MONEY LAUNDERING & TERRORIST FINANCING
ITS IMPACT ON SUSTAINABILITY

Bhanu Wijayaratne
Senior Manager - Compliance
Hatton National Bank PLC

1. What is Money Laundering? (ML)

Generally organized crimes such as theft, robbery, extortion, murder, arson, drug trafficking, human trafficking, bribery, corruption etc. are committed with a specific purpose of achieving economic gains. The gains/proceeds obtained through crime as stated above are tainted with criminality. Therefore it is hard for such criminals to use such ill-gotten proceeds for their benefit, which compels them to give such proceeds a legitimate appearance. Criminals use banking systems with weak regulations and controls, to hide the criminal origin of such ill-gotten money, which process is known as "Money Laundering".

Therefore, Money Laundering is a practice engineered to conceal or disguise the true origin of money or assets generated through unlawful activities, which are socially unfriendly as well.

Finding a clear-cut definition to ML is a hard exercise but the following definition captures the essence of what Money Laundering is.

"Money Laundering is the process of disguising the criminal origin of funds to hide the true owner and give them legal respectability, allowing them use of these funds without prosecution or confiscation"

Accordingly, it is evident that Money Laundering is the process (a criminal practice) of cleaning up ill-gotten gains, commonly known as dirty money, through a well organized series of transactions to give such proceeds a legitimate appearance, having recorded as earned in a "clean" manner.

Money Laundering is not a problem confined to a particular country or a region but a global phenomenon with multifaceted consequences. It is not only an effort to provide a legitimate appearance to fruits of crime but also an act that threatens national security, compromises stability and transparency of national economies which seriously undermines legitimate economic activities as well.

2. What is Financing of Terrorism? (FT)

This is the first stage of any terrorist activity. It is a continuous process. Funds may originate from both legal and illegal activities which complicate the task of identifying suspicious transactions. Donations from individuals, legitimate entities as well as funds raised through crime, forms the finances that support terrorist organizations and its activities.

3. Economic & Socioeconomic impacts of Money Laundering

3.1 Money Laundering undermines the legitimate business

This is one of the most serious microeconomic effects felt in the private sector as Money Launderers use front companies to mingle their ill-gotten money with legitimate funds. As a result, such front companies are allowed to subsidize their products and services even well below the market rates, so that such companies have a competitive advantage over legitimate firms that draw capital funds from the financial markets. This makes it extremely difficult for legitimate business enterprises to compete with such front companies with illegally subsidized funding. This would ultimately result in the crowding out of private sector businesses by criminal entities.

This leads to unfair competition and adversely affects legitimate businesses, thereby the entire economy.

In addition to the above microeconomic effects, the said phenomenon creates negative impacts on the society, as such criminal entities would not align themselves with free market principles which could result in negative macroeconomic impacts as well.

3.2 Money Laundering undermines the integrity of Financial Markets

Financial institutions which entertain ill-gotten money face additional challenges of effectively managing their assets, liabilities and operations. This is due to the fact that large sums of illegal money that may arrive at such institutions, can suddenly disappear without notice through modes such as wire transfers etc, owing to non market factors which could trigger sudden liquidity problems in such organizations. Such liquidity problems will certainly undermine the integrity of financial institutions, thereby negatively affect the public confidence, which could even develop to the extent of runs on such financial institutions. The failure of Financial Institutions would lead to failure of Fainancial Markets as well.

3.3 Money Laundering creates loss of control of Economic Policies

Money Laundering can affect interest rates and exchange rates of countries, as money launderers would invest / deposit their ill gotten money in large scale in economies, where the detection of such action is less likely to occur.

Accordingly, money laundering and financial crime may result in unexplainable / unpredictable sudden changes in demand and supply of money, which can lead to monetary instability due to misallocation of resources. This phenomenon will ultimately lead to loss of control of economic policies by the authorities & policy makers.

3.4 Money Laundering disrupts Capital and Trade Flows

It is not a secret that money launderers, upon achieving their ulterior motive of providing a legitimate status to the ill gotten money, would move out such funds to other jurisdictions worsening the scarcity of capital in developing economies. This phenomenon is called illicit capital flights.

3.5 Money Laundering increases the Risk of Macroeconomic Instability

As per the analysts, there are two identified mechanisms by which significant volumes of Money Laundering flows can induce Macroeconomic Instability, specially in developing economies.

Financial flows that stems from Money Laundering activities are not stable and long lasting, which in-turn would contribute to vibrant fluctuations of exchange rates, monetary aggregates (the amount of money available in an economy or supply of money) and general price levels and inflation.

Secondly, it is revealed that the hidden nature of money laundering processes, create an informal sector in the economy, thus such transactions do not appear or accounted in official monetary financial statistics, providing misleading information to policy makers and regulators who manage macroeconomic variables such as monetary levels, exchange rates, interest rates inflation etc.

3.6 Money Laundering facilitates Corruption and Crime at the expense of Economic Development.

Money Laundering encourages & promotes level and frequency of crime. Just as an efficient financial system serves as a key factor in developing the economy, an efficient money laundering channel is a key factor to crime, as such proceeds cost them very much less than the cost of legitimate funds.

The damage to the economy caused by corruption and criminal activities (facilitated by money laundering processes), are particularly more acute in the public sector in many developing economies due to more active role played by the state in such economies in providing goods and services & coupled the with the fact that lack of monitoring & control mechanisms available in the public sector. The failure of the public sector will undoubtedly affect the economic development in any country.

3.7 Socioeconomic effects of Money Laundering

As money laundering makes "crime" worthwhile, it generates significant social costs and risks to governing regimes of such countries.

Money laundering encourages drug traffickers, smugglers and other criminals to intensify and expand their operations which compels governments of such countries to strengthen the law enforcement and increase healthcare expenditures (eg: for treatment of drug addicts etc) in order to combat serious consequences of such illegal activities.

3.8 Threat to Territorial Integrity and Sovereignty of Independent Countries

Implication of Money Laundering & Terrorist Financing are not isolated issues and also not unique to a particular jurisdiction. It is a common problem that threatens the territorial integrity, sovereignty of independent states and also the financial systems and economies of countries. This was quite evident from our own past experience, as the origin of funds, raised by LTTE for their devastating terrorist activities was mainly through crime such as Drug Trafficking, Human Trafficking, Illegal Arm Deals, Extortion etc.

4. Negative Impact of Money Laundering on Financial Sector

Reviews of Money Laundering typologies suggest that, throughout the globe money launders use financial institutions and financial intermediaries such as banks, non bank financial institutions, (i.e. Insurance Companies, Finance Companies etc) and also the equity markets, as means of laundering tainted money, both internationally and domestically.

Specially the financial institutions of developing economies are used as vehicles for "placement" and "layering" phases of money laundering.

Also Money Laundering depresses economic growth. Besides the negative effects of Money Laundering on economic growth of financial sector, same triggers a negative effect on Real Sector as well, due to diversion of resources to less productive activities. It also facilitates domestic crime and corruption, which in turn depresses the financial sector.

Money Laundering distorts investments and depresses productivity. A close scrutiny of Money Laundering typologies reveal that the path of illicit funds that flow through the economy is quite different from the path it would take if such funds were clean legitimate funds. Such ill-gotten money laundered through institutions other than Financial Institutions are often placed in what are known as "sterile investments" or investments that are unproductive from an economic view point. Real Estate is one example for such sterile investments, whilst art, jewellery, antiques and high value precious metal, luxury vehicle can be cited as other areas in which such investments would be made. It is observed that such investments make hardly any contributions towards the growth of the financial sector.

Criminals can transform productive enterprises into sterile enterprises by using them for purposes of laundering ill gotten proceeds. Deployment of resources towards sterile investments as opposed to productive investments, ultimately reduces the overall productivity of the economy. As a result the funds that are being laundered through purchase of certain targeted unproductive assets would push the prices of such assets irrationally up, causing overpricing of such assets, thus "crowding out" productive investments to less productive assets, which results in irrational transactions without any economic rationale.

4.1 Money Laundering erodes Financial Institutions

Money Laundering generates adverse impacts on Financial Institutions of developing economies in three broad ways.

- It will increase the probability of individual customers being defrauded by corrupt staff members within the institutions.
- It will increase the probability of institutions becoming corrupt and also controlled by criminal elements which too would lead towards defrauding customers.
- It will also result in the institution itself being defrauded.

Such dangers would fall within the "Operational Risk" parameters, which would ultimately lead towards damaging reputation of Financial Institutions triggering "Reputation Risk". Such risks could emerge separately or together, which can reinforce each other. Any operational risk related issue could obviously trigger reputationl damages and vice versa. A sudden loss of reputation of a Financial Institutions could threaten the stability of such Institution and in an extreme case, could experience even a run on it's deposit base.

Financial Action Task Force (FATF) reports, reveal that next to drug trafficking, it is "Financial Crime" that comes second in volumes, among the predicate offences that gives rise to illicit funds that are laundered throughout the globe.

It is observed that the corrupt staff members who are aiding and abetting Money Laundering, often involve themselves in financial crimes and frauds as well. There is empirical evidence that employees willing to engage in Money Laundering are less likely to abstain from fraudulent activity or actively prevent frauds taking place, which is in-fact part of their duties & responsibilities. Although difficult to quantify, this relationship can be established by reviewing certain large scale frauds committed within banks.

Specially in developing countries Financial Institutions tend to be smaller which makes the tasks of taking control of the such institutions by criminal elements become much easier. On the other hand, in developing countries financial regulatory framework and supervision tend to be less stringent and effective than that of in developed economies, which are more troublesome when criminal penetration is tried out.

Accordingly, it is very clear that Money Laundering constitutes clear operational risk which will affect the stability of Financial Institutions which in turn would lead towards its loss of reputation & vice -versa. Financial experts are of the opinion that reputation of a Financial Institution is of paramount importance to promote the stability of such institutions. This opinion is based on the simple argument that the depositors of Financial Institutions are very unlikely to risk their funds in the hands of such financial institutions which are known to contain employees who are likely to commit fraud. Secondly such institutions, itself would become a criminal institution and therefore may defraud the individual or may become insolvent, thereby not being able to honour customer deposits.

4.2 Money Laundering weakens the Financial Sector's role in Economic Growth

The public confidence and the reputation of the Financial Institutions play an important role in the financial systems. The negative impact of Money Laundering on Financial Institutions is a great concern in developing countries for two main reasons.

- Majority of such Financial Institutions depend on public funds rather than equity / private funds.

- Financial Institutions in developing countries are often undergoing a transition, from being state owned to private investor ownership and control. It is obvious that private investors are reluctant to commit funds for institutions which are cited for corruption.

On the other hand, a country with less Anti Money Laundering regulations can be subject to sanctions on International Trade. Such sanctions need not necessarily be by governments, as non agreement by correspondent banks to maintain vostro / nostro accounts could also deprive banks / countries from engaging themselves in foreign trade, which could ultimately weaken the financial sector's role in countries which are non compliant or weak compliant to Anti Money Laundering & Combating Financing of Terrorism laws and regulations.

5. International Developments in combating Money Laundering

The infiltration of dirty money into legitimate financial sectors and national accounts can threaten economic and political stability. An IMF working paper concludes that money laundering impacts financial behaviour and macro-economic performance in a variety of ways including policy mistakes due to measurement errors in national account statistics, volatility in exchange and interest rates due to unanticipated cross border transfers of funds, the threat of monetary instability due to unsound asset structures, effects on tax collection and public expenditure allocation due to misreporting of income, misallocation of resources due to distortions in asset and commodity prices and contamination effects on legal transactions due to the perceived possibility of being associated with crime.

5.1 Money Laundering and International Regulations

Legislation incorporating measures to prevent, trace, freeze and confiscate criminal assets is still in it's early stages in developing countries, specially from the view point of implementation. Only a handful of industrialized western nations had systems in place by the end of the 1980s. Today there is an increasing number of States that are passing laws and regulations but the regulators have raised concerns on the effective implementation of such regulations.

A further problem is the absence of transparency in the corporate law of certain countries, which enables launderers to hide behind shell companies.

Action at the international level to combat money laundering began in 1988 with two important initiatives, The first one of them is Basel Committee recommendations on Banking Regulations and Supervisory Practices, which issued a 'Statement of Principles' covering the three cornerstones of money laundering controls which are as follows:-

- Avoidance of suspicious transactions
- Cooperation with law enforcement authorities.
- "Know Your Customer" concept.

A United Nations Convention was passed to counter Illicit Traffic in Narcotic Drugs and Psychotropic Substances, which has now been ratified by over 140 countries.

The said Convention is the first multilateral, legally-binding instrument developed to address the issue of money laundering. It encourages international cooperation to identify, trace, seize and confiscate the proceeds of drug trafficking and to prosecute those responsible for laundering illicit profits. It also encourages parties to contribute such proceeds to international organizations specializing in drug control.

Another important initiative came in 1989 when the Financial Action Task Force (FATF) was established by the Group of 7 major industrialized countries. The cornerstone of FATF's efforts are the 40 Recommendations, first elaborated in 1990 and updated in 1996, which laid down measures to counter money laundering including criminalization of money laundering, strengthening of international cooperation and amendment of certain secrecy laws. In 1995 the International Narcotics Control Board urged all governments to implement the FATF 40 recommendations. Upon the terrorist attack on USA in September 2001, the FATF introduced another 09 recommendations covering the combating of Terrorist Financing activities, which expanded the FATF recommendations to 49 numbers.

According to the UN Commission on Narcotic Drugs, there is broad international support for a number of concrete measures to combat money laundering including the application of "know-your-customer" concepts, banning of anonymous accounts, maintenance of detailed records of account relationships and financial transactions for a specified period (in Sri Lanka such retention period is 6 years) to be made available to investigators, mandatory reporting of suspicious transactions and the desirability to do more close monitoring and controlling of cross-border movements of funds.

However, many issues remain unresolved such as the non-compliance of off-shore centres with anti-money laundering laws, the reluctance of some countries to enact or implement appropriate legislations and to relax banks secrecy laws and the question of corporate criminal liability.

6. Financial Action Task Force (FATF).

At present FATF is recognized as the global governing body of AML / CFT regulations, thus quote below from a document issued by FATF in February 2012, keeping in line with the revisions made to FATF recommendations on International Standards on Combating Money Laundering & Financing of Terrorism & Proliferation,

Quote

The Financial Action Task Force (FATF) is an inter-governmental body established in 1989 by the Ministers of its Member jurisdictions. The mandate of the FATF is to set standards and to promote effective implementation of legal, regulatory and operational measures for combating money laundering, terrorist financing and the financing of proliferation, and other related threats to the integrity of the international financial system. In collaboration with other international stakeholders, the FATF also works to identify national-level vulnerabilities with the aim of protecting the international financial system from misuse.

The FATF Recommendations set out a comprehensive and consistent framework of measures which countries should implement in order to combat money laundering and terrorist financing, as well as the financing of proliferation of weapons of mass destruction. Countries have diverse legal, administrative and operational frameworks and different financial systems, and so cannot all take identical measures to counter these threats. The FATF Recommendations, therefore, set an international standard, which countries should implement through measures adapted to their particular circumstances. The FATF Recommendations set out the essential measures that countries should have in place to:

- Identify the risks, and develop policies and domestic coordination;
- Pursue money laundering, terrorist financing and the financing of proliferation;
- Apply preventive measures for the financial sector and other designated sectors;

- Establish powers and responsibilities for the competent authorities (e.g., investigative, law enforcement and supervisory authorities) and other institutional measures;

- Enhance the transparency and availability of beneficial ownership information of legal persons and arrangements; and
- Facilitate international cooperation.

The original FATF Forty Recommendations were drawn up in 1990 as an initiative to combat the misuse of financial systems by persons laundering drug money. In 1996 the Recommendations were revised for the first time to reflect evolving money laundering trends and techniques, and to broaden their scope well beyond drug-money laundering. In October 2001 the FATF expanded its mandate to deal with the issue of the funding of terrorist acts and terrorist organisations, and took the important step of creating the Eight (later expanded to Nine) Special Recommendations on Terrorist Financing. The FATF Recommendations were revised a second time in 2003, and these, together with the Special Recommendations, have been endorsed by over 180 countries, and are universally recognised as the international standard for anti-money laundering and countering the financing of terrorism (AML/CFT).

Following the conclusion of the third round of mutual evaluations of its members, the FATF has reviewed and updated the FATF Recommendations, in close co-operation with the FATF-Style Regional Bodies (FSRBs) and the observer organisations, including the International Monetary Fund, the World Bank and the United Nations. The revisions address new and emerging threats, clarify and strengthen many of the existing obligations, while maintaining the necessary stability and rigour in the Recommendations.

The FATF Standards have also been revised to strengthen the requirements for higher risk situations, and to allow countries to take a more focused approach in areas where high risks remain or implementation could be enhanced. Countries should first identify, assess and understand the risks of money laundering and terrorist finance that they face, and then adopt appropriate measures to mitigate the risk. The risk-based approach allows countries, within the framework of the FATF requirements, to adopt a more flexible set of measures, in order to target their resources more effectively and apply preventive measures that are commensurate to the nature of risks, in order to focus their efforts in the most effective way.

Combating terrorist financing is a very significant challenge. An effective AML/CFT system, in general, is important for addressing terrorist financing, and most measures previously focused on terrorist financing are now integrated throughout the Recommendations, therefore obviating the need for the Special Recommendations. However, there are some Recommendations that are unique to terrorist financing, which are set out in Section C of the FATF Recommendations. These are: Recommendation 5 (the criminalisation of terrorist financing); Recommendation 6 (targeted financial sanctions related to terrorism & terrorist financing); and Recommendation 8 (measures to prevent the misuse of non-profit organisations). The proliferation of weapons of mass destruction is also a significant security concern, and in 2008 the FATF's mandate was expanded to include dealing with the financing of proliferation of weapons of mass destruction. To combat this threat, the FATF has adopted a new Recommendation (Recommendation 7) aimed at ensuring consistent and effective implementation of targeted financial sanctions when these are called for by the UN Security Council.

The FATF also produces Guidance, Best Practice Papers, and other advice to assist countries with the implementation of the FATF standards. These other documents are not mandatory for assessing compliance with the Standards, but countries may find it valuable to have regard to them when considering how best to implement the FATF Standards.

The FATF is committed to maintaining a close and constructive dialogue with the private sector, civil society and other interested parties, as important partners in ensuring the integrity of the financial system. The revision of the Recommendations has involved extensive consultation, and has benefited from comments and suggestions from these stakeholders. Going forward and in accordance with its mandate, the FATF will continue to consider changes to the standards, as appropriate, in light of new information regarding emerging threats and vulnerabilities to the global financial system.

The FATF calls upon all countries to implement effective measures to bring their national systems for combating money laundering, terrorist financing and the financing of proliferation into compliance with the revised FATF Recommendations.

Unquote

7. Sri Lankan Scenario

7.1 Sri Lanka is in need of Capital Inflows

Sri Lanka was involved in civil war and fighting terrorism for almost three decades which pushed the country into the woods, both socially as well as financially. The physical devastation of assets and resources, mental trauma, political uncertainity, brain draining and migration of skilled workforce, investor non-conducive environment and adverse publicity created internationally, crippled the economic growth of the country.

During the relentless battle fought by Sri Lanka against terrorism, certain pro-LTTE undesired elements made a sinister move to paint a gloomy picture on humanitarian operations, quoting same as war, against a particular ethnic group and labelled it a genocide. However, the Sri Lankan security forces were able to totally defeat LTTE militarily. However, Sri Lanka is falling short in totally defeating the pro LTTE propaganda, through the humanitarian missions carried out in and off the battle field.

The increased government expenditure, fuel prices, increased prices in commodities, loss of government revenue coupled with investor non-conducive environment prevailed and the global economic slowdown, saw the foreign reserves of Sri Lanka deteriorating sharply, which compelled the government to seek a standby facility from IMF.

With the liberation of North and East, government has embarked on massive development projects in both provinces. Accordingly, infrastructure development in North and East are taking place at a rapid pace.

It is no secret that none of development projects can take off without availability of capital/ equity. Capital is raised by way of obtaining loans, grants by foreign donor, investments done by individuals/entities etc. However, finding capital on reasonable terms is not easy, as same requires "investor confidence" which Sri Lanka is building up now.

7.2 Heaven for Investors and haven for Money Launderers?

The ending of war, prevalence of political stability, restoration of peace in the country, tax incentives offered to investors have no doubt enhanced the "investor confidence", thereby significant capital inflows are encouraged.

In addition to the above, political instability and terrorist threats experienced in other emerging South Asian Markets such as Maldives, Bangladesh, Pakistan, would shift the investor attraction towards Sri Lanka.

Whilst inflow of funds to Sri Lanka are welcome, one must not forget the fact that Money Launders throughout the globe would also find emerging economies of the caliber of Sri Lanka, a haven for them, unless the Bankers and Regulators gear up themselves to meet the challenges of preventing the Banking system being used for Money Laundering & Terrorist Financing.

7.3 Challenges faced by Banks in combating Money Laundering & Terrorist Financing

As we are now in the post-conflict era in which Sri Lanka is entering the 'fast track' in the road to economic development, the need for more equity capital to flow into the country through banking streams is needless to be emphasized. Money Launderers & Terrorist Financiers will make use of such opportunities to carry out their unlawful acts of money Laundering & Terrorist Financing, in the guise of contributing towards the development of national economy.

With the inflow of capital and commissioning of new projects, the money supply and money circulation too will expand. Crimes such as Corruption, Bribery, Theft, Fraud, Misappropriation of funds etc. will also be on the increase, as the emerging environment will be very much conducive to such activities.

Nobody therefore, would disagree that strict implementation of Anti Money Laundering legislations and related controls and effective Law Enforcement are very much essential to efficaciously curb Money Laundering & Terrorist Financing.

One important concept of Anti Money Laundering & Combating of Financing of Terrorism (AML/CFT) is to identify and keep under surveillance (monitoring), questionable and suspicious financial transactions and inquire into the source of funds and the financial assets (wealth) at the time of inflow into the country and the financial system.

However, it is often argued that such surveillance and questioning by bank officials would dissuade customers from dealing with them, thereby pursue such customers to seek access to a competitor who is not compliant to AML/CFT regulations or "Informal Financial Channels", most of which flout the law.

In order to overcome the above, the banks operating in Sri Lanka have formed a forum in the name of "Association of Compliance Officers of Banks - Sri Lanka", which has taken steps to create a level playing field among all banks, so that no bank is either unduly benefited or be at a disadvantage by being complaint to AML regulations passed by the parliament and guidelines issued by Financial Intelligence Unit (FIU), which functions under the wings of Central Bank of Sri Lanka (CBSL), which is the local governing body of AML / CFT regulations.

Accordingly, all banks operating in Sri Lanka have agreed upon on a "Common set of minimum data" to be obtained from all customers who maintain or seek to maintain, account relationships with such banks. This, if practiced properly without any exception, will eliminate the problem of loosing good business to competitors, due to AML reasons, whilst depriving Money Launderers and Terrorist Financiers, entering the banking streams. Therefore it is upto all banks to ensure that they comply with the regulatory requirements without any exception.

Even if one is to disregard the concerns related to the share of business and growth of business, entertaining ill-gotten money into financial institutions and national economy, brings no positive result at the end. On the other hand, it is the duty of bankers and employees of other Financial Institutions to assist the law enforcement agencies to detect and prevent Money Laundering efforts, by following Know Your Customer (KYC) Concepts and carrying out Customer Due Diligence (CDD).

7.4 Action taken to facilitate international cooperation and greater coordination among countries

Keeping in line with the FATA recommendation, the FIU – Sri Lanka has entered into memoranda of understanding with FIU's of 20 countries. As such the Sri Lankan FIU has signed up with FIU's of countries such as Australia, Belgium, Bangladesh, Canada, India, Malaysia, South Korea, Indonesia, Philippines, Afghanistan, Nepal, Cambodia, Fiji, Slovenia, South Africa, Solomon Island, Mongolia, Russia, Saudi Arabia & USA, with a view of sharing financial information to facilitate investigation and execution of persons suspected of money laundering and terrorist financing.

7.5 Legislations and Regulations governing the Money Laundering & Combating Financing of Terrorism in Sri Lanka

There are three parliamentary legislations, governing AML/CFT activities in Sri Lanka

(i) Prevention of Money Laundering Act No. 05 of 2006

(ii) Convention on the Suppression of Terrorist Financing Act No. 25 of 2005

(iii) Financial Transaction Reporting Act No.06 of 2006

In addition, there are guidelines issued by Financial Intelligence Unit (FIU) from time to time.

7.5.1 Prevention of Money Laundering Act (PMLA)

Money Laundering has been made an offence (crime) in Sri Lanka, as per section 3(1) of the PMLA. Accordingly, any person who,

a) Engages directly or indirectly in any transaction in relation to any property which is derived from any unlawful activity or from proceeds of any unlawful activity

or

b) Receives, possesses ,conceals, disposes of or brings into Sri Lanka, transfers out of Sri Lanka or invest in Sri Lanka, any property which is derived from any unlawful activity or from proceeds of any unlawful activity, shall be guilty of an offence of Money Laundering

7.5.2 Predicate Offences under Money Laundering

It is evident from the above that the Money Laundering offence, relates to engaging in any transaction in relation to any property derived/realized from any "unlawful activity", whilst knowing or having reasons to know that the said property has been derived from such unlawful activity.

Under the act, the term "unlawful activity" has been defined as any act which constitutes an offence under any of the following laws, which are known as "predicate offences".

(i) Poisons, opium & Dangerous Drugs Ordinance

(ii) Law related to Suppression of Terrorism

(iii) Bribery Act

(iv) Fire Arms Ordinance, Explosives Ordinance & Offensive Weapons Ordinance

(v) Exchange Control Act

(vi) Laws related to Transational organized Crime

(vii) Laws relating to Cyber crimes

(viii) Laws relating to Offences against Children

(ix) Laws relating to offences against Trafficking of Persons

(x) Any other offense punishable with death or imprisonment of seven years or more, whether committed within or outside Sri Lanka.

Therefore, it is the property, that is derived from offences under any of the above, that becomes the subject matter of the offence of money laundering. However, in practice, a banker will find it difficult to ascertain whether a property (or money) in question is derived from a predicate offence or not. Therefore, for the convenience of establishing the nature of the property, the law has laid down a "rebuttable presumption" to the effect that, if money or property in question cannot or could not have been derived from the declared or known income of the person in question, it shall be deemed that such property whether movable or immovable, has been derived or realized directly or indirectly from an unlawful activity.

7.5.3 Who may commit Money Laundering

From the above it is observed that the persons who could commit the offence of Money Laundering can be categorized into two groups.

(i) Persons who commit a predicate offence and thereby come into possession or control of the property derived through commission of such predicate offence

or

(ii) Persons who transact with or receive, possess or come into control of property derived from the commission of a predicate offence, knowing or having reasons to believe the true nature of such property.

The Bankers and employees of Financial Institutions would come within the category (ii) above and would be a party to money laundering by aiding and abetting same although they may not be culpable for the commission of a predicate offence but by mere handling of the relevant property (by entertaining a customer relationship), if the banker had either known or had reasons to believe that the subject property had been derived from commissioning of a predicate offence.

7.5.4 Penalties Imposed

In the event of any person is found guilty for the offence of Money Laundering by a High Court in Sri Lanka, such persons would be subject to the following penal sanctions,

(i) to a fine not less than the value of the property in respect of which the offence was committed and not more than three times of the value
(ii) to rigorous imprisonment for a period of not less than five years and not more than twenty years

or

(iii) to both such fine and imprisonment

Further, assets of the person convicted including the assets derived from the commission of the offence of Money Laundering shall be liable to be forfeited.

In the event, the offence of Money Laundering is committed by a Body of Corporate or an Entity, the directors, partners, office bearers as the case may be, together with the relevant officers (employees) who were involved, shall be deemed to be guilty of such offence.

7.5.5 Remedies (in a nutshell) available to bankers in avoiding being liable for non compliant to AML regulations

i) Identification
- Acquire KYC details of the customer (Know Your Customer Concept)

ii) Monitoring
- Carrying out Customer Due diligence (CDD), which is an ongoing exercise
- Volumes and pattern of transactions to be monitored and compared with the declared/known profile of the customer

iii) Record Keeping
- Records pertaining to an account relationship must be maintained by banks without any exception. Also, such records must be retained for a minimum period of 6 years from the date of cessation of the account relationship. All transaction details need to be retained for 6 yeasr from the date of transaction.
- If an inquiry or an investigation has commenced, records pertaining to such accounts must be retained until the investigations are over, thus not restricted to 6 years.

iv) Reporting

- All suspicious transactions must be reported to FIU within a reasonable period of time but not later than 2 days from forming of the suspicion. This is done by submission of a Suspicious Transaction Report - (STR)

  - Mandatory Reporting:

All banks are bound to submit the following mandatory reports to FIU on a fortnightly basis, i.e. as at mid month and month end of every calendar month.

(i) All Cash Transactions in excess of Rs. 1.0 Mn. (CTR)

(ii) All Electronic Fund Transfers (both inward & outward) in excess of Rs. 1.0 Mn. (EFTR)

7.6 Financial Transaction Reporting Act (FTRA)

Parallel to the Prevention of Money Laundering Act, the Sri Lankan Parliament passed another law named Financial Transaction Reporting Act No.6 of 2006 under which the Financial Intelligence Unit (FIU) which is the governing body of AML laws & regulations in Sri Lanka was established. The FIU exercises statutory powers, in order to monitor suspicious financial transactions and conduct investigations into Money Laundering and Terrorist Financing.

FTRA has imposed certain obligations and prohibitions on banks (and designated non finance businesses as well) aimed at

(i) Enforcing the KYC concepts

(ii) Preventing Banking Products & Services being used for Money Laundering

(iii) Facilitating investigations

(iv) Monitoring Suspicious Financial Transactions

8. Conclusion

The facts discussed in this article suggest that money laundering is capable of creating serious macroeconomic, microeconomic and socioeconomic problems to the society.

The negative effect of money laundering can transfer economic powers from market, governments and citizens to the hands of criminals. In other words the magnitude of money laundering is such that the economic power that accrues to criminals has a corrupting effect on all elements of the society. In extreme cases, it can even lead to virtual collapse or takeover of legitimate governments.

On the other hand the world is developing more awareness on consequences of money laundering & terrorist financing & the importance of combating same. Despite the efforts taken by the regulatory bodies & communities all around the world, money laundering is still taking place in large scale.

Therefore all money laundering presents the global community, a very complex and dynamic challenge which suggests and merits global standards and international cooperation to combat the ability of criminals to launder their ill-gotten proceeds and thereby eliminating the crime of Money Laundering which creates serious macro, micro and socio economic problems to the society, if not countered would cartainley have a direct impact on sustainability.

References

"Cheap and Trusted," *Economist*, Nov. 24, 2001, p. 71. The *Economist* quotes Martin Comley of the UK's National Criminal Intelligence

Bank Report: Central Bank of Sri Lanka, 2009/2010

Money Laundering, Financial transactions reporting, Terrorist Financing – D C Jayasuriya 2007

Compendium of laws on money laundering, suppression of terrorist financing & the Financial Intelligent Unit – Perera, Senehelatha Abeywickra 2008

Capacity Enhancement Programme on AML & Combating the Financing of Terrorism Work Book – The World Bank 2005

20th Anniversary Convention Publication of APB – 2008

International standards on combating Money Laundering & the Financing of Terrorism & Proliferation : the FATF Recommendations – February 2012.

Wikipedia & Google