

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
FIs	- 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.

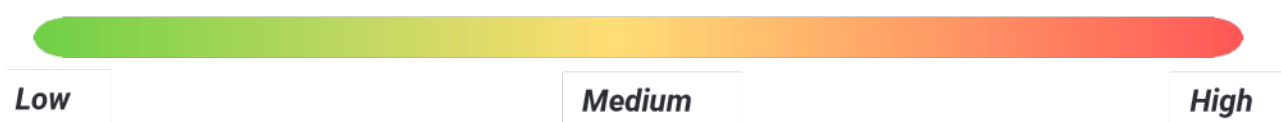


Table 1: Sectoral Money Laundering Threat, Vulnerability and Risks

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

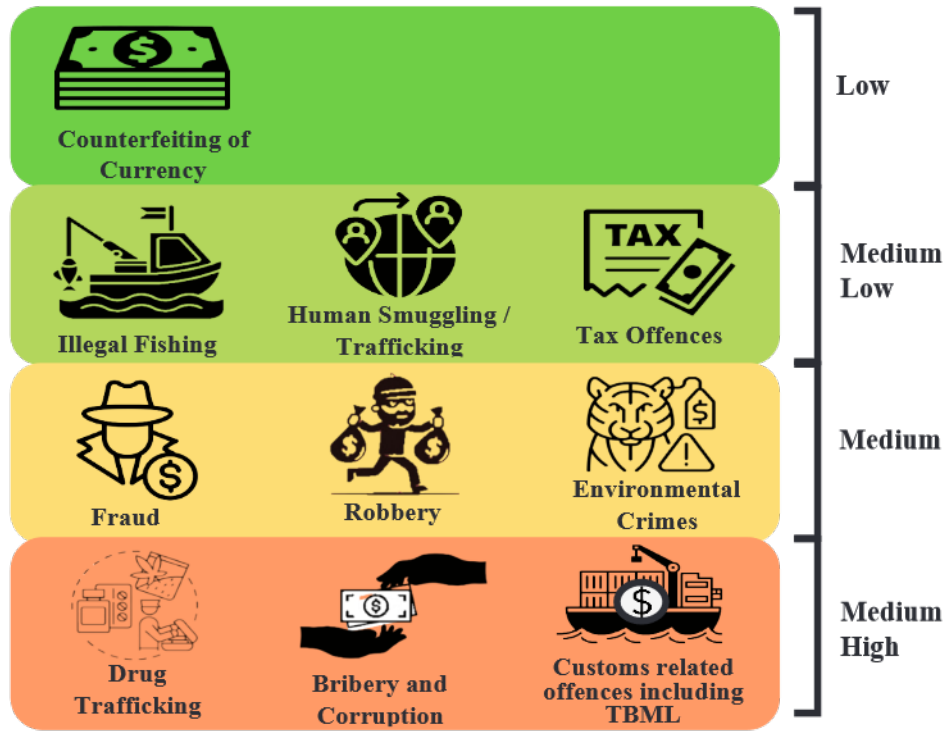
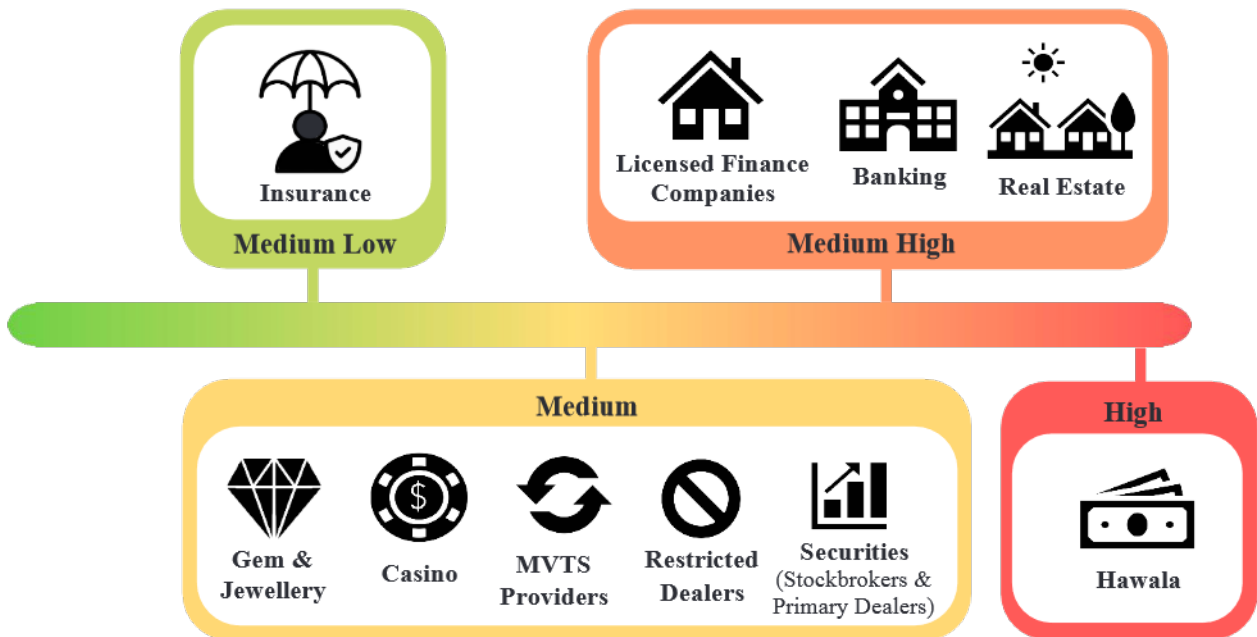


Figure 2: Sectoral Risk to Money Laundering



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, systemically 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.