

## **New PRC Legislation against Money Laundering**

Money laundering has long been a problem in China. To counter this illegal activity, the Chinese government has introduced the PRC Anti-money Laundering Law, a landmark legislation in the history of China's judicial system. How will this new law limit or promote the business scope of financial institutions and foreign-invested enterprises?

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The recently-promulgated *PRC Anti-money Laundering Law (new Law)* outlines new, specific provisions to prevent money laundering in China's financial market. The Law, which will become effective on January 1 2007, shows the Chinese government's efforts to combat money laundering and contains significant implications for multinational corporations doing business in or with China. The new Law will have a profound influence on how companies navigate the Chinese market.

### **LEGISLATIVE HISTORY**

Money laundering was first criminalized in an article of the *Criminal Law of the People's Republic of China* (PRC). This provision, which came into effect on October 1 1997, defined the scope and penalties for the crime of money laundering. Since then, it has been expanded and was most recently amended in June 2006.

The Criminal Law provision formed the basis for the Chinese government's anti-money laundering efforts. It was later augmented by piecemeal regulations issued by the State Council and the People's Bank of China (PBOC) in 2000<sup>1</sup> and 2003<sup>2</sup>. Nonetheless, despite the promulgation of these laws, money laundering continues to be a problem in the PRC.

According to the China Anti-money Laundering Monitoring and Analysis Center, established by the PBOC in 2004, 683 suspicious money laundering cases were reported to the police in 2005. The cases involved Rmb137.8 billion (US17.2 billion) and more than US\$1 billion in illegal transactions.<sup>3</sup> To counter this problem, the PRC government issued the following laws to reinforce its efforts against money laundering:

- i. the *PRC Anti-Money Laundering Law*, passed by the National's People Congress on October 31 2006 and scheduled to go into effect on January 1 2007; and
- ii. the *Financial Institutions' Anti-money Laundering Regulations* and the *Measures on Administration of Financial Institutions' Reporting of Large and Suspicious Transactions*, passed by the People's Bank on November 14 2006 and scheduled to come into effect on January 1 and March 1 2007, respectively.

The new Law is significant as the first anti-money laundering legislation ratified by the nation's highest lawmaking body. The new regulations will replace and repeal the anti-money laundering regulations issued by the PBOC in 2003. They mark the PRC government's most ambitious effort against money laundering and reflect China's positions as member of the Eurasian Group on combating money laundering and financing of terrorism and as an observer of the intergovernmental Financial Action Task Force (FATF) since January 2005.<sup>4</sup>

### **ENFORCEMENT OF ANTI-MONEY LAUNDERING LAWS IN CHINA**

### ***Authorities and powers***

To strengthen current enforcement strategies, the Regulations list the PBOC as the competent supervisory and administrative authority of all anti-money laundering projects. To deter money launderers, the new Law allows the PBOC to impose the following liabilities on financial institutions that impede its efforts or fail to fulfil its requirements:

- i. a fine of up to Rmb5 million (US\$638,000) and/or a revoking of the institution's financial operation permits;
- ii. fines of up to Rmb500,000 (US\$63,800) on the directors, senior management, and other personnel with direct responsibility in an institution and/or their removal from the financial sector, or prohibition to practice therein.

The new Law also gives the PBOC power to investigate suspicious transactions. When the PBOC detects an unusual transaction, it can review, copy, and seal all documents relevant to the case. It can also freeze accounts for up to 48 hours, depending on the investigation. If there is still suspicion of illegal activity after a thorough investigation, the PBOC will forward the case to a Public Security Bureau, China's primary judicial authority.

### ***Criminal liabilities for money laundering and related crimes***

Concurrent with the PRC Criminal Law, the new Law defines money laundering as the act of concealing or covering up the nature and source of income derived from the following activities: drug dealing, smuggling, organized crime, terrorism, corruption and bribery, financial disruption and financial fraud.

When combined with any of these criminal activities, money laundering may trigger criminal liabilities for money laundering as well as the other crimes. However, entities and individuals that did not commit predicate crimes but facilitated or assisted in money laundering schemes can be held liable for the crime of money laundering. The PRC Criminal Law imposes the following penalties on those found guilty of money laundering:

- i. fines of up to 20% of the money laundered and/or up to 10 years of imprisonment for individuals;
- ii. fines of up to 20% of the money laundered and/or up to 5 years of imprisonment for chief officers, executives or other personnel with direct responsibility for institutions.

### ***Domestic and foreign-invested financial and non-financial institutions***

The new Law and Regulations apply to local and foreign financial institutions established in China. The new Law also imposes general anti-money laundering obligations on local and foreign non-financial enterprises, a provision instituted for the first time in the history of PRC legislation. The Regulations expand the definition of financial institutions to include, among other establishments, the following:

- policy and commercial banks;
- urban and rural credit cooperatives;
- post and savings institutions;
- Fund management companies, securities and futures brokerages;
- insurance assets management companies and insurance;

- automobile finance companies, finance, finance leasing and finance asset management companies;
- trust and investment and money brokerage firms; and
- businesses handling currency exchange, payment settlements and fund sales.

The new Law requires financial institutions (and their branches) to establish internal control and monitoring systems to ensure robust methods of supervision. These include systems that verify client identities, maintain this information along with transaction records and report suspicious transactions to relevant authorities. When these systems do not fulfil the new Law's requirements to prevent money laundering, they may be rejected by authorities.

The new Law does not delineate the different types of non-financial enterprises. However, any institution with the potential to serve as a channel or vehicle for money laundering would fall in the bracket of non-financial enterprises. Specifically, these would include auction companies, pawn houses, accounting firms, law firms, real estate agents, jewellery vendors and art or antique dealers.

#### RED FLAGS

The new Law requires financial institutions to report large and suspicious transactions that give warning signs (red flags) to the China Anti-money Laundering Monitoring and Analysis Center. The new Regulations raise the standards for large transactions and expand the red flags for suspicious transactions to a total of 48. Most of these include activities that appear legal but are unusual in certain aspects, such as when:

- i. a foreign invested enterprise (FIE) makes an equity investment in China with newly injected funds from foreign sources (instead of its locally-retained profits) and the investment is not consistent with the FIE's regular operational scale or needs;
- ii. after receipt of a capital investment from its foreign investor, an FIE transfers the capital fund overseas (as payments for services, equipments, goods, royalties or dividends) and the quick fund transfer is not in line with the FIE's normal operational scale or needs;
- iii. a foreign investor makes a capital investment in an FIE in an amount greater than the FIE's approved registered capital;
- iv. a foreign investor makes a capital investment in an FIE (equity) in an amount greater than the FIE's loan borrowed from a foreign lender. (According to PRC laws, the amount of debt allowed for an FIE is based on, but usually greater than, the FIE's approved registered capital.); and
- v. a foreign investor gives capital contribution to an FIE and the capital originates in a country where the foreign investor has no affiliates.

Authorities are particularly cautious (and suspicious) when they investigate an FIE because of the unusual transactions mentioned above.

#### BEST PRACTICES

China's new Law and Regulations mark the government's most expansive endeavour against money laundering. To avoid complications that could result from the government's efforts, companies must try to implement the best practices possible when they conduct business in China.

Financial institutions can begin by instituting efficient monitoring and internal control systems that comply with the new Law to prevent money laundering. Non-financial

institutions, which are not mandated by law to employ these systems, should follow the same rules.

### ***Foreign-invested enterprises***

Foreign-invested enterprises should include anti-money laundering obligations in their corporate codes of conduct and provide relevant training to employees who serve in financial and managerial positions. Employees of FIEs should avoid making or receiving contract payments from third parties designated by other parties when the third parties have no connection to the transactions or the contractual parties.

Furthermore, FIEs should avoid acting as agents when making or receiving payments from parties which are not related to a contract. To ensure compliance with the law, FIEs should always submit unusual payment requests to their legal departments or legal counsel for review.

To standardize their contracts, FIEs should include clauses concerning anti-money laundering and anti-commercial bribery in all commercial contracts that involve significant payments. They should avoid making swift and unjustified domestic investments or inbound contributions and outbound payments of capital in the form of payments for services, equipment, goods, royalties, or dividends, which are not in line with the FIE's operational scale or needs.

Finally, FIEs should avoid irregular banking practices, such as fund transfers larger than necessary, which are at obvious odds with normal business operations. All FIEs which follow these guidelines will avoid unwarranted suspicions of money laundering.

The *PRC Anti-money Laundering Law* was formulated to uphold the PRC's commitment to a fair financial market. By adhering to this new Law, individuals and institutions will ultimately contribute to the benefit of everyone involved.

### ***Endnotes***

1 The *Regulation on the Use of Real Names on Individual Savings Accounts* issued by the State Council on March 20 2000.

2 The *Financial Institutions' Anti-money Laundering Regulation*, the *Measures on Administration of Reporting Large RMB Amounts and Suspicious Payment Transactions* and the *Financial Institutions' Measures on Reporting Large and Suspicious Foreign Exchange Capital Transactions* all of which were issued by the People's Bank on January 3 2003 and went into effect on March 1 2003.

3 China Daily, November 1 2006, *China Adopts Anti-money Laundering Law*. [www document] [www.chinadaily.com.cn/china/2006-10/31/content\\_721316.htm](http://www.chinadaily.com.cn/china/2006-10/31/content_721316.htm) (downloaded November 23 2006).

4 FATF GAFI, *FATF Members and Observers*. [www document] [www.fatf-gafi.org/document/5/0,2340,en\\_32250379\\_32236869\\_34310917\\_1\\_1\\_1\\_1,00.html#China](http://www.fatf-gafi.org/document/5/0,2340,en_32250379_32236869_34310917_1_1_1_1,00.html#China) (downloaded November 23 2006).