

Still a long way to go for China in relation to Anti Money Laundering

As China's market opens up and trade becomes ever more globalised, the flow of funds between organisations has become increasingly complex and difficult to monitor. This presents significant opportunities to money launderers, those organisations and individuals that manage the flow of funds from illegitimate sources through to the legitimate economy. It is estimated that up to 10% of money in circulation globally has its origins in crime, and 2-5% of world GDP can be attributed to this kind of illegal activity, making money laundering the world's 3rd largest business after oil and foreign exchange. China is currently particularly vulnerable due to her rapid expansion, as the development of robust systems of risk management and control lags behind the effervescent and rapidly expanding economy.

China has proved that its legislation meets the required standards to warrant admission to membership of the Financial Action Task Force in June last year, but developing appropriate legislation is only the first step in controlling the expanding money laundering industry. Further to this, the Chinese government needs to enforce compliance with the requirements, as well as develop appropriate systems for monitoring and preventative penalties for violation. Meanwhile, it is the responsibility of the institutions concerned to make sure that they fully understand the requirements of the law, and have implemented appropriate systems to comply. Furthermore, the FATF made a number of key recommendations to the Chinese legislators in its 2007 report, which are likely to eventually be enshrined in law. Forward looking organisations should also develop their AML processes in order to be compliant not only with the current law, but with global best practice and likely future regulations. While the scope of this article does not allow an in depth analysis, it focuses on two key areas where significant areas of weakness were identified, and highlights the key issues that were encountered.

Customer due diligence is a key part of developing a robust anti money laundering system. This involves the concept of "knowing your customer", ensuring that the customer is appropriately identified with original documentation and that the institution has an understanding of the nature of business for corporate customers. Nearly 50% of violations of the money laundering law documented in the FATF report were in relation to failure to meet customer due diligence requirements. Although the seriousness of each of these violations was not disclosed, these figures reveal that financial institutions have significant failings in this area. Many readers can no doubt associate with the weaknesses in these areas through their own personal experience of dealing with financial institutions. The FATF also recommended some specific areas of best practice, in order to fully comply with their requirements. Examples of these include appropriate identification of legal persons (directors etc) of companies, a requirement that customer due diligence should be ongoing and risk based and enhanced for politically exposed persons, and that a threshold should be set for additional CDD in relation to occasional / one off transactions. Furthermore, a specific recommendation was made that any failure to meet CDD requirements should be reported as a suspicious transaction to the appropriate authorities.

Another area which is fundamental to the overall anti money laundering strategy is reporting and investigation of suspicious and unusual transactions. Although Financial institutions are required to do this by law in China, the FATF have highlighted some basic barriers to the effectiveness of this. Over 8 million Suspicious transaction reports were made between 2004 – 2007. In the UK, the

PricewaterhouseCoopers Anti Money Laundering Survey in contrast reports a low level of suspicious transaction reporting, with a lion's share of institutions reporting less than 6 per year. The lack of discretion in reporting highlights a key problem in the effectiveness of suspicious transaction reporting in China. It is so prescriptive that it is seen as process rather than judgement. This can thus mask real failures in internal control such as inadequate training in AML techniques, and can waste vital resource that could be spent identifying more pressing issues.

Further to these specific areas, over 25% of failures of the law identified in the report relate to inappropriate keeping of records, and 12% of violations related to failure to meet appropriate standards of internal control, mainly in relation to inadequate experience of obligations and poor training. Additionally, the law has not yet been expanded to include specific requirements for non financial institutions.

Whilst China has clearly recognises the importance of implementing a strategy against money laundering, and has taken the first steps in putting this in place, it is evident that the long march has only just begun, and there is still a long way to go. As the law develops and the regulatory system becomes clearer, better resourced and more effective, it is essential that relevant institutions maintain a watchful eye over their compliance requirements, learn from experience elsewhere, and prioritise the realisation of the anti money laundering strategy.