

12. FINANCIAL INTELLIGENCE UNIT

The Financial Intelligence Unit (FIU) established in terms of the provision of the Financial Transactions Reporting Act No 6. of 2006 (FTRA) has been operating in CBSL since 2007. The key functions of FIU include collection and receipt of information on financial transactions for the purpose of detecting possible links to money laundering (ML), terrorist financing (TF) and other unlawful activities defined in the FTRA, investigations into suspicious financial transactions relating to the above unlawful activities and dissemination of information and details of such investigations to relevant law enforcement and/or regulatory authorities for appropriate actions and conduct of examination of reporting institutions. The highlights of key functions and other activities of FIU during 2013 as stipulated in the FTRA were as follows.

12.1 Collection of Information, Investigation and Dissemination

As per the current procedure, licensed commercial banks (LCBs), licensed specialised banks (LSBs), licensed finance companies (LFCs), stock brokering firms and insurance companies (ICs) continue to report to FIU on cash transactions and electronic fund transfers (both local and foreign) of Rs.1.0 million and above or its equivalent in foreign currencies through FIU's online database management system, "LankaFIN". The Authorised Money Changers (AMCs), who were designated as reporting institutions since January 2013, reported their transactions through the Controller of Exchange being the regulator of the AMC. Accordingly, over Rs. 3.8 million of cash/fund transfers and 498 suspicious transactions (STRs) were reported during the year 2013. After conducting preliminary investigations, 73 STRs were referred to the law enforcement and regulatory authorities for further investigation. Based on the investigations conducted by Criminal Investigations Department (CID), the Attorney General's Department (AGD) has so far filed seven indictments against money laundering and three indictments against terrorist financing as at end of 2013.

12.2 Examinations of Reporting Institutions

During the year 2013, FIU conducted twenty six examinations on reporting institutions to assess their exposure to risk of ML and TF and non-compliances with the provision of FTRA and other rules and directions issued by FIU. As a result, Rs. 2.9 million worth of penalties were imposed on six financial institutions with regard to non-compliance detected.

12.3 Other Activities

(a) Signing of Memoranda of Understanding

As a mechanism to facilitate sharing of information and intelligence for the purpose of investigation and prosecution of suspicious transactions in

terms of provisions of the FTRA, FIU signed four Memoranda of Understanding (MOUs) with Japan Financial Intelligence Centre (JAFIC), Lebanon Special Investigations Commission (LSIC) and the Financial Intelligence Units of Costa Rica and Denmark during the year. Accordingly, the total number of such MOUs signed increased to 24 as at end of 2013.

(b) Improvements in the Regulatory Framework

With the view to further strengthening the regulatory framework in line with the changes in international standards and best practices on Anti-Money Laundering (AML) and Countering the Financing of Terrorism (CFT), with the consultation of the legal review committee of FIU, several amendments were made to the Convention on the Suppression of Terrorist Financing Act, No. 25 of 2005, particularly to include the definition of "terrorist" and "terrorist act". Further, FIU issued Know-Your-Customer and Customer Due Diligence Rules to Authorised Money Changers in terms of FTRA.

(c) Institutional Capacity Building and Awareness Programmes

In continued efforts to enhance the awareness on detecting, analysing and reporting of money laundering and terrorist financing transactions, 36 awareness/training programmes were conducted during the year, accommodating 2,540 participants from licensed banks and finance companies, Sri Lanka Police, educational and public institutions. Four such programmes were conducted with the assistance from the AUSTRAC, the Australian FIU. Further, FIU conducted a special programme for Honourable Judges of the High Courts in collaboration with the High Court Judges' Association.

(d) International Relations

(i) **Egmont Group** : FIU obtained assistance from members of the Egmont Group, the Association of FIUs consisting of 132 member FIUs (as at 31 December 2013), to carry out investigations and collaborated with member FIUs for gathering evidence on their investigations.

(ii) **Asia Pacific Group on Money Laundering:**

As a founder member of Asia Pacific Group on Money Laundering (APG), Sri Lanka attended its 16th Annual Meeting held in China in July 2013 and the 16th Annual Typologies and Capacity Building Workshop held in Mongolia in September 2013 focusing on ML/TF vulnerabilities in the Non Profit Organisations (NPOs) sector and virtual currencies. During the annual meeting held in July 2013, Sri Lanka was endorsed as the rotating co-chair of the APG for 2016/2018

period and elected to host an annual meeting in 2017. This will be a significant event to showcase the Sri Lankan framework for AML and CFT, largely compliant with global standards in order to promote international investor confidence.

13. FINANCIAL STABILITY STUDIES

Maintaining financial system stability is one of the two core objectives of CBSL as per the Monetary Law Act. The Financial Stability Studies Department (FSSD) facilitates this objective by conducting relevant research and surveillance functions.

The main functions of the FSSD include conduct of research in the financial system stability area, assess risks and vulnerabilities in the financial system through a macro-prudential surveillance framework, propose appropriate policy measures based on such research and surveillance and conduct awareness in respect of financial system stability among policy makers as well as stakeholders.

13.1 Activities during the year

(a) Research

Five research studies were carried out during 2013. These studies include Exposure of the Banking and Non-banking sectors to gold price risk, Development of corporate debt market in Sri Lanka: Comparison with markets in the region, Impact of macroeconomic variables on NPLs of banks, Analytical framework on assessing systemic financial market infrastructure and Mortgage finance and consumer credit: Implications on financial stability.

(b) Macro-Prudential Surveillance

Under Macro-prudential surveillance, the following tasks were carried out.

- (i) Compilation of Financial Soundness Indicators for the banking, non-bank, financial markets and corporate sectors on a periodic basis to monitor the health of key financial and non-bank financial institutions.
- (ii) Submission of Financial Sector Risk Assessment Reports highlighting developments, risks and vulnerabilities in all relevant sectors to the Financial System Stability Committee, (FSSC) regularly.
- (iii) Submission of three board papers to the Monetary Board. These include risk exposure of banks and finance and leasing companies to fluctuations in gold prices and the impact of the recent gold price decline, financial system stability indicator (FSSI) and proposals made by the Financial System Stability Consultative Committee.
- (iv) Conducting of Stress Tests using sensitivity analysis for credit risk, market risk and liquidity risk

shocks to the banking sector on a quarterly basis.

- (v) Conducting of Macro stress tests using a credit risk model with panel data for individual banks on a quarterly basis.
- (vi) Compilation of stress testing thresholds on a quarterly basis to identify the threshold levels relevant to each risk; i.e. the level of shock, which triggers one more bank to go below the required level of CAR.
- (vii) Updating the Banking Soundness Index (BSI) on a quarterly basis.
- (viii) Updating the Financial Market Stability Indicator (FMSI) to assess the stability in the money and bond, equity and forex markets on a monthly basis.
- (ix) Updating the Macroeconomic Stability Indicator (MSI) to assess the stability in macroeconomic sectors such as fiscal, real, monetary and external sectors as well as the global environment on a quarterly basis.
- (x) Updating the Financial Systems Stability Indicator (FSSI), which is the composite indicator compiled using BSI, FMSI and MSI indicators to provide an overall picture of financial stability in the country, on a quarterly basis.
- (xi) Updating the Corporate Sector Creditworthiness Indicator, which analyses the creditworthiness of the corporate sector in Sri Lanka by assessing the probability of default of companies listed on the Colombo Stock Exchange on a quarterly basis.

(c) Publications

The annual Financial System Stability Review (FSSR) 2012 was published in April 2013. The FSSD also coordinated the preparation of the chapter on 'Financial Sector Performance and System Stability' in the Annual Report 2012 and chapter on 'Financial Sector Developments and Stability' in the Recent Economic Developments 2013.

(d) Coordination of the Committees on Financial System Stability

FSSD continued to serve as the secretariat for the two financial stability committees, namely, Financial System Stability Committee (FSSC), the internal committee and the Financial System Stability Consultative Committee (FSSCC) consisting of persons from the private sector.

13.2 Contribution

(a) Facilitating Financial Sector Risk Mitigation

- (i) Considering inconsistencies in property valuation, especially those used for financial reporting,