AML Compliance in South Asia

A Reality Check

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South Asia's economy was expected to grow at 7 per cent in 2017, increasing to 7.2 per cent in 2018, as per World Bank's South Asia Economic Focus 2017 report. The major contributors to growth are expected to be strong foreign direct investment and increasing domestic as well as foreign demand for goods.

However, the relative performance of the South Asian region on global indices relating to the ease of doing business, corruption and bribery, and anti-money laundering continues to be poor, undermining the growth potential of the region.

Another fallout of a proliferation in trade and investment opportunities is the higher risk of money laundering, terrorist financing and financial crime. Failure to comply with international expectations on Anti-Money Laundering (AML)/ Know Your Customer (KYC)/ Countering Financing of Terrorism (CFT) can lead to serious economic consequences such as downgrades by international rating agencies limiting the access to funds for industry and corporates from international markets, lower foreign direct investment, and fewer trade opportunities.

AML compliance indicators for the region

The BASEL AML Index is a good starting point for comparison, as it considers AML maturity along a total of 14 indicators such as AML/CFT regulations, corruption, financial standards, political disclosure and rule of law.

Basel AML Index 2017 (Rank out of 146 countries, 146 being the highest and 1 the lowest)	
India	88
Bangladesh	82
Pakistan	46
Sri Lanka	25
Nepal	14
Afghanistan	2
Bhutan	*NA*
Maldives	*NA*

In the BASEL AML Ranking for 2017, India fares the best within the region, with a rank of 88 out of 146 countries (The ranking places countries in the descending order). Bangladesh appears at second position at number 82. Bangladesh was also reported to be among the ten fastest developing regions on the AML index in 2017. The trigger for rapid progress in Bangladesh is arguably the cyber-heist case which brought the country's AML regime under international spotlight.

Incidentally, India and Bangladesh are the two countries in the region where the Central Bank or the Financial Intelligence Unit is empowered to levy monetary penalties on reporting entities for AML violations. Without legal frameworks that support conviction for violations, AML compliance may not be taken seriously. The fear of penalties is known to drive greater commitments to AML compliance owing also to non-monetary consequences such as loss of reputation.

Moreover, strong regulatory oversight mandates the use of resources and technology and necessitates adequate attention from the organisation's senior management and Board of Directors likely leading to more effective and efficient AML compliance.

Corruption perception

Tied closely to the poor performance of South Asia on the AML index is the perception of high corruption. Effective money laundering compliance can contribute to the detection and prevention of corruption, and therefore the two are being considered increasingly synergistic.

The Corruption Perceptions Index 2017 by Transparency International reports 'little progress across the South Asia region' over previous years. The index ranks 180 countries by their perceived level of public sector corruption. Bhutan is ranked the best within the South Asia region, at 26 out of 180. India is placed at second place on the index at number 81.

Transparency International's Corruption Perceptions Index (Rank out of 180 countries, 1 being the highest, 180 the lowest)	
Bhutan	26
India	81
Sri Lanka	91
Maldives	112
Pakistan	117
Nepal	122
Bangladesh	143
Afghanistan	177

Other countries in the region are even lower down the order, with Bangladesh at 143 and Afghanistan at the bottom at 177 among 180 countries.

The performance on the Corruption Perceptions Index can be taken as an indicator of the low effectiveness within the region on public sector and government commitments, especially with respect to international agreements. An improvement would necessitate stronger political will, along with demonstrably speedier and larger number of convictions for corruption offences.

FATF Mutual Evaluation

The Financial Action Task Force (FATF) mutual evaluation based on the new methodology not only highlights whether countries are complying with the 40 + 9 recommendations along AML compliance, but also assesses how effective they have been in achieving the defined set of outcomes (IO1 to IO9).

Relatively recently published mutual evaluation reports for three countries in South Asia – Bangladesh, Bhutan and Sri Lanka – are currently available. While Bangladesh fares relatively better in terms of effectiveness on the 11 immediate outcomes prescribed by FATF – with a Low Effectiveness rating on 4 out of 11, and Moderate Effectiveness rating on 4 out of 11 parameters, the other two countries Sri Lanka and Bhutan have Low Effectiveness rating on 9 out of 11 outcomes, pointing to an immediate need for remedial measures.

In November 2017, Sri Lanka was included by FATF in the list of countries with strategic deficiencies in its AML/CFT framework. There have also been unconfirmed reports about the likely inclusion of Pakistan in the FATF grey list.

Mutual evaluation is planned for the remaining countries in South Asia until 2024. To fare better on the upcoming evaluation, countries will have to focus on implementation along a range of parameters, especially in areas such as preventive measures (IO4), legal persons and arrangements (IO5), investigation and prosecution in money laundering cases (IO7) and confiscation of the proceeds of crime (IO8). These are also the four areas where Bhutan, Bangladesh and Sri Lanka have currently scored a Low Effectiveness rating.

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Managing global perceptions

Whilst political will and consequent regulatory enforcement will be an important pre-condition for increased AML effectiveness in the region, over the long run the campaign against money laundering may have to be spearheaded by banks themselves in the interests of their individual growth ambitions and the protection of their correspondent banking relationships.

Banks and financial institutions tend to be reactive in terms of complying with regulatory requirements. Where legislation is lax, reporting entities have little motivation to achieve beyond the bare minimum required from them. However, in an increasingly globalised world money launderers and criminals are constantly on the lookout for weaker links in the system. Sooner rather than later, international attention will weigh down on countries with relatively lax regimes and threaten them into financial isolation. A proactive and strategic approach to compliance can hence prove not only to be a competitive advantage but also increasingly, a means of survival.