Asia Focus
COUNTRY ANALYSIS UNIT FEDERAL RESERVE BANK OF SAN FRANCISCO NOVEMBER 2012

Implementation of Anti-Money Laundering Standards in Asia

Global money laundering and terrorist financing activities impose significant costs on and create risks to the world economy through disruptions in orderly and transparent economic activity, and political and social unrest. To address these challenges, Asian governments and regulators have adopted standards set by the intergovernmental Financial Action Task Force (FATF) to strengthen their anti-money laundering (AML) and combating the financing of terrorism (CFT) regimes. Economies in the region have strengthened AML laws, established financial intelligence units, developed AML/CFT supervisory frameworks for financial institutions, and improved coordination and cooperation between national agencies and across economies. However, compliance with these standards across Asia is uneven and generally remains low. This *Asia Focus* report reviews some of the unique factors that contribute to money laundering in Asia, describes international AML/CFT standards, analyzes the region's progress towards fuller compliance with FATF recommendations, and outlines challenges that remain.

Unique Factors Contributing to Money Laundering in Asia

Several unique factors in Asia contribute to the demand for money laundering activities and make it more difficult to detect such activities and to enforce AML/CFT regulations. These factors are discussed below.

Structural Issues

Asia has a number of developing economies characterized by relatively low institutional capacities, political and economic instability, and high levels of corruption. These forces create both demand and opportunity for money laundering. An effective domestic AML/CFT regime requires the existence of certain structures, such as a robust regulatory framework, the rule of law, government effectiveness, a culture of compliance, and an effective judicial system.[1] Some Asian economies do not have these structural elements, or have significant weaknesses or shortcomings that impair the implementation of an effective AML/CFT framework. Government policies on taxes, currency controls and trade restrictions can also encourage individuals to circumvent formal financial channels and drive the demand for money laundering.

Prevalence of Cash Transactions

Many economies in the region are still based on cash transactions. However, this acts as a significant impediment to the implementation of AML/CFT oversight and reporting schemes because money laundering reporting requirements make the implicit assumption that most legal economic activity is credit-based.[2] AML/CFT standards require that cash transactions above a specific threshold be reported and scrutinized. Because of their very nature, cash transactions generally do not leave electronic records, making them difficult to track and report.

Presence of Alternate Remittance Systems

Another reason that money laundering remains prevalent in the region is the presence of alternative remittance systems (ARSs). Ethnic banking systems[3] in the Asia/Pacific region began centuries ago, serving as a means for trade across long distances. Today, they parallel the conventional banking sector and still provide essential banking services for many in the region.[4] However, the very nature of these systems also makes them highly vulnerable to exploitation by perpetrators of money laundering and terrorist financing. ARSs leave no paper trail, making it hard for authorities to distinguish between money laundering and legitimate transactions.

High Level of Criminal Activity

Certain criminal activities in Asia generate illicit proceeds that create a demand for money laundering. Major centers of narcotics manufacturing–Central Asia, the Golden Triangle and the Golden Crescent—are located in Asia, and revenue from the drug trade is moved out of the area and laundered, or redistributed to other areas of production to cover operating costs. While drug trafficking is most likely the main source of money laundering business in Asia, the Asian Development Bank has identified gambling, bribery, tax evasion, and human trafficking as additional demand sources.[5]

Social, Cultural and Legal Norms

In addition to the prevalent use of cash, other social, cultural and legal factors and business traditions in Asia can pose obstacles to enforcing international AML/CFT rules. Rigid confidentiality rules and privacy laws in a number of jurisdictions prevent access by regulators and other authorities to information on suspicious transactions. In addition, the continued acceptance of nominee ownership (where an entity holds assets for the actual owner) in some economies prevents the proper identification of beneficial ownership, reduces transparency, and makes it difficult to enforce "know your customer" requirements.[6]

Brief History of FATF 40+9

Despite the aforementioned challenges, Asian economies have made significant progress towards meeting the FATF's international standards for AML/CFT. Established in 1989 in response to mounting concerns over money laundering, FATF is responsible for examining money laundering techniques and trends, reviewing existing actions to prevent money laundering taken at a national and international level, and recommending additional measures needed to combat money laundering. In 1990, FATF first published its "Forty Recommendations" (FATF 40), which identified best practices for tackling money laundering.

In 2001, FATF added the development of standards to combat terrorist financing to its mission. Accordingly, it issued "Eight Special Recommendations" to counter the financing of terrorism in October 2001, as revised in June 2003, and subsequently published a ninth Special Recommendation in October 2004. The complete standards are commonly referred to as the "FATF 40+9 Recommendations."

Core recommendations include requirements to:

- Implement relevant international conventions;
- Criminalize money laundering and terrorist financing and enable authorities to confiscate proceeds from criminal and terrorists activities;
- Establish a financial intelligence unit (FIU) to receive and analyze suspicious transaction reports;
- Ensure effective law enforcement and prosecution of money laundering and terrorist financing crimes;
- Implement customer due diligence, record keeping and suspicious transaction reporting requirements for financial institutions and designated non-financial businesses and professions; and
- Ensure that comprehensive and effective mechanisms are in place to for international cooperation.

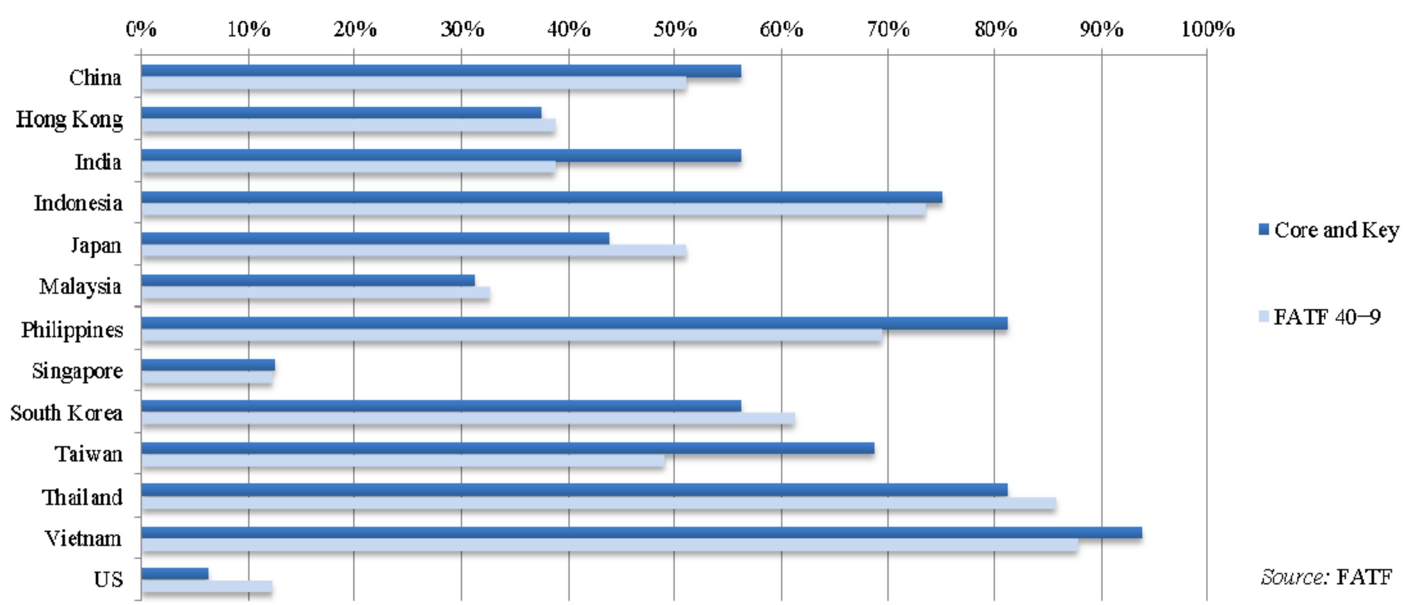
FATF currently has 36 members, including six Asian economies—Japan, Hong Kong, Singapore, China, India and Korea. A number of other Asian economies are monitored by FATF's International Cooperation Review Group.

Progress Toward FATF 40+9 Compliance

In recent years, Asian economies have made significant progress towards implementing the FATF 40+9 recommendations. The region has undertaken efforts to upgrade AML laws, establish FIUs, develop AML-CFT supervisory frameworks for financial institutions, and improve coordination between financial regulatory authorities and law-enforcement agencies. Through a web of bilateral memoranda, the region has improved its capacity to participate in international cooperation.[7]

To assess the level of compliance with its recommendations, FATF conducts peer reviews of members' and monitored economies' legal and regulatory systems on an ongoing basis to determine how well they conform to FATF standards and how well these standards are implemented. Based on these evaluations, FATF issues a rating to indicate the level of compliance. Each FATF 40+9 recommendation is rated on a four point scale: compliant (C), largely compliant (LC), partially compliant (PC), and non-compliant (NC).[8]

Figure 1: Percentage of Recommendations Rated Partially and Non-Compliant



Source: FATF

FATF has identified six core[9] and ten key[10] recommendations which are used to determine whether an economy should be required to submit a follow-up report on progress made in addressing any issues identified during FATF's review, or whether an economy should be deemed a "high-risk" jurisdiction. An analysis of the sixteen of core and key recommendations for the most economically significant Asian economies reveals a wide variance of compliance. In Singapore, for example, only 13% of core and key recommendations were rated PC or NC; however, in Vietnam 94% were thus rated. (*See Figure 1*). Four economies—Vietnam, Thailand, the Philippines and Indonesia—had 75% or more of core and key recommendations rated PC or NC. All four countries are listed on FATF's watchlist of high-risk jurisdictions.

Focusing on specific core and key recommendations, Asian economies have made substantial progress on updating secrecy laws (Core Recommendation 4), maintaining records (Core Recommendation 10), establishing financial intelligence units (Key Recommendation 26) and providing mutual legal assistance and other forms of cooperation (Key Recommendations 36 and 40). (*See Figure 2.)*

However, there are a number of areas of particular concern. For five of the sixteen core and key recommendations on money laundering, over two-thirds of the economies reviewed were rated PC or NC. In addition, over half of them were rated PC or NC for all five of the core and key special recommendations related to the financing of terrorism (i.e., Core and Key Recommendations I-V).

Core Recommendation 1

Three quarters of the jurisdictions reviewed were rated PC or NC for Core Recommendation 1, which stipulates that money laundering be criminalized according to international conventions and that money laundering laws apply to a wide range of predicated offenses. While most Asian economies criminalize money laundering, laws generally focus on drug trafficking and related crimes, falling short of the recommendation to include the widest range of possible offenses, such as: participation in an organized criminal group and racketeering; terrorism; human trafficking; corruption and bribery; smuggling; and insider trading and market manipulation.

Core Recommendation 5

The lowest overall level of compliance is for Core Recommendation 5, which establishes customer due diligence and record keeping standards; over 80% of the economies reviewed were rated PC or NC. While most have adopted customer due diligence standards, they often do not cover beneficial ownership, politically exposed persons, or correspondent banking relationships.

Core Recommendation 13

Core Recommendation 13 requires adequate monitoring of unusual and suspicious transactions. Financial institutions must file suspicious transaction reports to FIUs, which then submit that information to law enforcement agencies. Three-quarters of the economies reviewed were rated PC or NC for this recommendation. In many instances, there is a lack of a defined basis to recognize a transaction as suspicious, and FIU responsibilities are often not clear. Moreover, some fail to provide adequate resources to FIUs and regulatory authorities to supervise financial and other institutions for AML/CFT purposes.

Key Recommendation 23

Over two-thirds of the jurisdictions reviewed were rated PC or NC for Key Recommendation 23, which the adoption of measures to ensure the adequate licensing and supervision of financial institutions and businesses providing money or value transfer services. All financial institutions should be regulated and subject to supervision or oversight with regard to the risk of money laundering and terrorist financing. Designated non-financial high-risk businesses and professions should have effective systems to monitor and ensure compliance. However, most economies' AML laws focus solely on financial institutions, thereby leaving a major loophole that would effectively permit other types of entities or persons (*e.g.*, alternative remittance systems; businesses; shell companies; trusts; real estate agencies; car dealers; jewelers; casinos; and professionals such as accountants, financial advisers and lawyers) to continue money laundering activities.[11]

Key Recommendation 35

FATF recommends that countries become party to and implement fully the Vienna Convention, the Palermo Convention, and the 1999 United Nations International Convention for the Suppression of the Financing of Terrorism. Three-quarters of the countries reviewed were rated PC or NC for ratifying the recommended international money laundering conventions. Only Hong Kong, Malaysia and Singapore were deemed largely compliant with this recommendation. While most of the economies reviewed (with the notable exceptions of Japan, Korea, Thailand, Taiwan and Vietnam) have adopted international conventions, implementation still lags.

Key and Core Special Recommendations I-V

Overall compliance with AML Recommendations was better than with CFT Recommendations. Only Singapore was fully or largely compliant with all five key and core special recommendations. Indonesia, Taiwan, Thailand and Vietnam were non-compliant or partially compliant with all five special recommendations. Part of the reason for this disparity is that the Special Recommendations are relatively new, and national authorities are still in the early stages of implementing them. A 2005 IMF study on AML/CFT regimes concluded that recommendations that have been in place longer typically have higher compliance ratings.[12] Thus, Asian economies' overall compliance with the special recommendations will likely increase as they are allowed more time to implement them.

Figure 2: FATF Mutual Evaluation Ratings

	Legal System		Preventative Measures					Institutional & Other Measures	International Cooperation			Nine Special Recommendations (SR)				
	Money Laundering Offense	Confiscation & Provisional Measures	Secrecy Laws	Customer Due Diligence	Record Keeping	Suspicious Transaction Reporting	Regulation, Supervision & Monitoring	The FIU	Conventions	Mutual Legal Assistance	Other Forms of Cooperation	Implement UN Instruments	Criminalize Terrorist Financing	Freeze & Confiscate Terrorist Assets	Suspicious Transaction Reporting	International Co-operation
Recommendation	**1**	**3**	**4**	**5**	**10**	**13**	**23**	**26**	**35**	**36**	**40**	**SRI**	**SRII**	**SRIII**	**SRIV**	**SRV**
China	PC	LC	FC	PC	LC	PC	PC	LC	PC	FC	LC	PC	PC	NC	NC	LC
Hong Kong	LC	PC	FC	PC	PC	LC	LC	FC	LC	LC	FC	PC	PC	PC	LC	LC
India	PC	PC	FC	PC	LC	PC	PC	LC	PC	LC	LC	PC	PC	LC	PC	LC
Indonesia	PC	PC	LC	PC	LC	PC	PC	LC	PC	PC	LC	NC	PC	NC	PC	PC
Japan	LC	LC	FC	NC	LC	LC	LC	LC	PC	PC	LC	PC	PC	PC	LC	PC
Malaysia	PC	LC	PC	LC	FC	PC	LC	FC	LC	LC	PC	LC	LC	LC	PC	LC
Philippines	PC	PC	PC	PC	LC	PC	PC	PC	PC	LC	LC	NC	NC	PC	NC	PC
Singapore	PC	LC	FC	LC	LC	LC	NC	LC	LC	LC	FC	LC	LC	LC	FC	LC
South Korea	LC	PC	LC	PC	LC	PC	PC	LC	PC	LC	LC	PC	PC	PC	NC	LC
Taiwan	PC	LC	FC	PC	PC	PC	LC	FC	PC	LC	PC	NC	NC	NC	NC	NC
Thailand	PC	LC	FC	NC	PC	PC	PC	PC	PC	PC	LC	PC	PC	PC	PC	PC
Vietnam	PC	PC	LC	NC	PC	PC	PC	PC	PC	PC	PC	NC	NC	NC	NC	NC
US	LC	LC	FC	PC	LC	LC	LC	LC	LC	LC	FC	LC	FC	LC	LC	LC
Percentage Partially or Non-Compliant	**75%**	**50%**	**17%**	**83%**	**33%**	**75%**	**67%**	**25%**	**75%**	**33%**	**25%**	**83%**	**83%**	**75%**	**75%**	**50%**

Core recommendations Key recommendations FC = Fully Compliant; LC = Largely Compliant; PC = Partially Compliant; NC = Non-Compliant *Source: FATF*

Implementation Challenges

In addition to specific FATF 40+9 weaknesses already noted, the region shares several common implementation issues that cut across the economies. Continued challenges include a lack of enforcement, capacity constraints, and the need for coordination across jurisdictions.

A significant problem is a lack of enforcement. AML/CFT laws are a necessary but insufficient condition for the establishment of a truly effective AML regime. In some jurisdictions, the enforcement of AML/CFT legal measures is often inconsistent. Despite robust laws that criminalize money laundering and terrorist financing activities and empower authorities to confiscate assets, prosecutions and convictions have been few, and the rate of confiscation is low. (*See Figure 3*). Prosecutions tend to stop at the predicate offense level without further investigation or identification of any money laundering offenses. Furthermore, in those jurisdictions where regulators have taken public enforcement action in recent years, the penalties applied have been relatively small by U.S. standards. For example, while regulators in China have fined a relatively large number of financial institutions for suspicious transaction reporting deficiencies, a survey indicated that the size of the fines imposed has been less than USD 100,000 in each instance.[13]

Figure 3: Estimated Prosecutions and Convictions over One-Year Period

	Prosecutions	Convictions
China	NA	11456
Hong Kong	297	211
India	6	0
Indonesia	NA	5
Japan	191	NA
Malaysia	18	3
Philippines	50	1
Singapore	14	18
South Korea	NA	NA
Taiwan	27	11
Thailand	2	1
Vietnam	NA	0

Based on annualized data from U.S. Department of State *2012 International Narcotics Control Strategy Report Volume II: Money Laundering and Financial Crimes.*

Institutional capacity in AML agencies to effectively implement AML laws is equally as important as enforcement. However, in many Asian economies this remains inadequate. Lack of skills, training, and resources often hinders the capacity to establish and maintain FIUs and prevents competent supervisory authorities from conducting adequate oversight of AML/CFT matters. The challenge is compounded by the complexities of FATF requirements, particularly in the areas where economies are required to apply qualitative judgment, such as in the application of the risk-based approach and the analysis of suspicious or unusual transactions.[14]

Because of the fluid nature of money laundering and terrorist financing, international cooperation is imperative for the global AML/CFT regime to be fully effective. However, coordination across Asian economies is a challenge due in part to institutional traditions. Relationships between economies in the region, such through as the Association of Southeast Asian Nations (ASEAN), are based on mutual noninterference in one other's domestic affairs. This approach can render international cooperation and mutual assistance arrangements in the region more challenging and time consuming.

Conclusion

Non-compliance with FATF recommendations means heightened risk for an economy's financial systems, reputation, and its interests in dealing with other economies.[15] Recognizing this risk, most Asian economies have made considerable progress over the past few years in meeting FATF standards. Currently, many have the necessary regulations and infrastructure in place to achieve these standards. Nonetheless, significant weaknesses remain. In addition to not meeting certain core and key FATF recommendations, some economies in the region have not been able to fully implement existing laws and regulations. However, difficulties achieving full implementation are certainly not limited to Asia; creating robust AML/CFT regimes remain a challenge throughout much of the world. An IMF study of global FATF 40+9 found that compliance generally remains low, not just in Asia[16]. Further, AML/CFT development takes time and that most Asian economies are moving in the right direction.

Endnotes:

[1] International Monetary Fund. "Conception, Compliance with the AML/CFT International Standard: Lessons from a Cross-Country Analysis," by Vergugo Yepes. IMF Working Paper WP/11/177. July 2011.

[2] International Centre for Criminal Law Reform and Criminal Justice Policy. "Money Laundering in the Asia Pacific—Working Paper No. 1: Regional Challenges and Opportunities for International Cooperation," by Alan Castle. January 1999.

[3] The most well know alternative remittance systems are the *hawala* or *hundi* system in South Asia and the Chinese *chiti/chop shop* system.

[4] Interpol. "Alternative remittance systems distinguishing sub-systems of ethnic money laundering in Interpol member economies on the Asian continent," by Lisa C. Carroll. December 5, 2005.

[5] Asian Development Bank. "Enhancing the Asian Development Bank's Role in Combating Money Laundering and the Financing of Terrorism." March 2003.

[6] Federal Reserve Bank of San Francisco. "Asia Focus: Anti-Money Laundering Reforms and Trends in Asia," by Birgit Baxendale. July 2007.

[7] World Bank. "East Asian Finance: The Road to Robust Markets," by Swati R. Ghosh. 2006.

[8] The scores reflect the levels of compliance at the time these economies are assessed and do not take into account any progress made in addressing the deficiencies since then.

[9] FATF determines an economy to have significant AML deficiencies if any of the core recommendations (*i.e.*, recommendations are 1, 5, 10, 13, SRII and SRIV) are rated PC or NC.

[10] For FATF to remove an economy from the regular follow-up process, it has to be rated C or LC in the above mentioned core recommendations and the following key recommendations: 3, 4, 23, 26, 35, 36, 40, SRI, SRIII and SRV.

[11] Although not considered Core or Key Recommendations, for Recommendations 12, 16 and 24 pertaining to the application of AML/CFT to designated non-financial businesses and persons, all economies were rated PC or NC for all three recommendations with the single exception of Singapore's LC rating for Recommendation 24. Many non-financial institutions in Asia are not subject to the due diligence and record-keeping requirements that apply to financial institutions. Some economies provide for specific requirements for real estate agents, lawyers, accountants and casinos while other economies do not define the non-financial institutions covered by the law or limit applicability to financial intermediaries such as banks, security brokers and insurance companies. When laws do not clearly cover both financial institutions and the full range of non-financial entities, a number of professionals and institutions that frequently handle large cash transactions are unregulated, thereby increasing the likelihood of money laundering activities.

[12] International Monetary Fund and World Bank. "Anti-Money Laundering and Combating of Financing of Terrorism: Observations from the Work Program and Implications Going Forward (Supplemental Information)," pp. 5-11. August 31, 2005.

[13] KPMG International. "Regional Commentaries: Asia Pacific, Global Anti-Money Laundering Survey 2011," by Gary Gill and Jeremy Allan. 2011.

[14] "Implementation of the FATF 40+9 Recommendations: A perspective from developing economies," by Neil Jensen and Cheong-Ann Png. *Journal of Money Laundering Control*, Vol. 14 Iss: 2, pp.110 – 120. 2011.

[15] "Money laundering and FATF compliance by the international community," by Ali Alkaabi, George Mohay, Adrian McCullagh, and Alan N. Chantler. *IFIP Advances in Information and Communication Technology*. September 20-23, 2010. Brisbane, Australia.

[16] International Monetary Fund. "Conception, Compliance with the AML/CFT International Standard: Lessons from a Cross-Country Analysis," by Vergugo Yepes. IMF Working Paper WP/11/177. July 2011.

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