REVIEW OF COMPLIANCE WITH INTERNATIONAL RECOMMENDATIONS ON ANTI-MONEY LAUNDERING AND COUNTERING THE FINANCING OF TERRORISM IN SRI LANKA

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The Financial Action Task Force (FATF) promulgates forty recommendations on anti-money laundering and countering the financing of terrorism (AML/CFT) as soft laws. To align with international recommendations, it is essential to examine how the financial sector and designated non-financial sector comply with these recommendations, as these will determine the overall compliance of a country. Public criminal labelling, which is based on the premises of the Labelling Theory has been implicitly accepted as a form of punishment, although it was not a part of the substantive law. It claims that less powerful individuals are more likely to be labelled for their deviance (primary deviance), and once labelled, it is more likely to cause further deviance (secondary deviance). The concept of labelling has been applied as a method of law enforcement, but little attention has been paid to understanding how the theory can be implemented on legal persons, creating a research gap. The Financial Intelligence Unit of Sri Lanka (FIU) has imposed penalties and other administrative actions on financial institutions and publicly named and shamed the concerned financial institutions through the official webpage. This research paper followed content analysis, and accordingly, administrative penalties imposed by the FIU from 2019 to 2024 have been examined. If labelling is considered as a method of correction, then, the punishment needs to be proportionate and also adhere to the principles of natural justice. Raising suspicious transaction reports and complying with UNSCRs are the core principles of the AML/CFT framework, as they facilitate the identification of offences related to money laundering and terrorism financing. If the AML/CFT framework is not robust enough to identify suspicious activities, having such a system is questionable, as it does not fulfil the objectives of the FIU. The findings of this research have significant implications as this study advances the application of Labelling Theory to legal persons to fill the highlighted research gap and also to ascertain whether it is justifiable to label a legal person for their procedural non-compliances.

Keywords: Financial Action Task Force, terror finance, money laundering, Labelling Theory

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Introduction

The Financial Action Task Force (FATF) promulgates forty recommendations on anti-money laundering and countering the financing of terrorism (AML/CFT) as soft laws. Although these recommendations were introduced as soft laws, it has become necessary to comply with them to avoid the country being classified as a high-risk jurisdiction for money laundering and terrorist financing, which could lead to economic sanctions. To be in line with the international recommendations, it is therefore a must to examine how the financial sector and the designated non-financial sector comply with the said recommendations, as it will determine the overall compliance of a country. Public criminal labelling has been implicitly accepted as a form of punishment, although it was not a part of the substantive law (Hadjimatheou, 2016). It claims that less powerful individuals are more likely to be labelled for their deviance (primary deviance), and once labelled, it is more likely to cause further deviance (secondary deviance) (Aleksandra, 2016). If labelling is considered as a method of correction, then, the punishment needs to be proportionate and also adhere to the principles of natural justice (Greer & Reiner, 2013). The concept of labelling (Becker, 1963) has been applied as a method of law enforcement, but little attention has been paid to understanding how the theory can be implemented on legal persons, creating a research gap. The Financial Intelligence Unit of Sri Lanka (FIU) has imposed penalties and other administrative actions on financial institutions and publicly named and shamed the concerned financial institution through the official webpage. However, there was no assessment done to evaluate whether labelling financial institutions is a successful method of law enforcement for legal persons. Beyond intellectual curiosity, the above observations led me to pose the question: To what extent can the regulators apply labelling as a method of law enforcement on legal persons? By doing so, this research evaluates whether the FIU was able to fulfil the objectives of the FATF.

Methodology

The methods and techniques were designed to review the non-compliances with the provisions of the Financial Transactions Reporting Act, No. 6 of 2006 (FTRA) and the penalties given. For this purpose, adaptive theory was used to connote the theory-data relationship, which allows for reframing the research questions with the progression of data collection. Data has been collected from 2019 to 2024 from press releases/notices issued by the FIU under the headings of ‘administrative penalties imposed by the Financial Intelligence Unit on Reporting Institutions …’.

For the said period, the FIU has imposed penalties on 43 occasions (FIU, n.d.). To conduct content analysis, data were extracted and tabulated under the primary categories of penalized reporting institutions, the penalty amount, and the reasons for the penalty.

Results and Discussion

This research is centered on understanding where the premises of Labelling Theory can be applied to legal persons and to what extent. To answer the said questions, the findings of the non-compliances and the given penalties are tabulated as follows:

(a) Reporting Institutions

Labelling a deviant can be done in two ways: formally and informally. Formal labelling comes as a byproduct of a punishment (Becker, 1963), while in informal labelling, society labels the deviant person. Graph 1 denotes that FIU imposed penalties on licensed banks and licensed finance companies, followed by publishing the details of the penalty. Data reveals that penalties were imposed on the reporting institutions for their non-compliance (primary deviance) and in some reporting institutions, penalties were imposed several times for their secondary deviance. This scenario is different when compared to natural persons. In a natural person, both formal and informal labelling can be done and for legal persons, the labelling is limited only to formal labelling. Further, in legal persons, it cannot be established that primary deviance led to secondary deviance.

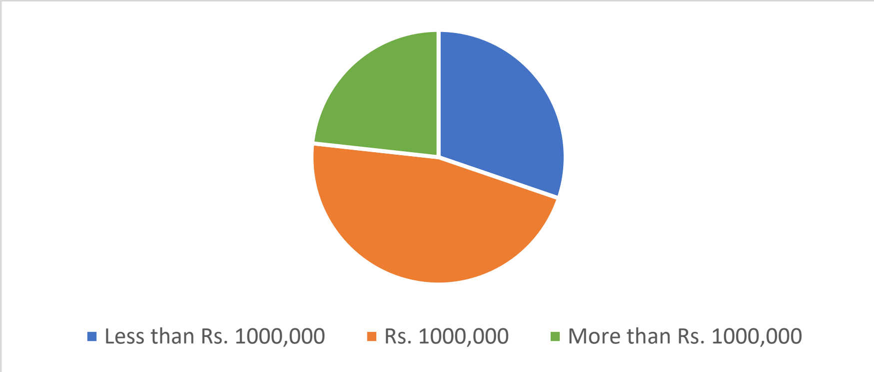
Graph 1: Penalties imposed on reporting institutions

Source: Press releases/notices issued by the Financial Intelligence Unit of the Central Bank of Sri Lanka

(b) The amount of the penalty

As per the press releases, penalties were imposed based on the nature and gravity of the non-compliances. The details of the penalty are depicted in Graph 2. The amount of the penalty has varied from Rs. 300,000 to Rs. 7,000,000. With the provisions of the FTRA, it was observed that the maximum penalty of Rs. 1000,000 has been imposed most of the time. These penalties support the fact that the legal persons were subjected to formal labelling, as the name of the institution was published only after imposing the penalty.

Graph 2: The amount of the penalty

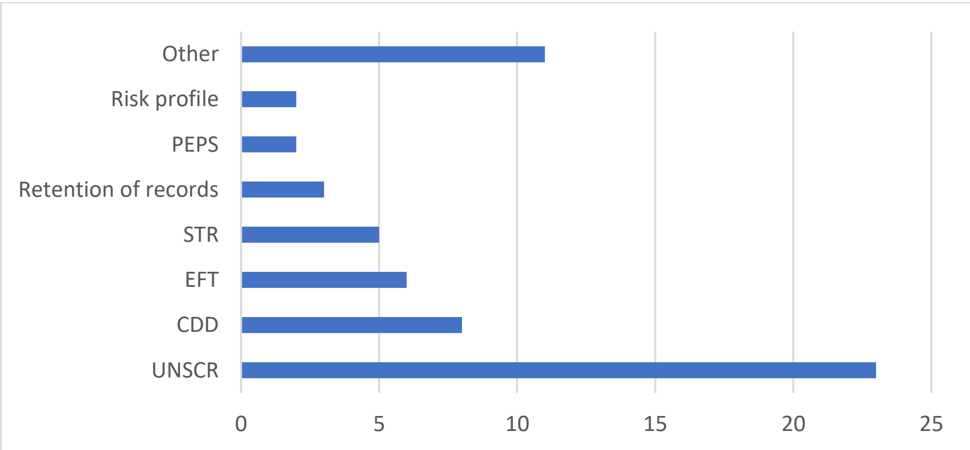


Source: Press releases/notices issued by the Financial Intelligence Unit of the Central Bank of Sri Lanka

(c) Reasons for the non-compliance

It claims that punishment needs to be proportionate and adhere to the principles of natural justice. The FIU has given reasons for their decisions and the reasons are categorized as in Graph 3.

Graph 3: Reasons for the decision



Source: Press releases/notices issued by the Financial Intelligence Unit of the Central Bank of Sri Lanka

As revealed in Graph 3, findings can be categorized as violations of the core principles of the AML/CFT and procedural non-compliances. Raising STRs and complying with UNSCRs are the core principles of the AML/CFT framework, as they facilitate the identification of offences related to money laundering and terrorism financing. The procedural non-compliances are failing to conduct customer due diligence, failing to retain records as stipulated by law, and failing to follow the procedure when dealing with politically exposed persons.

Conclusions and Recommendations

The FIU has implemented legal, regulatory, and operational measures to comply with AML/CFT by enacting laws, regulations, and rules. It has also made these legal provisions and operational measures effective by imposing penalties. The FIU has further used formal labelling as a method of law enforcement, even though there was no provision in the substantive law to label an institution. The research findings support the fact that the premises of Labelling Theory can be applied to legal persons, subject to limitations. As an example, Labelling Theory does not explain the secondary deviance of legal persons as in natural persons. Further, it claims that less powerful individuals are more likely to be labelled for their deviance; but, with the penalties imposed by the FIU, it was observed that the penalties were imposed on financial institutions without taking their financial capabilities into account.

If labelling is considered as a method of correction, then the punishment needs to be proportionate and also adhere to the principles of natural justice. The FIU has given reasons for the penalties and therefore it can be concluded that the FIU has adopted the principles of natural justice. However, it questions whether the punishments are proportionate. Punishments can be broadly categorized as violations of the core principles of the AML/CFT framework and procedural non-compliances. The research findings reveal that labelling has been imposed on each non-compliance. This research argues that it is not necessary to label an institution for procedural non-compliances, as they have a lesser degree of non-compliance when compared to non-compliance of core principles of the AML/CFT framework.

Raising STRs and complying with UNSCRs are the core principles of the AML/CFT framework, as they facilitate the identification of offences related to money laundering and terrorism financing. If the AML/CFT framework is not robust enough to identify suspicious activities that may violate the offence of money laundering and terrorism financing, having such a system is meaningless, as it does not fulfil the objectives of the FIU, which is based on the recommendations of the FATF. Therefore, the message given in the data has to be duly taken into consideration. Remedial actions can be taken to address procedural non-compliances, such as adhering to the customer due diligence rules, properly maintaining and retaining records.

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