

BOX 6

Mutual Evaluation of Sri Lanka 2025: Its National Significance**1. Introduction**

Money Laundering (ML) and Terrorist Financing (TF) pose significant challenges to the world's financial systems, as well as to national security and economic stability. ML and TF affect countries around the world by weakening their economies and societies. While some countries are at higher risk due to weak governance and corruption, no country is entirely free from the risks associated with ML and TF. Given the increasing prevalence of financial crimes worldwide, fighting against ML and TF has become a global priority. It requires cooperation among governments and law enforcement agencies, financial institutions, designated non-finance businesses and professions, and international organisations to protect the financial system and combat the risks of these crimes.

The Financial Action Task Force (FATF), the global policy setter in Anti-Money Laundering and Countering the Financing of Terrorism (AML/CFT), plays a vital role in combatting ML and TF by establishing global standards and promoting collaboration among nations.

As a proactive step, FATF and FATF-Style Regional Bodies (FSRBs) conduct Mutual Evaluations (MEs) to assess countries' technical compliance with the FATF standards and their effective implementation of AML/CFT measures. This evaluation process has significant national importance for member countries as it identifies weaknesses in national systems and identifies areas for improvement within their AML/CFT frameworks. At the same time, it promotes a level playing field among countries and encourages them to implement AML/CFT measures on a consistent basis, globally.

Sri Lanka will face its third ME in 2025. Given the country's past experience of two MEs which resulted in it being included in the FATF "Grey List" and subsequent economic and financial repercussions, the upcoming ME will be a significant event in the country's economic and financial progression.

2. Mutual Evaluation Process

The ME process involves an in-depth analysis of a country's AML/CFT system undertaken as a peer review. MEs are conducted over a period of 14 – 18 months and consist of two main components: technical compliance assessment and effectiveness assessment.

- **Technical compliance:** *Implementation of the specific requirements of FATF Recommendations, including the framework of laws and enforceable means; and the existence, powers and procedures of competent authorities.*
- **Effectiveness assessment:** *Effectiveness is the extent to which financial systems and economies mitigate the risks and threats of money laundering, and financing of terrorism and proliferation. This could be in relation to the intended result of a given (a) policy, law, or enforceable means; (b) programme of law enforcement, supervision, or intelligence activity; or (c) implementation of a specific set of measures.*

The stages in the ME process throughout which the technical compliance and the effectiveness are assessed, are outlined below.

- i. Assessing technical compliance (4 months):** The country provides information about its laws and regulations.
- ii. Scoping:** In preparation for the effectiveness assessment and the on-site visit, assessors undertake a preliminary scoping exercise to determine the areas of focus of the on-site visit.
- iii. On-site visit (2 weeks):** The assessors travel to the country for the on-site visit.
- iv. Report drafting:** Immediately following the on-site visit, the assessors finalise the mutual evaluation report with the findings of the effectiveness and technical compliance assessment.
- v. Plenary discussion (15 months after technical compliance assessment):** The assessors present the draft report to the FATF Plenary at one of the three meetings it holds every year.
- vi. Final quality review (2 months after approval):** Following Plenary approval, the report is reviewed for technical quality and consistency before it is published on the website.
- vii. Follow-up:** After adoption, the countries are required to address the shortcomings identified in the report which are followed-up annually until the next ME.

3. National Significance of Mutual Evaluations

The ME process requires countries to implement the AML/CFT framework efficiently and effectively ensuring a safe and robust financial system. Accordingly, achieving a favourable outcome in the ME process ensures a secure financial system by protecting the country's position in the global financial system and thereby accelerating economic growth.

The following are some of the factors which show the national significance of MEs:

- i. Preserving Financial Stability:** Effective AML/CFT measures play a vital role in preserving the integrity and stability of the financial system. By adhering to FATF recommendations, countries mitigate the risk of being a high-risk jurisdiction, which could adversely affect their access to international banking services and capital markets.
- ii. Enhancing National Security:** A robust AML/CFT regime is essential for national security, preventing the use of illicit funds for financing terrorism and other criminal activities. By undergoing MEs and rectifying identified weaknesses, countries strengthen their capacity to disrupt illicit financial flows, thereby safeguarding national security interests.
- iii. Compliance with International Standards:** Participation in MEs is vital for countries to showcase their commitment to adhering to international AML/CFT standards. Maintaining these standards enhances a country's reputation in the global financial community while promoting trust among international partners and investors.
- iv. Facilitating International Cooperation:** Successful MEs promote greater international cooperation and information sharing among countries in combating financial crime. Enhanced compliance with the FATF standards improves a country's standing within the global financial system, facilitating efficient collaboration with other jurisdictions in investigations and enforcement actions. This collaboration strengthens the collective efforts to combat ML and TF on a global scale, leading to more effective outcomes in preventing and deterring financial crimes.
- v. Identification of Weaknesses:** MEs enable countries to identify weaknesses and gaps in their AML/CFT frameworks. Countries are informed of vulnerabilities such as legislative

gaps or deficiencies in enforcement which is crucial for preventing exploitation by criminals and enhancing the effectiveness of AML/CFT measures.

4. Sri Lanka's Past Experience of Facing Mutual Evaluations

Sri Lanka has undergone two MEs by the Asia/Pacific Group on Money Laundering (APG), the regional FSRB for the Indo-Pacific. The two MEs were in 2006 and 2014/15. Both these evaluations resulted in Sri Lanka being listed by the FATF as a "jurisdiction with strategic deficiencies" in its AML/CFT framework, commonly referred to as "Grey Listing". The grey-listing resulted in adverse economic and financial consequences on both occasions.

Subsequent to Sri Lanka's "Grey Listing" by the FATF after 2015, the European Commission also listed Sri Lanka as a high risk third country with AML/CFT strategic deficiencies in February 2018, which affected Sri Lanka's correspondent banking relationships.

As Sri Lanka took steps to significantly improve its AML/CFT system subsequent to 2015, Sri Lanka was delisted by the FATF and the European Commission in October 2019 and May 2020, respectively.

5. Sri Lanka's Preparedness for the Upcoming Mutual Evaluation

Given the adverse impacts of past evaluations, the upcoming ME will require Sri Lanka to further strengthen the country's AML/CFT regime. This requires collective action from stakeholders including the government and law enforcement agencies, financial institutions, designated non-finance businesses and professions, coordinated by the Financial Intelligence Unit of Sri Lanka (FIU-SL).

In this context, the country's preparedness is vital to showcase its dedication to combating financial crimes. This evaluation provides a thorough assessment of Sri Lanka's AML/CFT frameworks, highlighting strengths, weaknesses, and areas for future improvement. Accordingly, several key initiatives have been taken by the FIU-SL, in preparation for the ME.

- i. Establishing an AML/CFT Task Force:** A task force for AML/CFT was appointed by the Cabinet of Ministers, comprising five members under the chairmanship of a retired Supreme Court Justice, to oversee the progress of implementation of the stakeholder-wise action plans to address the identified gaps and coordination among relevant stakeholders.

ii. Collaboration with the National

Coordinating Committee: The AML/CFT National Coordinating Committee (NCC) is the advisory body that maintains national level coordination among stakeholders in implementing AML/CFT measures in Sri Lanka. With the leadership of the NCC and AML/CFT task force, all work relating to the upcoming ME is being coordinated.

iii. Conducting National Risk Assessment (NRA) in 2021/22:

In line with the FATF recommendations, the FIU coordinated the completion of the second NRA in 2021/22 to identify, assess and understand the ML/TF risks faced by the country. Accordingly, the country's overall ML/TF risk was assessed as "medium" which is a combination of medium level of threat and medium level of vulnerability.

iv. Development of AML/CFT National Policy

2023 – 2028: Based on the findings of the NRA, the National AML/CFT Policy for 2023 – 2028 was prepared, which was approved by the Cabinet of Ministers, to address the gaps identified to effectively combat ML and TF in the country.

v. Developing stakeholder-wise action plans:

With the purpose of preparing the key stakeholders for the next ME, the stakeholder-wise action plans for relevant 24 stakeholder institutions were approved by the Cabinet of Ministers to improve the effectiveness and technical compliance level of AML/CFT framework of the country. The action plans were distributed among stakeholders with regular updates being provided by them to the NCC and to the AML/CFT task force.

vi. Carrying out legislative amendments:

In order to further strengthen the legal framework on AML/CFT and to ensure adherence to the

international standards, the FIU is in the process of amending key legislations which includes the Financial Transactions Reporting Act, No. 06 of 2006; the Prevention of Money Laundering Act, No. 05 of 2006; the Convention on the Suppression of Terrorist Financing Act, No. 25 of 2005. The FIU is also assisting in making the amendments to the Companies Act, No. 07 of 2007. These amendments are expected to be completed by the third quarter of 2024.

6. Conclusion

FATF MEs are events of national significance for member countries, as they play a vital role in assessing compliance with international AML/CFT standards, identifying weaknesses in national frameworks, enhancing national security, facilitating international cooperation, and preserving financial stability. By actively participating in the ME process, countries can strengthen the measures against financial crime and contribute to a safer and more secure global financial environment. Accordingly, collective efforts of all key stakeholders will ensure that Sri Lanka's AML/CFT framework is implemented efficiently and effectively, enabling the country to achieve a better compliance level at the upcoming ME while strengthening its position within the global financial community.

References

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