

# After Gaining FATF Membership, China Still Faces AML Enforcement Hurdles



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By Brian Orsak

Ao Man Long, a former secretary of transport and public works in Macau, was indicted last month for abuse of power, accepting bribes and money laundering, activities that Chinese authorities say helped build his assets to a level 50 times greater than his annual salary.

What's most remarkable about the case, which occurred in one of China's two special administrative regions, is that it's not unusual, says anti-money laundering compliance consultant Peter Gallo. "There's barely a day that goes by without a corruption scandal," he said.

The ordinariness of such lower-level government corruption is inhibiting the enforcement of anti-money laundering laws that China enacted to get on par with international standards, said Gallo, founder of Pacific Risk Ltd., a Hong Kong-based AML consultancy.

Last October, China passed comprehensive AML laws in an effort to join the Financial Action Task Force (FATF) and in May added rules requiring institutions to report transactions suspected of being tied to terrorism. Last month China gained full membership in FATF, the global organization aimed at combating money laundering.

But despite China's acceptance into FATF, money laundering and corruption in the country may get worse before they get better as root problems remain unaddressed, said Dr. Nicole Schulte-Kulkmann, a researcher who follows AML regulation in China for Trier University in Trier, Germany.

## Far from the Emperor

"There are a lot of problems, and I do not see how these will be overcome in the short-term," said Schulte-Kulkmann, adding that as the country continues to open up to its partners in the World Trade Organization, opportunities for money laundering will increase.

China's biggest stumbling block remains enforcement of its AML laws and regulations, an effort hampered by venality among lower-level government officials, such as municipal leaders, who are less likely to feel compelled by federal law, according to Gallo.

"There is a saying in China: heaven is high and the emperor is far away," said Gallo. "This is essentially saying you can ignore half of what comes out of the federal government."

Some financial institutions outside of the country's major financial centers often either ignore or are unaware of AML regulations, including requirements to practice customer due diligence and keep records, Schulte-Kulkmann said. Bank staff is often in a position "to simply decide" whether identity documents are valid or not, she said.

"Money launderers are in a very good position to present false documents," she said.

## Informal Channels, Shelf Companies

China should also address its *fei quian*, an informal remittance system known outside of the country as a hawala, said Gallo. While most *fei quian* transactions are done for legitimate reasons and are made to obviate the often slow and costly service of Chinese banks, ineffective regulation has translated into opportunity for abuse. Operating an unlicensed remittance system is a federal offense, but the prevalence of remitters is an "open secret," he said.

Furthermore, the proliferation of Chinese-owned offshore shelf companies is a concern unaddressed by China's new regulations, said Kenneth Rijock, a financial crime consultant with London-based consultancy World Check.

While no numbers exist on how many Chinese companies have started offshore operations to avoid mainland and Hong Kong taxes, the sharp increase of businesses should give pause to Chinese regulators, Rijock said. "Because of the sheer volume of businesses, they don't have the ability to audit," said Rijock, adding that the major source for British Virgin Island shelf companies is China.

Chinese money launderers wishing to disguise the beneficial owner of a transactions would be difficult to identify in the literally thousands of shelf companies operating out of the British Virgin Islands and other offshore centers, said Rijock.

"If you think about it, it's frightening," he said, adding that the Chinese government is unlikely to clamp down much on a process that helped create national jobs by bringing greater wealth into the country. "It's only going to get worse."

### Identifying Company Owners

But criticism might fall closer to home, according to Kenneth L. Bryant, the managing director of Bryant & Associates, a Hayesville, North Carolina-based AML consultancy, noting that many U.S. companies use offshore centers to disguise the parties behind transactions.

"Here in the U.S., we have trouble with beneficial ownership even with onshore companies, so why would it be any different for [Chinese companies that do offshore business]," said Bryant. "I don't think this in an exclusive Chinese problem."

FATF, which criticized China in a July 5 evaluation of its AML regime for lax requirements for identifying the beneficial owners of companies, made similar criticisms of the U.S. in a June 23, 2006 report. (See "[Global Watchdog Gives China, U.K. High Marks in AML Evaluations.](#)")

Whatever criticisms directed at China's effort, the government should be commended for faring well against "a huge problem," according to Gallo, adding that the scale of the country and the differences in living conditions among regions has made the task of revamping the country's AML regime difficult.

While there is the chance that China will push less hard for change internally now that the country has been rewarded with FATF membership, the international pressure associated with membership is likely to give momentum to implementation, said Schulte-Kulkmann.

"It will be more difficult for China to do things the Chinese way," said Schulte-Kulkmann. "There will be an attitude that China should learn quickly."