regulators continue to address with commensurate consumer protection rules, guidance, and awareness. Although cross-border transactions have the probability to expose the sector to ML/TF risks, the risk of ML/TF is reduced, given a lower aggregate threshold amount per month and the current average transaction amount is very low. Considering the possibility for terrorist groups and drug traffickers to channel funds for their activities using e-money and remittance transfers, the service providers scrutinize and analyze all transactions and make the necessary reports in compliance with the requirements of the CDD rule on wire transfers. Moreover, service providers have information on high-risk jurisdictions, UNSCR sanction screening and have blocked transactions to these high-risk jurisdictions and designated individuals and entities.

#### *9.3.5.8 Deposit Backed Loans/ Collateral Savings*

The ML/TF risk for deposit backed loans continues to be Low. The value thresholds and the existing risk mitigants for the product significantly contribute to such low risk. These products are issued to existing customers who are risk rated, hence, anonymous usage of product is not allowed. Deposit taking is allowed only for institutions regulated under the CBSL. Fund withdrawals and transferring are significantly limited. These saving accounts are mainly offered only to individuals in Sri Lanka or to existing customers who are already known to the institution. All the transactions are complied with AML/CFT regulations and transaction monitoring.

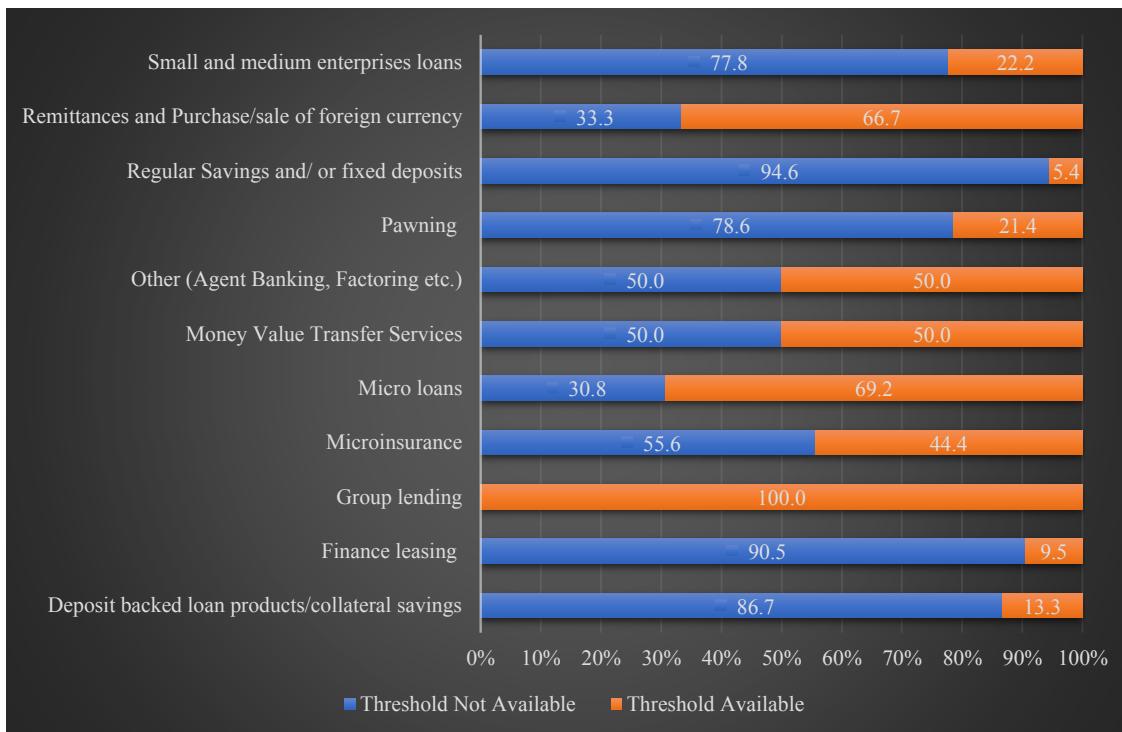
#### *9.3.5.9 Finance Leasing*

The ML/TF risk for finance leasing remains to be Low, primarily because of the existence of risk mitigants such as threshold limits, loan to value ratios imposed by the regulator i.e., CBSL and the regulation and supervision by CBSL. The product typically creates a long-term obligation to the company. This product typically does not involve a high volume of transactions over a short period of time. The approval and actual opening of accounts were done only at the head office or a branch. The leasing product disbursements are subject to stringent appraisals of the customer. The fact that finance leasing products are offered only by financial and leasing companies which are licensed and supervised by the CBSL, greatly contributes to the sustained low ML/TF risk. These accounts cannot be opened without KYC compliance. All the service providers are required to be compliant with the FTRA and CDD rules. The average daily transactions are monitored and sanction screening is carried out. Compliance is verified through supervision. This product is not offered to non-residents.

#### *9.3.5.10 Group Lending Products*

The ML/TF risk for Group Lending Products is Low, due to the small size of the loan, and existence of risk mitigants for the product. Anonymous use of the product is not possible since the institutions are carrying out customer identification and these products are issued in village level individuals who are known to each other. Loan products are used only by natural persons who are citizens residing in the country. Recommendation of the Grama Niladhari or the monk of the temple, etc., is required. The value and number of loan transactions are limited, and the majority of products have threshold limits for value and frequency of transactions. There are no cross-border transactions. Transactions are generally face-to-face and often conducted onsite (in or near clients' place of residence by authorized loan officers or agents). Agent banking is allowed, however, there is a close relationship between the service providers agents and customers.

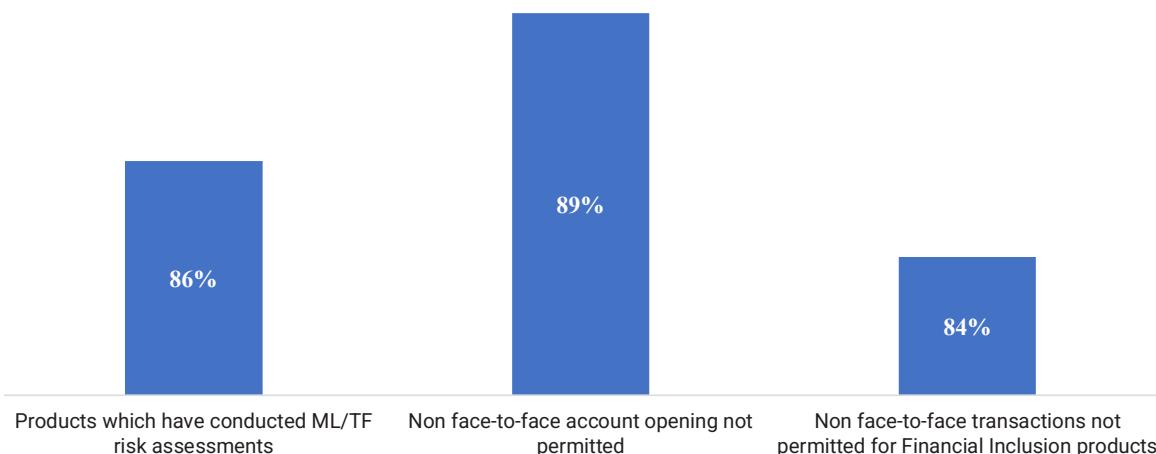
**Figure 3: Product wise Availability of Threshold for Value of Transactions of Financial Inclusion Products**



#### 9.4 Summary of Control Measures taken by the Institutions

Among the surveyed products, 88.6 per cent institutions had developed policies and procedures for AML/CFT. Further, 86 per cent of the institutions carry out risk assessment with regard to ML/TF risk of the customer. The measures in order to mitigate the misuse of these products from ML/TF and related frauds by minimizing customer risk, the institutions have implemented periodical audits, requirement of customer being a member of a particular society or the institution, providing training to staff, ongoing monitoring of customers, requirement of proof of low-income status of customer and recommendation of the customer by Grama Niladhari or an acceptable authority.

**Figure 4: Availability of Non Face-to-Face Account Opening and Transactions and Institutions that have Conducted Money Laundering/Terrorist Financing Risk Assessment for Financial Inclusion Products (as a percentage of all financial inclusion products)**



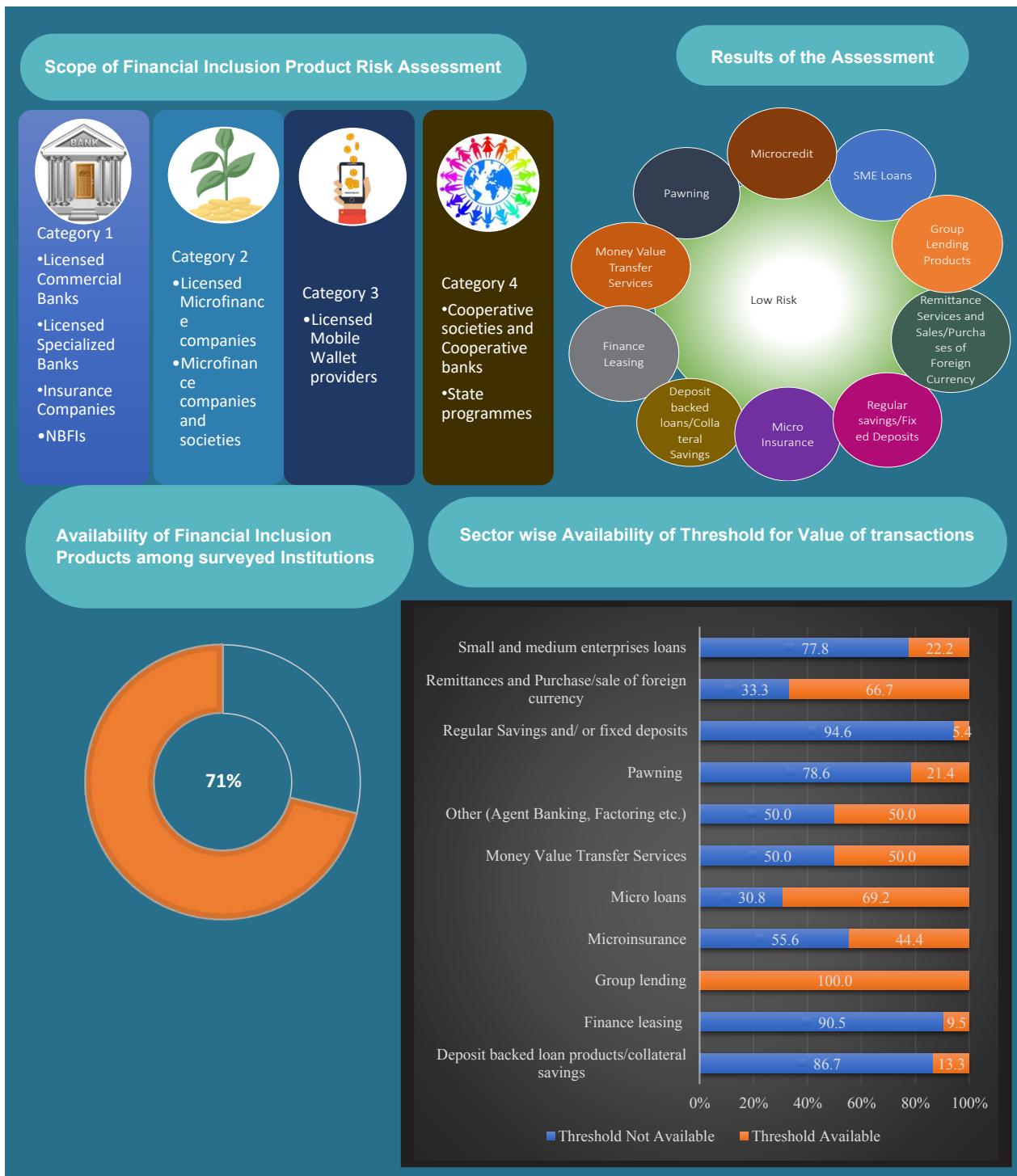
## 9.5 New Products Planned to be Launched

Of respondents, 26 per cent have responded that they have planned to introduce new financial inclusion products in the future. Out of them, 63 per cent of products would not permit for non face-to-face account opening. Of the future products, 70 per cent would not allow for cross-border transactions. Such products would not allow sending money to high-risk jurisdictions. Of the products, 75 per cent would not be offered to, and used by, non-resident and/or non-citizen customers.

## 9.6 The Challenges that Institutions Encounter when Providing Financial Inclusion Services

Findings of the survey highlight that 41.7 per cent of respondents claiming stringent KYC requirements as a major challenge for providing financial inclusion products. Among the difficulties in relation to stringent KYC regulations, obtaining proof of income of customers, the requirement to periodically review the KYC of the Account Holder/Customer, ascertaining the source of income / origin of funds, lack of knowledge on regulatory requirements of the agents were highlighted. Lack of digital identification documents was another key challenge highlighted by 31.3 per cent respondents. Among other challenges which the respondents highlighted were, high mobility of customers without any forwarding addresses, clients' exposure to external shocks which undermines loan recoveries in the absence of a reasonable collateral and the lack of awareness in low-income segments.

**Figure 5: Financial Inclusion Product Risk Assessment**



## 10. THE ENVIRONMENTAL AND NATURAL RESOURCE CRIMES RISK ASSESSMENT

### 10.1 Introduction

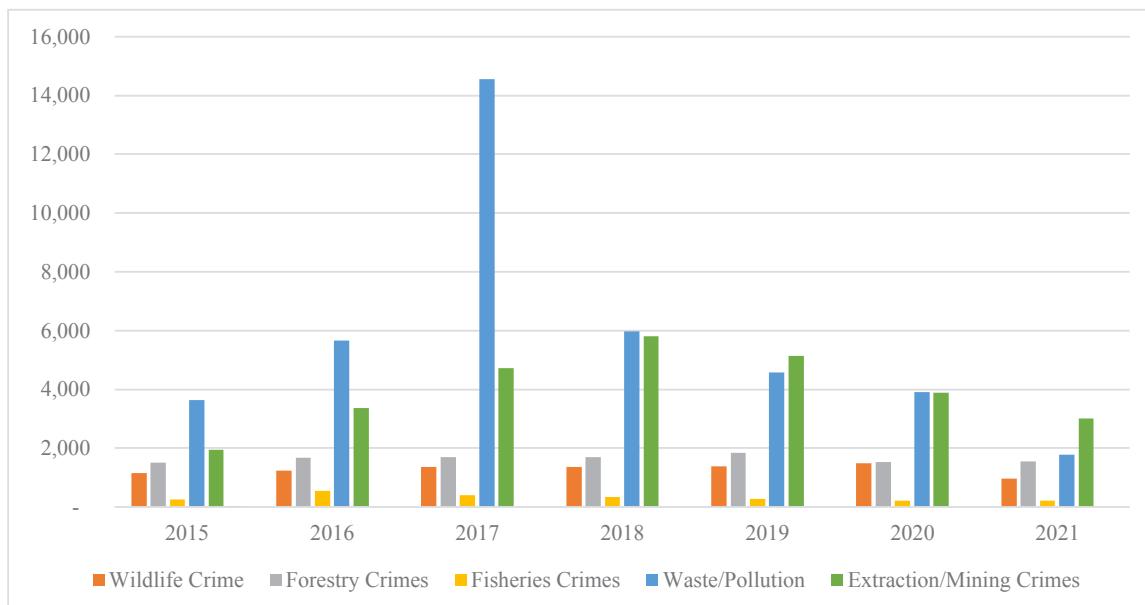
The ENV-NR Crimes Risk Assessment of the NRA focuses on identifying main ENV-NR crime threats in Sri Lankan context, assessing vulnerabilities to financial crimes in the ENV-NR sectors and developing recommendations to strengthen ENV-NR crime and related ML controls and to reduce vulnerabilities to ML in natural resource sectors.

Sri Lanka has a well-established legislative framework for ENV-NR sector. Further, an institutional framework has been established for each ENV-NR sector. Accordingly, legal framework is effectively implemented for ENV-NR crimes as preventive measures and controls. In addition, Sri Lanka is a signatory country of the Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES).

### 10.2 Threat and Vulnerability Assessments of Environmental and Natural Resource Sectors

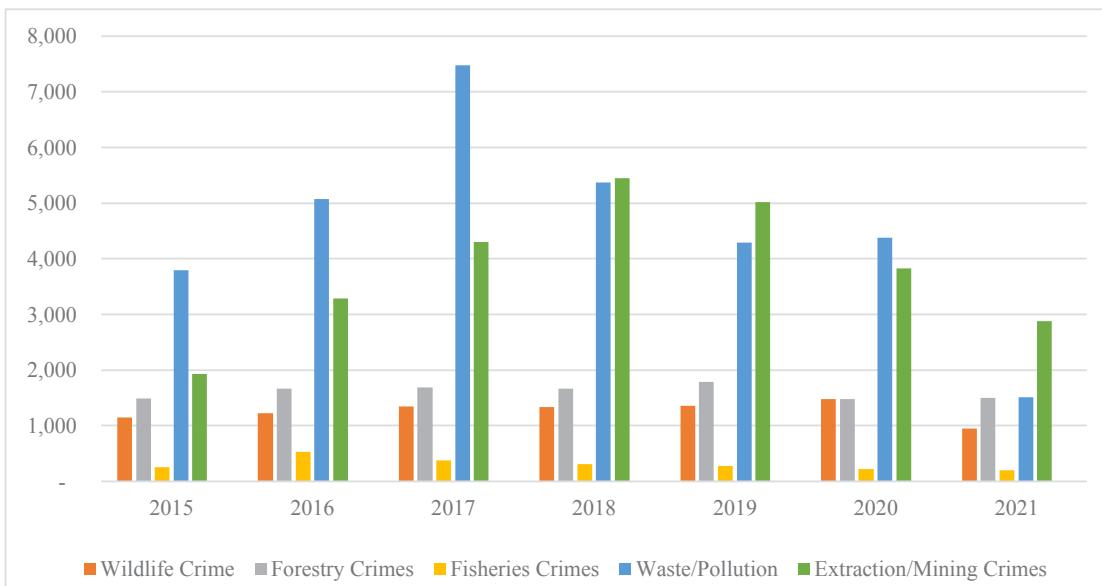
Administrative sanctions, investigations, prosecutions, and convictions have been executed for fauna crimes, flora crimes, fisheries crimes, extraction/mining crimes and waste/pollution offences under the related legislative enactments by the respective agencies in Sri Lanka. Accordingly, The Department of Wildlife Conservation is responsible for the protection of wildlife (fauna and flora) resources of the country and actively engaged in detecting wildlife offences. Department of Forest Conservation is responsible for forest resources of the country. Ministry of Fisheries formulates policies in relation to the subject of fisheries in conformity with the prescribed Laws and Acts, for the betterment of the fisheries industry. Sri Lanka has taken initiatives to make fisheries sector sustainable and to be in compliant with the international obligations. Central Environmental Authority deals with the waste/pollution related offences of the country. The Geological Survey and Mines Bureau is the authorized agency for the mineral development in Sri Lanka. Environmental Protection Division of Sri Lanka Police has also conducted investigations related to environmental offences within the applicable legislative provisions and in coordination with respective environmental enforcement agencies. Number of investigations, prosecutions, convictions and confiscations of environmental crimes are presented in the graphs below. However, no ML or TF cases were investigated within the ENV-NR sector.

**Figure 1: Number of Investigations (2015 – 2021)**



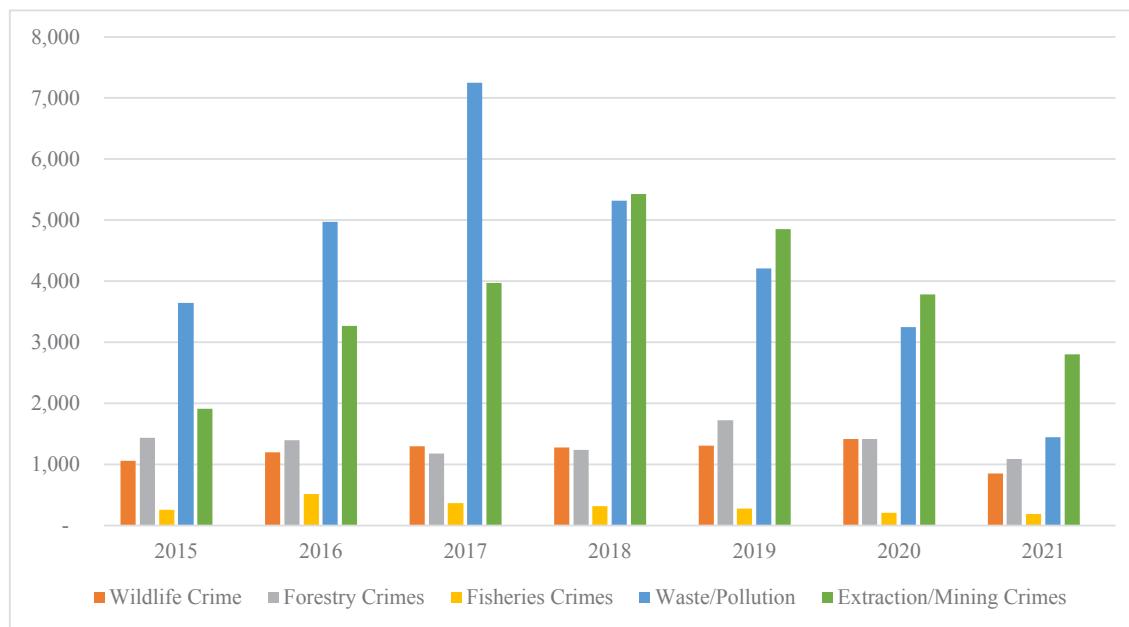
Source: Sri Lanka Police

**Figure 2: Number of Prosecutions (2015 – 2021)**



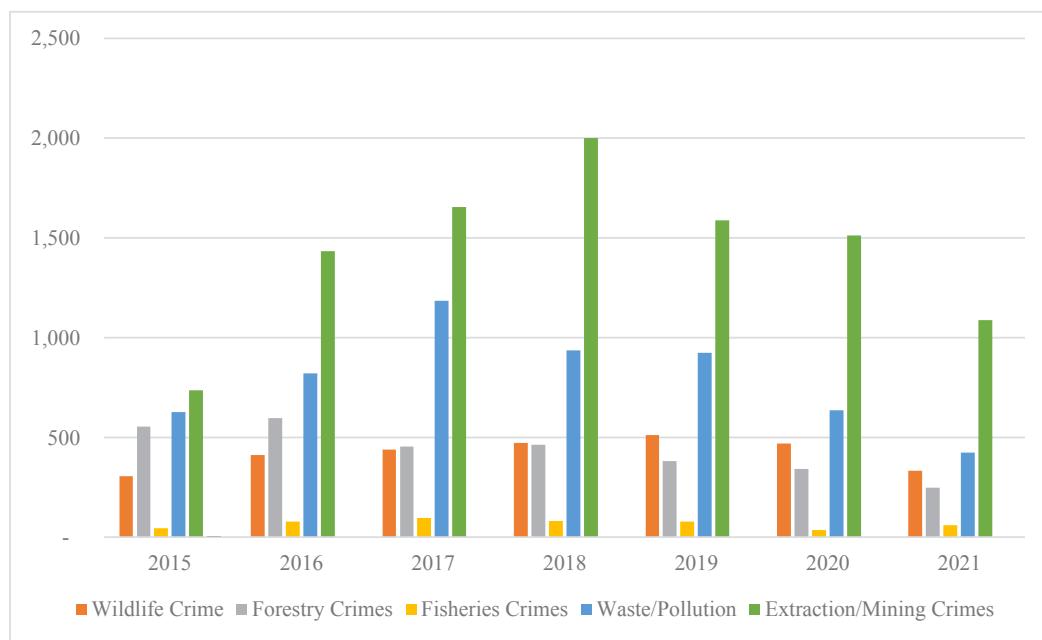
Source: Sri Lanka Police

**Figure 3: Number of Convictions (2015 – 2021)**



Source: Sri Lanka Police

**Figure 4: Number of Seizures/ Confiscations (2015 – 2021)**



Source: Sri Lanka Police

Based on the analysis of the quantitative and qualitative data related to wildlife offences, it is assessed that ENV-NR sector offences have a likelihood of occurring crimes in ENV-NR sector and moderate impact of crime to ENV-NR sector, environmental ecosystem, country's economy and criminal environment. Hence, the overall threat of ENV-NR sector is assessed as **Medium**.

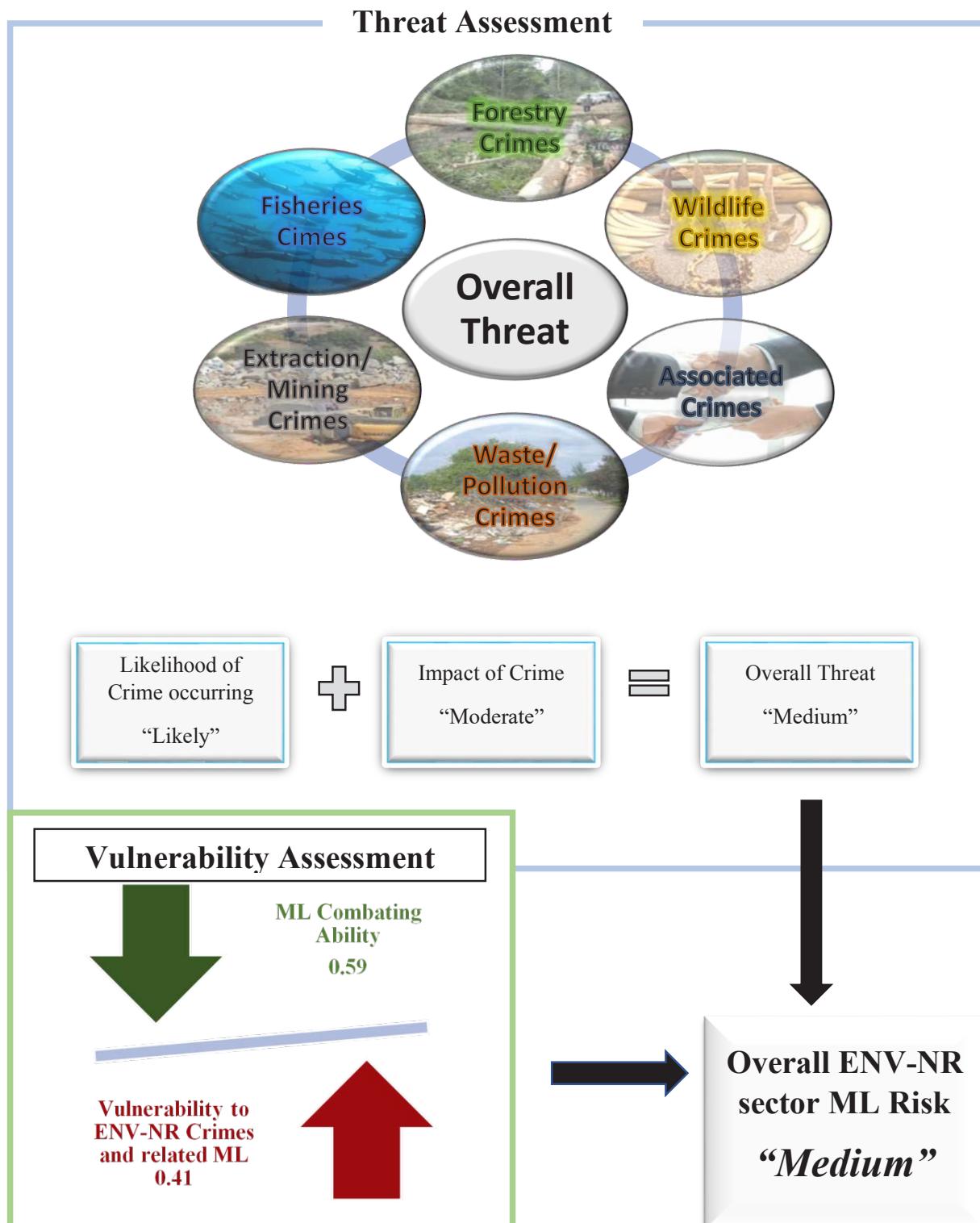
In relation to vulnerability assessment of ENV-NR sector, the WG measured the strength of the legal provisions and the preventive measures and controls to ensure that the legal framework is effectively implemented, and control measures are effectively monitored in the Sri Lankan context.

Sri Lanka has established border controls for illegal wildlife trade by implementing licensing requirements governing the import and export of fauna and flora and related products and any other irregularities via Customs operations. The CIABOC has also conducted investigations, prosecutions and convictions relating to crimes of ENV-NR sector. A total of 104 NPOs are operating in ENV-NR sector with the main objectives of environment protection, disaster management, etc. NPOs intervene to protect environment via public interest litigations if enforcement of the law is violated or government institutions fail to enforce the law. e.g., sludge dumping, deforestation of Wilpattu National Park, Seeking Justice for Elephants, etc.

The vulnerability assessment shows the quality of the general environmental crime controls at Sri Lanka's national level and the ability of the country to combat criminal activity in the ENV-NR sector. Sri Lanka has strong legal framework of ENV-NR violations, preventive and criminal law enforcement, customs and border controls. However, conducting financial investigations on ENV-NR crimes are identified as inadequate in ML perspective. Accordingly, in the Sri Lankan context, overall ENV-NR sector ML combating ability and national vulnerability of ENV-NR crimes and related ML controls were assessed to be in a moderate level. Hence, overall ENV-NR sector ML risk is arrived at **Medium**.

The risk assessment has identified AML related gaps in ENV-NR sector such as non-inclusion of offences related to fauna, flora, fisheries, mining/extraction and other offences related to ENV-NR sector as unlawful activities for ML offence. Further, lack of capacity development and awareness of Law Enforcement Agencies, judiciary and relevant authorities/ institutions to follow the money behind each ENV-NR crime and the non-availability of database for ENV-NR crimes have inhibited effective combating of ML related to ENV-NR crimes. Furthermore, the less awareness among reporting institutions and the general public including employees of ENV-NR sector to identify suspicious activities has resulted in a very low level of reporting of STRs to the FIU. It was also revealed that there is moderate level of international coordination to establish preventive measures and controls on ENV-NR crimes since law level of MLA requests made on ENV-NR crimes. Even though Sri Lanka is a signatory to the CITES, it is yet to introduce national laws implementing all aspects of the CITES in the country.

Figure 5: Highlights of the Environmental and Natural Resource Crimes Risk Assessment



## 11. IDENTIFYING THE CATEGORIES OF NON-PROFIT ORGANIZATIONS AT RISK OF ABUSE FOR TERRORIST FINANCING

### 11.1 Introduction

The NPO module of the NRA serves as an instrument for jurisdictions to support the analysis on the abuse of NPOs for TF.

In the Sri Lankan context, the formation, registration, monitoring and supervision of a majority of the NPOs are covered under the Voluntary Social Services Organizations (Registration and Supervision) Act, No. 31 of 1980 (VSSO Act) and the NSNGO is designated as the statutory body which is entrusted with the registration and supervisory functions under the VSSO Act.

The NPOs which are registered under the VSSO Act, are mainly categorized into 3 categories as National, District and Divisional Level NPOs by the NSNGO. Accordingly, the type of registration and the total number of NPOs registered at each Level are as follows.

**Table 1: Non-Profit Organizations registered under the Voluntary Social Services Organizations Act (As of 2021)**

Registration Type	National Level	District Level	Divisional Level
Source of funding and operational locations	<ul style="list-style-type: none"><li>• All local NPOs with foreign funding;</li><li>• All International NGOs (INGOs) registered overseas and have projects in Sri Lanka;</li><li>• All local NPOs operational in more than one district.</li></ul>	<ul style="list-style-type: none"><li>• All NPOs financed solely by local funds but operational in more than one division.</li></ul>	<ul style="list-style-type: none"><li>• All local NPOs financed solely by local funds and operative only in one division.</li></ul>
No. of NGOs <sup>(a)</sup>	1,668	936	35,434

(a) Provisional

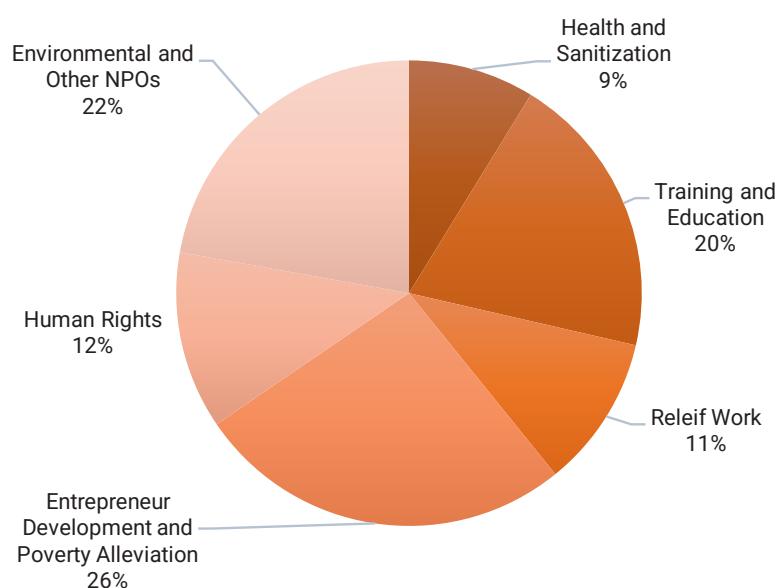
Source: National Secretariat for Non-Governmental Organizations

In view of the above, out of the three categories, it has been identified that the National Level NPOs carry a higher risk as it is the only category which is directly exposed to international risk due to the receipt of foreign funds. Further, it carries a higher risk in terms of the level of income compared to District and Divisional NPOs. As per the information gathered from all 3 levels of NPOs, all NPOs registered under the National Level receive an annual income of more than Rs. 5 million or in any foreign currency equivalent. Conversely, only 18.7 per cent of District Level NPOs and 1.2 per cent of Divisional Level NPOs receive an annual income of more than Rs. 5 million, on average. Even though, a higher number of NPOs were registered under District and Divisional Levels, as per the view of NSNGO, most of those NPOs raise funds mainly from their members and the funds are disbursed among themselves for their own betterment (e.g., Rural Welfare Societies, Death

Donation Societies, Thrift and Credit Societies, etc.) thus, associated with less risk. Hence, risk assessment was performed focusing more on National Level NPOs based on the higher risk exposure.

For the purpose of the assessment, National Level NPOs are further sub-categorized into 6 main categories based on their nature of objectives/functions as “Health and Sanitization”, “Training and Education”, “Relief Work”, “Poverty Alleviation and Entrepreneur Development”, “Human Rights” and “Environmental and Other NPOs”.

**Figure 1: Categories of Non-Profit Organizations**



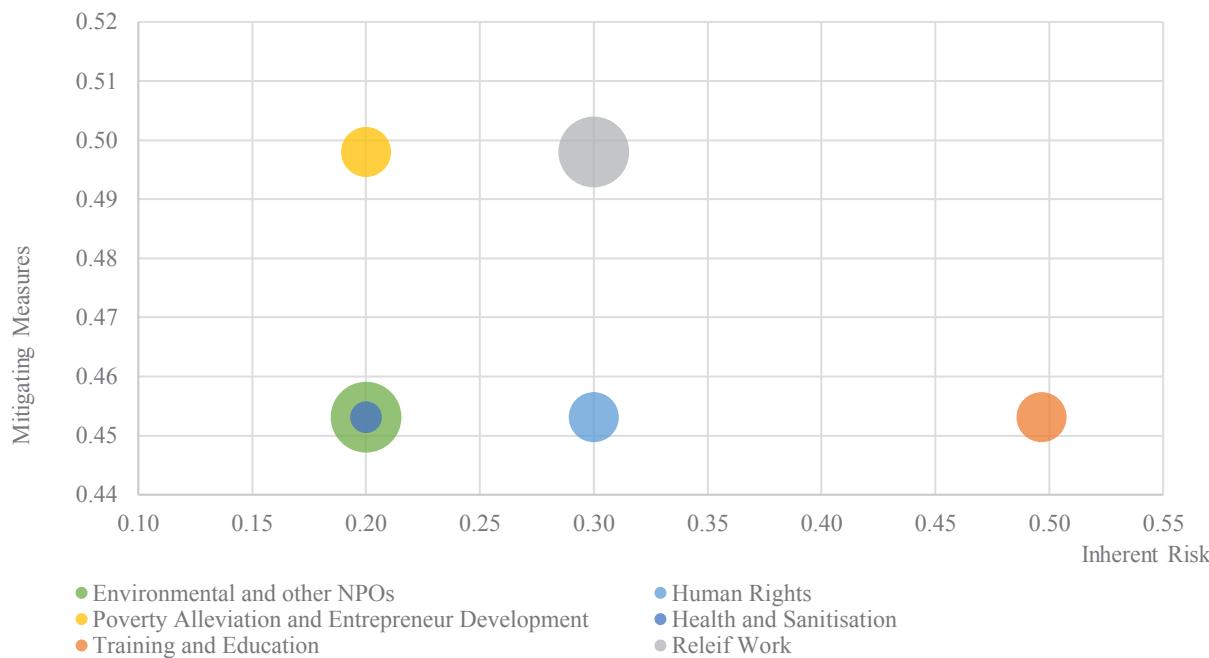
Source: National Secretariat for Non-Governmental Organizations

## 11.2 Overall Assessment<sup>1</sup>

According to the quantitative and qualitative data and information gathered for the assessment period, the final ratings of the inherent risk of abuse of the NPO sector in Sri Lanka for TF, distributed from **Low to Medium** for the 6 different categories of NPOs while mitigation measures implemented by the government and the respective categories of NPOs rated as **Medium** (refer Figure 2).

<sup>1</sup> The level of inherent risk and the quality of mitigating measures spans in a scale of 0 to 1.

**Figure 2: Inherent Risk and Mitigating Measures of Non-Profit Organizations in Sri Lanka**



### 11.3 Sector Assessment

As shown above, NPOs included in “Health and Sanitization”, “Poverty Alleviation and Entrepreneur Development” and “Environmental and Other NPOs” categories carry a comparatively **Low** inherent risk as there were less number of TF investigations (5 per cent out of total TF investigations for all 3 categories) conducted by the CTID, less number of STRs (refer Table 2) and intelligence reported, and no specific evidence and typologies of TF abuse was identified within these categories of NPOs.

Regarding the “Relief Work” and “Human Rights” categories, some intelligence and circumstantial evidence indicate that certain NPOs carrying out charitable work in the areas of Northern and Eastern provinces have more exposure to active terrorist threat and the organizations formed to safeguard the human rights of the minority nationalities are also vulnerable to the threats of collection, transfer and expenditure of funds to promote terrorist ideology. Accordingly, the 2 NPO categories are having a medium level of proximity to active terrorist threat. However, both NPO categories are assessed to have **Medium Low** inherent risk due to the low level of specific typologies identified.

NPOs in the “Training and Education” category carry a **Medium** level of inherent risk compared to the other categories due to the fact that NPOs in this category are allegedly involved in the Easter Sunday Bomb Attack taken place on 21st April, 2019. In the aftermath of the Easter Sunday Bomb Attack, several local extremist NPOs which were apparently formed to promote radical Islamic ideology, were proscribed under the Emergency Regulations as terrorist organizations which are directly and indirectly connected with the attack. Most of the said extremist organizations abused their legitimate programmes and diverted funds to promote radical

Islamic ideology mainly through education and training programmes. Further, the majority of STRs reported on the suspicion of TF abuse of NPOs was based on the “Training and Education” sector (refer Table 2).

The distribution of STRs reported on the suspicion of TF during the assessment period for different NPO categories are given below.

**Table 2: Suspicious Transaction Reports Submitted on Non-Profit Organizations on the Suspicion of Terrorist Financing (2015 - 2022)**

NPO Category	STRs on NPOs	As a percentage of total STRs on the suspicion of TF
Entrepreneur Development and Poverty Alleviation	16	0.79%
Training and Education	73	3.62%
Health and Sanitization	1	0.05%
Relief Work	26	1.29%
Human Rights	17	0.84%
Environmental and Other	25	1.24%
<b>Total</b>	<b>158</b>	<b>7.84%</b>

Source: Financial Intelligence Unit - Sri Lanka

## 11.4 Mitigating Measures

With regard to the mitigating measures, the government as well as the respective NPOs have taken proactive mitigating measures in order to mitigate the risk associated with the NPOs being abused for TF.

The NSNGO has initiated district wise awareness programmes covering all National and District Level NPOs, carried out district wise risk based on-site visits to project sites to maintain the quality of outreach and directed to submit mandatory reports on a quarterly basis on their operational and budgetary conditions to emphasize the quality level of their financial and project management. In addition to the above, the NPO sector has been addressed in the CDD Rules<sup>2</sup> and circulars issued by the FIU on conducting Enhanced Due Diligence on NGOs, NPOs and Charities under Financial Institutions (Customer Due Diligence) Rules, No. 1 of 2016 based on the importance and the gravity of the sector.

Based on the responses received in terms of the mitigating measures implemented by the individual NPOs, most of the NPOs maintain the quality of governance, financial management, project management and staff vetting and oversight, level of commitment to ethics and transparency and the level of self-regulation at a satisfactory level.

In overall, mitigating measures taken by the government and the respective NPOs in all 6 categories were rated as **Medium**.

<sup>2</sup> Financial Institutions (Customer Due Diligence) Rules, No. 1 of 2016 – Extraordinary Gazette No. 1951/13, January 27, 2016  
Designated Non-Finance Business (Customer Due Diligence) Rules, No. 1 of 2018, Extraordinary Gazette No. 2053/ 20, January 10, 2018  
Insurers (Customer Due Diligence) Rules, No 1 of 2019 – Extraordinary Gazette No. 2123/14, May 13, 2019

## 11.5 Gaps Identified

The VSSO Act and its only amendment in 1998 empower the NSNGO with the registration and supervisory functions of NPOs. However, the NSNGO has identified the following salient weaknesses in the existing legislation which hinder its ability to effectively supervise and monitor NPOs.

- No adequate penal provisions to deal with non-registration, refusal to register and non-compliance with regulatory requirements.
- No express provisions to deal with re-registration, de-registration, or provisional/ temporary registration and blacklisting of non-complying NGOs.
- No clear legal framework for onsite inspection.
- No specific provisions to depoliticize INGOs and NGOs.
- No statutory requirement to disclose financial status, funding sources, funds utilization of equitable apportionment of funds for projects and beneficiaries.

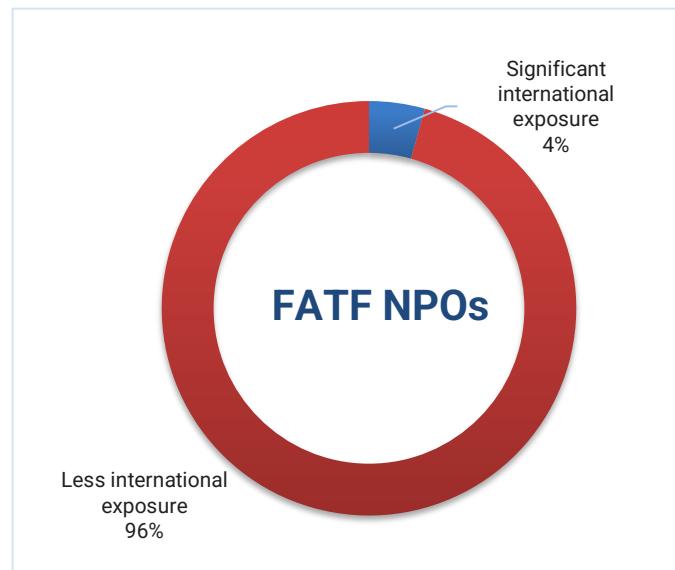
Even though a majority of the NPOs are registered with the NSNGO under the VSSO Act, it was observed that several other NPOs are getting registered under different Laws, Acts and Ministries without any proper regulatory or monitoring mechanism. Therefore, the absence of a single legislation to cover registration and effectively monitoring of all NPOs operating in the country, has been identified as a limitation.

In view of the above, the NSNGO is currently in the process of amending the existing legislation to address the aforesaid limitations. Accordingly, the new legislation will enable the NSNGO to enhance its powers as the primary agency of registration, supervision and monitoring of all NPOs operating within the country including taking effective regulatory actions against the failure to register, non-compliance and violations of the provisions. It will facilitate deepening awareness of TF risk, promote accountability and better data management which safeguard NPOs from the risk of abuse for TF.

Further, it was observed that the NSNGO has limited capacity and resources to effectively regulate and monitor the substantial number of NPOs registered at the District and Divisional Levels. This needs to be addressed by providing necessary technology, human and other resources enabling NSNGO to effectively carry out the required service to the nation.

**Figure 3: Highlights of the Assessment of Categories of Non-Profit Organizations at Risk of Abuse for Terrorist Financing**

*Level of International Exposure on Non-Profit Organizations*



*Composition of National Level Non-Profit Organizations*



## 12. RISK ASSESSMENT OF LEGAL PERSONS, LEGAL ARRANGEMENTS AND BENEFICIAL OWNERSHIP-RELATED RISKS

### 12.1 Background and Context

Despite the essential and legitimate role, the corporate vehicles play in the global economy, under certain conditions, they have been misused for illicit purposes, ML, bribery and corruption, insider dealings, tax fraud, TF, and other illegal activities. This is because, for criminals who try to circumvent measures for AML/CFT, corporate vehicles are an attractive way to disguise and convert the proceeds of crime before introducing them into the financial system (*FATF Guidance – Transparency and Beneficial Ownership, 2014*).

The objective of this study is to assess the ML related risk of legal structures, created/operate in Sri Lanka. This is the 1st of such assessment conducted on legal structures in Sri Lanka.

**Table 1: Scope of the Assessment**

	Legal Persons	Legal Arrangements
Scope	All types of legal persons created under the Companies Act, No. 7 of 2007	Express Trusts registered under the Trust Ordinance
Legislation	Companies Act, No. 7 of 2007 ( <i>herein referred as Companies Act</i> )	Trusts Ordinance, No. 9 of 1917 and Trusts (Amendment) Act, No. 6 of 2018
Registration	Department of the Registrar of Companies	Registrar General's Department

The assessment consists of 4 modules, as Mapping, Threat Assessment, Vulnerability Assessment and Entity Risk Assessment. Data and information were considered for the five-year period 2017 - 2021. Data collection for the assessment included information and statistics obtained from DRC, RGD and other related institutions, questionnaires, interviews, publicly available reports and indices on Sri Lanka as well as other related open-source documents. The working group also referred related Acts, regulations, rules, and guidelines in the assessment.

### 12.2 The Assessment

The Threat level relating to Legal Persons, Legal Arrangements and BO related risks was identified as **Medium** and the overall vulnerability level of the same was derived at **Medium High** Level. Accordingly, the overall ML risk level of legal persons, legal arrangements and BO related risks was identified as **Medium High**.

Summary of the modules which were assessed at the assessment were outlined as follows.

### 12.2.1 Mapping

As per the Companies Act, there are 8 types of legal persons that can be registered with the DRC which has been considered for the assessment,

- a) **Limited company:** a company that issues shares, the holders of which have the liability to contribute to the assets of the company, if any, specified in the company's articles as attaching to those shares. Limited liability companies are further categorized as private limited companies and public limited companies.
- b) **Unlimited company:** a company that issues shares, the holders of which have an unlimited liability to contribute to the assets of the company under its articles.
- c) **Company limited by guarantee:** a company that does not issue shares, the members of which undertake to contribute to the assets of the company in the event of its being put into liquidation, in an amount specified in the company's articles.
- d) **Overseas company:** any company or body corporate incorporated outside Sri Lanka and established a place of business within Sri Lanka.
- e) **Offshore company:** a company or a body corporate incorporated under the laws of any foreign country, which has power to carry on any business outside Sri Lanka; but shall not be entitled to carry on any business within Sri Lanka.
- f) **Quoted Public Company (QPC) /listed company:** a company, where any shares or securities of which are quoted on a licensed stock exchange.
- g) **Association:** Associations are registered by the Registrar of Companies under section 34 of Companies Act, for promoting commerce, art, science, religion, charity, sport, or any other useful object, and intends to apply its profits, if any, or other income in promoting its objects.

**Table 2: Type and Number of Legal Persons created under the Companies Act**

Company Type	No. of entities by 31.12.2021	No. of entities by 31.12.2022
Pvt. Ltd.	143,863	161,266
Public Ltd.	4,351	4,388
Overseas	493	508
Off-shore	11	11
Unlimited	3	3
QPC	254	254
Limited by Guarantee	839	965
Associations	2,780	3,018

Source: Department of the Registrar of Companies

In the Sri Lankan context, the requirement on BO is yet to be introduced to the Companies Act. However, measures have been taken by the FIU to introduce the concept of BO through CDD Measures. Requirements relating to BO have been included in the CDD Rules and Guidelines issued on identification of BOs.

Trust Ordinance, No. 9 of 1917 was amended in 2018 with the objective of introducing requirements of FATF Recommendation 25 relating to legal arrangements. In terms of the Trusts (Amendment) Act, No. 6 of 2018 and subsequent Trusts (Information Relating to Express Trusts) Regulations of 2018, upon creation of an Express Trust in relation to any immovable or movable property, the trustee of such Trust is required to obtain and maintain information as specified in the Regulation. It also addresses the requirements of verifying and updating information every three months and specifies penalties for non-compliances against the requirements introduced in the amendment.

**Table 3: Number of Trusts Registered under the Trust Ordinance, No. 9 of 1917**

	2017	2018	2019	2020	2021
No. of Trusts	137	197	196	185	186

Source: Registrar General's Department

#### **12.2.2 Money Laundering Threat Assessment**

As per the assessment, overall ML threat of the legal structures created in Sri Lanka is at **Medium** level. The threat level has been arrived at analyzing enforcement data such as STRs, MLA requests sent /received, criminal investigations, civil enforcement/ forfeiture actions, proceeds in such cases, criminal prosecutions, and criminal convictions for the assessment period. In the threat analysis, the threat perception was also considered through information collected from credible open sources and threat perceptions by public and private sector experts. It has been observed that there is a limited or low level of STRs, criminal investigations and criminal prosecutions and convictions on abuse of legal structures on ML. At the same time, MLA requests sent on abuse of legal structures for ML during 2017-2021 was 15 per cent out of total MLA requests sent. During the 5-year period, only two MLA requests were received relating to abuse of legal structures for ML. Criminally investigated proceeds that was laundered through legal structures, on ML were not at a high level as per the general understanding based on the cases by relevant authorities. No sufficient data was available on civil enforcement actions on ML abuse of legal structures.

When it comes to threat perception, credible open sources, civil society/academic experts, public sector experts (AGD, LEAs, Tax authorities, DRC) and private sector expert (LBs and TCSPs) perceived medium level of abuse of legal structures for ML purposes.

Under the Threat Assessment, the existence of 15 typologies relating to abuse of legal structures were also analyzed through a questionnaire sent to all LBs. The majority of such typologies found to be existed but in limited frequency. Few typologies were reported as does not exist in Sri Lanka. Summary of the analysis is given in Table 4 below.

**Table 4: Typologies Analysis**

Exist
<ul style="list-style-type: none"> <li>• Foreign ownership/control by shell companies</li> <li>• Use of nominee directors/nominee shareholders/front men</li> </ul>
Exist but Limited
<ul style="list-style-type: none"> <li>• Multi-jurisdiction Splitting</li> <li>• Anomalous complex ownership/control structures</li> <li>• Control through power of attorney</li> <li>• Use of trusts or foundations in ownership/control structures</li> <li>• Use of private investment funds/hedge funds</li> <li>• Use of International Business Companies/exempt companies</li> <li>• Use of large professional firms</li> <li>• Use of fake ID documents for formation/registration</li> </ul>
Does not Exist
<ul style="list-style-type: none"> <li>• Use of legal persons as company directors</li> <li>• Use of bearer shares (cannot exist as per the legal terms on shares)</li> <li>• Use of fictitious entities</li> <li>• Abuse of professional privilege</li> <li>• Use of deceptive names of legal structures</li> </ul>

#### **12.2.3 Vulnerability Assessment**

The vulnerability of legal structures has been assessed based on the level of Sri Lanka's attractiveness for non-resident incorporations and strength of mitigation measures. Accordingly, the assessment resulted a **Medium High** level of vulnerability of legal structures for ML with a medium level of attractiveness for non-resident incorporations and a low level of strength of mitigation measures.

**Attractiveness for non-resident incorporations:** was measured using eight factors where overall attractiveness of Sri Lanka was assessed at medium level.

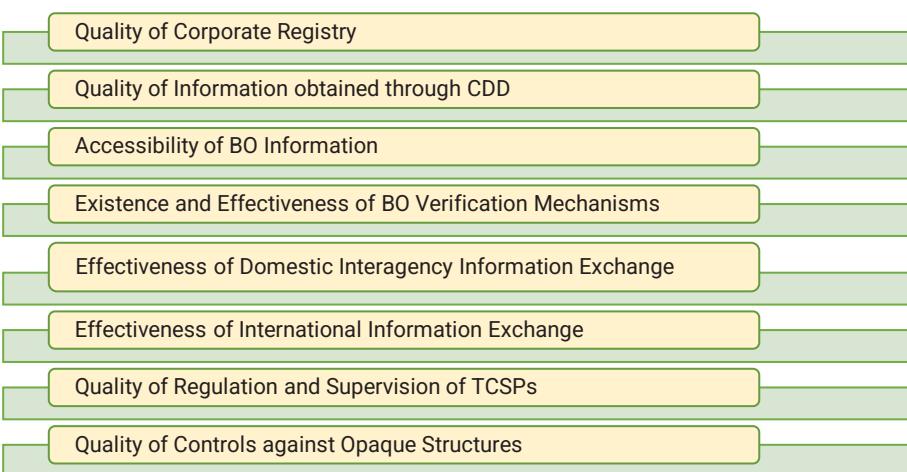
**Figure 1: Attractiveness for Non-Resident Incorporations Score**



The share of offshore companies out of total number of legal structures as at December 31, 2021 stood below 1 per cent, as well as, during 2017-2021 no offshore companies have been registered in Sri Lanka. The availability of many advertising campaigns for the promotion of company formation for non-residents<sup>1</sup> and strength of rule of law<sup>2</sup> and legal framework for asset protection<sup>3</sup> in Sri Lanka have a positive impact on the attractiveness for non-resident incorporation. At the same time, low political and economic stability<sup>4</sup> mainly due to unexpected fluctuations occurred as a result of Easter Sunday attack and COVID-19 Pandemic, complex and frequently changing taxation policies<sup>5</sup>, deficiencies in BO transparency due to non-availability of legal requirements on BO identification and verification of legal persons as well as high perceived corruption level<sup>6</sup> have made a negative impact on the level of attractiveness for non-resident incorporations.

**Strength of Mitigation Measures:** was measured considering eight factors.

**Figure 2: Strength of Mitigation Measures**



a) The quality of corporate registries was assessed at medium level :

A comprehensive coverage of legal persons and structures was observed with limited exemptions such as partnerships. There are 8 types of legal persons in Sri Lanka which are registered under the Companies Act as described before. All express trusts created in Sri Lanka should be registered with the RGD as required by the Trust Ordinance and its subsequent amendments. Further, a sufficient level of accurate and up-to-date basic information is available on legal persons with the DRC. Facilities are available in the current eROC system to automatically alert legal entities when an update is required or inform entities of possible penalties if information is not updated. General public have online access to the eROC to search basic information with a fee and LEAs have been given online access to information on request free of charge. However, the staff strength of the DRC and RGD is at an insufficient level.

1 <https://www.drc.gov.lk>, <https://investsrilanka.com>, <https://gic.gov.lk>

2 Rule of Law Index, 2021 Investment Climate Statement by US Department of State

3 Doing Business in Sri Lanka, [www.treasury.gov.lk](http://www.treasury.gov.lk)

4 <https://www.cbsl.gov.lk>, The Economic Freedom Index, The Sri Lankan Economy—Charting a New Course by Asian Development Bank

5 <http://www.ird.gov.lk>, A step by step guide to Doing Business in Sri Lanka

6 The Corruption Perception Index by Transparency International, Global Corruption Barometer by Transparency International, [www.ciaboc.gov.lk](http://www.ciaboc.gov.lk)

b) Quality of information obtained through CDD was assessed at medium level :

The FIU has issued CDD Rules to FIs, Designated Non-Finance Business and Insurance in 2016, 2018 and 2019 respectively under Section 2(3) of the FTRA has prescribed the CDD requirements that should be applied by such institutions, which also states the requirements to be complied relating to legal structures. The Designated Non-Finance Business CDD Rule is applicable to DNFBPs including real estate dealers, accountants, legal professionals, notaries and TCSPs. The FIU initiated conducting awareness for TCSPs on AML/CFT requirements in latter part of 2021. When a financial institution or DNFBP conducts transactions with a legal structure, they are required to undertake risk profiling measures and conduct due diligence as per the risk identified.

c) Quality of regulation and supervision of TCSPs was assessed at medium level:

Section 221 of the Companies Act establishes the legal requirement of having a Secretary for legal persons. Regulations on Secretaries were also issued under the Companies Act and the administration of such regulations are vested with the DRC. With respect to AML/CFT coverage, the FIU issued Designated Non-Finance Business (Customer Due Diligence) Rules, No. 1 of 2018 under Section 3(2) of the FTRA, prescribing the requirements relating to risk assessment, CDD, record keeping, internal control, use of new technologies etc for TCSPs. Furthermore, the FIU issued Guidelines on AML/CFT Compliance Obligations for Accountants and TCSPs in 2020. During both 2020 and 2021, the FIU carried out offsite risk assessment on the TCSPs to identify implementation of CDD within identified TCSPs. However, so far, no onsite examinations have been conducted on TCSPs.

d) Level of accessibility of Beneficial Ownership Information was rated as low:

The low level of accessibility of BO information was mainly due to non-availability of legal requirements relating to BO of legal persons under Companies Act. Accordingly, DRC has no legal requirement to maintain registry of BO of legal persons as well as LEAs or competent authorities do not possess direct access to such details. However, as per section 6B (1) of the Trusts (Amendment) Act, No. 6 of 2018, Registrar General is required to provide information relating to express trusts registered with RGD to the FIU or any authority sanctioned by the FIU, and as per the section 19B (1)(a) of the same Act, trustee and a co-trustee, required to provide any information in the record maintained relating to express trusts, to any relevant authority as defined in the Act. In addition, CDD Rules also require all FIs, Insurance and DNFBPs to record BO of legal persons and legal arrangements whenever they are dealing with such customers. LEAs and the FIU have access to such BO information maintained by FIs. General public do not have access to any BO information of legal persons as well as legal arrangements.

e) Level of existence and effectiveness of BO verification mechanisms was rated as very low:

Since there is no legal requirement for the DRC to maintain a register of BO of legal persons, a BO register for legal persons does not exist and hence no mechanisms available to verify the accuracy, cross-check with other sources and perform enhanced checks on red flags for BO information.

f) Domestic interagency information exchange was rated at medium level:

Mechanisms are available to cooperate with all government authorities by sharing information relating to companies registered whenever there is a request for such information. As at end of 2021, DRC has provided information to agencies such as Central Bank, Magistrate's Courts, Sri Lanka Police (CID, Colombo Crime Division, Fraud Investigation Bureau, CTID, etc.), CIABOC, SIS, Exercise Department of Sri Lanka, AGD and IRD.

g) Effectiveness of international information exchange was rated at medium level:

Access is available to BO information by the FIU through FIs, which can be shared with its counterparts through Egmont Group. Further, Sri Lanka has entered into a Multilateral Treaty with South Asian Association for Regional Cooperation (SAARC) and double tax agreements with 45 countries to exchange tax information.

h) Effectiveness of enforcement of sanctions/fines was rated at medium level:

Companies Act, identifies offences for non-compliance with the Act and prescribes penalties for such violations. Similarly, Section 19 (C) of the Trust Ordinance (Amendment) Act, No. 6 of 2018 prescribes penalties for non-compliance with the Act.

i) Quality of controls against opaque structures was rated at medium level:

No mechanisms are available to ensure BO transparency measures on opaque legal persons, as similar to other legal structures specified under the Companies Act. Also, the Act does not have provisions to disclose PEP status of shareholders or beneficial owners, although, PEP disclosure is included in CDD rules issued for FIs, DNFBPs and Insurance companies. Further, there are no prohibitions or restrictions under the Companies Act on any person acting as nominee directors. However, a company cannot be registered with identical names or similar names that are already registered. The concept of "Bearer Shares" does not exist in Sri Lanka in terms of the definition of the shareholder as per the Companies Act. In addition, CDD Rules issued specify BO identification mechanisms when a legal entity is entering into a business relationship with an RI. In relation to trusts, the BO transparency for structures owned/controlled by trusts should be available as required by the provisions of Trusts (Amendment), No. 6 of 2018.

## 12.3 Entity Risk Assessment

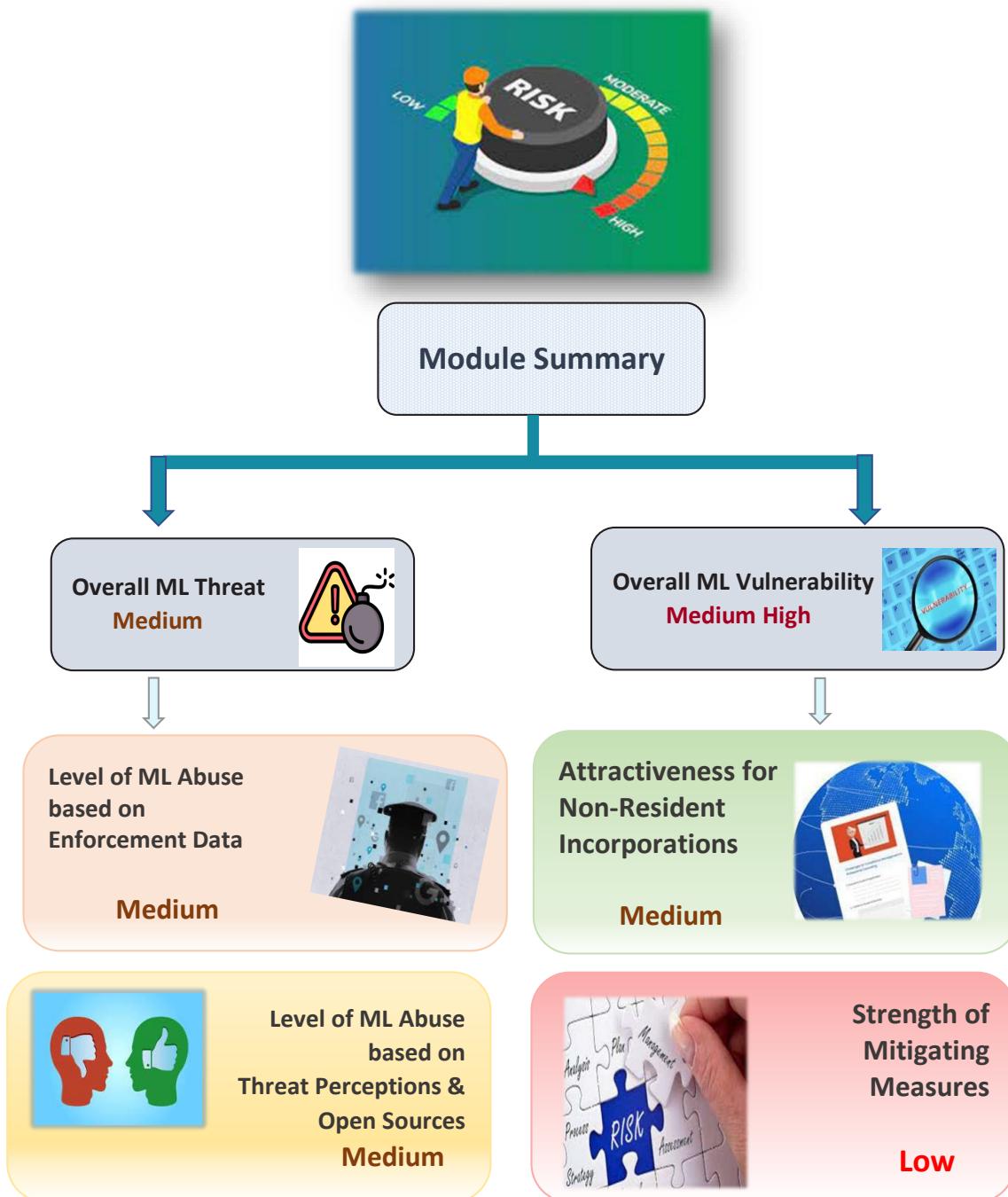
Due to data limitations, the entity risk assessment was performed for private limited liability companies, public limited liability companies, overseas companies and companies limited by guarantee. Further, data on assets and financial flows on each legal structure were not available in conducting the entity risk assessment.

**Table 5 : Summary of Entity Risk Assessment**

Entity Type	Entity Risk Level	Attributes
Private Limited Liability Companies	Medium	<ul style="list-style-type: none"><li>Out of total legal structures, around 94 per cent comprises of private limited liability companies.</li><li>85 per cent of companies had 100 per cent local ownership while companies with foreign ownership mainly distributed among countries such as India, China, Malaysia, Singapore, USA and UK (Survey Results)</li><li>Ease and speed of formation/registration of private limited companies is high, where, with the introduction of eROC, a company could be formed within 1 day.</li><li>Average cost of formation of a private limited company is around Rs. 10,000 /USD 32 (plus tax and depends on number of directors)</li><li>No specific residency requirement is available for directors or office bearers in the Companies Act. However, the Act specifies that only a natural person is qualified to hold director's position (Section 202 (2) (f) of the Companies Act).</li><li>No provisions are available relating to identification and verification of BO of legal persons.</li><li>Private limited companies are the most prone category for ML/TF, based on the STRs reported by RIs as well as LEAs.</li></ul>
Public Limited Liability Companies	Medium	<ul style="list-style-type: none"><li>2nd largest legal structure type created in Sri Lanka totaling around 3 per cent.</li><li>Cross border exposure of public limited companies is low, as 72 per cent of companies had 100 per cent local ownership while companies with foreign ownership mainly distributed among countries such as India, UK, Malaysia, Netherland, UAE and Hong Kong (Survey Results).</li><li>Ease and speed of formation/registration of public limited company is at satisfactory level. Even though, the cost is relatively low, it would take comparatively longer time compared to private limited companies in the formation process. There is no specific residency requirement for directors or office bearers in the Companies Act. However, the Act specifies that only a natural person is qualified to hold director's position.</li><li>The average cost of formation of a public limited company is Rs. 8,000/ USD 25 (plus tax and depends on number of directors).</li><li>There are no provisions available relating to identification and verification of BO of legal persons.</li></ul>

Companies Limited by Guarantee	Medium	<ul style="list-style-type: none"><li>Out of total legal persons registered in Sri Lanka only 0.5 per cent represent companies limited by guarantee.</li><li>Cross border exposure of Companies Limited by Guarantee is very low as only a below 1 per cent had foreign ownership (Survey Results).</li><li>Ease and speed of formation/registration is high and takes less time for formation.</li><li>Average cost of formation of a company limited by guarantee is Rs. 30,000/ USD 94.</li><li>There are no provisions available relating to identification and verification of BO of legal persons.</li></ul>
Overseas Companies	Medium	<ul style="list-style-type: none"><li>Out of total legal persons registered in Sri Lanka only 0.3 per cent represent overseas companies.</li><li>Cross border exposure of overseas companies is very high. As per the survey results, apart from 15 companies that had some domestic ownership ranging from 3 per cent to 75 per cent. The rest of the companies had 100 per cent foreign ownership. Foreign ownership was distributed among many countries such as India, Pakistan, Maldives, Malaysia, UK, USA, Australia, Germany, Singapore, Japan, China (Survey Results).</li><li>Informal international cooperation on information sharing on overseas companies, between FIU to FIU or Police to Police, is very effective, while formal cooperation on the same is relatively low. Sri Lanka has made many MLA requests, however, only few MLA requests were received by Sri Lanka from other jurisdictions on all types of legal structures.</li><li>Overseas companies are required to obtain registration under Companies Act and also it is required to have a local representative.</li><li>Comprehensiveness of basic information is high as most of the basic information relating to legal persons are available with ROC.</li><li>There are no provisions available in the Companies Act relating to identification and verification of BO of legal persons.</li></ul>

Figure 3: Risk Assessment of Legal Persons, Legal Arrangements and Beneficial Ownership-related Risks



## 13. RISK ASSESSMENT OF VIRTUAL ASSETS AND VIRTUAL ASSETS SERVICE PROVIDERS

### 13.1 Introduction

Over the last decade, VAs and VASPs have been identified as emerging asset class and technology across the globe. In June 2019, the FATF amended its Recommendation 15 on New Technologies to include the new requirements relating to VAs and VASPs. Complying with Recommendation 15, Sri Lanka conducted its first NRA of the VAs and VASPs sector by utilizing the WB Tool. WG on VAs and VASPs has been appointed to complete the task of assessing the VAs and VASPs sector related ML/TF risk in Sri Lanka.

### 13.2 Virtual Assets Ecosystem in Sri Lanka

In Sri Lanka, the VA ecosystem is currently in the developmental phase. The country is yet to announce its policy stance whether to regulate VAs and VASPs or prohibit. However, as at the time of the assessment, there were several emerging initiatives pertaining to VAs and VASPs. While there have been some attempts to establish VASPs within Sri Lanka, the presence of foreign firms engaging in VA-related activities is limited. Since 2017, there has been notable interest among Sri Lankans in VAs and VASPs, as evident from STRs, discussions on social media, and information gathered from FIs. Traditional obliged entities (FIs and DNFBPs) are not directly involved in VA-related products or services. However, these entities are aware of the ML/TF risk and operational risk that can arise from VAs. Indirect involvement of FIs can be identified in Peer-to-Peer (P2P<sup>1</sup>) transactions through VASP.

The WG has identified that only few types of Cryptocurrencies and Stablecoins hold considerable prominence as VAs within Sri Lanka, in contrast to the broader spectrum of globally utilized VAs, including Cryptocurrencies, Stablecoins, NFTs, Central Bank Digital Currencies (CBDCs), Tokenized Assets, Utility Tokens, and Security Tokens such as bankera.

The majority of individuals involved in VA-related products and services can be categorized as young adults, typically between the ages of 18 and 28. This demographic is largely attributed to the widespread knowledge and usage of social media, online VASPs, and crypto forums among the younger generation. Moreover, there is a noticeable inclination among this youth community to view these opportunities as attractive avenues for earning income. The following figures illustrate the Google Trends for major keywords related to VAs and VASPs sector.

<sup>1</sup> In accordance with the classification outlined by the WB tool regarding P2P services offered by Virtual Asset Trading Platforms

Figure 1: Google Trend for Keywords related to Famous Virtual Assets

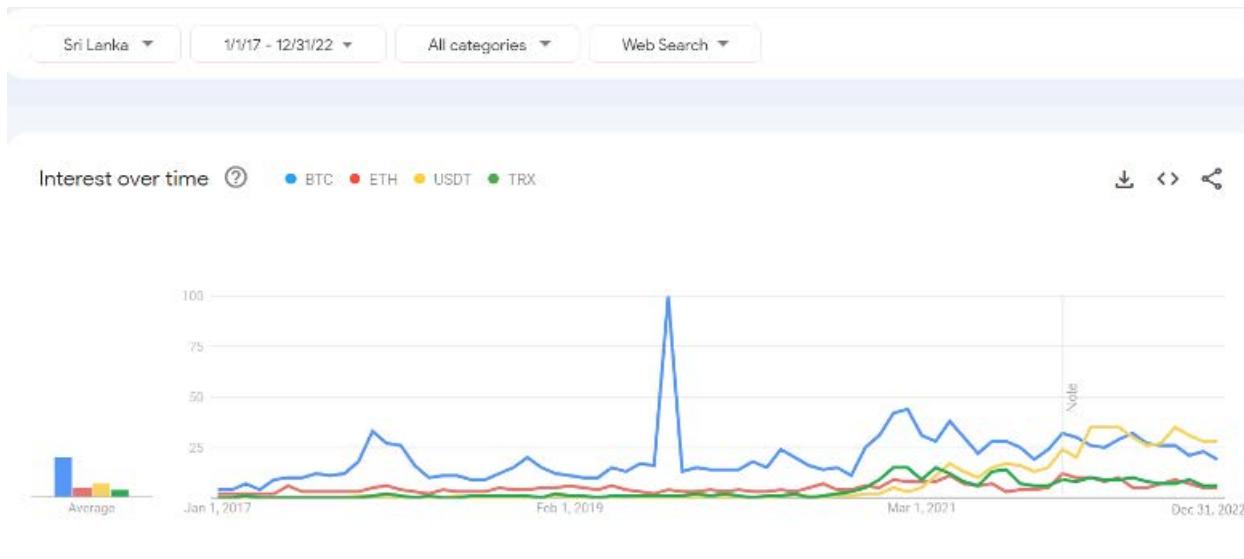
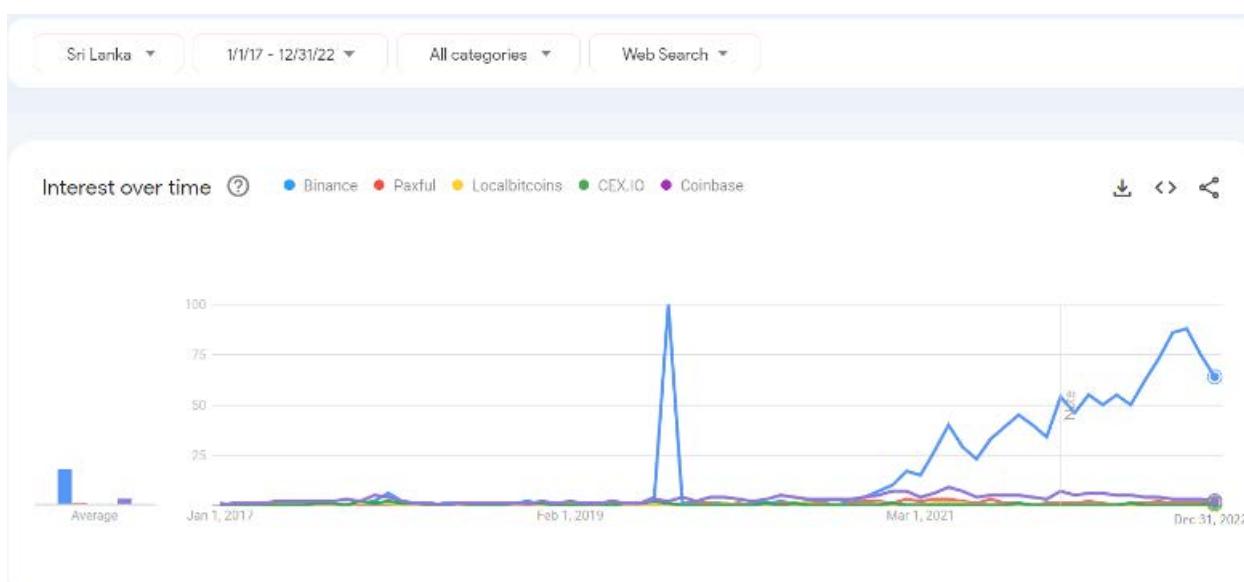


Figure 2: Google Trend for Keywords Related to Famous Virtual Assets Service Providers



VA users can be categorized in three main groups; individuals such as retail investors or natural persons transacting using VAs, corporate users such as firms holding or investing in VAs or transacting using VAs (not on behalf of customers), and merchants, who may be firms or individuals that accept VAs as payment for products and services. Due to the high volatility of VA values, the majority of the people use VAs for speculative purposes to generate profits when asset values fluctuate. The WG noted very few instances of merchants using VAs as a payment instrument in Sri Lanka. At present, three merchants accept VAs as a payment method.

**Table 1: Commonly Used Virtual Assets in Sri Lanka**

Virtual Asset Code	Type of Virtual Asset	Estimated Percentage
BTC	Bitcoin	42%
USDT	Tether	32%
ETH	Ethereum	10%
TRX	Tron	6%
Other VAs		10%

The table above illustrates the VAs that are commonly used by Sri Lankans. These specific VAs were chosen from a pool of over 12,000 globally used VAs, utilizing data gathered from sources such as social media, STR analysis, and other available information channels.

**Table 2: Commonly Used Virtual Assets Service Providers in Sri Lanka**

Name of the VASP	Type of the VASP	Incorporated Country	CDD Requirement	Applicability of CDD Requirements
Binance	Wallet Provider and Exchange	Cayman Island (China until 2017)	Available	3 levels of CDD based on deposit and withdrawal limits
Paxful	Wallet Provider and Exchange	USA	Available	4 levels of CDD based on trade limits
Localbitcoins.com	Wallet Provider and Exchange	Finland	Available	3 levels of CDD based on deposit and withdrawal limits
CEX.IO	Wallet Provider and Exchange	UK	Available	3 levels of CDD based on deposit and withdrawal limits
Coinbase	Wallet Provider and Exchange	USA	Available	CDD measures vary by region and payment method. Coinbase employs an algorithm considering factors like account age, location, and transaction history

Foreign VASPs mentioned in the Table 2 facilitate P2P<sup>2</sup> VA transactions for Sri Lankans, and they have multiple levels of CDD requirements. If a customer completes the advanced CDD requirements, the platform will increase their transaction limits, while customers who do not complete or partially complete the CDD requirements will have limited transaction thresholds. The CDD procedures usually involve selfie image verification, ID verification, and address verification.

<sup>2</sup> In accordance with the classification outlined by the WB tool regarding P2P services offered by Virtual Asset Trading Platforms

### 13.3 Existing Legal Framework

At present, mechanism of formation, registration, licensing, monitoring and supervision of VASPs have not been identified under the existing legislations in Sri Lanka.

However, few directions and press releases have been issued by the CBSL with regards to the VAs and VASPs sector in Sri Lanka.

- Direction No. 03 of 2021 under FEA issued by FED, resident cardholders are not allowed to make foreign exchange payments related to VC transactions via EFT cards.
- Press release dated April 16, 2018, issued by PSD, warning the public of the risks of using VCs.
- Press release dated April 09, 2021, issued by PSD, warning of the public regarding significant financial, operational, legal, customer protection and security related risks posed by investments in VCs to the users as well as to the economy.
- Press release dated July 12, 2022, issued by PSD, informing that CBSL has not given any license or authorization to any entity or company to operate schemes involving VCs, including cryptocurrencies, and has not authorized any Initial Coin Offerings (ICOs), mining operations or VC Exchanges.

Further, VCs are not identified as a permitted investment category for Sri Lankan citizens in terms of Regulations, No. 01 of 2021 (Classes of Capital Transactions Undertaken Outside Sri Lanka by a Person Resident in Sri Lanka) issued under the FEA.

### 13.4 Data Collection Methodology

The assessment was made based on the expertise of the team members and the information that was accessible. Given the absence of regulations in Sri Lanka's VAs and VASPs sector, the WG had limited access to information through official channels. As a result, the WG utilized both formal and informal sources of information to collect data pertaining to the VAs and VASPs to obtain insights regarding VAs and VASPs. To ensure accuracy and reliability, formal data collection methods included the use of questionnaires, virtual discussions, one-to-one meetings, telephone interviews and statistical data derived from STRs concerning VAs. The WG conducted an analysis of the STRs using various criteria to extract valuable insights. In addition, open-source information was obtained from various platforms such as social media, online forums, media journals, and even the dark web. This extensive data collection process spanned from 2017 to 2022, providing a thorough understanding of the VAs and VASPs landscape for the purpose of risk assessment.

### 13.5 Risk Assessment

The ML/TF risk associated with VAs and VASPs was assessed by considering the product and threat dimension, vulnerability entity dimension, and mitigating measures. This evaluation took into account 6 distinct categories of VASPs as outlined in the WB tool, which encompasses VASP activities specified by the FATF definitions. These categories include Custodial Wallet Providers, Non-Custodial Wallet Providers, P2P transfer services, Fiat-to-Virtual Conversion Services, Virtual-to-Fiat Conversion Services and Virtual-to-Virtual (V2V) Conversion Services. The identification of these categories was accomplished through the data collection process.

However, several wallet providers commonly used by Sri Lankans were identified as being registered in foreign countries. The inherent characteristics of VAs, such as anonymity, pseudonymity, non face-to-face nature, and portability, pose a significant ML/TF risk to the economy and financial system. Furthermore, the ease of transferring VAs across different countries and the lack of consistent global controls and preventive measures contribute to this risk.

The WG observed that difficulties arise in identifying the source and destination of VA-related transactions due to non face-to-face customer relationships or the inability to access information obtained through digital face-to-face CDD processes by foreign VASPs. As a result, the WG rates the risk related to custodial wallets as **Low** level and non-custodial wallets as **Medium** level. This differentiation is mainly due to the fact that the VASP has full control over the assets in a custodial wallet, resulting in a lower risk compared to non-custodial wallets.

Due to restrictions on cross-border card payments for purchasing VAs since March 2021, many individuals have moved to using P2P<sup>3</sup> transfer services to acquire VAs. Further, people have increasingly turned to VASPs as a method for international payments or as intermediaries for exchanging foreign currency outside the country. The first method identified by the WG involves transferring fiat currency to a third party residing in a foreign country in order to transfer VAs to wallets owned by Sri Lankans via VASPs (similar to Hawala and Hundi systems). The second method, discussed on social media platforms, involves traveling as a tourist to foreign countries while carrying dollars, and purchasing cryptocurrencies using VASPs/ATM machines in those countries where VAs are legalized. Subsequently, individuals transfer VAs to wallets owned by their Sri Lankan counterparts. In this case as well, the WG lacks strong evidence to assess the scale and behaviour of this market. Most of the foreign VASPs which facilitate P2P transfer services for Sri Lankans have a satisfactory level of AML/CFT controls. Even though they have AML/CFT implementations, none of them are licensed or registered in Sri Lanka. Therefore, there is no requirement for foreign VASPs to report any suspicious transactions to Sri Lankan FIU/ LEAs, if foreign VASPs identify a suspicion. The final risk score for the P2P transfer services is **Medium** level.

Due to the absence of physical presence of VASPs within the country, the exchange of fiat currencies to VAs over the counter or via cryptocurrency ATMs/Cash Deposit Machines is not available. However, based on limited survey information, the WG has identified two commonly used methods by which Sri Lankans exchange fiat currencies for VAs. The first method involves using foreign VASP services. However, in accordance with Direction, No. 03 of 2021 under the FEA, most LCBs have blocked payments to many foreign VASPs through EFT cards. The second method used by people is to employ intermediate payment platforms, such as Neteller, Skrill, and PayPal, to convert fiat to VAs. As per the discussions had with FIs, the WG concluded that payments to above mentioned intermediaries have been restricted by FIs. The risk score for Fiat to Virtual Conversion is calculated as **Low** level.

There is limited evidence of the Virtual to Fiat conversion markets. Foreign VASPs operating in Sri Lanka do not support exchanging VAs to fiat currencies to accounts in LKR. Most of these conversions are done through P2P transfer services. The risk related to Virtual to Fiat Conversion services is rated at a **Low** level.

<sup>3</sup> In accordance with the classification outlined by the WB tool regarding P2P services offered by Virtual Asset Trading Platforms

V2V Conversion Services also have very few interested parties, as most people in Sri Lanka are involved in a limited range of VAs. Although the WG has identified several well-known VAs in Sri Lanka, they belong to different VA categories (categories of digital assets). Consumers predominantly own Bitcoin as a crypto asset, while USDT, which is a stablecoin, is mostly held as a payment instrument. Since these two digital assets belong to different categories, the WG believes that consumer investments in these two categories work independently of one another. Due to the lack of sufficient data, the WG is unable to assess and assign a risk rating for this sector.

Apart from the 6 categories considered for the assessment, following categories were included in the WB tool covering Limb (iv)<sup>4</sup> and (v)<sup>5</sup> of the FATF definition of VASP.

- Virtual Asset Broking / Payment Processing

This category includes ATM, Merchants and Cards. The WG could not identify any ATM services or card services in Sri Lanka. However, the WG has located 3 merchants that accept VAs as payment services. Despite this, these merchants have conducted a very limited number of transactions. As a result, the WG has chosen not to consider this category for the assessment.

- Virtual Asset Management Providers

This category comprises Fund Management, Fund Distribution, and Compliance, Audit and Risk Management. The WG did not find any evidence regarding this category. Consequently, the WG did not include this category in the assessment.

- Initial Coin Offering Providers

This category includes Fiat-to-Virtual Fund Raising, V2V Fund Raising, Investment on Development of Product and Services, Security Token Offerings (STOs) and Initial Exchange Offerings (IEOs). No supporting evidence was discovered by the WG in relation to this category. Therefore, the WG did not include this category in the assessment.

- Virtual Asset Investment Providers

This category includes Platform Operators, Custody of Assets, Investment into VA-related commercial activities by Trading Platforms, Non-Security Tokens and Hybrid Trading Activities, Stablecoins, Crypto Escrow service and Crypto-custodian Services. Due to non-availability of supporting evidence in connection with this category, the WG chose not to incorporate this category into the assessment.

### 13.6 Cryptocurrency related Scams

The WG identified developing risk on VA related fraudulent activities, particularly in pyramid, Ponzi, and ICO scams. The preferred payment method among scammers is USDT, which makes it challenging to track down their identities. Victims of these scammers can be found across various professions and geographic locations, making it evident that the impact of these fraudulent activities extends far and wide. The victimized individuals

4 Safekeeping and/or administration of virtual assets or instruments enabling control over virtual assets.

5 Participation in and provision of financial services related to an issuer's offer and/or sale of a virtual asset.

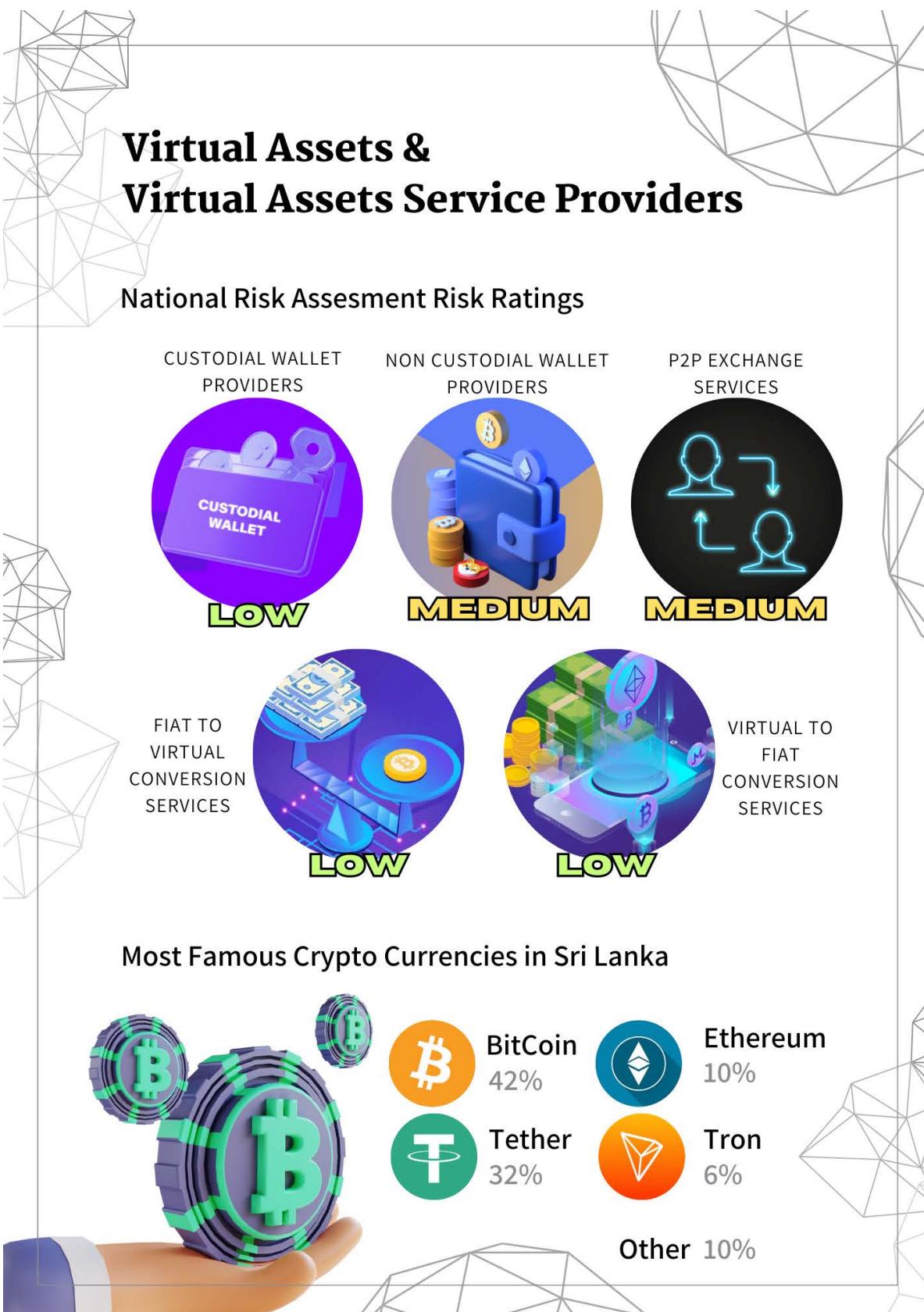
in these cryptocurrency-related scams can be classified into distinct categories, transcending professional boundaries and geographical locations. Regardless of their occupation or where they reside, these scams have impacted people from diverse backgrounds. These categorizations shed light on the varying degrees of vulnerability among victims. The first category comprises individuals with limited knowledge or understanding of VAs who inadvertently become targets of these fraudulent activities. The second category includes individuals with some knowledge of VAs but are still susceptible to falling victim due to the complex nature of these scams. Lastly, there are those who willingly participate in these schemes, enticed by the prospects of attractive financial gains. It is essential to recognize these different categories of victims to develop tailored strategies for prevention, education, and support, thereby mitigating the risks posed by cryptocurrency-related scams in Sri Lanka. These categorizations have been established through a combination of data collected from social media platforms, strategic analysis, and information provided by LEAs.

The Resolution and Enforcement Department of the CBSL is actively involved in the identification and enforcement of prohibited schemes, including those related to VAs. Through their diligent efforts, the Resolution and Enforcement Department works towards identifying individuals and entities engaged in fraudulent practices and takes appropriate enforcement actions.

Fraudsters employing pyramid and Ponzi schemes in Sri Lanka lure individuals to invest their cryptocurrency on their platforms and encourage them to invite others to join. Existing members receive fixed benefits on a daily, bi-weekly, or monthly basis, as well as incentives for recruiting new members. However, scammers often delay the refund process when members attempt to withdraw their benefits. In the initial stages, they may use new members' funds to pay back previous participants. But when there is insufficient cash or cryptocurrency inflow to support their fraudulent activities and the number of withdrawal requests rises, scammers typically vanish, abandoning their business.

Scammers of the ICO type promote a new cryptocurrency and typically receive payments for the new coins in the form of USDT payments. Once users purchase ICO tokens from these scammers, they are provided access to a cryptocurrency wallet that displays their ICO tokens. Despite the scammers' assertions of storing the coins on blockchains, most often, there is no associated blockchain. The wallet interface is also a counterfeit system created by the scammers. After collecting their funds through the ICO project, the scammers shut down their systems or allow them to remain idle.

Figure 3: Highlights of the Risk Assessment of Virtual Assets and Virtual Assets Service Providers



## PART III

# CONCLUSION

## 1. OVERALL SUMMARY

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### 1.1 Rating of the Major Money Laundering Threats

ML threat levels emanating from each major predicate offence considered in the assessment are listed below with the rating. The major changes that can be identified since 2014 are bribery and corruption moving upwards, identification of new priority areas related to customs, environmental, and tax related offences.

- i. Drug trafficking - **Medium High**
- ii. Bribery and Corruption - **Medium High**
- iii. Customs related offences including laundering of trade-based proceeds - **Medium High**
- iv. Fraud (including offences in relation to fraud - scams, criminal breach of trust, cheating or criminal misappropriation, or any combination thereof) - **Medium**
- v. Robbery (includes housebreaking, extortion, and theft) - **Medium**
- vi. Environmental and natural resource (ENV-NR) crimes - **Medium**
- vii. Illegal, Unreported and Unregulated (IUU) fishing and related unlawful activities (trafficking and smuggling) - **Medium Low**
- viii. Human smuggling/ trafficking - **Medium Low**
- ix. Tax offences - **Medium Low**
- x. Counterfeiting of currency - **Low**

### 1.2 Rating of the Money Laundering Vulnerability

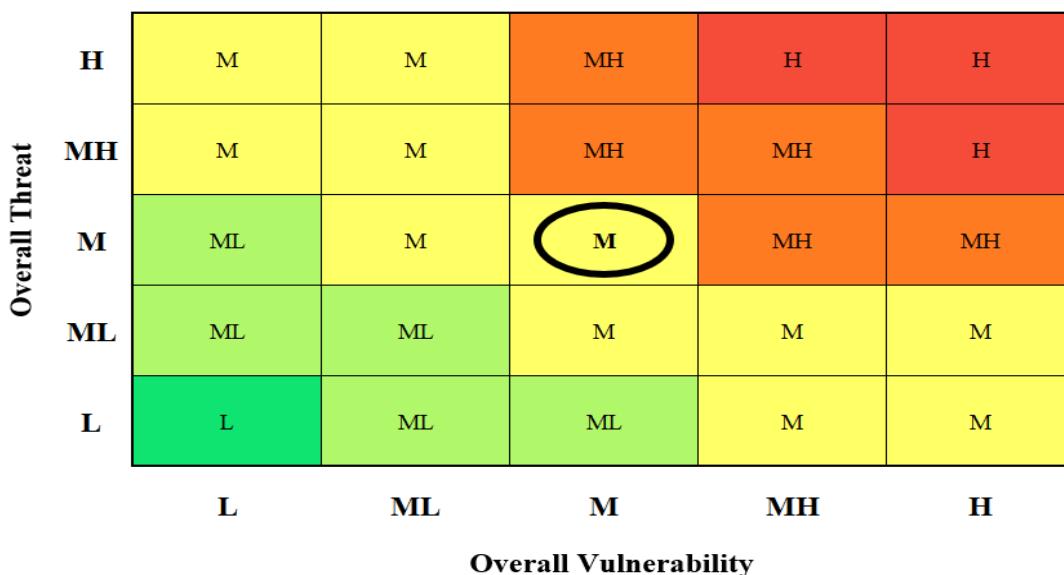
The overall national vulnerability level of Sri Lanka was determined at a **Medium** level. There is a slight improvement when considering the numerical values as a result of the various measures taken by authorities to address deficiencies which were identified in the previous ME. This progressive trend is also reflected in the overall sectoral vulnerability. The overall sectoral vulnerability also improved due to the initiatives of strengthening institutional compliance with the issuance of CDD Rules, Risk-Based Supervision and imposing of administrative penalties. On the other hand, the national combating ability has declined marginally when compared with the numerical values and determined at a Medium level. This marginal decline is due to the limited improvements in the law enforcement process.

### 1.3 National Money Laundering Risk and Terrorist Financing Risk

Accordingly, the overall ML threat and vulnerability of Sri Lanka has been assessed as **Medium** and the ML risk level in the country has been rated as **Medium**.

As per the TF risk assessment, the TF threat, which is considered under four elements: the Domestic TF Threat, Outgoing TF Threat, Incoming TF Threat, and Transit TF Threat, is assessed as **Medium**. Similarly, TF vulnerability under four specific areas, Vulnerability to Internal TF, Vulnerability to Outgoing TF, Vulnerability to Incoming TF, and Vulnerability to Transit TF is also assessed as **Medium**. Therefore, the overall TF risk is assessed as **Medium**.

**Figure 1: Overall Money Laundering/Terrorist Financing Risk in Sri Lanka**



#### 1.4 Rating of the Sectoral Money Laundering Risk

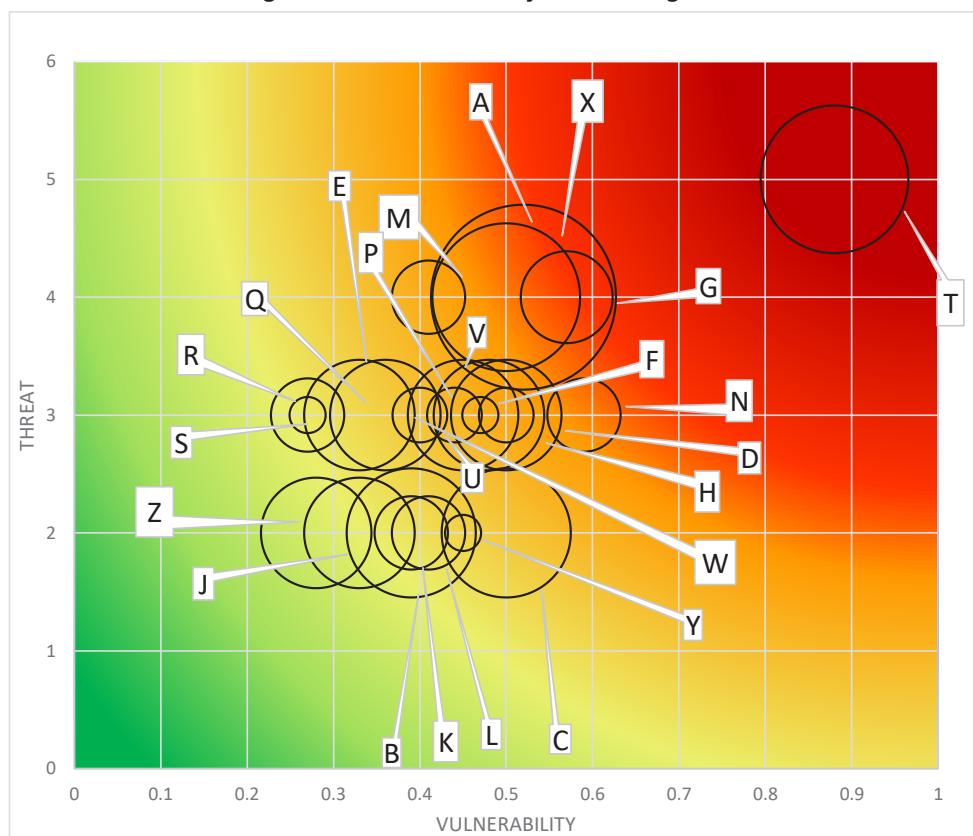
The overall ML threat, ML vulnerability and ML risk in each sector have been assessed as follows.

**Table 1: Sectoral Money Laundering Threat, Vulnerability and Risks**

Sector		ML Threat	ML Vulnerability	ML Risk
Banking		Medium High	Medium	Medium High
Other Financial Institutions Sector	Finance Companies	Medium High	Medium	Medium High
	Money or Value Transfer Service (MVTs) Providers	Medium	Medium	Medium
	Informal (Hawala/Hundi) Remitters	High	High	High
Securities	Stockbrokers	Medium Low	Medium	Medium
	Primary Dealers	Medium	Medium	Medium
Insurance		Medium Low	Medium Low	Medium Low
Designated Non-Finance Businesses and Professions (DNFBPs)	Casinos	Medium	Medium	Medium
	Real Estate Agents	Medium High	Medium	Medium High
	Dealers in Precious Metals and Precious Stones (DPMS)	Medium	Medium	Medium
	Lawyers	Medium Low	Medium	Medium
	Notaries	Medium		
	Accountants	Medium Low	Medium Low	Medium Low
	Trust and Company Service Providers (TCSPs)	Medium Low	Medium Low	Medium Low

When different sectors are plotted in a heat map, the Informal (Hawala/Hundi) Remitters sector stands out as the sector with highest ML risk. Similarly, Banks, Finance Companies and Real Estate Agents demonstrate a medium high ML risk. Most of the sectors are in the medium range while Insurance sector and few DNFBPs are at the medium low ML risk level.

**Figure 2: Sectoral Money Laundering Risk**



Sector	Short Form	Sector	Short Form
Banking	A	Other FIs - MVTS providers	N
Insurance	B	Other FIs - RDs	P
Securities - SBs	C	Other FIs - SLCs	Q
Securities - PDs	D	Other FIs - CSs	R
Securities - UTs and IMs	E	Other FIs - Samurdhi Banks	S
DNFBPs - Casinos	F	Other FIs - Hawala	T
DNFBPs - Real Estate	G	Other FIs - IPBs	U
DNFBPs - Gem and Jewellery	H	Other FIs - IMLs	V
DNFBPs - Accountants and Auditors	J	Other FIs - EMS	W
DNFBPs - TCSPs	K	Other FIs - LFCs	X
DNFBPs - Lawyers	L	Other FIs - UMFIs	Y
DNFBPs - Notaries Public	M	Other FIs - MFIs	Z

## 1.5 Risk Ratings of the Other Sectors

### i. Financial Inclusion Products

With respect to the financial inclusion, for 8 categories of products which are Micro Loans, Small and Medium Enterprises (SME) Loans, Group Lending/Self Help Groups, Regular Savings/Fixed Deposits, Microinsurance, Deposit Backed Loan Products, Finance Leasing, and Pawning, initial and final risk assessment arrived as low risk. For MVTS and Remittances and Sale/Purchase of Foreign Currency, initial product risk assessment was medium and final risk assessment after considering risk mitigants, arrived at low risk.

### ii. Newly Assessed Modules

- Overall threat of ENV-NR sector is assessed as **Medium**. Hence, overall ENV-NR sector risk is also arrived as **Medium**.
- National Level NPOs are sub-categorized into 6 main categories based on their nature of objectives/functions as Health and Sanitization, Training and Education, Relief Work, Poverty Alleviation and Entrepreneur Development, Human Rights and Environmental and Other NPOs and all of them are in the **Low to Medium** level of risk. As the majority of TF related STRs are reported on the suspicion of the abuse of NPOs in the Training and Education category, the risk of only that category is assessed as **Medium**.
- As per the assessment, overall ML threat of the legal structures created in Sri Lanka is at **Medium** level and vulnerability of legal structures has been assessed as **Medium High** with medium attractiveness and low level strength of mitigation measures. Further, the entity risk remains at medium level for the Private Limited Liability Companies, Public Limited Liability Companies, Companies Limited by Guarantee, and Foreign Companies.
- The assessment of VASPs was conducted across 6 categories: Non-Custodial Wallet Providers, Custodial Wallet Providers, P2P Transfer Services, Virtual to Fiat Conversion Services, and V2V Conversion Services. All categories received ratings in the **Low to Medium** level of risk range, except for V2V Conversion Services, which was not assigned a rating.

## 2. LIMITATIONS OF THE ASSESSMENT

The assessment faced a number of limitations as outlined below:

- Since the entire NRA process took almost two years, it was challenging to keep the teams intact throughout the NRA process, especially, given staff transfers/rotations and turnover in stakeholder institutions.
- Lack of available and adequate data from the targeted sources in some instances. This was common among even in some formal financial sectors. However, this was more prominent in the informal financial sector, DNFBPs, Legal Structures, NPOs, VA/VASPs and ENV-NR Crimes. The data provided was not sufficient to come up with a proper ML risk rating for certain areas. This resulted in dependence on expert judgments for assessing particular areas of certain sectors.
- Where the data was available, some institutions were, however, not forthcoming with the information. This was applicable to some government institutions where they had to obtain official clearance before releasing the data. Some institutions were less cooperative during the assessment in providing information they possessed. At the same time, information from the informal sector was also held back due to the fear of the informal sector participants that they would have to face adverse repercussions as a result of divulged information related to their businesses.
- As the understanding of AML/CFT measures and ML/TF risk is still at a developing stage in the country, specifically, for some sectors, assessing the impact of ML/TF was challenging.
- Proceeds generated from criminal activities are usually not captured in some cases, as the templates used by LEAs for their usual reports do not demand data on proceeds generated. It was therefore difficult to obtain data on proceeds of crimes as the major focus is on the number of investigations, prosecutions, and convictions.
- Many government institutions are still maintaining data manually, and even in instances where data is maintained digitally, for some information there is no centralized databases from which information could easily be accessed.
- Some institutions faced the problem of retrieving data from their existing system to suit with the module requirements within the limited time allocated.
- The data collection was undertaken amidst the COVID-19 pandemic, and the economic crisis prevailed in the country. Therefore, most of the meetings conducted by the WGs were non face-to-face. This might have adversely affected the NRA process.
- The assessment was undertaken by individuals from various institutions who had other demanding institutional assignments during the same period. This caused issues with data collection and finalization of the draft report.

Nonetheless, the data limitations do not in any way invalidate the results of this assessment.

### 3. MAIN RECOMMENDATIONS OF THE NATIONAL RISK ASSESSMENT

<b>Strengthening Legislative Framework</b>
1) Amend/introduce relevant legislations to meet international standards and best practices (E.g., Proceeds of Crimes, NPO, Companies Act, Trust Ordinance, CIABOC, etc.)
2) Enhance the transparency of legal persons and arrangements on beneficial ownership requirements.
3) Develop regulatory mechanism on VA/VASPs, Real Estate Sector, informal money remitters.
<b>ML/TF Investigations, Prosecution and Asset Recovery</b>
4) Increase ML/TF investigations and prosecutions, especially, in relation to areas identified as generating higher proceeds of crime.
5) Develop policy guidelines to enhance the confiscation of proceeds of crime.
6) Build the capacity of the Investigators, Prosecutors, Judiciary, and the FIU on AML/CFT.
7) Establish a proper mechanism and an Asset Management Authority for asset recovery.
<b>Risk-Based AML/CFT Supervision</b>
8) Strengthen risk-based AML/CFT supervision and monitoring on FIs and DNFBPs.
9) Improve risk-based supervision capacity of Regulatory and Supervisory Bodies.
10) Establish a feedback and collaboration mechanism between the FIU, regulators, and RIIs.
11) Impose proportionate and dissuasive sanctions for non-compliances observed and introduce necessary amendments to legislations where necessary.
12) Introduce fit and proper criteria for shareholders, beneficial owners and key management personnel across FIs and DNFBPs.
13) Increase the number of institutions covered for AML/CFT supervision in FIs and DNFBPs sectors.
<b>Strengthen Domestic and International Cooperation</b>
14) Promote formal international cooperation through MLA, counterpart agreements (Sri Lanka Police, Sri Lanka Customs, NSNGO, CIABOC, Regulators, etc.) as well as informal cooperation.
15) Promote domestic coordination and cooperation among relevant stakeholders to share information, intelligence, and experience.
16) Promote exchange of information and intelligence to support ML/TF investigations and prosecution among LEAs.
17) Strengthen feedback and case monitoring mechanism among LEAs in order to enhance information sharing on ML/TF investigations and prosecution.
18) Launch a regular consultative forum/mechanism to facilitate communication between supervisors and the private sector.

**Strengthen Capacity and Enhance Awareness**

- 19) Provide adequate human, financial and technological resources to where required.
- 20) Enhance awareness of all stakeholders on the ML/TF risk and vulnerabilities faced by the country.
- 21) Strengthen the independence, autonomy and integrity of all stakeholders involved in the AML/CFT framework.
- 22) Introduce advanced technologies into basic infrastructure such as Biometric NIC, integrated databases, online access to databases, shared KYC, etc.
- 23) Deepen AML/CFT awareness among public and private sector stakeholders including the general public.
- 24) Include AML/CFT as a subject in degree programmes in Universities, Law College, other private and public educational institutions.
- 25) Enhance the identification and reporting of ML/TF related STRs within FIs and DNFBPs.

**Develop and Maintain Databases/Statistics**

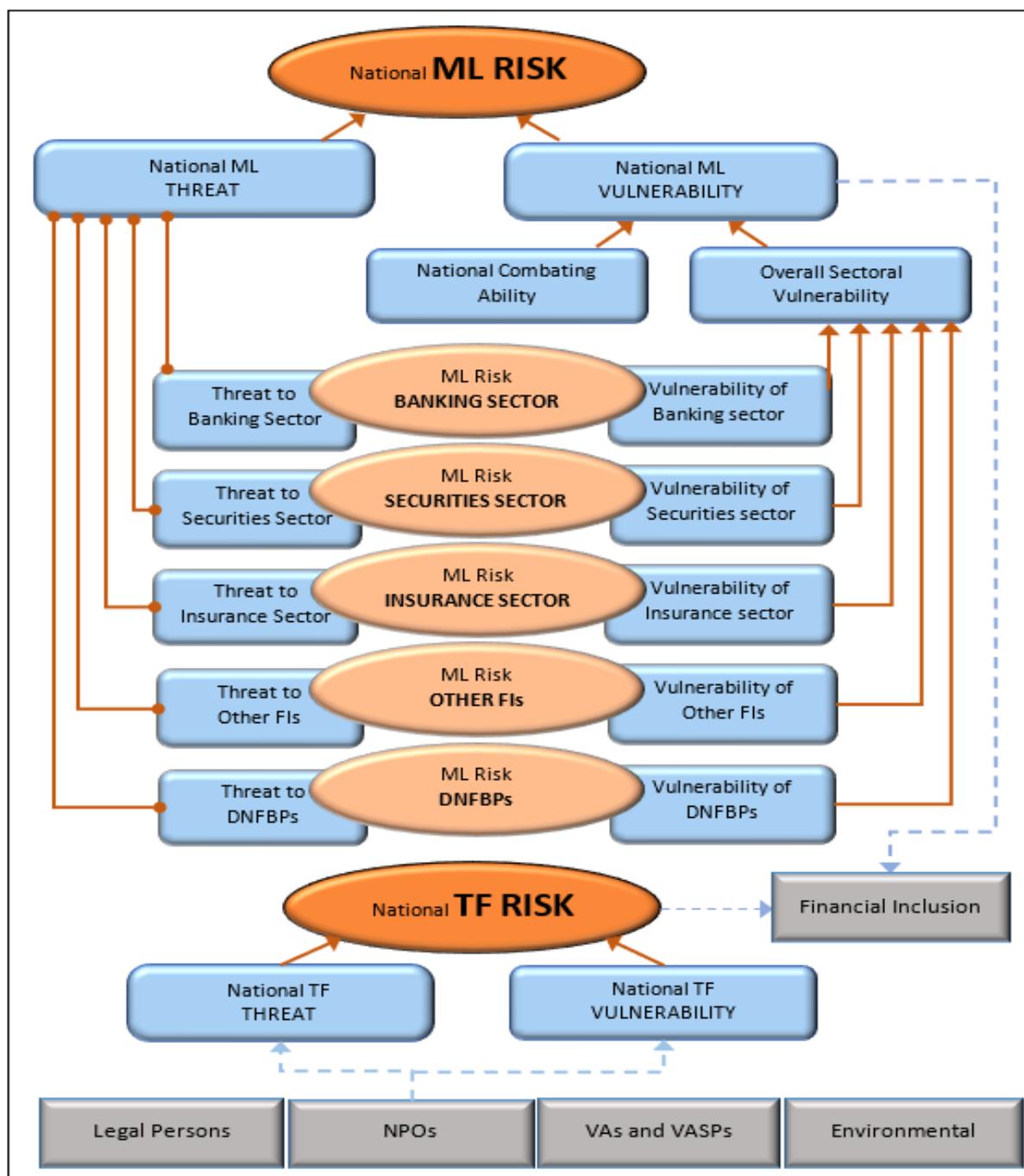
- 26) Develop a methodology for all LEAs and Competent Authorities to collect and maintain accurate statistics, electronically or in a promptly accessible manner on their operations.
- 27) Ensure that the databases maintained by competent authorities are accessible to LEAs and other competent authorities and even FIs and DNFBPs where necessary (E.g., Criminal record, Personal identification, Passport, Motor Vehicle, Land Registry, Company Registry, Trust Registry, etc.) free of charge or at a minimum cost.
- 28) Ensure information security and confidentiality of all statistics and databases.

**Facilitate the Implementation of the National Financial Inclusion Strategy**

- 29) Promote sustainable financial inclusion and increase financial literacy.
- 30) Increase the availability and usage of innovative financial products and services.
- 31) Identify low risk financial inclusion products and target groups.
- 32) Encourage launching financial inclusion products to low risk groups.
- 33) Introduce simplified CDD framework for financial inclusion products/low risk groups.

## ANNEX I

### Structure of the National Risk Assessment Tool



## ANNEX II

### Stakeholders of the National Risk Assessment Working Group

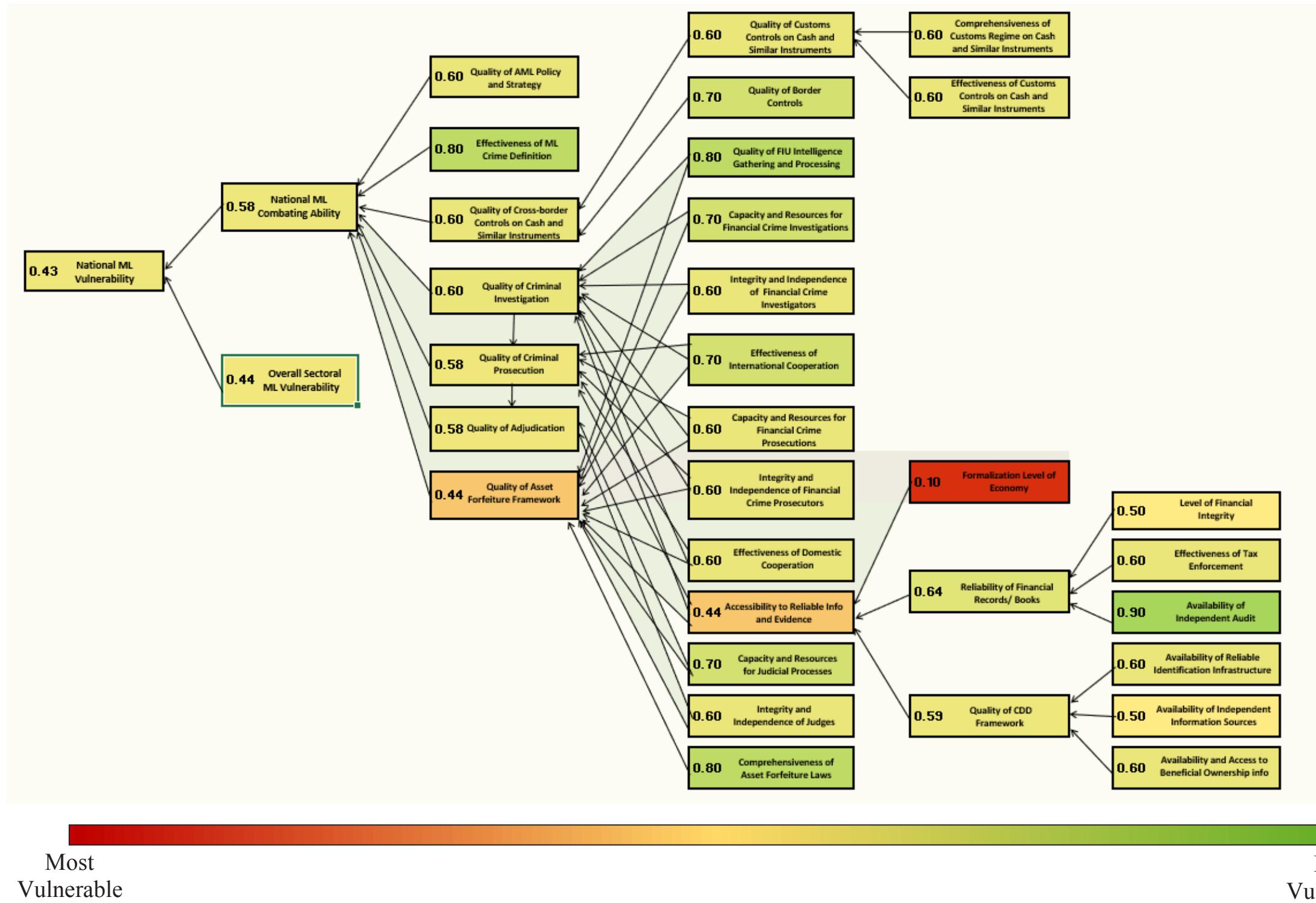
No	Stakeholder	Module
1	Attorney General's Department	ML Threat, National Vulnerability and TF Risk
2	Ministry of Justice, Prison Affairs and Constitutional Reforms	ML Threat, National Vulnerability and TF Risk
3	Ministry of Finance, Economic Stabilization and National Policies	ML Threat, National Vulnerability and DNFBPs Vulnerability
4	Ministry of Foreign Affairs	ML Threat, National Vulnerability and TF Risk
5	Ministry of Defence	ML Threat, National Vulnerability and TF Risk
6	Auditor General's Department	ML Threat and National Vulnerability
7	Commission to Investigate Allegations of Bribery or Corruption	ML Threat and National Vulnerability
8	Sri Lanka Police	ML Threat, National Vulnerability and TF Risk
9	Sri Lanka Customs	ML Threat and National Vulnerability
10	Department of Inland Revenue (Revenue Authority)	ML Threat, National Vulnerability and DNFBPs Vulnerability
11	Department of Immigration and Emigration	ML Threat and National Vulnerability
12	Registrar of Companies	DNFBPs Vulnerability and Legal Persons, Legal Arrangements and Beneficial Ownership-related Risk
13	Registrar General's Department	DNFBPs Vulnerability
14	National Dangerous Drugs Control Board	ML Threat and National Vulnerability
15	Ceylon Chamber of Commerce	DNFBPs Vulnerability
16	National Gem and Jewellery Authority	DNFBPs Vulnerability
17	Condominium Management Authority	DNFBPs Vulnerability
18	Department of Co-operative Development	Financial Inclusion Product Risk
19	Department of Samurdhi Development	Other Financial Institutions Vulnerability and Financial Inclusion Product Risk
20	Institute of Chartered Accountants of Sri Lanka	DNFBPs Vulnerability
21	National Secretariat for Non-Governmental Organizations	ML Threat, National Vulnerability, NPOs Risk and TF Risk
22	Securities and Exchange Commission of Sri Lanka	Securities Sector Vulnerability
23	Colombo Stock Exchange	Securities Sector Vulnerability
24	Insurance Regulatory Commission of Sri Lanka	Insurance Sector Vulnerability
25	Bar Association of Sri Lanka	DNFBPs Vulnerability
26	Condominium Developers' Association of Sri Lanka	DNFBPs Vulnerability
27	Sri Lanka Gem and Jewellery Association	DNFBPs Vulnerability
28	Sri Lanka Jewellery Association	DNFBPs Vulnerability

29	Ministry of Environment	ENV-NR Crimes
30	Department of Forest Conservation	ENV-NR Crimes
31	Department of Wildlife Conservation	ENV-NR Crimes
32	Central Environmental Authority	ENV-NR Crimes
33	Ministry of Fisheries	ENV-NR Crimes
34	Geological Survey and Mines Bureau	ENV-NR Crimes
35	Casino Marina	DNFBPs Vulnerability
36	Casino Bellagio	DNFBPs Vulnerability
37	Casino Bally's	DNFBPs Vulnerability
38	Bank of Ceylon	Banking Sector Vulnerability
39	Peoples Bank	Banking Sector Vulnerability
40	Sampath Bank	Banking Sector Vulnerability
41	HSBC Bank	Banking Sector Vulnerability
42	National Savings Bank	Banking Sector Vulnerability
43	Dialog Axiata PLC	Other Financial Institutions Vulnerability and Financial Inclusion Product Risk
44	Berendina Micro Investments Company Limited	Other Financial Institutions Vulnerability and Financial Inclusion Product Risk
45	MMBL Money Transfer (Pvt.) Ltd	Other Financial Institutions Vulnerability
46	SLT Mobitel PLC	Other Financial Institutions Vulnerability
47	LOLC Finance PLC	Other Financial Institutions Vulnerability
48	Singer Finance (Lanka) PLC	Other Financial Institutions Vulnerability
49	Assetline Leasing Company Limited	Other Financial Institutions Vulnerability
50	Candor Equities Limited	Securities Sector Vulnerability
51	First Capital Treasuries PLC	Securities Sector Vulnerability
52	NDB Wealth Management Limited	Securities Sector Vulnerability
53	Lynear Wealth Management (Pvt) Ltd	Securities Sector Vulnerability
54	Sri Lanka Insurance Corporation Limited	Insurance Sector Vulnerability
55	Ceylinco General Insurance Ltd	Insurance Sector Vulnerability
56	Ceylinco Life Insurance Ltd	Insurance Sector Vulnerability
57	Softlogic Life Insurance PLC	Insurance Sector Vulnerability
58	Senaratne Insurance Brokers (Pvt) Ltd	Insurance Sector Vulnerability
59	CBSL - Bank Supervision Department	Banking Sector Vulnerability and Financial Inclusion Product Risk
60	CBSL - Department of Supervision of Non-Bank Financial Institutions	Other Financial Institutions Vulnerability and Financial Inclusion Product Risk
61	CBSL - Department of Foreign Exchange	Other Financial Institutions Vulnerability
62	CBSL - Payments and Settlements Department	Other Financial Institutions Vulnerability and VAs and VASPs Risk

63	CBSL - Regional Development Department	Financial Inclusion Product Risk
64	CBSL - Public Debt Department	Securities Sector Vulnerability
65	CBSL - Economic Research Department	ML Threat and National Vulnerability
66	CBSL - Statistics Department	National Vulnerability and Other Financial Institutions Vulnerability
67	CBSL – Financial Intelligence Unit	All Modules

## ANNEX III

### Vulnerability Map



## ANNEX IV

### Typology 1: Trade-Based Money Laundering

The ongoing NRA coordinated by the FIU identifies Trade-Based Money Laundering (TBML) as an emerging ML/TF risk in the financial system of Sri Lanka.

The FIU received an STR from a bank about Company Z, a private limited company, established recently and based in Sri Lanka. The company is said to be engaged in importing different types of products such as apparel, electric items, yarn, solar panels, tyres, etc. All payments of Company Z are handled by its agent, Company Y located in Country A, at a nominal fee. Further, Company Z imports solar panels from Country B, a zero-tax product in Sri Lanka and imports tyres from Country C, a highly taxed product in Sri Lanka. Commercial invoices from Country B are overvalued because of zero tax and the commercial invoices from Country C are undervalued due to high tax.

The local bank account of Company Z receives large cash deposits which are immediately remitted as advance payments under outward telegraphic transfers to Country D for the purchase of apparel and yarn. Shipments of advance payments made one year ago have not yet reached Sri Lanka since no Customs Declarations were submitted to the bank for endorsement.

Additional information requested by the FIU from the STR reporting bank revealed that Company Z recently submitted a set of commercial invoices to the bank to facilitate payments to import electric items. However, the commercial invoices appear to be forged and a search of importers in the public domain revealed that they are not engaged in the said business. At the same time, as per the agency agreement provided by Company Z, a large fee is paid to Company Y as support service fees monthly where there is a minimal difference between the value of the import payment and the monthly support service fee.

Based on the unusual nature of account transactions, the bank made inquiries from Company Z. However, the given contact numbers were not reachable. Later, the bank visited the given address of Company Z but could not find any physical business therein.

The FIU analysed the case based on threshold reports, financial data, and beneficial owners with the support of the goAML system and Egmont Secure Web. Accordingly, information of the beneficial owners was obtained from countries A, B, and C through the Egmont Secure Web. The analysis revealed indications of a clear attempt at TBML by an organised group. The findings were forwarded to Sri Lanka Customs to initiate further investigations in this regard.

Above scenarios show that the financial sector has a key responsibility to prevent and detect TBML. For this purpose, the financial sector must be smart enough to identify possible red flags and indicators and some of them are given below.

- Undervalued or overvalued commercial invoices.
- Supplier/importer payments are made through third parties.
- Unusually large support service fees paid.
- Frequent advance payments followed by outward telegraphic transfers.
- Non-submission of Customs Declarations to confirm the physical movement of goods for the relevant advance payments made.
- Absence of a place of business.

## ANNEX V

### **Typology 2: Misuse of Corporate Vehicles for Money Laundering Purposes and Beneficial Ownership**

Misuse of corporate vehicles such as companies, trusts, foundations, and other types of legal arrangements for ML/TF purposes is a global paradigm, where criminals use complex corporate structures like special purpose vehicles spread across the globe, to launder money that they earn from illicit sources. In this regard, the FATF Recommendations require countries to ensure that adequate, accurate and timely information on the BO of corporate vehicles is available and can be accessed by the competent authorities in a timely manner.

The FIU received an STR from one of the LCBs, which elaborated on a recently incorporated Sri Lankan company, Company A and it had received a significant amount of IFTs from a different jurisdiction, to make a strategic investment in Sri Lanka. The Company A had received the said funds by way of a loan from a foreign company, Company B which is a fully owned subsidiary of another foreign company, Company C incorporated in a Tax Haven.

When scrutinized the ownership of the Company C by the FIU, it was revealed that a trust formed in another jurisdiction owns total shares of Company C and the specific trust was created by Mrs. Y for the benefit of Mr. X and his children. Mr. X is a citizen and a PEP of Country Z and his business ventures are spanning across the entire region. Some of the business ventures owned by Mr. X are allegedly engaged in illegal activities and are being investigated by the LEAs of those countries.

Apart from the information available domestically, the FIU in its analysis had gathered information about BO of aforesaid legal persons and arrangements from different foreign FIU counterparts through ESW and identified that the funds ultimately remitted to Sri Lanka for strategic investment purpose had been originated from the business ventures of Mr. X which are under investigation in Country Z and other foreign jurisdictions. The aforesaid complex corporate structures were apparently used by the offenders to conceal the origin and flow of the said funds.

Afterward, the FIU referred its analysis and the information gathered from foreign FIU counterparts about BO of the concerned legal persons and arrangements to the CID of Sri Lanka Police to assist their further investigations.

Accordingly in this case, the availability and the accessibility of adequate, accurate and timely information on BO of aforesaid companies and trusts were vital to identify the illegitimate origin of the funds flowed to Sri Lanka and to detect possible money laundering efforts.

Furthermore, the following have been identified as some general ML red flag indicators relating to misuse of corporate vehicles to disguise BO which the FIs should be vigilant.

- Customers provide insufficient or incomplete information about the BO of their institutions.
- Transactions that involve sender or beneficiary companies in offshore locations typically Tax Havens or high-risk jurisdictions.

- Institutions engage in transactions irregularly, occasionally, or that seems unusual for their industry.
- Transactions are in amounts that do not match with the company's business profile.
- Institutional customers produce fabricated documents to support significant amounts of remittances received or sent out.

