

FATF



Anti-money laundering and
counter-terrorist financing
measures

People's Republic of China

1st Enhanced Follow-up Report &
Technical Compliance Re-Rating

Follow-up report



September 2020



The Financial Action Task Force (FATF) is an independent inter-governmental body that develops and promotes policies to protect the global financial system against money laundering, terrorist financing and the financing of proliferation of weapons of mass destruction. The FATF Recommendations are recognised as the global anti-money laundering (AML) and counter-terrorist financing (CTF) standard.

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PEOPLE'S REPUBLIC OF CHINA: 1ST ENHANCED FOLLOW-UP REPORT

1. INTRODUCTION

The mutual evaluation report (MER) of the People's Republic of China (China) was adopted in February 2019. This follow-up report analyses China's progress in addressing technical compliance deficiencies on R.26, 29 and 34 identified in China's MER. Re-ratings are given where sufficient progress has been made. This report also analyses China's progress in implementing new requirements relating to FATF Recommendations which have changed since the end of the on-site visit to China in July 2018: R.2 and R.15. This report does not address what progress China has made to improve its effectiveness. A later follow-up assessment will analyse progress on improving effectiveness which may result in re-ratings of Immediate Outcomes at that time.

2. FINDINGS OF THE MER

The MER rated China for technical compliance as follows:

Table 1. Technical compliance ratings, February 2019

R.1	R.2	R.3	R.4	R.5	R.6	R.7	R.8	R.9	R.10
LC	C	PC	C	LC	PC	NC	PC	C	LC
R.11	R.12	R.13	R.14	R.15	R.16	R.17	R.18	R.19	R.20
C	PC	LC	LC	PC	PC	LC	PC	C	LC
R.21	R.22	R.23	R.24	R.25	R.26	R.27	R.28	R.29	R.30
LC	NC	NC	NC	NC	PC	LC	NC	PC	C
R.31	R.32	R.33	R.34	R.35	R.36	R.37	R.38	R.39	R.40
C	LC	LC	PC	PC	LC	LC	PC	LC	LC

Note: There are four possible levels of technical compliance: compliant (C), largely compliant (LC), partially compliant (PC), and non-compliant (NC).

Source: China MER, February 2019: www.fatf-gafi.org/media/fatf/documents/reports/mer4/MER-China-2019.pdf.

Given these results and China's level of effectiveness, the FATF placed China in enhanced follow-up. The following experts assessed China's request for technical compliance re-rating:

- Ms. Lida Tsagaraki, Executive - AML Department, Ministry of Finance, Greece.
- Mr. Andy Watson, Senior Associate, Financial Crime Advisory and Transformation Department, United Kingdom.

Section 3 of this report summarises China's progress made in improving technical compliance. Section 4 sets out the conclusion and a table showing which Recommendations have been re-rated.

3. OVERVIEW OF PROGRESS TO IMPROVE TECHNICAL COMPLIANCE

This section summarises China's progress to improve its technical compliance by:

- a) Addressing some of the technical compliance deficiencies identified in the MER, and
- b) Implementing new requirements where the FATF Recommendations have changed since the on-site visit to China (R.2 and R.15).

3.1. Progress to address technical compliance deficiencies identified in the MER

China has made progress to address technical compliance deficiencies identified in the MER in relation to R.26 and 34, rated PC. Because of this progress, China has been re-rated on these Recommendations.

The FATF welcomes the progress achieved by China in order to improve its technical compliance with R.29. However, insufficient progress has been made to justify an upgrade of this Recommendation's rating.

Recommendation 26 (originally rated PC)

In its 4th round MER, R.26 was rated PC. The main technical deficiency was related to a scope issue as the online lending sector was not subject to the AML Law and this had an impact on the main aspects of R.26. In addition, there was a shortcoming in market entry requirements mostly relating to limited mandatory periods for criminal record searching.

China made significant progress in relation to the scope issue. China issued the Administrative Measures for Anti-Money Laundering and Combating the Financing of Terrorism of Internet Finance Institutions (FI) that make the online lending sector subject to AML/CFT requirements. The online lending sector is now supervised by the PBC in collaboration with the National Internet Finance Association (NIFA) of China and industry self-regulatory bodies for the fulfilment of its supervisory competencies. The frequency and intensity of supervisory measures are determined on the basis of the conclusions of the ML/TF risk assessments of each regulated FI. The online lending sector is required to conduct a ML/TF risk assessment (on a regular basis) that will feed into the risk classification and grading system. However, specific industry rules of internet finance institutions have not been formulated. This deficiency in addition to the one related to market entry requirements are considered to be minor shortcomings.

China has addressed most of the identified deficiencies and only minor deficiencies remain. On this basis, **R.26 is re-rated largely compliant**.

Recommendation 29 (originally rated PC)

R.29 was rated PC in China's 4th MER due to several shortcomings: China's FIU does not act as a national centre for the receipt and analysis of STRs and other information, and for the dissemination of the results of that analysis. In addition, CAMLMAC does not have the power to request from the reporting institutions any additional information as needed to perform its analysis properly. Furthermore, the FIU's work is limited in terms of operational and strategic analyses, with some specific shortcomings related to its operational independence and autonomy. Finally, China did not file an unconditional application for Egmont Group membership.

Since its MER, China has taken some steps to address the deficiencies identified in relation to R.29. China has launched the 2nd Generation AML Monitoring and Analysis System, a new platform for large value and suspicious transaction reports of obliged institutions accessible by CAMLMAC, the AMLB and PBC Branches. However, moderate deficiencies remain, such as the lack of FIU's power to request additional information as needed to perform its analysis, the need of a signature of the President of the Branch and an unconditional application for Egmont Group membership.

China's progress is noted; however, the rating for R. 29 remains partially compliant.

Recommendation 34 (originally rated PC)

R.34 was rated PC in China's 4th round MER, as guidance did not apply to online lending institutions and DNFBPs [aside from trust companies and dealers in precious metals (DPM)] to assist them in complying with AML/CFT obligations.

China has since made progress and competent authorities issued guidance to assist online lending institutions, real estate agents, dealers in precious metals and accountants in applying AML/CFT requirements. However, guidance for lawyers and notaries is outstanding.

China has made progress to address the above noted deficiency and the remaining deficiency related to the issuing guidance for lawyers and notaries is considered minor, taking into account the low weight given to lawyers and notaries in the MER.

On this basis, **R.34 is re-rated largely compliant.**

3.2. Progress on Recommendations which have changed since the adoption of the MER

Since China's 4th round ME on-site visit, the FATF has amended Recommendations 2 and 15. This section considers China's compliance with the new requirements and progress to address the technical compliance deficiencies identified in the MER in relation to R.2 and R.15.

China remains compliant with the revised R.2 and re-rated to largely compliant with the revised R.15.

Recommendation 2 (originally rated C)

In October 2018, R.2 was amended to require countries to have cooperation and coordination between relevant authorities to ensure compatibility of AML and counter-terrorist financing (AML/CFT) requirements with Data Protection and Privacy rules. The amended Recommendation further requires a domestic mechanism for exchange of information. In its 4th round MER, China was rated C with R.2.

China complies with the revised requirements of R.2. China's AML Joint Ministerial Conference (AMLJMC) counts 22 members including the Peoples' Bank of China (PBC), financial regulatory authorities, Law Enforcement Agencies (LEAs), judiciary, foreign affairs departments, and industry competent authorities. This mechanism allows co-operation, co-ordination and domestic exchange information concerning the development and implementation of AML/CFT policies and activities, at both policymaking and operational levels.

In addition, cooperation and coordination exist between the authorities in charge of the AML/CFT and those in charge of data protection. The Ministry of Public Security, responsible for data protection and privacy, is a member of the AMLJMC and ensures the compatibility of AML/CFT requirements with Data Protection and Privacy rules. In addition, the co-operation mechanisms concerning the development and implementation of AML/CFT policies and activities explicitly states the need to ensure compatibility with data protection and privacy.

The revised and new requirements of R.2 are met. R.2 remains rated compliant.

Recommendation 15 (originally rated PC)

In its 4th round MER, China was rated PC with R.15, based on the deficiency that there were no requirements on new technologies for payment institutions.

In October 2019, revisions were made to methodology for assessing R.15, to reflect amendments to the FATF Standards incorporating virtual assets (VA) and virtual asset service providers (VASP). These new requirements include: requirements on identifying, assessing and understanding ML/TF risk associated with VA activities or operations of VASPs; requirements for VASPs to be licensed or registered; requirements for countries to apply adequate risk-based AML/CFT supervision (including sanctions) to VASPs and that such supervision should be conducted by a competent authority; as well as requirements to apply measures related to preventive measures and international cooperation to VASPs.

Several new criteria of R.15 are not applicable to China and therefore not assessed, as China has decided to prohibit virtual assets activities. China has taken steps to address the remaining new criteria of R.15, through the following actions, although minor deficiencies remain:

The Anti-Money Laundering Bureau of the People's Bank of China's Guidelines for the Management of Money Laundering and Terrorist Financing Risks of Financial Institutions, issued in 2018, requires payment institutions (PIs) to identify and assess ML/TF/Proliferation risks that may arise in relation to the development of new products, or in relation to the application of new technologies on existing products. However, it does not explicitly require PIs to assess new technologies in the development of new-products, although a risk assessment is needed on new products.

Consequently, there is also no specific requirement for PIs to take measures to manage and mitigate these risks.

China identified and assessed the ML/TF risks emerging from virtual asset activities in the report Money Laundering and Terrorist Financing Risk Assessment Report on Virtual Currencies, issued in 2017. The same year, China prohibited the use of VA and VASPs in its jurisdiction and the provision of services for virtual currency transactions by FIs and PIs. China has further taken effective measures to prevent payment channels from being used for VA transactions. Chinese law sanctions Initial Coin Offerings (ICO) financing activities. In application of that policy, China has taken steps to identify and sanction natural or legal persons carrying out VASP activities. In 2017, the National Internet Finance Association of China (NIFAC) created the Virtual Currencies Identifying System (VCIS), which has submitted 14 reports on ICO and Token Business Monitoring to the PBC up to now. In addition, the FIU has received 14,533 STRs allegedly related to VA activities. These reports only led to a small number of referrals to law enforcement, even though evidence has been provided of efforts to enforce the prohibition against natural or legal persons carrying VASP activities. From 2018, 88 domestic virtual assets trading platforms and 85 ICO platforms were identified, punished and forced to shut-down. China provided a case study of a prosecution for financial fraud linked to a virtual asset services provider, which represented cooperation between the PBC and local police leading to four individuals being sentenced both to prison sentences and fines.

China relies on the existing forms of co-operation to provide international co-operation in relation to money laundering, predicate offences, and terrorist financing relating to virtual assets. Therefore, deficiencies highlighted in China MER regarding its international co-operation system also apply to virtual assets matters.¹ However, there are no specific examples of any co-operation 'rapidly' put in place in respect of virtual assets.

On this basis, R.15 is re-rated to largely compliant.

3.3. Overview of other Recommendations rated NC/PC

China reported progress on several other Recommendations rated NC/PC. On R.6 and R.7, the Ministry of Foreign Affairs (MFA) amended its procedures in September 2019 to ensure the implementation of the UNSCRs without delay. On R.8, the competent authorities have started to reassess the TF risk of all types of NPOs and developed an action plan to conduct outreach and enhance training of NPOs to raise awareness of the risk of TF abuse of NPOs. On R.18, the PBC issued Guidelines for the Management of Money Laundering and Terrorist Financing Risks of Financial Institutions that included a requirement to address the deficiencies related to internal control and training. On R.28, PBC issued a Notice on Strengthening the Anti-Money Laundering Supervision Work on Designated Non-Financial Businesses and Professions requiring all DNFBPs to implement AML/CFT obligations since July 2018. On R.35, a new Benchmark of AML/CFT Sanctions was implemented in 2019. On R.38, a new MLA Law was issued to address relevant deficiencies.

¹ In its MER, China was rated largely compliant for R.37, R.39 and R.40 and partially compliant for R.38.

4. CONCLUSION

Overall, China has made progress in addressing the technical compliance deficiencies identified in its MER, sufficient to justify upgrading three Recommendations: R.15, R.26 and R.34.

R.2 remains compliant given the mechanisms in place to ensure the compatibility of AML/CFT requirements with rules on data protection and confidentiality and to promote the exchange of information among competent authorities.

In light of China's progress since the adoption of its MER, its technical compliance with the FATF Recommendations has been re-rated as follows:

Table 2. Technical compliance with re-ratings, October 2020

R.1	R.2	R.3	R.4	R.5	R.6	R.7	R.8	R.9	R.10
LC	C	PC	C	LC	PC	NC	PC	C	LC
R.11	R.12	R.13	R.14	R.15	R.16	R.17	R.18	R.19	R.20
C	PC	LC	LC	LC	PC	LC	PC	C	LC
R.21	R.22	R.23	R.24	R.25	R.26	R.27	R.28	R.29	R.30
LC	NC	NC	NC	NC	LC	LC	NC	PC	C
R.31	R.32	R.33	R.34	R.35	R.36	R.37	R.38	R.39	R.40
C	LC	LC	LC	PC	LC	LC	PC	LC	LC

Note: There are four possible levels of technical compliance: compliant (C), largely compliant (LC), partially compliant (PC), and non-compliant (NC).

China will remain in enhanced follow-up and will report back to the FATF on progress in October 2021.

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Anti-money laundering and counter-terrorist financing measures in the People's Republic of China

1st Enhanced Follow-up Report & Technical Compliance Re-Rating

As a result of China's progress in strengthening their measures to fight money laundering and terrorist financing since the assessment of the country's framework, the FATF has re-rated the country on 2 of the 40 Recommendations.

The report also looks at whether China's measures meet the requirements of FATF Recommendations that have changed since their Mutual Evaluation in 2019.

Follow-up report