

Questions and answers based on the radio interview at Sri Lanka Broadcasting Corporation

Interview on Payments and Settlements system and money laundering activities.

Q 1) Sri Lanka's banking system could fall at risk with the use of payment cards as well as due to money laundering activities. This paves way for certain parties to misuse the banking system and subsequently the whole financial system. Therefore, could you provide an introduction to the banking system of Sri Lanka?

Banking system of Sri Lanka

Banking system includes licensed commercial banks and licensed specialized banks, and it provides liquidity and money to facilitate transactions in the entire economy. Banking system further maintains payment services required to facilitate financial transactions of all banking institutions. Currently, there are 26 licensed commercial banks and 7 licensed specialized banks operating in the Sri Lankan financial system. This can be considered as the heart of our economy.

The stability of the banking system is very important as it allows maintenance of liquidity and smooth execution of transactions. Further, stability enriches public trust in the banking system.

Value of banking sector assets amounts to Rs. 12 trillion.

Value of financial system amounts to Rs 17 trillion.

Value of registered finance companies and specialized leasing companies amounts to Rs 1.4 trillion.

Q 2) What is a payment card? Explain briefly about how it is used in the banking system.

It's a card that facilitate customers to access their bank accounts to withdraw or deposit cash using Automated Teller Machines (ATMs), Point-of-Sales (POS) machines or internet, instead of visiting a bank branch.

What are the types of payment cards used globally?

There are 4 main types:

- 1 Debit card
- 2 Credit card
- 3 Charge card
- 4 Stored-value card

Q 3) Could you explain about the importance, popularity and penetration of modern day card payments? Do you have any data and/or statistics to support your comment?

The use of cashless transaction mechanisms to make payments was introduced in 1990. These mechanisms expanded exponentially, especially with the evolution of electronic banking. According to a survey done by the United States of America in 2016, 75% of the sample of people preferred to use debit and credit cards while only 11% preferred cash (Source: '2016 US Consumer payment Study', 2016). Total value of cash transactions in Sweden was as low as 2% (Source: 'People in Sweden barely use cash – and that's sounding alarm bells for the country's Central bank', Browne Ryan, 2018)

Nordic countries head the list of countries where cash is seldom used. Moreover, 61% of total transactions in Singapore are executed through payment cards (Source: 'Future of Cashless Payments in Singapore', Frost & Sullivan, Lee, Quah Mei, 2018).

Currently, there are around 21 million payment cards in use. Further, there are 1.6 million credit cards in use.

Q 4) Explain the evolution of payment cards in Sri Lanka and its current composition.

ATM was introduced to Sri Lanka in 1986

In 1989, commercial banks started issuing Credit cards in Sri Lanka (Source: 'Payment Bulletin', Q3, 2018)

POS machines were introduced to Sri Lanka in 1994 and Debit cards were first issued in 1997 (Source: 'Payment Bulletin', Q3, 2018).

Customers can enjoy their card facilities at any ATM or POS machine. By the end of third quarter in 2018 there were:

59,419 - POS machines

4,496 - ATM machines in use.

Moreover, cardholders can use their cards over the internet to make payments.

What are the institutions that are involved in card issuing process?

Central Bank of Sri Lanka - Licensing Authority

All licensed service providers

Q 5) Is it necessary to obtain permission to issue or to introduce payment cards? If so, from which institution?

Yes, Permission has to be obtained from the Central Bank of Sri Lanka. The following entities qualify to apply for licenses to become a payments card service provider.

- Licensed Commercial Banks
- Licensed Specialized Banks
- Registered finance companies

- An operator who provides cellular mobile telephone services under the authority of a license issued in terms of the Sri Lanka Telecommunications Act No. 25 of 1991 as amended
- A company registered under the Companies Act, No. 7 of 2007 having an unimpaired capital of at least Rupees One Hundred and Fifty (150) Million or such other amount determined by the Central Bank, other than a company limited by guarantee, an offshore company or an overseas company within the meaning of the Companies Act, No. 7 of 2007,

Q 6) What are the existing regulations that govern the usage of payment cards in Sri Lanka

Acts, regulations and directions,

- Payment and Settlement systems Act, No. 28 of 2005
- Payment Cards and Mobile Payment Systems Regulations No. 1 of 2013 which replaced the Service Providers of Payment Cards Regulations No. 1 of 2009
- Credit Card Guideline No. 01/2010 issued by the CBSL, in order to ensure safe, secure and efficient operations when Credit Cards are used as a payment instrument

Q 7) What are the difficulties and dangers faced by the consumers while they transact with payment cards?

There is a possibility that fraudsters may steal the Personal Identification Number (PIN) and card associated data while transactions are taking place. Few incidents were reported in the past where PIN and card data was stolen using hidden cameras and card skimming devices.

Customers should exercise due care and vigilance when using payment cards and ATMs in order to ensure the safety of ATM transactions. Please check the presence of any suspicious devices attached to ATM machines before you start your transaction.

Any incident of unidentified or unauthorized transaction and lost or misplaced cards should be notified to the relevant bank, immediately.

Q 8) Few incidents of fund withdrawals using fraudulent payment cards were reported in the recent past. Please explain. What are the measures taken by the Central Bank of Sri Lanka to minimize such scams?

In order to assure complete protection of customers, both payment card and ATM machine has to be enabled with EMV (Europay, Mastercard and Visa) technology. However, not all banks have enabled EMV technology in their ATMs.

Further, banks should bear the responsibility of card related frauds if their ATM is EMV inactive and the payment card used is EMV enabled.

Subsequently, banks suspend access to accounts at other banks through their ATMs in order to avoid such losses and to eliminate frauds in the entire ATM network upon receiving reports on ATM associated frauds.

Furthermore, you can opt for the Short Message Service (SMS) which will keep you up-to-date regarding transactions associated with your payment cards. Accordingly, the customers will know whether the particular transaction was initiated by him or someone else. Customers can take appropriate measures (such as blocking the payment card) instantly if he/she receives a notification of transaction when the corresponding card hasn't been in use.

Q 9) What is EMV (Europay, Mastercard and Visa) technology? Why is it special? What's the current situation with EMV?

There is an electronic chip integrated to the EMV enabled payment cards which store card-related sensitive data. These cards can be read at EMV enabled ATMs and this process is fully secured compared to cards with magnetic strips. Therefore, the possibility of card related data theft could be eliminated.

Currently, all licensed institutions are in the process of issuing EMV enabled payment cards. This may take some time as every payment card needs to be replaced with an EMV enabled payment cards and all ATMs and POS machines needs to be updated with EMV technology.

Should the consumer bear the loss that originates from an EMV inactive ATM?

EMV enabled cards can be used at EMV active or EMV inactive ATMs.

Use of EMV enabled cards

The ATM own bank is responsible if EMV is not enabled in ATM and liability shifts to the ATM owned bank.

Use of EMV inactive cards

The issuing bank of the payment card is responsible for ATM related frauds if EMV is not enabled in the said ATM.

Q 10) What are the measure to be taken in general to assure the safety of the payment system and the stability of the financial system?

Enclose the Personal Identification Number (PIN) during the whole payment process using cards.

The use of EMV enabled payment cards is essential

Enable the SMS alert service offered by banks, which will immediately confirm the transaction.

Customers should exercise due care and vigilance when using payment cards and ATMs in order to ensure the safety of ATM transactions. Please report any suspicious transaction to and from your account to compliance officers or financial intelligence unit directly. The assistance of corresponding bank or finance company is essential in this regard.

Q 11) What is Money Laundering?

Money Laundering is the process by which proceeds from a criminal activity are disguised to conceal their illicit origin. Money launderers send their illicit funds

through legal channels in order to conceal their criminal origin and convert them into legitimate assets.

Stages of Money Laundering

1st Stage - Placement

The initial stage of the process involves placement of illicitly earned funds into the financial system, usually through a financial institution. This can be accomplished by placing cash deposits into bank accounts or cash purchase of shares or insurance contracts.

2nd Stage- Layering

The second money laundering stage, layering occurs after the ill-gotten funds have entered into the financial system, at which point the funds, securities or insurance contracts are converted or moved to other institutions further separating them from their criminal sources.

3rd Stage - Integration

The third stage involves the integration of funds into the legitimate sector. This is accomplished through the purchase of assets such as real estate, securities, other financial assets or luxury goods such as cars, gems & jewellery etc.

What are the Predicate offences/unlawful activities of money laundering?

Predicate offences of money laundering are unlawful activities from which money is earned, such as

- Drug trafficking
- Human trafficking
- Fraud and corruption

- Violation of Section 83C of the Banking Act, No. 30 of 1988
- Offences against children
- Bribery or Corruption
- An offence which is punishable by death or with imprisonment for a term five year or more

Q12) What is the impact of money laundering activities on the financial system?

- Money Laundering / Terrorist Financing expansion affects the stability of the financial system
- Act as a barrier in conducting transactions with international financial market/ institutions
- Negative impact on the financial system due to adverse social consequences
- Damages to reputation of financial institutions and financial systems
- The inability to function as a global financial center due to possible reputational damage to country image internationally
- Issues in attracting foreign investment

Q13) What is a Financial Intelligence Unit? Have these Financial Intelligence Units always been established in a Central Bank? What are the types of FIUs in the world?

FIU is a national centre for the receipt and analysis of: (a) suspicious transaction reports; and (b) other information relevant to money laundering, associated predicate offences and financing of terrorism, and for the dissemination of the results of that analysis. A few major considerations shape the creation of the FIUs: anti-money laundering and counter terrorism financing laws, existing law enforcement, and the need for an authority that will receive, assess and share financial information.

Only in some countries Financial Intelligence Units are established in the Central Bank.

Example: Sri Lanka, Malaysia, Philippines

Types of FIUs in the world

The Judicial Model is established within the judicial branch of government.

The Law Enforcement Model implements anti-money laundering measures alongside already existing law enforcement systems.

The Administrative Model is a centralized, independent, administrative authority, which receives and processes information from the financial sector.

The Hybrid Model serves as a disclosure intermediary and a link to both judicial and law enforcement authorities. It combines elements of at least two of the FIU models

Q14) What is Terrorist Financing?

Terrorist financing is the financial support for any form of terrorism or for those who encourage, plan or engage in terrorism. Funds used to support terrorism may originate from legitimate sources, criminal activities or both.

Terrorist attacks on economic centers are having serious consequences for economic stability

Example: Central Bank Bombing, 11/09/2001 attack on USA

Q15) What are the laws relating to combating money laundering/terrorist financing in Sri Lanka?

Sri Lanka's Anti Money Laundering (AML) and Countering the Financing of Terrorism (CFT) regime comprises with three pieces of legislations.

- a) Conventions on the Suppression of Terrorist Financing Act, No. 25 of 2005 (CSTFA).
 - Conventions on the Suppression of Terrorist Financing (Amendment) Act, No. 41 of 2011.
 - Conventions on the Suppression of Terrorist Financing (Amendment) Act, No. 03 of 2013
- b) Prevention of Money Laundering Act, No. 05 of 2006 (PMLA).
 - Prevention of Money Laundering (Amendment) Act, No. 40 of 2011
- c) Financial Transactions Reporting Act, No. 06 of 2006 (FTRA)

Q16) Sri Lanka cannot work alone and it is essential to build and sustain international co-operation. What is our role here and what actions have we taken?

In the fight against money laundering and terrorist financing the Financial Intelligence Unit works closely with the Financial Actions Task Force and its regional monitoring body in which Sri Lanka is a founding member; Asia Pacific Group on Money Laundering. In addition, other organizations such as United Nations, International Monetary Fund, World Bank, Asian Development Bank also closely work with the FIU in this regard.

What is Financial Actions Task Force (FATF)

The Financial Action Task Force (FATF) is an inter-governmental body established in 1989 by the Ministers of its Member jurisdictions. The objectives of the FATF are to set standards and promote effective implementation of legal, regulatory and operational measures for combating money laundering, terrorist financing and other related threats to the integrity of the international financial system.

The FATF has developed a series of Recommendations that are recognised as the international standard for combating of money laundering and the financing of terrorism and proliferation of weapons of mass destruction.

The FATF monitors the progress of its members in implementing necessary measures, reviews money laundering and terrorist financing techniques and counter-measures, and promotes the adoption and implementation of appropriate measures globally

At present there are 38 members, 9 FATF styled regional monitoring bodies and observer organizations included in the FATF

What is Asia Pacific Group on Money Laundering (APG)

The Asia Pacific Group on Money Laundering the largest FATF styled regional monitoring body established in 1997. Currently 41 countries and several observer organizations are members of the APG and Sri Lanka is a founding member of the APG. Primary function of the APG is to monitor level country of compliance in line with FTAF recommendations.

Q17) What are the institutions covered in the FTRA?

a) Institutions engaged in finance business –

Eg; licensed banks, finance companies, stock brokers, insurance companies, money changers, money or value transfer service providers, etc.

b) Institutions engaged in designated non-finance businesses and professions (DNFBPs)

Casinos, Real Estate Dealers, Gem and Jewellery Dealers, Lawyers, Accountants, Trust or Company Service Providers

Q18) What is a Suspicious Transaction Report (STR)?

A Suspicious Transaction Report (STR) is a report filed when there are reasonable grounds to suspect that the transaction is related to money laundering, terrorist financing or any other related criminal offence. A suspicious transaction can include both completed and attempted transactions.

As per Section 7 of the FTRA, any Institution who has reasonable suspicion of any transaction relating to ML/TF is required to submit STRs. Institution means, any person or body of persons engaged in or carrying out any finance business or designated non-finance business.

All Suspicious Transaction Reports should be forwarded to the FIU.

The FIU is responsible for keeping the confidentiality of all Suspicious Transactions.

Reporting Suspicious Transactions as public complaints should be done in good faith and all required information should be provided and cannot be anonymous.

Q19) What are the classifications issued by the Financial Action Task Force?

The ratings issued by the Financial Action Task Force are as follows:

- a) Jurisdictions subject to a FATF call on its members and other jurisdictions to apply counter-measures to protect the international financial system from the on-going and substantial money laundering and terrorist financing (ML/FT) risks emanating from such jurisdictions – Black List

Country included: Democratic People's Republic of Korea (DPRK)

- b) Jurisdictions subject to a FATF call on its members and other jurisdictions to apply enhanced due diligence measures proportionate to the risks arising from the jurisdiction – Dark Gray List

Country Included: Iran

- c) Other Monitored Jurisdictions - Improving Global AML/CFT Compliance On-going Process – Gray List

Countries Included: The Bahamas, Botswana, Cambodia, Ethiopia, Ghana, Pakistan Serbia, Sri Lanka, Syria, Trinidad and Tobago, Tunisia, Yemen

How does it affect our country?

- Limiting financial connections with Sri Lankan banks including the impact on international banking.

- Subject to additional surveillance procedures when carrying out international transactions by Sri Lankan customers and financial institutions.
- High cost of international borrowings
- Reputational risk

How could Sri Lanka exit from the Gray List

This has to be done in two steps,

- 1) Completion of the Action Plan provided by the Financial Action Task Force within the given time period
- 2) A team of evaluators will be visiting Sri Lanka during May 2019 to evaluate the progress achieved in the implementation of the Action Plan by different institutions in Sri Lanka.

The report of the evaluator will be submitted to the Financial Action Task Force Meeting in June 2019 and it will be decided therein to remove Sri Lanka from the Grey List

Q20) European Union Classification and its Adverse Effects

The European Union added Sri Lanka into its Black List subsequent to the FATF placing the country on its Gray List

Like the Financial Action Task Force, the classification of countries is carried out by the European Union under several parts. All countries who are weak in the Anti-Money Laundering and Countering the Financing of Terrorism are classified in one document.

The impact arising from European union classification is similar to the impact arising from Financial Action Task Force classification while some European financial institutions limit dealing with Sri Lanka's financial institutions can be identified as an additional impact.

Actions taken to resolve these issues

With the exit from the Grey List of the Financial Action Task Force, the European Union will consider removing Sri Lanka from their list.

Q 21) Are you satisfied with the current situation with regard to facts discussed earlier?

The legal and institutional framework in this regard has been established in Sri Lanka and the Financial Intelligence Unit cooperates with all relevant stakeholders. The necessary awareness programs are conducted frequently. The Financial Action Task Force is satisfied with the steps we have taken and Sri Lanka's technical compliance level has improved during last few years. (Sri Lanka complies with 27 recommendations of the Financial Action Task Force). As Financial Intelligence Unit, we are satisfied with the measures so far taken and intend to further expand them. Awareness of the people is essential in strengthening these measures.

The payment and settlement systems have been modernized to resist threats and remains comparable with many developed economies. Further, all measure to be taken in order to protect payments and settlements network and bank transactions have been communicated to financial institutions. Risks on payments and settlements system can be mitigated upon adhering to those measures and, exercising due care and vigilance.

Subsequently, banks and the financial system will remain protected.