

Money Laundering and Its Regulation in China

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Research Methods)**

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Contents

Abstract.....	iv
Declaration and Statements	v
Acknowledgements	vii
List of Abbreviations	viii
 Chapter I: Introduction	 1
 Chapter II: Literature Review Part 1 – An Historical Overview of Money Laundering in China	 13
2.1 Introduction	13
2.2 Money Laundering Activities in Dynasty Periods	14
2.3 Chinese Triads and Money Laundering	17
2.4 The Period between 1949 and the Beginning of Economic Reform	21
2.5 The Resurgence of Money Laundering after the 1980s	25
2.6 An Historical Review of Chinese Underground Banking System	27
2.7 Conclusion.....	34
 Chapter III: Literature Review Part 2 – The Money Laundering ‘Problem’ and Contemporary Responses	 35
3.1 Introduction	35
3.2 The International ‘Problem’ and Pressures to Respond	35
3.2.1 Definitions of Money Laundering	35
3.2.2 Extent and Scope of the Problem.....	40
3.2.3 FATF Pressure	41
3.2.4 United States’ Demands.....	50
3.2.5 Global Institutions’ Requirements	56
3.3 The Domestic ‘Problem’ and Response	58
3.3.1 Definitions of Money Laundering	58
3.3.2 Extent and Scope of the Problem.....	62
3.3.3 Prevention	65
3.3.3.1 Administrative and Regulatory Sanctions	65
3.3.3.2 Regulation and Supervision	67
3.3.3.3 Reporting.....	77
3.3.3.4 Customer Due Diligence	82
3.3.4 Enforcement.....	88
3.3.4.1 Predicate crimes	88
3.3.4.2 Investigation.....	107
3.3.4.3 Prosecution and Punishment	111

3.3.4.4 <i>Civil and Criminal Confiscation/Forfeiture</i>	115
3.4 Conclusion.....	118
Chapter IV: Research Methods.....	120
4.1 Introduction	120
4.2 Research Design.....	121
4.3 Ethics.....	124
4.4 Participants and Access	124
4.5 Primary Data	132
4.6 Secondary Data (government reports, Chinese university data)	133
4.7 Conclusion.....	134
Chapter V: Analysis of Contemporary Money Laundering Cases	136
5.1 Introduction	136
5.2 Cases Examples.....	138
5.2.1 Predatory Offences.....	140
5.2.2 Market-based Offences	142
5.2.3 Commercial Offences	158
5.3 Analysis of Laundering Methods and Predicates	171
5.4 Predicate offences and money laundering methods	182
5.4.1 The Banking Sector.....	183
5.4.2 Non-Bank Financial Institutions.....	185
5.4.3 Non-financial Businesses or Professions.....	186
5.5 Conclusion.....	189
Chapter VI: The Impact of AML Regulation	192
6.1 Introduction	192
6.2 Prevention.....	194
6.2.1 Administrative and Regulatory Sanctions	194
6.2.2 Regulation and Supervision	197
6.2.2.1 <i>Structural effectiveness</i>	197
6.2.2.2 <i>Chinese FIU</i>	204
6.2.2.3 <i>The Coverage of the Supervision</i>	208
6.2.2.4 <i>Converting Chinese Underground Banking</i>	210
6.2.2.5 <i>Anti- Money Laundering Media Influence, Training Programme and Conference</i>	215
6.2.2.6 <i>A Risk-based Approach to AML Compliance</i>	218
6.2.3 Reporting.....	234
6.2.4 Customer Due Diligence.....	241
6.3 Enforcement	254
6.3.1 Predicate Offences	255
6.3.1.1 <i>The Impact on Drug Trafficking</i>	261
6.3.1.2 <i>Impact on Underground Banking</i>	261
6.3.2 Investigation.....	263

6.3.3 Prosecution and Punishment	276
6.3.4 Civil and Criminal Confiscation/Forfeiture	279
6.4 Conclusion.....	283
Chapter VII: Conclusion.....	284
7.1 Major Themes Emerging From this Work	297
7.2 Recommendations for AML Policy	297
7.3 Recommendations for Further Research	297
Bibliography	298
Appendix One.....	323
The Chronological Evolution of Anti-Money Laundering System.....	323
Appendix Two	333
Questions for Checking the Quality Risk Assessment.....	333
Appendix Three	334
Questions to Address Risk Responses	334
Appendix Four	335
The Minimum Information Needed for Record	335
Appendix Five	336
Five Forms Filed in a Customer Record in Future Company	336
Appendix Six	337
Legislation in the Context of Money Laundering	337
Appendix Seven.....	345
Countries that have a Mutual Legal Assistance Agreement with China that is in legal effect	345
Appendix Eight.....	347
The Problems of China's AML System Identified and Amendments Suggested in Comparison with the FATF 40 Recommendations and 9 Special Recommendations	347
Appendix Nine.....	365
Interview Questions- Financial Institutions	365
Interview Questions- Law Enforcement Agencies.....	367
Interview Questions- Service Users	369

Abstract

Money laundering activity in China emerged hundreds of years ago, although the concept of money laundering is recent terminology. The thesis provides an overview of money laundering history in China. This includes selected dynastic periods, the time between the creation of the People's Republic of China in 1949 and the beginning of economic reform, the resurgence of money laundering following the 1980s, and underground banking. It explores the money laundering 'problem' and contemporary responses in China. This includes discussion of the external pressures exerted by international bodies and agreements, including the influence of the United States, and an overview of the domestic Chinese response to the 'problem' of money laundering. Data collection methods included reviews of money laundering cases identified in newspaper and journal articles, and court cases. It also includes twenty (N=20) interviews with participants drawn from the fields of banking, police, security, entrepreneurs and members of the general public. These methods permitted the identification of twenty-three (N= 23) cases that were subject to systematic analysis, and compared against international evidence on money laundering methods and predicate offences. Using the generic AML structure of prevention and enforcement components (Levi and Reuter 2006) that addresses the international standards, an effort is made to assess the potential impact of the AML regime in the context of China. The work concludes with discussion of the major themes that have emerged, and it offers recommendations for AML policy and further research on this topic.

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List of Abbreviations

ACRONYM	ORGANISATION OR CONCEPT
\$	United States Dollar
£	United Kingdom Sterling
¥	Yuan or Ren Min Bi (Chinese Currency)
ABOC	Agricultural Bank of China
ACLA	All China Lawyer Association
ADB	Asia Development Bank
ADBC	Agricultural Development Bank of China
AML	Anti-Money Laundering
AML/CFT	Anti-Money Laundering/Combating the Financing of Terrorism
AMLB	Anti-Money Laundering Bureau
AMLJMC	Anti-Money Laundering Joint Ministerial Conference
APEC	Asia Pacific Economic Cooperation
APG	Asia Pacific Group
BBA	British Bankers' Association
BC	Bureau of Commerce
BCs	Bureau of Customs
BFA	Bureau of Foreign Affairs
BINLEA	Bureau of International Narcotics and Law Enforcement Affairs
BIS	Bank for International Settlements
BOC	Bank of China
BOIC	Bank of Industry and Commerce
BSA	Bank Secrecy Act (US)
CAMLMAC	China Anti-Money Laundering Monitoring and Analysis Centre
CAMLR	Chinese Anti-Money Laundering Regulation
CBC	China Bank of Communication
CBD	Central Budget Deficit
CBOC	Construction Bank of China
CBRC	China Banking Regulatory Commission
CCB	China Construction Bank
CCP	Chinese Communist Party
CDD	Customer Due Diligence
CFATF	Caribbean Financial Action Task Force
CFIAML	Chinese Financial Institutions Anti Money Laundering Regulation
CFT	Combating Financing of Terrorism
CIRC	China Insurance Regulatory Commission
CIREA	China Institute of Real Estate Appraisers and Agents
CISC	Criminal Intelligence Service Canada

CNA	China Notaries' Association
CNPC	Chinese National People's Congress
CNPCSC	Chinese National People's Congress Standing Committee
CPC	Country of Particular Concern
CPL	Criminal Procedure Law
CSRC	China Securities Regulatory Commission
DEA	Drug Enforcement Administration
DNFBPs	Designated Non-Financial Businesses and Professions
DPP	Department of People's Procuratorate
DPRK	Democratic People's Republic of North Korea
EAAMLG	Euro-Asia Anti-Money Laundering Group
EAG	Eurasian Group
ECID	Economic Crimes Investigations Department
EU	European Union
FATF	Financial Action Task Force
FBI	Federal Bureau of Investigation
FCMB	Foreign Currency Management Bureau
FDI	Foreign Direct Investment
FEB	Foreign Exchange Bureau
FFE	Foreign Funded Enterprise
FIE	Foreign-Invested Enterprise
FIU	Financial Intelligence Unit
FSA	Financial Service Authority (United Kingdom)
G7	Group of Seven: France, Germany, Italy, Japan, United Kingdom, United States, and Canada
GAC	General Administration of Customs
GDP	Gross Domestic Product
HK	Hong Kong
HKD	Hong Kong Dollar
HKSAR	Hong Kong Special Administrative Region
HT	The Hizb-e Tehrir
IBA	International Bar Association
IBCs	International Business Companies
ICB	Industrial and Commercial Bureau
ICBC	Industrial & Commercial Bank of China Ltd.
IEB	Import and Export Bank of China
IFSRA	International Financial Services Regulatory Authority
IMF	International Monetary Fund
IRC	Insurance Regulatory Committee
IVTS	Informal Value Transaction System
	Chinese concepts for IVTS
	Ch'iao hui (overseas remittance)
	Fei-ch'ien (flying money)

	Hui kuan (money remittance)
	Nging sing kek (money letter shop)
JB	Jurisdiction Bureau
KYC	Know Your Customer
LVT	Large Value Transaction
MC	Ministry of Construction
MCA	Ministry of Civil Affairs
MF	Ministry of Finance
MFA	Ministry of Foreign Affairs
MFR	Ministry of Foreign Relation
MJ	Ministry of Justice
ML	Money Laundering
MLA	Mutual Legal Assistance
MLAA	Mutual Legal Assistant Agreement
MLAET	Mutual Legal Assistance and Extradition Treaty
MLCA	Money Laundering Control Act (United States)
MOU	Memorandum of Understanding
MPS	Ministry of Public Security
MS	Ministry of Supervision
MSS	Ministry of State Security
MT	Ministry of Trade
NBSC	National Bureau of Statistics of China
NCCT	Non-Cooperative Countries and Territories
NFIC	National Financial Institutions Congress
NPC	National People's Congress
OAS	Organization of American States
OECD	Organization for Economic Co-operation and Development
OFAC	Office of Foreign Asset Control (US)
PBC	People's Bank of China
PC	Penal Code (Criminal Law of the People's Republic of China)
PDIC	Party Disciplinary Inspection Committee
PDN	People Daily Newspaper
PEPs	Politically Exposed Persons
POCA	Proceeds of Crime Act (United Kingdom)
PRC	People's Republic of China
RMB	Ren Min Bi
SAFE	State Administration of Foreign Exchange
SAIC	State Administration for Industry & Commerce
SAR	Suspicious Activity Report
SC	Supreme Court
SCNPC	Standing Committee of the National People's Congress
SDB	State Development Bank
SEZ	Special Economic Zone

SGE	Shanghai Gold Exchange
SOCBs	State Owned Commercial Banks
SOE	State-owned Enterprise
SOSBs	State Owned Specialised Banks
SPB	State Post Bureau
SPC	Supreme People's Court
SPP	Supreme People's Procuratorate
SRC	Security Regulatory Committee
STR	Suspicious Transaction Report
SU	Soviet Union
TB	Tax Bureau
TF	Terrorist Financing
UB	Underground Banking (See Informal Value Transfer System)
UK	United Kingdom
UN	United Nations
UNCAC	United Nations Convention Against Corruption
UNDP	United Nations Development Programme
UNODC	United Nations Office on Drugs and Crime
US	United States
US FinCEN	United States Financial Crimes Enforcement Network
US\$/USD	United States Dollar
USA PATRIOT Act	Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act
US-BINLEA	U.S. Department of State, Bureau for International
USC	United States Code
VAT	Value Added Tax
WGC	Working Group on Counterterrorism
WTO	World Trade Organization
XUAR	Xinjiang-Uighur Autonomous Region

Chapter I: Introduction

The Organization for Economic Co-operation and Development (OECD) suggest in 2005 that China's economic growth has averaged 9½ per cent over the previous two decades. The size of the economy, when measured at market prices, now exceeds that of a number of major European economies. According to the National Bureau of Statistics of China (NBSC) in 2006, China's 2005 Gross Domestic Product (GDP) was ¥18.4 trillion (£1.67 trillion), which was equal to less than one-fifth the size of the economy of the United States (US). In 2007, it was reported that China became the third or fourth largest economy in the world. Niall Ferguson (2009) has argued that 'Chimerica', the economic and political relationship between China and the United States is critical to understanding our current economic woes and the path of economic progress in the coming decades. The living standards of the Chinese people and the international position of China have been much improved. In the United Nations (UN) Human Development Report 2009, China has been identified as a "medium development" country, which accounts for 5.5% of global GDP or \$3.2 trillion United States Dollar (USD) of the total world output of \$54.5 trillion USD in 2007 (UNDP, 2009). China is becoming more important as a financial centre, including a consideration of internationalising Chinese currency (Lewis, 2009). China has become an important member of the international community. A number of international events such as the 2008 Olympic Games and

regional affairs have also strengthened its international power and prestige. A large number of laws and regulations have been adopted, amended and changed to an international standard in recent years. This has been exemplified by the acceptance of China's entry into the World Trade Organisation (WTO) in 2001. The regional and international importance of its political economy also highlights the need to analyse and assess the unexplored and under-researched risks it confronts such as the vulnerability of China to financial crimes such as money laundering.

There are two significantly different ways in which people use the term 'money laundering', which are often confused or implicit. The first refers to hiding of the illicit origins of funds in order to make tainted wealth look legitimate. This, we suspect, is what most people who encounter the term would expect money laundering to mean. The second – acquiring, possessing or using proceeds of crime - comprises all the acts that fall within the laws and regulations against money laundering, which are intentionally framed broadly in order to stimulate business, finance and the professions to make it harder for criminals to legitimate their wealth in the first sense above. It also penalises broadly defined self-laundering by those who commit the primary money-generating crimes (often referred to as 'predicate crimes'), to the extent that almost anything they do with proceeds constitutes laundering.

The aim of money laundering is to prevent the victim or enforcement agencies from following their money trail. Money laundering is a western phrase of recent origin,

which primarily emerged as the social and political echoes against the considerable amount of proceeds of drug offence since the 1960s. Traditional crime control methods to crack down on the drug trade appeared to make unsatisfactory success in the United States. Drug traffickers have been reported not only enjoying the immediate criminal proceeds, but also seeking to launder their ill-gotten gains for future economic opportunities through financial institutions. In recent years, countries and international bodies have vigorously developed a range of anti-money laundering (AML) laws and regulations, including the:

- US Bank Secrecy Act (BSA) 1970,
- 1988 United Nations Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances,
- 40 recommendations and 9 Special Recommendations on Combating Financing of Terrorism (CFT) of the Financial Action Task Force (FATF),
- 1999 United Nations International Convention for the Suppression of the Financing of Terrorism,
- 2001 and 2005 Money Laundering Directives of the European Union (EU),
- 2000 United Nations Convention Against Transnational Organised Crime.

It can be seen that money laundering control has become a world-wide policy. More and more states have realised that “Fighting money laundering is rather like tackling global warming: unless everybody joins in, there is little hope of curbing the problem” (The Economist, 1997).

How has China responded to AML initiatives? Money laundering was first criminalised in 1997 under Chinese Criminal Law. The response of criminalisation of money laundering in China lagged behind international action. China had also been keeping a low profile in the context of money laundering control prior to the promulgation of AML regulation in 2003. Since then Chinese AML initiatives began intensifying. Massive media reports on the seriousness of money laundering in China have been repeated on TV, radio, internet and newspaper. What are the reasons behind China's rapid implementation of the AML system in recent years other than the past?

The coverage of money laundering predicate offences has been expanded to cover all kinds of profit-driven crimes, which have surplus proceeds and that are intended to be laundered "white". Internationally, predicate offences including arms trafficking, gambling, corruption and smuggling are believed to play a significant role to share the illicit proceeds market with drug trafficking. Among the questions that it seems appropriate to ask are the following: How are money laundering and its predicate offences defined in China? How have China's money laundering and its countermeasures evolved? What are money laundering methods in China? What are the differences between Chinese money laundering methods and those elsewhere, resulting from China's cultural distinctiveness, social and political considerations?

China has established an AML institutional framework. A Chinese Financial Intelligence Unit (FIU) has been set up and made functional. The key AML control players including the People's Bank of China (PBC), Ministry of Public Security (MPS), the Supreme Court (SC), Ministry of Foreign Affairs (MFA), China Banking Regulatory Commission (CBRC), China Securities Regulatory Commission (CSRC), and China Insurance Regulatory Commission (CIRC) have actively engaged in AML campaigns. With regards to money laundering prevention, China has adopted AML regulation in financial institutions. The aspects of Customer Due Diligence (CDD), reporting, regulation and supervision, and administrative/regulatory sanctions have been created, with the expressed aim to deter criminals from abusing financial institutions to launder criminal proceeds. For instance, the use of the Chinese underground banking system for fund transactions, seemingly on purpose after the promulgation of the AML regulation by some criminals may be seen as the deterrent effect of the AML regulation. The establishment of AML in financial institutions may also be to satisfy the international community. Enforcement strategies including investigation, prosecution and punishment, and confiscation and forfeiture have also been pursued to combat money laundering.

In addition, China has also participated in international and regional AML actions. In 2004, China became a key member of the Eurasian Group (EAG) on combating money laundering and financing of terrorism, a FATF-style regional body. On the 28th June 2007, China gained full membership in FATF. China has also

continuously updated its regulation and enhanced its international co-operation to combat money laundering. How does China's AML regulation compare with the FATF standards? How efficient and effective is the Chinese AML regime? How could China best use international standards and practices in China's policy making to improve its AML regime?

I am Chinese and worked in the Police Force in China for over five years after a four year university study at the Criminal Police College of China. I have undertaken a number of roles in a variety of Departments in different level Police Bureaus. I have been residing in the UK for the last eight years pursuing a PhD in order to improve my knowledge at an international level. There are a number of reasons for wishing to engage in this study. The primary and direct reason is linked to my professional role as a police officer in China, where I witnessed and experienced numerous incidents that criminals had been penalised, but they still enjoyed a luxury lifestyle both in prison and upon release. Some criminals seemed never to lack money, but without any obvious legitimate source of income. Proceeds of crime have generated substantial financial and political power. Conventional investigations were executed extensively on catching offenders, but little work has been done in China to address their assets despite some cases involving proceeds physically seized at the scene during arrest. Usually a custodial sentence suggests a success and the end of the case; and little work is required particularly to be undertaken to pursue criminal proceeds. Perhaps there was little awareness of how criminals dealt with their criminal proceeds. Clearly

limited legislation in regard to criminal proceeds in China was specified at that time. The impact of criminal proceeds was not fully addressed. The performance of law enforcement agencies was linked to the number of cases investigated and offenders arrested, prosecuted and convicted. The financial institutions and law enforcement agencies hardly had a common ground to work closely. A debate occurs. Is a criminal case fully completed without addressing criminal proceeds? Currently, the answer is certainly not. The consequences of such uncompleted crime investigations have been problematic. Some offenders were still able to remotely control their wealth and criminality inside the prison. Some offenders were released earlier due to their financial contributions to the prison or bribing corrupt officials. Some offenders continued to re-offend, whilst their investments were funded by their previous criminal gains. Some offenders enjoyed their luxury lifestyles upon release. A common phenomenon is that family members of profit-driven offenders are visibly wealthy without reasonable legitimate income. It is not a secret in China that those enormous assets actually belong to these offenders. The law works to incarcerate many (though not all) offenders, but was inadequate to deprive criminal proceeds and reduce their risk of re-offending and harm.

My aspiration to undertake this research was directly from curiosity about a smuggling case uncovered in the city of Xia Men in the year of 1999. The case was reported at the time as being one of the most serious crimes in terms of the quantity of criminal proceeds involved in modern Chinese history. The newspaper People's Daily (2001) reported that the company Yuan Hua was responsible for a

series of smuggling cases amounting to a value of approximately ¥53 billion (US\$6.38 billion, £3.53 billion) between 1996 and 1999. The evaded tax accounted for a total of ¥30 billion (US\$3.6 billion, £2 billion). More than 600 people were involved in the commission of those illegal activities. A number of high level Community Party officials including the Vice Minister of the Ministry of Public Security (MPS) and the City Mayor participated in the crime. Some 200 suspects who had fled the area were caught and arrested. The local Courts put on trial nearly 300 suspects until 2001. The Chinese Police announced that at least ¥12 billion (£0.89 billion) was laundered abroad. An underground bank named “Dong Shi Li” played a lifeline role contributing to the financial transactions between mainland China and Hong Kong for the “Yuan Hua” smuggling group.

The existence of underground banking is not new for Chinese law enforcement agencies. However, Chinese underground banking appeals to international law enforcement agencies to understand this cultural and historical issue. There are issues that China needs to reconsider. For example, how one underground bank was capable of supplying such enormous amount of cash for the “Yuan Hua” smuggling group? What are the characteristics of underground banks attracting criminals? I used to work as a detective combating crimes occurring in financial sectors, wholesale markets, pawnshops, second hand automobile markets, and commercial streets. I have experience of working with banks, security companies, second hand goods dealers, and underground bankers. I considered that I would be able to help to understand the extent of Chinese underground banking from the perspective of a

Chinese Police Officer. I am also obliged to provide an observation for China, the region, and the international community to better appreciate the nature and extent of the difficulties that are being confronted and the solutions that are being implemented.

The thesis intends to address a number of research aims:

- What are the historical antecedents of money laundering and its current nature and scope in China?
- What are the contemporary internal and external pressures upon China to adopt AML controls?
- What are contemporary Chinese money laundering methods and how do selected money laundering cases in China differ from international examples?
- How can we assess if AML controls are efficient and effective? and to what extent does this impact of AML performance vary according to the context in which these are implemented?

Currently, there is very little literature or data on China's money laundering available to the world, especially not in the English language by native Chinese academics. Available articles mainly focus on describing Chinese anti-money laundering efforts and legislation. Critical analyses of China's money laundering methods, regulation and its impact are still less informative. This thesis provides a more in depth understanding of money laundering by deconstructing the patterns of

China's money laundering and reactions to it and, in the process, addressing the central research questions outlined above. In other words, to seek answers to the questions that problematise money laundering by focusing upon China's perspectives compared with international experiences. The intention of this exercise is to discuss the problem of money laundering and both international and Chinese domestic responses to it. It will analyse current domestic case examples of money laundering and underground banking to compare and contrast against selected international data. The thesis will also assess the potential impact of AML policy and operations in the context of an emerging economic power.

The literature review that follows provides an overview of money laundering history in China. Although this is a new concept, the problem can be traced back to dynastic periods, and the later involvement of triad criminal organisations. It is also present during the period between 1949 and the beginning of economic reform, but it has experienced resurgence after the 1980s. The history of underground banking is also discussed, as this has played an important role in efforts to avoid official scrutiny in the movement of money.

The literature review continues in chapter three, which discusses the money laundering problem and responses in the contemporary context. This includes an examination of the pressures to respond brought about by international understandings of the nature and extent of the problem and the influence of powerful international bodies and governments such as the United States. It also includes the identification and discussion of the development of the anti-money

laundering regime in China, which encompasses many of the prevention and enforcement components that are recommended by international bodies and implemented by many governments.

In chapter four, the reader will find an exploration of the possibilities and the limitations of research design that are encountered in studying the topic of money laundering in China. This includes discussion of the ethical and participant access difficulties, the securing of semi-structured interviews with several key participants from different institutions, and the use of secondary data such as government reports and Chinese university data.

The next chapter offers a critical analysis of money laundering cases in China. These are categorised using the Naylor (2003) typology of predatory, market-based and commercial crimes as well as the identification of hybrid types of crime. It compares Chinese examples against an international review of money laundering cases (Reuter and Truman 2004) to assess similarities and differences. It therefore aims to identify how China is focussing (or could focus) its efforts to target the money laundering and predicate offences that occur within or affect its jurisdiction.

In chapter six, the reader is offered a critical analysis of Chinese efforts to target money laundering and related predicate offences. It directly utilises the generic AML structure (Levi and Reuter 2006) of prevention and enforcement components that form the benchmark international standards. This structure is used to assess

the strengths and limitations of the AML regime as it is being implemented within the legal, political-economic, and cultural context of contemporary China.

The concluding chapter reviews the major themes that emerge from this work, and it offers suggestions and recommendations for the further development of AML policy and research specific to China.

Chapter II: Literature Review Part 1 – An Historical Overview of Money Laundering in China

2.1 Introduction

Money laundering is a metaphoric term that appears to originate from the United States in the 1920s. The Italian Mafia used criminal proceeds derived from a number of profitable crimes such as extortion, prostitution, gambling to mingle with legitimate income from laundry businesses to perplex law enforcement investigation (Malinoski, 2007). Neither was China advanced in machinery equipments (laundries), nor were there the same social and cultural backgrounds to create the same type of laundering money operation at that time. However, in the light of the characteristics of money laundering, retrospectively, the practice of hiding money from authority has a long history, although the concept of money laundering may not have been known explicitly in China. This chapter seeks to explore the historical overview of money laundering in China. This will provide a cultural, social and political background for better understanding money laundering development and its importance. Firstly, it introduces the money laundering activities in dynastic periods. Secondly, it describes the link between triads and money laundering. Thirdly, it discusses the money laundering activities during the period between 1949 and the beginning of economic reform. Fourthly, it illustrates

the resurgence of money laundering after the 1980s. Lastly, it talks about the history of underground banking system.

2.2 Money Laundering Activities in Dynasty Periods

Many forms of money laundering have been observable in Chinese history, though the label of laundering has only recently been given to these disparate phenomena. In ancient China (BC 2000) all properties in the state legitimately belonged to the ruler. Some merchants would embezzle some income and then move these assets with the aim of investing in businesses to remote provinces or even outside jurisdictions. The aim was to escape from their ruler's investigation should the ruler be suspicious about the loss of his assets, and eventually to achieve the goal of having the ownership and/or control of these assets. These merchants were concerned that their hidden assets could be reported to the authorities, which would lead to severe penalties such as the death penalty or banishment (China Culture, 2006).

In the late Han Dynasty (206BC-AD220), a special school of tomb raiders named "Fa Qiu Jiang Jun" was established. These tomb raiders usually had their own legitimate identities and had to hide their criminality and illicit proceeds from the public and authority. There were severe penalties to punish tomb raiders by law should they be found. To launder their criminal proceeds to escape detection, these tomb raiders sought to work for pawnshops or as antique dealers as a front. It is reported that until the present, members of this school still exist in South-East Asia,

North of Africa, and Central Asia, and some have worked as archaeologists in some national projects in China (PHPWind, 2008).

During the Tang Dynasty between 618 and 907 BC, money laundering was seen in the tea trade between the North and the South in China. A letter of “to Commander Li to discuss the pirate” by a well-known poet Mu Du describes:

About over one hundred pirates in 2 or 3 ships as a group in large or 20-30 pirates in ship at least were mugging the rich merchants in the river. Sometimes they landed on banks to mob towns. These pirates were all tea merchants. The criminal assets and proceeds were shipped to the southern hilly areas and bartered with tea producers for tea. The reason that these pirates delivered these proceeds to the tea producing areas explained by Mu Du was because these pirates dare not sell the proceeds in the cities or towns due to the unusual luxury and incurring investigations from the law authorities. The only place that the proceeds could be sold was the tea producing areas. When tea was harvested, the tea merchants came from all over the place with silk, gold or silver to barter tea. The local community was so wealthy, even women and children were wearing expensive clothing. Although you had rare treasure, the law enforcers did not interrogate, and the people were not surprised. Therefore, the pirates joined the trade and exchanged the criminal gains for tea. When these pirates got the tea, they left as the

normal tea merchants... these crimes keep taking place like encirclements (Teaculture, 2009).

A sophisticated money laundering method was invented by Shen He, one of the most corrupt governmental officials in Chinese history, in the Qing dynasty (1644-1911). He was the Prime Minister in the Qian Long period (1711-1799). Due to He's high political position and being the most liked servant of Emperor Qian Long, many people bribed him with the purpose of gaining a favour. He understood that in time, Emperor Qian Long would become old and a new Emperor would eventually take power. He was aware of the severe punishment for corruption. On one occasion, Emperor Qian Long's predecessor Kang Xi (1654-1722) decapitated a corrupt official and made a bowl and drum with this official's skull and skin. The skull bowl and skin drum were exhibited and knocked at by the monks in a temple everyday to warn public officials to behave (Cheng, 2006). However, He did not want to give up opportunities to continuously accept bribes. As a result, He began considering the risk of being exposed, investigated and punished for his corruption by the new Emperor. He had an idea and established a pawnshop. He also displayed his less valuable items in the shop for sale. When somebody wanted to bribe He, this person would go to the pawnshop and redeem a low value item for a much higher price than it was worth; alternatively this person swapped his higher value bribes with less valuable items instead as a deal. He secretly checked the items received with the shop manager behind the counter and then sought to satisfy the requests in accordance with the amount of bribe he received (World Financial

Report, 2006). Thus, He did not need to contact with these bribers directly and the bribes were laundered “white”. All He’s assets would be proved from the profit of his legitimate business, if his excessive assets were questioned.

2.3 Chinese Triads and Money Laundering

More recent Chinese money laundering history has been significantly associated with the development of organised crime -triads. Triad societies, with a tradition of secret lore and initiation rituals dating back to the 17th century, have long dominated the underworld of Chinese communities. Initially they were established by the remains of Ming dynasty (1368-1644), and were oriented to defend against the Qing dynasty (1636-1912). It was also diversified by a number of mutual support organisations for people at the bottom of the power structure to make a living, based on sworn brotherhood and built on kinship; and for businessmen to protect their goods from being robbed on the delivery route. They had a clear structure, nicknames for different level of their posts, training programmes, different responsibilities and duties in different teams, ceremonies for entering the organisations, strict disciplines, codes and figure signal communicating techniques, and identification recognition systems.

According to He (2002), over time, triads have gradually become involved in a wide range of criminal activities such as smuggling salt and marijuana, running casinos, trafficking people for sex trade, and committing kidnap for redemption. Between 1912 and 1949, triads were highly influential in Chinese society. In the

early 20th century there were a number of triad societies, and the best known triad was “Qing Bang” based in Shang Hai and run by three ringleaders: Jin Rong Huang, Yue Sheng Du and Xiao Ling Zhang. To disguise its criminal income from the law enforcement agencies and the public, “Qing Bang” took a number of ways to launder their criminal proceeds generated from offences of racketeering, drug trafficking, sex trade, and running casinos.

Firstly, “Qing Bang” collaborated with the political ruling power. For example, in November 1916, the second son Ke Wen Yuan of the president Shi Kai Yuan was invited to join “Qing Bang”, and Yuan junior was appointed with a high ranking in the group. Secondly, “Qing Bang” forged an alliance with local warlords to seek military protection, and thus to benefits each other. “Qing Bang” was responsible for drug trafficking and funding the military expense of warlords. As a return, the army protected the safety of drug trafficking and maintained “Qing Bang”’s monopolised position in the drug trade. For instance, warlord Chuan Fang Sun’s army was paid 15 million in then Chinese currencies each year by “Qing Bang” when Sun was in power. Thirdly, “Qing Bang” itself tried to obtain political power to facilitate their crime. Jin Rong Huang obtained the support of the French Ambassador and was selected as the Police Commissioner in the French administrative area of Shang Hai. With protection from both the foreign and domestic military power, drug trafficking and other money-oriented crimes were able to develop and flourish.

Fourthly, to launder criminal proceeds effectively “Qing Bang” actively infiltrated into the financial services and commercial business. Initially as a stepping stone, Yue Sheng Du managed to become a board member of Shang Hai Commodity and Stock Exchange. He then established a financial institution- Zhong Hui Bank. The business of Zhong Hui Bank was slack and its capital ranked the 47th in the Shang Hai banking industry. Zhong Hui Bank’s major business was to launder money by depositing, layering and integrating criminal proceeds, which were mainly derived from drug trafficking and gambling. The bank charged other drug traffickers high commission fees for transactions. The bank even guaranteed the sales for the drug dealers if the fees were paid high enough. In 1935, Yue Sheng Du and Xiao Ling Zhang took over the Tong Shang Bank (Trading Bank) through illegal means. They spread rumours and this led to a credit crisis for Tong Shang Bank. People withdrew money from their accounts. The crisis forced the bank governor to hand in the Bank Asset and Liability Sheet to Du and Zhang. Du and Zhang were then elected as the governor and vice-governor of Tong Shang Bank. They immediately nominated members of triads in key posts to take over the control of the bank. Tong Shang Bank was then used to serve their criminal clients for money laundering. It was not long before Du took the post of the managing director of China Bank of Communication (CBC), the Governor of Pu Dong Bank, Guo Xin Bank and Ya Dong Bank, and the commissioner of Shang Hai Bank Consortium. The Shang Hai banking industry was almost wholly controlled by the criminals.

Fifthly, after gaining the control over the banking industry, “Qing Bang” expanded their business to other sectors such as commerce. They dominated major industries such as fishing, entertainment, food, and transportation in Shang Hai. These businesses became resources to enlarge further criminal finance and worked as front covers to launder their criminal proceeds with legitimate appearances. The reasons behind these money laundering activities are three fold. First, at that time the political power changed often. As a result of surviving in the that instable society, following any single political power was risky in regard to suffering with the consequences of the asset confiscation should a new party take over the power with the reasons of illegal activities under the protection of previous political power. If their assets were approved legal, they would not be easily deprived without acceptable reasons. Second, the political competitions were challengeable. The politicians who were in power and received financial support from triad groups did not want to be involved in scandals to endanger their future careers. This required that their funds from crimes were not publicly reported. Criminal proceeds should have a legitimate appearance and money laundering was needed. Third, triad groups were associated with Japanese invaders when Shang Hai was invaded by Japan. Triad groups were concerned about the public outrage and conviction for treason in the future. They had an incentive to launder criminal proceeds so that they would not be found out with evidence should the Japanese be defeated.

The Japanese invaders and the Nationalist Party later used triads groups during the Second World War and National War to collect intelligence against the Communist

Party and to help to suppress the public. Thus, the triads lost their secret characteristics and traditions of acting against suppression by the ruler. Triads eventually became a political tool utilised by the Nationalist Party and Japanese imperialism. When power in China was taken over by the Communist Party in 1949, the Communist Party severely suppressed and punished these anti-revolutionary triads. As a result, the key members of triads fled to Tai Wan and Hong Kong; and gradually others were eliminated in mainland China.

2.4 The Period between 1949 and the Beginning of Economic Reform

When the People's Republic of China (PRC) was founded in 1949, the Chinese government tried to embrace a pure socialist economic model to achieve greater equality and give the workers greater control of the means of production. Private property and capital were banned and a new model of socialist economy was explored. Three rounds of 'Five-Year' Plan were announced aiming to achieve socialist industrialisation; to transform the industries of agriculture, handicraft, and capitalist technology; and to develop commerce in a high speed. In the first Five-Year- Plan, Prime Minister En Lai Zhou stated that "capitalism will be utilized to help the building of the 'New China' and finally merged into communism". The private businesses that survived from the liberation war were suppressed by the 'Three-anti campaigns' (anti-corruption, anti-waste and anti-bureaucratic) between 1951 and 1952. The campaigns were notorious for being anti-capitalist, and imposed baseless charges that allowed the government to punish capitalists with

severe fines (Spence, 1991). During the period of the second Five-Year-Plan, the so-called Great Leap Forward occurred. A plunge in agricultural output occurred. The irregular and haphazard backyard production drive failed to achieve the intended objectives as it turned out enormous quantities of expensively produced, low quality goods, most notably steel produced from low quality iron which cannot be used to build (Chan, 2001). In 1966, the “Great Proletarian Cultural Revolution” began, initially as a campaign for Mao Ze Dong to retake power from Liu Shao Qi and to “eliminate the liberal bourgeoisie” from the Party. In industry, wages had been frozen and bonuses had been cancelled. Industrial production was badly affected by the ensuing confusion and strife, when hundreds of millions of people simply stopped working, while notable politicians, factory owners, and even teachers were victims to the massive “uprisings” (William et al., 1991).

Between the 1950s and 1980s, the Chinese communist party and government always appreciated the dominant position of Marxist ideology, opposed and eliminated the ideological influence of imperialism, feudalism and capitalism. China criticised the capitalism Western lifestyle as so-called “Western decayed ideology and lifestyle”. The propaganda and education to anti-capitalism were always based on large scale public campaigns and were made obligatory for the public to attend. The events such as intelligentsia brainwashing and socialist educations cast people’s ideology and limited capitalist ideology. People lived in a spiritual and moral society rather than in a materialised world. A socialist transformation of agriculture, individual ownership of handicrafts into collective

ownership, and capitalist industry and commerce (He, 2009) diminished inequality in income. Motivation to legally pursue personal financial gain was discouraged. The motivation to commit crime was minimal. Crimes such as the commission of predicate offences or of related money laundering were not major social problems. In addition, during the above period China faced an international hostile economic environment led by Western capitalism. China felt no desire or need to communicate with capitalist nations and to participate in international activities. The Chinese domestic industry grew up by its own efforts rather than foreign assistance. Thus, China was not influenced by outside economic and political power. China was not tied by the powerful nations and international institutions to comply with international initiatives including anti-crime policies and laws. Money laundering legislation did not exist in the West until the mid 1980s; neither did China have it at that time. Furthermore, China enclosed itself to the outside world prior to economic reform. Foreign influence was regarded as 'spiritual pollution' in a communist society and politically and publicly rejected. It was more risky for Chinese governmental officials to be exposed at that time in China, should they be found to have an association with international criminals. As a result, international organised criminals would find it hard to infiltrate China's borders and to utilise China to facilitate their crimes. The perspectives of economic status, strict state control on financial institutions, social and educational circumstances, foreign policies, and ideology made little incentives for criminals to launder their proceeds in China.

In the context of political discourse to discuss China's money laundering evolution prior to economic reform, the PRC created a single, powerful and centralised government; and established a solid socialist totalitarian political power. Apart from the political and structural control, a number of organisations were also generated to serve to endorse communist party's ruling power. These organisations included the Young Pioneers, the Communist Young League, Industrial Unions, Social Order Protective Organisations, Women's League and Voluntary Social Control Organizations. These organisations worked with all ranges of the general public in terms of age, gender, location, employment and class. These organisations knitted a massive net to assist the Community Party to control China. The activities of people were monitored and controlled. Crime was spotted and intervened against in a classic preventative model. Especially the people's commune in the rural areas was characterised with militarily socialist and tightly controlled peasants at that time. Any anti-social behaviour would be identified and disclosed to the authorities. In addition, a number of nationally organised political campaigns and class struggles strengthened communist dictatorship and made control reach an ever more powerful degree. People lived in a monitored environment and a fearful world. The omnipresent and powerful control effectively suppressed the generation of crime. Large scale organised crime was impossible to generate. Furthermore, during that period, as far as is known even today, the communist party leaders and governmental officials were of integrity, loyalty and incorruptibility, which also curbed the development of organised crime and other large scale crimes in terms of

generating profound proceeds. China was agriculture-based and largely poor at that time. There really were no additional monies or commodities to steal or to convert and no real incentives to do so. If all your neighbours had nothing and you came into any visible wealth, you would be vulnerable and suspicious, particularly whilst in a heavily controlled regime. Predicate offences of money laundering were hardly reported in the media.

2.5 The Resurgence of Money Laundering after the 1980s

At the early stage of economic reform in the early 1980s, class struggle no longer existed. Political education was lessened. People gradually recovered from political campaigns. Materialism had become the dominant worldview of the people. The desire for material gain (money or expensive belongings) has significantly led to the increase of social problems such as crime. However, harsh punishments targeting offenders involved in organised crime, economic crime and public order offences impressed as China's major anti-crime strategies. Seizure of criminal proceeds was seen as an accessory of a successful crime investigation. The terminology of money laundering was new and incidents of money laundering were seldom if ever identified and reported in China due to lack of legislation and regulation. Drug offences in China had a geographical character, which mainly concentrated in the south and west. The harm of drug proceeds in China was not seen as posing a serious threat to the nation as a whole, as China was more used as a drug transit route for the Golden Triangle rather than a major drug production and consumption

country. In the 1980s, the creation of anti-money laundering regimes was initially to combat international drug trafficking by targeting their finances. The dimension of defined predicate offences of money laundering was narrow. The impact of money laundering on China did not draw enough attention of the law and policy makers. Unlike its Western counterparts, drug trafficking in China did not outweigh other types of crimes. The initiatives of the Financial Action Task Force (FATF) of fighting drug trafficking appeared not to meet China's immediate needs at that time. Anti-money laundering in China was not as enthusiastic as that in other states such as the United States in the early 1990s. Although China had opened its gate to the rest of the world; however, China still needed to take time to understand international working routines and disciplines. China needed time to learn how to meet international standards and requirements. Little work was done specifically in regard to the crime of anti-money laundering; the effort was merely combating what are now viewed as money laundering predicate offences. No discourse in law or regulation in the 1980s was generated to clearly address the term or substance of money laundering.

However, money oriented crime including corruption increased significantly in the late 1990s. The commission of money laundering was noted and rose. Organised criminals, drug traffickers, smugglers, and corrupt officials have been reported laundering a large quantity of criminal proceeds (the cases will be introduced in the later chapters). Criminal proceeds have been considered as a threat to the stability of China's economic reform. According to Yang (2006), China has been considered

a 'magnet' for money laundering activities, perhaps up to ¥30 to 40 billion (£2-2.67 billion), calculated according to the current foreign exchange rate) every year. Levi and Reuter (2006) have expressed considerable doubt about the accuracy of estimates of the amount of money laundered each year for every jurisdiction; however, use of the figure, accurate or not, still can roughly indicate that money laundering in China has become a social problem. As a result, the Chinese government needs to address it, both for internal and external reasons.

2.6 An Historical Review of Chinese Underground Banking System

Chinese underground banking system is less known to the international law enforcement and policy makers. The lack of understanding is largely due to lack of understanding of the culture in which this system operates. Chinese underground banking has historically demonstrated to be one of the safest methods to transfer large sums of money to evade governmental investigation. A concerning modern phenomenon is that there is a link between money laundering activity and the Chinese underground banking system.

Underground banking is described as a commercial activity involving the transfer of money across national borders through a non-bank institution or organisation (Schaap and Mul, 1995). There are many terms used to describe informal remittance systems worldwide such as "alternative remittance systems", "underground banking", and "informal value transfer system". The specific terms employed for such practices vary according to country and ethnic origin. Internationally, the terms

used to describe Chinese traditional informal value transfer system are many, including fei-ch'ien (flying money), hui kuan (money remittance), Ch'iao hui (overseas remittance), Nging sing kek (money letter shop), Chop shop, and Chiti banking – (refers to the “chit” used as receipt or proof of claim in transactions introduced by the British in China; short for “chitty”). Underground banking in China was developed much earlier than the formation of modern banking institutions. It has a well documented history of serving legitimate trade or other transactions when needed. In modern China, Informal Value Transaction System (IVTS) is referred as Di Xia Qian Zhuang (underground banking/underground money shop), which has a clear character of being illegitimate. In Chinese early banking history, these networks were essentially established to serve perfectly legitimate needs, although these are used for illegal purposes such as the violation of currency exchange controls and the by-passing of various laws as a by-product. However, there is a trend to show that Chinese underground banking has increasingly played an important role as a fund transferor in contemporary China's large profit-driven crime.

There have been studies conducted on Chinese early banking facilities and it is widely recognised that fei-ch'ien (flying money) was an IVTS and its creation was the result of convenient means of exchange to cope with growing tea commerce between locals and the imperial capital. A common story is that Fei-ch'ien emerged as a method of settling accounts between traders and local government authorities

to avoid the inconvenience of physically transporting large amounts of money or goods from place to place. As Cassidy (1994) notes,

“Provincial governors maintained ‘memorial offering courts’ at the capital. Southern merchants paid the money they made from the sale of goods at the capital to these courts, which then used it to pay the tax quotas due from the Southern provinces to the central government. In return, the courts issued the merchants with a certificate. When the merchant returned home, he presented this certificate to the provincial government and was paid an equivalent sum of money. Thus ... both the merchant and the local government avoid[ed] the risk and inconvenience of carrying quantities of copper or silk”.

It should be noted that fei-ch’ien was actually a transaction authorised and supervised by the government to facilitate commerce between provinces and the capital. In this sense, Fei-ch’ien was used by legitimate companies, traders, and government agencies to conduct business in countries with no or inadequate formal financial systems. Fei-ch’ien was a formal value transfer system.

My finding, however, suggests a relevant explanation that why Fei-ch’ien has been regarded as an IVTS. According to Xin Hua news (Xinhua, 2004) Fei-ch’ien (flying money) was invented in the era of emperor of Tang Xian Zhong (806-820). At that period domestic and international trade were developed. The silk road between Chang an (Tang’s capital) and Iran and Turkey made China become the trade centre

of Asia. “Kai Yuan Tong Bao”, the copper currency of Tang, became popular and prevalent in many countries that traded with Tang. The situation intensified, which led many domestic areas to a shortage of copper money. The central government then regulated the local governments not to allow copper currency abroad. Thus fei-ch’ien was invented for exchange control. This is very much like the role that Fei-ch’ien plays in the current environment.

Other types of IVTS were also developed subsequently. In the early era of Northern Song (960-1127), only iron cast currency was allowed for use in Si Chuan Province. The iron cast currency was even heavier than copper money. In 991, people needed to use approximately 60kg iron cast to buy a bolt of cloth. The weight associated with carrying and transporting currency became prohibitive. As a result, the earliest paper currency- “Jiao Zi” was invented by 16 rich merchants in the capital of Si Chuan- Cheng Du. The “Jiao Zi” shop was like a bank conducting financial transactions as an alternative value transfer system. In Southern Song (1127-1279) other type of IVTS such as “Hui Zi”, “Chuan Yin”, “Huai Jiao” and “Hu Hui” were invented in different areas (Chinanet, 2005).

In Ming (1368-1644) and Qing (1644-1911) dynasty Shan Xi merchants established and developed “Piao Hao- Shan Xi Banks”, which were the early Chinese banking institutions. To deal with the transfer of large amounts of cash from one branch to another, Xi Yue Cheng Dye Company introduced drafts, cashable in the company's many branches around China. Although this new method was originally designed

for business transactions within the Xi Yue Cheng Company, it became so popular that in 1823 the owner gave up the dye business altogether and reorganised the company as a special remittance firm, Rishengchang Piaohao. They were family based and soon grew beyond Shansi province to the whole country (Cassidy, 1994). Other “old style banks”, such as local retail banks, money exchangers, clearinghouses, customs banks and silver shops, emerged to compete with Shan Xi Banks.

Chinese modern banking institutions have been developed since the first opium war (1839-1842) (Zurndorfer, 2004). British and other European banks entered China around the middle of the nineteenth century to service the growing number of Western trade firms. Following a series of military defeats, the Qing government was forced to borrow from foreign banks and syndicates to finance its indemnity payments to foreign powers. Foreign banks enjoyed extraterritorial rights. They also enjoyed a complete control over China’s international remittance and foreign trade financing. Being unregulated by the Chinese government, they were free to issue banknotes for circulation, accept deposits from Chinese citizens, and make loans to the Qian Zhuang (native banks). Piao Hao was gradually left out as a major financial institution. After 1949, the banking system was centralized early on under the Ministry of Finance (MF), which exercised firm control over all financial services, credit, and the money supply. Any unregulated financial institutions were regarded as being illegitimate including Piao Hao and Qian Zhuang. Therefore, their financial activities were illegal and they were forced out of the market.

Since the economic reform, underground banking activity has reappeared and rapidly developed and spread all over China. Underground bankers in China are difficult to identify or locate with certainty. Even if it were possible to detect them, their transactions were so varied and secretive it would be difficult to understand the exact detail of their operation. The following illustration of underground banking practice is based on detected cases and identified information. Broadly speaking, Chinese underground banking mainly located in the areas of Guang Dong, Fu Jian, Zhe Jiang, Jiang Su, Shan Dong and other economically developed areas (Sinanews, 2004). I would like to distinguish Chinese underground banking into three types. One mainly undertakes foreign currency exchange business illegally, and is mainly located in Guang Dong, Fu Jian and Shan Dong Provinces. Due to the current foreign exchange restriction, this type of underground banking makes profit from the margin between official and underground exchange rates. This type of underground banking originated from Guang Dong Province due to its geographic character of bordering with Hong Kong. Their major customers are travellers and private entrepreneurs. A great number of enterprises are located in coastal areas and make products for exports. These businesses have a great deal of demand for foreign currencies. The reasons for demanded foreign currencies are twofold. The first is to use foreign currencies to import materials. Two is to transfer capital to evade tax. These underground banks are created for legitimate businesses purposes and for tax evasion. Underground banks in Guang Dong and Fu Jian Province mainly deal with US and Hong Kong Dollars, and those in Shan Dong

Province mainly deal with US Dollars and South Korea Currency. The type of foreign currency popularized in different location reflects the dominance and demand of foreign currency and location of foreign businesses. Guang Dong and Fu Jian Province are close to Hong Kong and Shan Dong Province is close to South Korea. Both legitimate and criminal enterprises in these areas are influenced by their strong neighbouring economy and need to meet currency demand for their business transactions. The second is to conduct illegally banking type financial activities such as taking on savings and issuing loans based in Zhe Jiang, Jiang Su, Fu Jian and Yun Nan Provinces. These underground banks are usually called Biao Hui, Tai Hui, or Hu Zhu Hui. These areas are usually economically developed areas, which need enormous capital to fund their businesses, whilst the local official banking system is not sufficient to meet their immediate needs. The people there self-organise and put together the capital. The money is loaned to businesses which need urgently and are willing to pay higher interest. The third type illegally runs pawnshops and conducts loans business. This type of underground bank is mainly located in Hu Nan and Jiang Xi Province.

The clients of underground banking have been not only limited to individuals and small domestic enterprises, but also gradually extended to foreign investors and large foreign companies. The number and scale of transactions are also rising. According to the Chinese Anti Money Laundering Report 2007, Chinese Police launched more than 50 actions to combat underground banking, along with the Bank of China (BOC) and Foreign Currency Management Bureau in 2007 (SAFE,

2007). Some 43 serious cases in relation to underground banking were detected with an apprehension of over 180 suspects and a calculation of proceeds of approximately ¥11.4 billion (£0.76 billion at that time). The above data indicate that Chinese IVTS is active and is of concern to the Chinese government.

2.7 Conclusion

This chapter illustrates that money laundering in China is not a modern product but has developed for centuries, although the evolution of money laundering appeared to fluctuate. It suggests that money laundering and IVTS have been important to Chinese economic, social and political history. It has been at times publicly endorsed and despised. The understanding of this chapter will be a necessary element in lubricating the development of China and navigating the difficult problems associated with development. Historically a number of serious offences including embezzlement, burglary, maritime piracy, bribery, drug trafficking, smuggling, sex trade, racketeering, and gambling sought to hide their criminal proceeds. Money laundering methods used in the past included self-laundering and using a legitimate business as a front whilst laundering criminal proceeds mixed with legitimate business income. Other methods such as laundering criminal proceeds in financial and non-financial institutions, outside the jurisdiction, and through underground banking system are also considerable. The fast recovery speed of money laundering suggests Chinese criminals are prone to and capable of using traditional money laundering methods to evade official sanctions.

Chapter III: Literature Review Part 2 – The Money Laundering

‘Problem’ and Contemporary Responses

3.1 Introduction

Chapter three discusses the money laundering problem and responses in the contemporary context. This includes the definition of money laundering from an international perspective, an examination of the pressures to respond brought about by international understandings of the nature and extent of the problem and the influence of powerful international bodies and governments such as the United States. It also includes Chinese definition and scope of money laundering, the identification and discussion of the development of the anti-money laundering regime in China (see Appendix One), which encompasses many of the prevention and enforcement components that are recommended by international bodies and implemented by many governments. The current money laundering response in China is illustrated in line with Levi and Reuter’s (2006) generic AML structure.

3.2 The International ‘Problem’ and Pressures to Respond

3.2.1 Definitions of Money Laundering

Since the end of cold war, much attention and resource of western governments have been shifted to protect domestic security by attacking drug related and organized crimes. Targeting criminal finance was regarded as an innovative initiative and strategy to achieve better anti-crime effects. Uncovering, tracing,

freezing, and confiscating criminal proceeds have been focused, which require the criminal justice system to criminalize and combat criminals managing their finance process, which is known as money laundering. The first time that the emergence of money laundering addressed was in the United States in the Bank Secrecy Act (BSA) of 1970, which required that insured depository institutions maintain records and report transactions. The objective was to prevent banks from being used to hide money derived from criminal activity and tax evasion. Since then, the number of legislative and regulatory standards has been introduced to help prevent money laundering. In the United States, Money Laundering Control Act (MLCA) of 1986 and the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT) Act of 2001 (the U.S.A. Patriot Act), also criminalize money laundering. These three laws have formed a fundamental legal framework for governmental bodies to implement the country's AML policies.

In the UK, the concept of money laundering was firstly contained in the Drug Trafficking Offences Act 1986 and was later consolidated into the Drug Trafficking Act 1994. The scope of money laundering predicate offences was expanded to include indictable non-drug offences in The Criminal Justice Act 1987 and The Criminal Justice Act 1993. The Proceeds of Crime Act (POCA) of 2002 extends the definition of money laundering to all crimes.

The concept of money laundering was soon developed internationally. The United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances held in Vienna in 1988 (the 1988 Convention) was the first time money laundering was launched internationally as a criminal offence in a drug context. To carry this forward, the Financial Action Task Force (FATF) was created to counter drug production, consumption and trafficking as well as “the laundering of its proceeds” by the Summit Meeting of the Heads of State or Government of the seven major industrial nations (Group of Seven, or G7), joined by the President of the Commission of the European Communities in Paris in July 1989. International co-operation to prevent the utilization of the banking system and financial institutions for the purpose of money laundering was strengthened. Most importantly, in April 1990, the FATF issued 40 recommendations. They have been recognised, endorsed, or adopted by many international bodies. The principles for action have been set out and countries are allowed with a measure of flexibility in implementing these principles according to their particular circumstances and constitutional frameworks (FATF, 2008). Responsible membership and non-membership countries have gradually criminalised money laundering and adapted anti-money laundering policy in their legal and regulatory systems by this inspiration (or ‘soft law’ pressures), although they are diverging on some points. These points include different understanding and perspectives on local predicate crimes, and anti-crime priorities in different sectors, regions and states. At least

rhetorically, money laundering countermeasures have become a key issue in global anti-crime programmes and political declarations.

There are a number of definitions of money laundering worldwide. Simply speaking, money laundering activity refers to a process of transforming the proceeds of criminality into seemingly legitimate funds. The standard definition and understanding of money laundering tends to presuppose substantive criminal involvement linked to organised crime activities, if not the possible presence of professional launderers (Hicks, in press). The coverage of predicate offences of money laundering in many countries such as the UK has been expanded to include all crimes, which seek to launder criminal proceeds. Money laundering usually consists of three stages: placement, layering, and integration. Placement is the depositing of funds in financial institutions or the conversion of cash into negotiable instruments. Layering involves the wire transfer of funds through a series of accounts through the financial system in an attempt to hide the true origins of the funds. Integration is the step to mix “legitimate acquired” criminal proceeds into legitimate world. Legally, money laundering refers only to the proceeds of specific crimes (often referred to as the predicate crimes), the list of which varies cross countries but which has gradually been extended in most parts of the world to ‘all crimes’ capable of being sentenced to a year or more imprisonment (Levi and Reuter, 2009).

Internationally, a number of AML agreements have played an important role in combating money laundering (ML). These agreements include:

- the Statement on Prevention of Criminal Use of the Banking System passed by Basel Committee on Banking Supervision in 1988,
- Council Directive on Prevention of the Use of the Financial System for the Purpose of Money Laundering passed by Council of the European Union in 1991,
- the Wolfsberg Anti-money Laundering Principles, Wolfsberg Statement on The Suppression of the Financing of Terrorism,
- Wolfsberg AML Principles for Correspondent Banking,
- the FATF Forty Recommendations against Money Laundering and Terrorists Financing, and FATF Eight Special Recommendations on Terrorist Financing.

Meanwhile, with the strengthening of the international cooperation for AML, some important international organisations have been created to combat criminal proceeds from entering financial institutions and other areas of ‘vulnerability’. These organisations include the Financial Actions Task Force, the Egmont Group, and the Wolfsberg Group. In brief, the FATF is consisted of 34 members including 32 jurisdictions and two territorial international organizations and 23 advisors including five AML territorial international organizations and 18 international organizations as World Bank, International Monetary Fund (IMF), Asian

Development Bank (ADB), African Development Bank, etc. The Egmont Group is built up by the Financial Intelligence Units (FIU) in 116 (by the end of 2009) countries for the purpose of information exchange and cooperation. The Wolfsberg Group was set up by 12 multinational banks, who set up an elite private sector grouping to develop their standards of AML and ensure greater consistency (Pieth and Aiolfi, 2003).

3.2.2 Extent and Scope of the Problem

The seriousness of money laundering is said to be indicated by the figure of proceeds laundered. The International Monetary Fund in 1996 estimated that the aggregate size of money laundering in the world could be somewhere between two and five percent of the world's Gross Domestic Product. Using 1996 statistics, these percentages would indicate that money laundering ranged between USD 590 billion and USD 1.5 trillion (FATF, 2009). The United Nations Office on Drug and Crime (UNODC, 2009) estimated amount of money laundered globally in one year is \$800 billion - \$2 trillion in current US dollars. The figure of criminal proceeds involved in money laundering is astonishing. However, the reliability of the statistics is questionable. Accordingly to Hicks (in press) the estimates of money laundering often suffer from non-existent or questionable methodologies, indirect indicators of supply and demand with large margins of error, and mathematical incoherence combined with the generation of "facts by repetition" (Van Duyne 2002; Passas

1999). Levi (1999) further argued the accuracy of the quantity of money laundered that

“...we lack more than a modest understanding of the incidence and prevalence of current techniques [of laundering] even from the systematic analysis of detected cases, let alone from those that are undetected. Instead of overly ambitious ‘global’ data and pattern estimates...- however organizationally and politically useful- it may be better to build up from the ground more modest analyses of what we can plausibly know about criminal money management”.

3.2.3 FATF Pressure

The political concerns about the growing numbers of drug dealers in the United States triggered the “War on Drugs”. The initiatives were extended to “follow the money” to catch the beneficial owners of the illicit funds internationally. A world wide policy of the 1988 UN Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances was adopted in Vienna on 19th December 1988 to implement the previous narcotics treaties and came into force 11th November 1990. Article 2 (1) of the Convention required states to make money laundering itself an offence. At the time of calling for strengthening of the criminal law to combat money laundering, the article 5 (3) also required the financial industry to comply with this act. The combination was considered to play an effective preventative role to combat money laundering.

Concerns about the abuse of financial institutions by criminals, who transfer or deposit criminal proceeds, the United States, the United Kingdom, France and other leading industrial nations established the Financial Action Task Force on money laundering in Paris in 1989. The FATF opted for First World type procedures by standardising international criminal law; establishing regulatory obligations for banks and non-banking financial institutions; setting up rules on international co-operation of authorities; and making additional rules on the supervision of the financial sector pertaining specifically to the prevention of money laundering. The members of the group are industrialised nations and strategically important countries and jurisdictions such as financial centres. On the basis of these mighty participants, the FATF has become initially an influential and lately an international crime control body with strong sanctioning procedures in terms of regulating international financial transaction, along with the Basel Committee on Banking Supervision. The above standards were initially made as soft laws and eventually developed to binding law for all members of the group. In addition, the FATF is an inter-governmental body whose purpose is the development and promotion of policies, both at national and international levels, to combat money laundering and terrorist financing. The expansion of its membership from 16 during 1991 and 1992 to 35 in 2009 increased the coverage and influence of the FATF worldwide. National law making and international co-ordinated rules have all been developed in line with the FATF recommendations. Although the 40 recommendations initially applied only to members of the FATF, they have gradually extended to

non- member countries of the FATF. The FATF has strict accession procedures and a strict monitoring mechanism based on peer pressure. “Naming and shaming” mechanisms in 2000 illustrating 23 non-co-operative countries and territories was a prevailing example to demonstrate its power. For those on the list ‘the FATF recommends that financial institutions should give special attention to business transactions and relations with persons, including and companies financial institutions’ from listed jurisdictions (FATF 2001). Whether they wish to be or not, and if found not meeting the minimum international AML standards, states would be subject to international sanctions- in particular, the threat of loss of access to the most significant financial institutions and jurisdictions of the world; in addition, would undermine confidence and lead to disinvestment. Two of the examples best illustrates the negative consequence of being subject to international sanction due to the concerns about money laundering through financial system. One was the case of the Seychelles. According to Sharman (2006):

“The Seychelles decided to enter the market for financial services in 1993 in response to worries about chronic shortages of hard currency, and the country’s heavy dependence on only two industries: fish and tourism. To kick-start the new offshore centre, the government passed the Economic Development Act in 1995, which established an Economic Development Board for the purpose of approving investors and granting concessions and incentives to potential investors. Investors shall invest no less than US\$10 million (s. 5). Concessions and

incentives which the Board may grant include immunity from prosecution for all criminal proceedings whatsoever, except those arising from acts of violence or drug trafficking in Seychelles (s. 7). The FATF explicitly condemned the Act in February 1996 and urged its members to apply special scrutiny to all transactions involving the Seychelles. Chastened by the strongly negative publicity and international protests the Economic Development Board was never convened, but the Act (and the international advisories) lasted until 2000. In a 2004 report, the IMF explained the relatively slow growth of the offshore sector in the Seychelles by lingering negative associations with the Economic Development Act. The second example was the case of Antigua. Shortly after the cautions were issued, the Bank of New York, Bank of America, Chase Manhattan and HSBC Banks all terminated their correspondent banking relations with Antiguan institutions. Those banks that continued to provide correspondent banking services raised their fees by 25 per cent, on the grounds that they had to take extra precautions against illegal money. Even firms that maintained a presence sought to distance themselves from any association with the country. Thanks to a sudden drop-off in interest in the country by foreign investors, the number of offshore banks declined from 72 at the end of 1998 to 18 in December 2000 and 15 in 2003, causing a decline in government revenue and job losses. Investment

professionals and bankers in the US and Britain were obliged to warn clients about the advisories, many of whom instead chose other Caribbean jurisdictions, while those investors that persevered tended to drive a harder bargain with Antiguan authorities. The number of active International Business Companies (IBCs) incorporated in Antigua has not yet recovered to the pre-2000 level. The local authorities immediately set about reviewing and suspending banking and company licences as well as launching several money laundering investigations. The compromised regulatory body at the heart of the 1998 legislation was replaced with a new International Financial Services Regulatory Authority, all of whose members were on the public payroll rather than industry representatives. In turn, this body was replaced in early 2002 with a further expanded Financial Services Regulatory Commission, employing a staff of 44. Additionally, a new office of the National Drug Control and Money Laundering Policy was established to exercise FIU functions. Bearer shares were abolished, and service providers had to establish the identity of every one of the thousands of bank account holders and IBC owners. Financial secrecy provisions were weakened with regards to both domestic and foreign authorities. The government signed a Mutual Legal Assistance and Extradition Treaty with the US in 1999 and a Tax Information Exchange Agreement in December 2001. After making more than 30 changes to relevant legislation, the

advisories against Antigua and Barbuda were dropped in July (United Kingdom) and August (United States) 2001. After the country was de-listed the Prime Minister was finally able to remark ‘We now look forward to growing our financial services industry without any shadows hanging over it’”.

To integrate into the international financial system, it is essential to set out the basic framework for anti-money laundering efforts in line with the FATF requirements, which in turn reflect the process of globalisation. Globalisation is the progressive integration between national economies and the breaking down of barriers between trade and financial flows around the world. The increasing link with the rest of the world is essential for the future of China’s economic development. China has successfully developed its labour oriented industries in the process of globalisation. The side effect of its globalisation process is visible. There has already been a number of anti-China elements spread over the world; for example, some manufacturing companies closed down their factories in western countries to reduce labour costs and open new branches in China instead. As a result, these countries will have to experience the loss of employment and even social unrest. In addition, China has challenged some countries that were famous for their traditional industry. An incident of burning Chinese shoes in Spain could reveal the anger of some local shoe-makers due to competition from their Chinese counterparts (Guo et al, 2004). Furthermore, the industries “invaded” by China have diversified to the high technology oriented fields. A Chinese automobile company took over the

internationally famous car brand Rover. The products made in China have benefited consumers but also alerted the rest of the world as being a strong international competitor in the process of economic globalization. China's rise is no longer defining itself solely as an outsourcing destination for low-cost labour: China wants to be the driving force behind the global business in many other areas such as the banking industry and financial markets. Many messages such as holding the Olympic Games have indicated that China wants to be an important player in global power and prestige. The global business community demands transparency and better avenues for legal redress, under the banner of Rule of Law. Capitalism is a ruthlessly competitive process. 'Maintaining a level playing field', 'ensuring the competitiveness of the financial sector' and 'reducing unfair competitive advantage of inadequately regulated jurisdictions' were consistently cited as important reasons for the global scope of the AML regime. China does not want the perception of being seen as a haven for money laundering. To integrate itself into this, to gain global commercial and financial power and even to shape tomorrow's global business trends; China has to become more tactical, realistic and practical. Money laundering can be used as an instrument to interfere in the global market with its rising economic and political power. China has changed politically in a manner commensurate with its embrace of markets and globalization by adopting laws in line with international standards, although there is an important difference between passing laws and communicating/implementing them.

China began a major overhaul of its banking system in 2002, which led its biggest banks to take on foreign strategic investors and make initial public offerings. Cash infusions from the government and the share sales have put the banking system on a much stronger financial footing (Carew and Colchester, 2007). With the fact that Chinese companies increasingly operate globally, the Chinese banks are looking forward to moving into developed economies to better serve their main corporate clients.

The financial services market is no doubt an important industry that China needs to consider how to solve the potential disputes with other countries. The basic and essential condition that China has to do is to comply with international rules and reduce the risk of having conflicts with advanced western countries. The sanctions of non-compliance are serious. For example, according to the Office of Foreign Assets Control (OFAC) of the US (OFAC, 2009), the U.S economic sanctions takes three different forms with respects to against designated non-U.S. countries. The sanctions (a) prohibit transactions or dealings with the targeted individuals, entities and governments described below, (b) require U.S. persons to block (freeze), upon receipt, any property of the persons and (c) restrict trade with or investment in certain targeted countries.

AML regulations were originally developed in western hemisphere, then move to other areas of the world. In general, western countries have implemented AML regulations with a higher standard than Asian and African countries, although the

level of implementation varies individually. Chinese financial institutions are willing to become global institutions. They will inevitably communicate with different jurisdictions with different AML regulation standards. The better solution for China to establish an AML regulation going for the highest or at least widely accepted denominator and to apply that across all jurisdictions. This will make Chinese financial institutions more competitive in the global market. The majority of these economically powerful countries are the members of FATF and are regulated by FATF 40 recommendations in the context of anti-money laundering. These jurisdictions have a FATF standard AML regulation. Globalisation of financial markets has made China inevitably conduct numerous international money transactions with various regions. To reduce the risk of reputation damage, financial penalties and being left out from the global financial market, China has to establish and implement its anti-money laundering laws and regulations in line with international standards- the FATF standards. The establishment and implementation of the AML regulation in line with the FATF standard not only help to prevent itself being associated with criminal proceeds or terrorist financing at a maximum level, but also help China integrate into financial market without experiencing difficulties in AML issues. Certainly even the AML regulation is in place, it cannot prevent Chinese financial institutions from being contaminated. China could not fall due to a single issue of AML violation occurred in an individual financial institution as a whole. However, there would be unnecessary critics for China to bear if China has no a standardised AML regulation.

3.2.4 United States' Demands

Following the collapse of the Former Soviet Union and decline of Russia, China has become the substitute target for the United States, and is considered as the strategic competitor and the threat. The growth of China's political and economic power in Eastern Asia and the growing share in the world economy has challenged the interests of the United States.

The United States is the most powerful state in the world; any nation's conflicts with the US will tend to hamper their developments. The relationship with the US is the most important foreign policy for China. Therefore, China is pressurised to change the elements that conflict with the United States' foreign and domestic policies.

The US employed their military groups in some central Asian countries with the name of combating the terrorists. A surrounding line around China will be forged if the United States establishes a strong foothold in central Asian countries together with the USA military bases in Japan and Tai Wan from the East. China certainly does not want a military threat from the United States and considers central Asian countries as geographically important areas for China to ensure its national security and peace. In addition, Chinese separatists in the western province of Xin Jiang have a close link with some central Asian countries. The terrorist attack in the United States in 2001 has made Chinese authorities begin to actively participate in United States and international efforts to identify, track, and intercept terrorist

finances, specifically through implementation of United Nations Security Council counterterrorist financing resolutions. Drafting and enacting comprehensive anti-money laundering and terrorist finance laws can enable China to freeze and seize assets that comply with the revised FATF Forty Recommendations and its Special Nine Recommendations on Terrorist Financing. To increase its influence in some central Asian countries to combat Chinese separatists and balance the international power against the expansion of the United States, China has accelerated its domestic anti-money laundering regulation and actively became an initiate body of Euro-Asia anti-money laundering group.

However, the ability of the US to resist China (and, up to a point, vice versa) is undermined by US bond and currency holdings in China. In 2003 China overtook the United States and became the largest foreign investment country. The United States current account deficit is steadily rising. The foreign exchange reserve of China, however, has experienced an enormous increase during the recent years. There already have accusations and debates in the United States about the source, propensity and legitimacy of foreign investment into China. One of the claims is “most countries in the America, Europe and Pacific Rim have comprehensive money laundering laws, routinely sanction non-compliant financial institutions and indict, prosecute, and convict launderers. By contrast, relatively little has yet been achieved in the Middle East, South Asia, most of Africa, China, and much of Islamic Southeast Asia, including Indonesia and Malaysia...(Winer and Roule, 2002)”. As a Chinese economist Zu Liu Hu cited in the Phoenix TV interview on

23rd November 2005 that China contributes about one quarter of the deficit due to the trade surplus. According to the statistics of the account of deficit US\$ 660 billion made by Cooper in 2004, there should be about \$165 billion surplus run by China. However, the United States has different calculation. China has run a modest trade surplus since 1990 (except for 1993), which reached a peak of US\$44 billion in 1998, registering US\$33 billion for 2004. The gap between the two figures is about US\$132 billion; the question is coming out consequently. Where does the US\$132 billion come from? The comparison makes the following allegation more likely to have occurred.

The allegation of China's lack of control on the "dirty money" has conflicted with the US interests of controlling criminals' finance. Especially after the "9/11" terrorist attacks, actions to prevent terrorist finance from being transmitted have been aggressive. The consequences in the event that China does not take legal control over criminal proceeds while trading with the United States-led powerful states are twofold.

First, the market access to the United States financial institutions regulated by the United States could be denied. The United States is the leading anti-money laundering regime and dominates the distribution of the world capital resources. For Chinese banks who want to expand business and open branches in the United States market, anti-money laundering regulation requires essential software to be installed. In 1994, when China was far less powerful politically, the Bank of China was

delayed to open its branches in the United States due to inadequate legislation to meet the host country's AML standards and requirements. Chinese banking industry is ambitious to expand overseas. A precondition is that China needs to demonstrate its state banks are sound enough to operate abroad. After the Bank of China Ltd. and Bank of Communications Co. opened branches in the United States, three Chinese banks, Industrial & Commercial Bank of China Ltd. (ICBC) China Construction Bank (CCB) and China Merchants Bank Co., have been approved to open branches in New York in the last two years. China's compliance with the US AML regulation has facilitated its successful expanding businesses in the US.

In addition, the US Code (USC) (Title 12: Bank and Banking) requires American banks to be specially prohibited from engaging in any activities considered to be "unsafe or unsound" (USC, 2002), although it has to be read with irony in the light of the global meltdown. If American banks take on correspondent banking business with foreign banks, which do not have satisfactory money laundering control framework, the US banks will be discredited, fined and even penalized civilly and/or criminally. A symbolic lesson was the Bank of New York money laundering scandal, which broke in September 1999. The Bank of New York was the correspondent for Inkombank, which was the largest private bank in Russia. This Russian bank had connection with organized criminals, involvement in drug trafficking and other crimes. The Bank of New York was alleged to aid and abet the Inkombank to launder US\$40 million. The consequence of this scandal was detrimental. It cost the bank of New York nearly US\$5 million to settle the suit. The

credit of the bank of New York was seriously damaged, the shares fell 89 cents to US\$44.01 (though they subsequently recovered both profitability and share prices). Without addressing money laundering issues, Chinese banks will find it is hard to work in partnerships with the US banks to expand their businesses.

Moreover, according to the Bureau for International Narcotics and Law Enforcement Affairs (US Embassy, 2006) the United States exerts bilateral pressure through application of Section 311 of the USA PATRIOT Act in appropriate circumstances. Section 311 of the USA PATRIOT Act authorizes the Secretary of Treasury, after consultation with the various United States agencies including the Board of Governors of The Federal Reserve, the Secretary of State and the Attorney General and other relevant federal agencies, to designate a foreign jurisdiction, financial institution, class of transactions, or type of account as being of “primary money laundering concern”, and to impose one or more of five remedies known as “special measures”. Four of the special measures impose information-gathering and record-keeping requirements upon those United States financial institutions that maintain accounts for specific jurisdictions, institutions or types of accounts as described in the 311 designation. Under the fifth special measure, the Secretary of Treasury can issue rules that prohibit U.S. financial institutions from establishing, maintaining, administering or managing any correspondent account or a payable-through account for or on behalf of the designated primary money laundering concern. In 2005, the USG designated two Latvian banks, VEF Banka and Multibanka, and Macau-based Banco Delta Asia S.A.R.L. as primary money

laundering concerns. According to the Federal Register Notice, Banco Delta Asia S.A.R.L. provided financial services for more than 20 years to multiple North Korean government agencies and front companies that are engaged in illicit activities, and worked with Democratic People's Republic of North Korea (DPRK) officials to accept large deposits of cash, including counterfeit U.S. currency and agreeing to place that currency in circulation. In addition to the activities of the DPRK, investigations revealed that Banco Delta Asia S.A.R.L. serviced a multi-million dollar account on behalf of a known international drug trafficker. The Latvian government has taken steps to improve its anti-money laundering laws and successfully prosecuted four individuals for money laundering in 2005. Shortly after the United States Treasury Department published its proposed rule against Macau's Banco Delta Asia, the bank went into receivership and is governed by three interim managers appointed by the Macau government.

Second, with the increasing economic contacts between China and outside the world, some states have become increasingly powerful stakeholders in China by having a number of contracts or providing financial assistance. For instance: China had overtaken Japan to become the EU second-largest trading partner outside Europe, with a trade volume of over €115 billion in 2002. Some ongoing co-operation activities under the national programme reaching approximately €260 million in terms of multi-annual financial commitments (Sigurdson, 2003). China certainly wants to maintain these projects and develop further. But, investment from criminal proceeds has widely been believed to pose a substantial risk of harm on the

stability and consistency of the local economy. It is because plausibly money launderers are more likely motivated to avoid detection primarily, and to seek the return on their “investment” secondarily. As a result, their economic activities are prone to disobey normal economic rules and cause unfair competitions and destroy the confidence of investors. Protecting the interests of foreign investors requires China to speed up its anti-money laundering system to track down unhealthy investments and provide a rule-based investment environment for high-quality funds.

Third, faced with the pressure of international censure and open to training and technical assistance from the United States and other donor nations and organizations, China could be benefited from undertaking the corrective measures FATF prescribed. A number of Chinese Officials in charge of combating money laundering received free training in the United States, UK and Egypt. Fourteen anti-money laundering experts from U.S. government departments concerned gave lectures on legislation, institutions and operations concerning the issue in that country. They also informed the Chinese trainees of the situation regarding money laundering in the banking sector and international cooperation in the field.

3.2.5 Global Institutions' Requirements

The institutions of global governance mainly include the OECD, the Bank for International Settlements (BIS), the Basle Committee, the International Monetary Fund (IMF), the G7, the WTO, the World Bank, and the Asia-Pacific Economic

Cooperation (APEC). With the process of globalization, China can receive unprecedented benefits from these institutions. For example: (i) to obtain valuable support in designing institutions and policies that maximise the benefits of liberalisation while minimising its costs in international co-operation; and (ii) to access to financial resources. These global institutions are the enthusiastic advocates and promoters of anti-money laundering campaign. They set up the rules by pursuing an agenda of common regulatory standards, criminalization, and institution-building, as well as cooperative investigative, prosecutorial and preventive techniques in the control of money laundering. For example, the Basle Committee issued its statement of principles on the “Prevention of Criminal Use of the Banking System for the Purpose of Money-laundering” on 12th December 1988. Part III asks bank management to adhere to high legal and ethical standards, stating that although it might not always be possible to know whether (particularly foreign) laws are being broken, banks should not offer services or provide active assistance in transactions which they have good reason to suppose are associated with money laundering (The Basle Committee, 1988).

It can be seen that efforts to combat international financial crime are being overseen by these organisations and powerful states, particularly the FATF and USA. These organisations and states rely upon technocrats from the law enforcement and regulatory agencies of participating countries to develop anti-money laundering recommendations, criteria and questionnaires for self-evaluations, and to undertake mutual evaluations among countries consenting to such review. China has desired

to participate in the international economy to pursue its economic goals. As a precondition to engage in international market and become a world player, China has to compromise itself and obey (at least up to the point of sanction) the international rules including anti-money laundering. China has to adjust its anti-money laundering policy to be in line with the requirements of powerful states, the FATF and global institutions.

3.3 The Domestic ‘Problem’ and Response

Broadly speaking, there are four key stages of criminal legislation development in regard to money laundering in China. First, in 1979, prior to criminalization of money laundering internationally, Article 312 of Chinese Criminal Law criminalise activities receiving and handling proceeds of crime. Second, in 1988, under the influence of UN Convention 1988, China expanded new drug related offences. The Article 349 criminalises the handling or laundering of proceeds generated from drug-related. Third, in 1997, the Criminal Law criminalize the act of laundering proceeds generated from four broad categories of offences- drugs, smuggling, organised crime (mainly violent offences by criminal syndicates) and terrorism offences. Fourth, in 2001, China began to criminalise offences of financing terrorism in response to the ‘9/11’ attack in the US.

3.3.1 Definitions of Money Laundering

With international experience as reference and China's real circumstance, China has gradually developed its AML legislation. Money laundering was for the first time criminalized and adopted in China's criminal law at the Fifth Session of the Eighth National People's Congress on 14th March, 1997 under Article 191 "Whoever, while clearly knowing that the funds are proceeds illegally obtained from drug trafficking or from crimes committed by organized criminals or smugglers and gains derived, commits any of the following acts in order to cover up or conceal the source or nature of the funds:

- (a) Providing funds accounts;
- (b) Assisting to turn money and goods into cash or financial instruments;
- (c) Assisting to transfer funds through transferring accounts, or other ways of settling accounts;
- (d) Assisting to remit funds abroad; and
- (e) Other ways to cover up and withhold what is illegally obtained through committing crimes, and the nature and sources of such gains (Criminal Law of the People's Republic of China/Penal Code, 1997).

After the "9/11" terrorist attacks, funds controlled and utilized by terrorists have aroused high attention of the United States and the international community. Many countries have expanded money laundering legislation with the amendment of

adding terrorism into predicate offences of money laundering. In China, the third law amendment draft was implemented at a session of the Standing Committee of National People's Congress (SCNPC) in December 2001. The amendment was formulated "to deal more harshly with criminal acts of terrorists, for the protection of national security, social order and safeguard of safety of people's lives and property". Terrorism was consequently added into money laundering predicate offence category. Such, predicate offences of money laundering are finally defined from the four predicate offences: drug trafficking, organised crime (mainly violent offences committed by criminal syndicates), smuggling and terrorism. The enactment of Anti-Money Laundering Law was discussed at the 24th Meeting of the Standing Committee of the Tenth NPC on 31st October, 2006. It was promulgated and came into force on the 1st January 2007. The SCNPC widened the definition of money laundering to cover all types of serious crimes, particularly to include embezzlement and bribery, violating the Socialist market economic order, and financial fraud. Violating the Socialist market economic order is a unique Chinese term for a range of tax offences. It includes illegally selling value added tax (VAT) receipts, refusing to pay tax, escaping from collecting tax, falsely claiming a refund of tax after exporting, and providing a false amount on a VAT receipt.

Different countries define predicate offences of money laundering according to their priorities. The amendment indicates that these offences are the contemporary large scale money driven offences, and the current political concerns in terms of the harm of these offence on the national security, economy and society. The expansion

of upper stream offences of money laundering are in correspondent with increased awareness of the dimension and harm of money oriented crime, political concerns and international pressures.

The amendment of Chinese legislation has expanded the coverage of predicate offences to include any disposition of the proceeds of crime. However, Chinese legislation defines the offenders' culpability in the commission of the offences as "clearly knowing the funds from crime", and behaviour of mainly concealing funds. It is narrow compared with other states, which have expanded to cover arrangement, acquisition, use and possession of criminal assets, on top of concealing illicit funds. For example, according to Hicks (in press), the UK Proceeds of Crime Act (POCA) covers

- Concealing in the form of attempts, conspiracy, incitement, aiding, abetting, counselling, or procuring the commission of virtually any interaction with criminal property or its removal from the country;
- Arrangements that indicate knowing or suspecting that one is facilitating another in the 'beneficial' ownership of criminal property; and
- Acquisition, use and possession of criminal property also constitute an offence of money laundering.

The expansion of money laundering predicate offences corresponds to an increased awareness of the narrow definition of money laundering, the operational difficulties to distinguish proceeds of criminalised money laundering predicate offences from

those derived from non-criminalised offences, and the scope and extent of seriousness of non-criminalised offences. The potential financial power and social impact from predicate offences have appeared to become a concern within the Chinese government. Enormous criminal proceeds are believed to have been laundered for the purpose of prevent law enforcement agencies from investigation, prosecution and conviction. The expansion also reflects political concerns of the threats from profit-driven crime to the society, economic reform and stabilisation in Chinese financial markets, and international pressures of suppressing money laundering and terrorism. It could also plausibly argue that there is enough internal capital being generated from licit activities at this stage to allow Chinese society to expand AML without criminal capital.

3.3.2 Extent and Scope of the Problem

Understanding the volume of money laundering is essential to draw the politician's awareness, facilitate policy makers' assessment at law making stage, as well as for any assessment of the AML regime's effectiveness, although no accurate measurements on the quantity of money laundered have been widely accepted. In China, the incidents of money laundering were unrecognised and hardly reported prior to the 20th or even 21st century. However, since the money laundering control initiatives were instigated at the beginning of this century, the extent of money laundering has become a focus. The State Administration of Foreign Exchange (SAFE) announced that mainland China suffered from illegal capital flight

amounting to US\$ 58.8 billion and US\$14.1 billion, US\$31.7 billion and US\$13 billion respectively during a consecutive three year period between 1997 and 1999. Money laundering was reported to have played an important role in the loss of Chinese capital. The distinction between money laundering and illegal capital flight was not clearly identified at that time. To further convince and illustrate the scope of money laundering, the SAFE was also adamant about the harm of money laundering in 2000. It stated that China achieved a favourable trade earning of US\$ 24.1 billion and coupling with a foreign investment amounting approximately US\$ 40 billion. However, there was merely a growth of US\$10.97 billion of foreign currency reserve over 1999. Money laundering was described as rampant and being responsible for the total loss of approximately US\$ 30 billion. The media also corresponded with the SAFE's analysis by reporting that the number of money laundered in the Chinese mainland must be up to a yearly sum of ¥200 billion, a figure about 2 percent of the nation's GDP or a near equivalent of US\$22.5 billion of the country's export earnings in China in 2001. In addition, it reported that money laundering was responsible for laundering ¥70 billion of smuggling gain, ¥30 billion of embezzlement, and tax evaded from foreign-funded companies. China's 2002 Central Budget Deficit of ¥309.8 billion would be cut by 64 percent when it takes into account the money lost (People Daily, 2002). In 2004, the same newspaper reported that the annual amount of laundering money in China is as high as ¥200-300 billion.

The reasons behind the increased quantity of money laundered within one year were unclear. Without a transparent basis for calculation, reviewing ‘the causes’ is mere speculation. It might have been caused artificially by the increased number of money laundering; by the updated technology of monitoring and analytic tools; or an exaggerated figure driven by political consideration. Or it might be because the data cited by the newspaper were from two different sources. The methods of estimating the sum of money laundered in China follow their western counterparts’ path and mainly fall into two categories- macroeconomic and microeconomic. The conclusion appears no major difference from foreign study that the data reported appeared theoretically useful but functional unreliable. We should also be aware that data in China are either journalistic and anecdotal or partial at best. As Levi and Reuter (2008) suggest that

“Neither method yields estimates that can be considered as anything more than indicative. The macroeconomic estimates are methodologically flawed: they generate implausibly high figures. The microeconomic estimates lack a credible empirical base. These figures confirm that the phenomenon of money laundering is of sufficient scale to warrant public policy attention, but they are too imprecise to provide guidance for policy”.

Although we are unsure about the real extent of criminal proceeds involved, we can certainly conclude that substantial criminal proceeds have been generated or are

being generated by criminals, and thus there are incentives for the commission of the offence of money laundering. As the SAFE's director Shu Qing Guo (2002) remarked: "With the increased foreign economic exchanges and the growth in cross-border capital flow, money laundering may well increase".

3.3.3 Prevention

3.3.3.1 Administrative and Regulatory Sanctions

At the initial stage of AML campaign in 2003, China initially established an Anti-Money Laundering Unit in its Security Bureau, and a Payment Transactions Monitoring Division in its Payment and Settlement Office to analyze large and suspicious transaction reports. The SAFE also initiated similar arrangements, including the issuance of some guidelines and reporting forms. However, the complex characteristics such as trans-industry and trans-region transactions of money laundering and the situation of there being no responsible body to lead and co-ordinate different departments made the AML campaign less effective and more complex. It was only in 2003, when the State Council approved to adjust and reinforce the original AML coordination mechanism, and to strengthen the responsibility of relevant departments on AML, that a formal AML framework began to be institutionalized (see the chart below). The institutional arrangements include the structure, organization, staffing and training designed to familiarize their staff with the unique features of money laundering and the methods of detecting and preventing the crime. A number of Chinese legislation agencies under

the state council became involved to legislate or modify the AML related laws. These agencies include most of the bureau or institutions such as the People's Bank of China, Customs, Bureau of Commerce (BC), Bureau of Foreign Affairs (BFA), Ministry of Finance (MF), and Supreme Court. The information agencies include the financial regulation agency and financial institutions. The financial regulation agency refers to the People's Bank of China, including its subordinate bodies: China Anti-Money Laundering Monitoring and Analysis Centre (CAMLMAC) and Anti-Money Laundering Bureau (AMLB). The financial institutions include commercial banks, policy banks (referring to China Development Bank, Export-Import Bank of China, and Agriculture Development Bank), security companies, insurance companies and other financial institutions. The jurisdiction agencies refer to the People's Court, People's Procuratorate, and Public Security and Jurisdiction Bureau. The administration agencies include Industrial and Commercial Bureau (ICB), Bureau of Customs (BCs), Tax Bureau (TB), China Securities Regulatory Commission (CSRC), China Insurance Regulatory Commission (CIRC), and China Banking Regulatory Commission (CBRC).

Thus, AML responsibilities and cooperation mechanism have been developed. As consequence, the PBC began to actively play its role in the fight against Money Laundering. To enhance the importance of the AML efforts, the PBC works with the CBRC, CSRC, CIRC and SAFE to promote AML in regulatory and supervisory sectors in Chinese financial institutions. From April to December 2004, the People's Bank of China conducted special inspections on commercial banks'

compliance with anti-money laundering regulations, making commercial banks pay more attention to the supervision over non-banking areas such as the transactions of real estate, and jewel and cultural item auctions (Chinese Embassy, 2005). The inspection could be the prelude to joining the Eurasian Group (EAG) in October 2004 without being criticised for poor performance; or be the preparation prior to the FATF President's visit for the purpose of considering whether China met all of the requirements for observership. China's observer status would be an important step toward its ultimately becoming a full FATF member if it was granted at that time.

There are a number of the regulatory and administrative sanctions for the violation of Chinese AML regulation. Financial institutions who failed to apply the AML regulation can be forced to cease their business until they have improved. Or their licences will be suspended or revoked. Those held responsible will be penalised with administrative sanctions such as disciplinary punishment or dismissed. According to the Regulations on Closure of Financial Institutions promulgated by the BOC in 2001, for more serious problems, these liable people will be suspended from performing their functions. It is unsure whether any sanction for the violation of AML regulation has been published or not.

3.3.3.2 Regulation and Supervision

International initiatives inspired Chinese government to establish its own regulatory framework to develop and enhance its financial institutions. Prior to the

establishment of the formal AML regulation, the PRC had already experimented some preliminary regulatory and administrative rules as a part of prudential regulation requirement at early stage, and as a stepping stone for the formal adoption of AML regulation at the beginning of the twenty-first century.

The regulatory attention on money laundering began in 1996, when money laundering started to be researched by the law making department of PBC. During that time, a special group was also founded to supervise the law making process. A primary anti-money laundering act “China’s Anti-money Laundering Act” was even drafted. It, however, was not handed in to the higher Ministry due to a consideration of the stage of being immature, although it was changed and amended many times on the basis of enormous research previously. It seems the draft act is not political acceptable; however, the reason is unknown. It could be the result of the concerns of the impact of the AML initiatives on sustained capital investment at China’s early economic reform stage, the cost of implementation of AML regulation, and the feasibility of compliance due to financial institutions’ capability. In July 1997, China participated in the initial meeting of the Asia Pacific Group (APG) on Money Laundering in Beijing. However, China did not attend subsequent meetings of the APG because it raised the issue of Taiwan nomenclature as an obstacle for China’s participation, and the APG would not force Taiwan to change. On the 15th August 1997, the PBC issued “The Notice on Management of Large-Value Cash Payments”. In August 1999, the State Council issued a regulation of “Administration of Foreign Exchange with the General Administration of Customs”, which required the licensing of exports of US\$10,000 or more in foreign currency by Chinese citizens. This regulation was issued to prevent the transfer of illegal

proceeds from pretending to be capital flight and to intend to frighten off capital flight or extract bribes.

On the 20th March 2000, the State Council issued “The Rules on Opening a Personal Saving Account with Real Name”. In June 2001, an anti-money laundering committee was founded in the Bank of China, of which the general director Ming Kang Liu was nominated as the president and eleven heads of different departments of the BOC were elected as the members. An anti-money laundering booklet was designed and distributed to the every office in the BOC (People daily, 2002). In September the same year, in order to improve the local government cooperation among different agencies in scrutinizing foreign exchange transactions, a joint circular was issued by the SAFE and the MPS. Its aim is to crack down illegal foreign exchange trading that facilitates money laundering.

In 2002, the PBC set up an anti-money laundering team tasked with developing the legal and regulatory framework for countering money laundering in the banking sector in July. The team was chaired by the Vice Governor of the PBC and consisted of representatives from fifteen functional departments of the PBC. An office was set up in the Payment System and Technology Development Department of the PBC aiming to develop a system for monitoring the movement of suspicious transactions through the PBC-licensed financial entities (People daily, 2002). Not only did the central bank instigate AML initiatives from the top level, but also so did individual financial institutions. For example, an anti-money laundering

committee was founded in the Bank of China (BOC) in June 2001, of which the general director Ming Kang Liu became the president and 11 heads of different department of the BOC were nominated as members. An anti-money laundering booklet was made and distributed to every office in China Bank (Peopledaily, 2002). On the 5th September 2002, the Finance Minister Huai Cheng Xiang remarked at the opening session of the two-day ninth Meeting of Finance Ministers of the Asia-Pacific Economic Cooperation (APEC) that China will explore the possibility of becoming a member of international and regional organizations for fighting money laundering, and keep promoting international cooperation in this area (Xinhua, 2002). The SAFE adopted a new system to closely supervise foreign exchange accounts. The new system allows for immediate electronic supervision of transactions, collection of statistical data, and reporting and analysis of transactions. On 11th September, the first national anti-money laundering meeting was held in the PBC, where delegates from the heads of four biggest state ownership commercial banks, commercial banks and policy banks participated in. During the meeting, four documents “Financial Institutions Anti-money Laundering Regulations”, “Financial Institutions Transaction Reporting Regulations”, “Large Scale and Suspicious Foreign Currency Reporting Regulations” and “Improving Anti-money Laundering Notice” were issued (Chen, 2002). This meeting suggests that China had formally announced its anti-money laundering initiatives in key financial institutions. The Ministerial Joint Conference System on Anti-money Laundering was set up with the approval of the State Council.

In 2003, China took immediate actions to enhance its anti-money laundering regime. Between 13th and 15th January, China formally announced three regulations of “The Rules for Anti-money Laundering by Financial Institutions”, “Administrative Measures on the Reporting of Large Value and Suspicious Chinese Currency (Ren Min Bi) Transactions by Financial Institutions”, and “Administrative Measures on the Reporting of Large Value and Suspicious Foreign Exchange Transactions by Financial Institutions” (Peopledaily, 2003). The first two rules are administered by the PBC and the third is administered by the SAFE. These three rules clearly require that financial institutions should monitor and report any large-value and/or suspicious transactions and cooperate with the judiciary and administrative departments to combat money laundering. It also issued the classification of the reporting of large-value and suspicious fund transactions and the punishment for any breaches. Indeed, these three rules were designed for closely monitoring financial institutions and their financial transactions so as to prevent and punish the violation of anti-money laundering rules. These measures appeared to address the issues of customer due diligence, reporting of large-value and suspicious transactions, record keeping, establishment of internal controls and systems, establishment of a regulatory supervision or financial intelligence role for the PBC, and a leadership role for the PBC in organizing and conducting due diligence training for financial institutions. These rules are broadly in accordance with the Recommendations 5-16 of the FATF. Meanwhile, the Chinese Government established a new banking regulator- CBRC, which has substantial authority over

the regulation of the banking system. The CBRC is authorized to supervise and regulate banks, asset management companies, trust and investment companies, and other deposit-taking institutions, with the aim of ensuring the soundness of the banking industry. One of its regulatory objectives is to combat financial crimes.

In February, China held a National Financial Institutions Congress to review and evaluate anti-money laundering standards. An agenda was set to monitor the anti-money laundering progress in financial institutions on a national scale. The National Financial Institutions Congress was held to discuss about the standard of evaluation work on anti-money laundering, and regulated to inspect the anti-money laundering progress in financial institutions in a national scale. On the 1st March, the above three regulations took effect. Meanwhile, related other strategies were also made. A number of regulations were published, which include the “Tax Register Regulation”, “China’s Bill Regulation”, “Commercial Bank Regulation”, “China People’s Bank Regulation” and “High Ranking Official Income Register Regulation”. After conducting studies on how to strengthen the system, the PBC and the SAFE promulgated a series of anti-money laundering regulatory measures for financial institutions. These include: “Regulations on Real Name System for Individual Savings Accounts”, “Rules on Bank Account Management”, “Rules on Management of Foreign Exchange Accounts”, “Circular on Management of Large Cash Payments”, and “Rules on Registration and Recording of Large Cash Payments”. Between 27th and 28th in March, an international anti-money laundering conference organized by the FATF was held for the first time in China. In October,

the first national “Banking System Anti-money Laundering Training Programme” was held in Zhengzhou (Xinhua, 2003). A separate Anti-Money Laundering Bureau was established at the PBC in late 2003 to coordinate all anti-money laundering efforts in the PBC and among other agencies.

On the 27th August 2004, the Ministerial Joint Conference on Anti-money Laundering was held its first meeting in Beijing. Mr. Zhou Xiao Chuan, Governor of the People’s Bank of China, attended the meeting as the moderator along with the leading officials from 23 conference member agencies including the Supreme People’s Court, the Supreme People’s Procuratorate, and the Ministry of Public Security. The joint conference allowed relevant government departments to cooperate closely and make concerted efforts in combating money laundering crimes and in strengthening international cooperation, thus effectively containing the rising trend of money laundering offences. In addition, China joined the newly-created Eurasian Group (EAG), a Financial Action Task Force (FATF)-style regional body which includes Russia and a number of Central Asian countries. In January 2005, China was accepted as an observer to the FATF in line with the expansion of the G20 and reflecting the FATF’s own desire to include all major economic powers and regions. In the same year, China’s CBRC signed a memorandum of understanding with the Philippine Central Bank, Bangko Sentral ng Pilipinas, to share information on suspected money laundering activity. China’s financial intelligence unit also signed its first Memorandum of Understanding (MOU) with a foreign counterpart at the end of 2005, with South Korea’s FIU,

allowing the two to exchange information related to money laundering, terrorism financing and other criminal financial activity.

A comprehensive and formalized AML regulation- the Chinese Financial Institutions Anti Money Laundering Regulation (CFIAMLRL) was promulgated on the 14th November 2006 and came into effect on the 1st January 2007. The CFIAMLRL comprises 27 Articles and introduces the AML application dimension, PBC's supervision responsibility, financial institutions' AML obligation, AML supervision, AML investigation, legal liability and co-operation mechanism among the departments in state government and law enforcement agencies. At the end of 2006, the State Administration of Foreign Exchange (SAFE) handed over its AML function, infrastructure, human resource and information system to the PBC, which resulted in a central management of Chinese and foreign currency. The PBC further strengthened its AML system and increased the number of AML staff by allowing a number of 36 provincial level or above branches to establish AML Bureaux. In the 3rd National Joint AML Departments Conference on the 25th December 2006, a number of changes were made aiming to achieve a more effective AML outcome. First, the members of joint AML departments were adjusted. The Civil Administrative Department was taken up as a member of the group. Meanwhile, the Post Office Bureau was taken off from the group due to the structural reform and current situation of saving service in the Post Office. Second, the AML duty of the PBC, the CBRC, the Security Regulatory Committee (SRC), and the Insurance Regulatory Committee (IRC) has been amended and implemented. Third, the AML

responsibilities of Ministry of Foreign Relation (MFR), the Ministry of State Security (MSS), the Ministry of Justice (MJ), the MF, the Ministry of Construction (MC), the Ministry of Trade (MT), the BCs, and the ICB have been extended. The content of extradition, identification check, the basic information check on enterprises, cash flow across the border, regulation on non-financial institutions have been added into the daily work of above agencies to prevent money laundering.

Money Laundering Supervisory Authorities	Law Enforcement, Prosecutorial and Judicial Authorities	Ministry of Public Security (MPS)
		Ministry of State Security (MSS)
		Supreme People's Procuratorate (SPP)
		Supreme People's Court (SPC)
		General Administration of Customs (GAC)
	Public Sectors	Ministry of Supervision (MS)
		State Administration for Industry & Commerce (SAIC)
	Financial Sectors/ People's Bank of China (PBC)	China Anti-Money Laundering Monitoring and Analysis Centre (CAMLMAC)
		Anti-Money Laundering Bureau (AMLB)
		China Banking Regulatory Commission (CBRC)
		China Securities Regulatory Commission (CSRC)
		China Insurance Regulatory Commission (CIRC)
		State Administration of Foreign Exchange (SAFE)
		State Post Bureau (SPB)
	Designated Non-Financial Businesses and Professions (DNFBP)	Ministry of Civil Affairs (MCA)
		Ministry of Construction (MC)
		Ministry of Justice (MJ)
		All China Lawyer Association (ACLA)
		China Notaries' Association (CNA)
		China Institute of Real Estate Appraisers and Agents (CIREA)
		Shanghai Gold Exchange (SGE)
	International Co-operation	Ministry of Foreign Affairs (MFA)
		Ministry of Justice (MJ)

The People's Bank of China (PBC), China's central bank, additionally maintains primary authority for countering terrorist finance coordination. The PBC also shares some anti-money laundering responsibilities with other financial regulatory agencies, including the CBRC, which supervises and regulates banks, asset management companies, trust and investment companies, and other deposit-taking institutions; the CIRC, which supervises the insurance sector; and the CSRC, which supervises the securities sector.

3.3.3.3 Reporting

There are examples of the fact that Chinese financial services have been able to track down criminal financial activities prior to the formal adoption of reporting mechanism. In early 2001, a suspicious transaction was found in Xin Jiang Province: a large amount of cash were withdrawn in very short time by some customers, it was reported to the committeewoman of National People's Congress Standing Committee Yi Wu, who was highly concerned about, and assigned the PBC to make related methods to monitor the transactions (Li, 2003). The AML role of the PBC was introduced in the Regulation of People's Bank of China in 2003, where the PBC was assigned as the leadership and responsible body in AML operation of financial institutions and fund monitoring. To achieve the AML goals, the PBC set up an AML Bureau and a Chinese style central national FIU - the Chinese AML Monitoring and Analysis Center (CAMLMAC) in 2004. Its function is to collect, analyze and disseminate suspicious transaction reports and currency

transaction reports. Especially it works to collect and analyse information of Chinese currency- Ren Min Bi (RMB) and foreign exchange. The CAMLMAC can exchange information and materials with the relevant foreign institutions upon authorisation through the PBC. The CAMLMAC also needs to fulfil other duties as determined by the PBC. The CAMLMAC in China presents the characteristics of both administrative and law enforcement type. On the one hand, the CAMLMAC is established in the central bank- PBC and works on the receipt, analysis and dissemination of suspicious transactions. The PBC AML Bureau has a right to impose administrative sanctions such as administrative punishment and fines against financial institutions who fail to comply with and implement the AML requirements. On the other hand, the PBC AML Bureau plays a law enforcement role in investigation. To be in line with Recommendation 26 of the FATF, the Chinese government has extended the duties of the FIU. In terms of transaction reports, the Chinese FIU is responsible for the receipt and analysis of large-value and suspicious RMB transaction reports and large-value and suspicious foreign exchange transaction reports. In addition, the Chinese FIU established a national money laundering data base for the purpose of adequately retaining reports and information about large-value and suspicious transactions submitted by financial institutions. It is also required to submit the results of the analysis to the PBC in accordance with the rules. The CAMLMAC can request financial institutions to immediately replenishing and correcting large-value transaction reports and suspicious transaction reports.

The basic working process of the collaboration between these two agencies is as follows. The financial institution hands on Large Value Reports and Suspicious Activity Reports to the CAMLMAC. The CAMLMAC analyzes large value reports and uses other information shared by other administrative agencies to make further decisions. When high potential suspicious reports are found, they are transferred from the CAMLMAC to the Anti-Money Laundering Bureau for a further check on the suspicious accounts or transactions from financial institutions. If the Anti-Money Laundering Bureau can not eliminate the possibility of crime for the reports, they will be sent to the law enforcement agencies. According to the FATF (2007), between 1st July 2005 and 30th June 2006, the CAMLMAC received 619,962 RMB STRs and 2,245,267 foreign currency suspicious transactions. By the end of September 2006, the CAMLMAC had identified over 1070 reports on suspicious transactions for administrative investigation or for dissemination to the MPS (683 of which had been identified by the end of 2005). In total, 57 files containing 82 suspicious transaction dossiers involving about 80 000 suspicious transactions have been transferred to the MPS for investigation (7 in 2004, 14 in 2005, and 36 so far in 2006). Nine of those disseminations have resulted in cases being filed for investigation and one of these has been transferred to the SPP for prosecution. The data indicate the CAMLMAC has capability to analyse STRs in the first place, and not only simply pass the reports onto the law enforcement agencies.

New measures in regard to reporting came into effect in 2004. They included a regulation entitled “Regulations on Anti-Money Laundering for Financial Institutions”, which strengthens the regulatory framework under which Chinese banks and financial institutions must treat potentially illicit financial activity. The regulation effectively requires Chinese financial institutions to take responsibility for suspicious transactions, instructing them to create their own anti-money laundering mechanisms. In brief, banks are required to report suspicious or large foreign exchange transactions of more than US\$10,000 or ¥100,000 per person in a single transaction or cumulatively per day in cash, or non-cash foreign exchange transactions of US\$100,000 or ¥500,000 per individual or US\$200,000 or ¥2 million per entity either in a single transaction or cumulatively per day.

Security, Futures and Fund Management Companies are required to provide Suspicious Activity Reports. Some examples of 13 circumstances that need to be reported are as follows: (i) purposely conducting financial transactions just under the reporting threshold; (ii) clients with a limited transaction history requiring conducting a large amount of transactions without clear trading purpose; (iii) clients’ security accounts are hardly used but with frequent fund transactions; (iv) clients accounts have not been in use for a long period of time but suddenly a large amount of transactions have been undertaken frequently; (v) clients have business connections with high risk countries and regions; (vi) clients conduct a large amount of transactions just after opening accounts and then cancel the accounts after this short period; (vii) clients have not conducted trading for a long period of

time or have conducted minimum trading histories but have had a large amount of transactions; (viii) accounts have not been in use for a long period of time, but suddenly have been used with a frequent large amount of transactions without clear reasons. In addition, Insurance Companies are also required to provide Suspicious Activity Reports under 17 circumstances.

The PBC executed a revised regulatory framework in early 2007 to support the new Anti-Money Laundering Law. “Rules for Anti-Money Laundering by Financial Institutions” (AML Rules) took effect on the 1st January 2007, and “Administrative Rules for Reporting of Large-Value and Suspicious Transactions by Financial Institutions” (LVT/STR Rules) took effect on the 1st March 2007. Under the revised rules, all financial institutions-including securities, insurance, trust companies and futures dealers are considered accountable for managing their own anti-money laundering mechanisms and must report large and suspicious transactions. The LVT/STR Rules were amended on the 21st June 2007 to require financial institutions to report suspicious transactions linked to terrorist financing.

According to the US Department of State (2008), a number of 683 reports on suspicious transactions, involving ¥ 137.8 billion (£9.19 billion), were identified for further investigation by the end of 2005. From 1st July 2005 to 30th June 2006, the CAMLMAC received 619,962 RMB suspicious transaction reports and 2,245,267 foreign currency suspicious transactions. From the establishment of the centre until 2005, the People’s Bank of China and the State Administration of Foreign

Exchange provided 1,500 pieces of suspicious anti-money laundering clues to the police, helping them to detect 51 criminal cases. The cases involved ¥3.096 billion and US\$ 460 million separately (Chinese Embassy, 2005). In 2007, a number of 34,700 reports of STRs were received and 89 cases of money laundering involving proceeds over ¥28.8 billion were uncovered (Wang, 2008).

3.3.3.4 Customer Due Diligence

Customer Due Diligence (CDD) has become the key issue that financial institutions to improve to combat money laundering. Among the CDD, the principle of Know Your Customer (KYC) is one of importance, which requires the firms to determine the true identity of all customers. KYC is a common practice for businesses to survive and develop. In respect of anti-money laundering and managing financial risk, KYC has an additional function of preventing financial institutions from being abused by criminals to launder criminal proceeds. The KYC is a fundamental principle used in complying with the obligations of due diligence in firms to identify money launderers, who newly open an account or use products and services, meanwhile to cover firms from receiving criminal sanction by meeting reporting obligations. Intelligence gathered at the stage of the KYC is important and will best inform law enforcement agencies when and how to instigate investigation.

Financial institutions' association with criminals will undermine the confidence of the public. Sound KYC procedures will be vital to effectively manage the reputational risk to financial institutions. Internationally, the first blueprint that

bank supervisors mutually adopted to address the risk of abuse to the financial system by criminals by transferring or depositing criminal proceeds could be seen as the Basle Statement of Principles in 1988. An agreement was drawn to prevent criminal proceeds from entering financial institutions. The original CDD in the context of customer identification emerged. The obligation of identifying criminal proceeds in financial institutions was further reinforced by the Basle Committee's Core Principles for Effective Banking Supervision in 1997. The necessity of KYC was articulated in its Principle 15 as "Banking supervisors must determine that banks have adequate policies, practices and procedures in place, including strict 'know-your-customer' rules that promote high ethical and professional standards in the financial sector and prevent the bank being used, intentionally or unintentionally, by criminal elements (the Basle Committee, 1997)". Other international and regional AMT bodies request financial institutions to undertake KYC measures. The examples can be seen in Recommendation 5 of The FATF 40 Recommendations and the Article 3 of the European Money Laundering Directive. States have also established regulations in the context of the KYC, which have become the compulsory principles that financial institutions must obey. For example, the United States' the 1970 Bank Secrecy Act and Money Laundering Control Act of 1986, the United Kingdom's 1994 Drug Trafficking Act 1994 and Money Laundering Regulations 1993, the Australia's 1988 Cash Transaction Reports Act.

China's CDD can be traced back to the 1990s. Presumably it was aimed at controlling private commercial conduct, although the CDD at that time was not deliberately designed for the purpose of combating money laundering. A number of regulatory rules, such as the Notice on Management of Large-Value Cash Payments, the Bank Account Administrative Rules, the Bank Card Administrative Rules, Cash Management Provisional Rules, The Rules on Opening a Personal Saving Account with Real Name, the Administrative Rules on Chinese Currency Deposit by the Unit, the Administrative Rules on Foreign Currency Transmittance Bank Accounts, Administrative Measures on the Safe-Keeping of Customer Identification Materials and of Transaction Records by Financial Institutions, Administrative Measures on the Reporting by Financial Institutions of Large-Value and Suspicious Transactions, Administrative Measures on the Reporting by Financial Institutions of Transactions Suspicious of the Financing of Terrorism, and Guidelines for Commercial Banks on Internal Control Systems, have requested the banking system to tighten their internal control and management, identify their customer, identify suspicious transactions, record large transactions. These regulations and rules have played certain roles in the fight against money laundering, but exist in different rules separately and appear to lack systematic and comprehensive analysis and need integration.

Under the influence of international initiatives against money laundering by strengthening the CDD, Chinese CDD procedures have changed dramatically to meet international standards. For example, the dynamic of the regulations on the

use of real names when an individual opens a bank account could illustrate the whole picture of the changes of Chinese regulation in the context of preventing Chinese financial institutions from being abused by criminality.

In April 2000, the PRC promulgated the Rules on Opening a Personal Saving Account with Real Name, requiring anyone opening a new bank account to do so in his or her real name. The rules are made with the intent of ensuring the authenticity of personal savings accounts. “Personal savings account” mentioned in these rules refers to Chinese currency or foreign currency deposit account, including current accounts, term accounts, current-or-term accounts, notice accounts and personal savings accounts in any other form. “Real-name” as mentioned in these rules refers to the name used on the identity card which is in conformity with the law, administrative regulations and relevant provisions of the State. When customers open or deposit money into a new account, an identification card to verify his or her identity must be provided. Existing anonymous accounts may remain open for five years from the time of the account’s establishment. After five years, the account holder must re-register the account in his or her real name only. Anonymous accounts were phased out in 2005 in line with the FATF mandates, which require that financial institutions should not keep anonymous accounts or accounts in obviously fictitious names. No equivalent rules for foreigners were applied at the same time.

It can be seen that the early regulations were simple and only cover current and fixed accounts in deposit taking financial institutions. The new Anti-Money

Laundrying Law enacted in 2006 broadened the scope of existing anti-money laundrying regulations by mandating that financial institutions maintain thorough records on accounts and transactions, and report large and suspicious transactions. These actions firmly established the PBC's authority over national anti-money laundrying efforts by obligating financial institutions to perform customer due diligence, regardless of the type of customer (business or individual), type of transaction, and level of risk. The new law also explicitly prohibits financial institutions from opening or maintaining anonymous accounts or accounts in fictitious names. To enhance the CDD, the PBC launched a national credit-information system in January 2006. This system allows banks to have access to information on individuals as well as on corporate entities. Some other regulations have also changed and emphasised accordingly to address the CDD principle in respect of money laundrying. The Guidelines for Commercial Banks on Internal Control Systems was amended to fit the purposes of anti-money laundrying.

In addition, with the enactment of the AML Law, the coverage of the CDD on the number of accounts and in the number of financial institutions has been extended. According to the Anti-money Laundrying Law of the People's Republic of China, the Provisions on the Real-name Personal Savings Account System (Order No.285 of the State Council), the Administrative Measures for Chinese Currency Bank Settlement Accounts (Order No.5 [2003] of the People's Bank of China) and the Administrative Measures for Identification of Client Identity, Management of Client Identity Materials, and Transaction Recording of Financial Institutions

(Order No.2 [2007] of the People's Bank of China, China Banking Regulatory Commission, China Securities Regulatory Commission and China Insurance Regulatory Commission), all personal RMB bank savings accounts (including personal bank settlement accounts, personal current savings accounts, personal fixed deposit accounts and personal notice savings accounts, hereinafter referred to in general as "personal bank accounts") must be opened in real name. It means that depositors must provide authentic, legal and integrated valid certificates to open personal bank accounts and the account name shall be identical with that stated in the certificates. Financial institutions require their clients to provide their legitimate identities and record the name and unique identify code. The intermediary, who helps individuals to open bank accounts, is also required to provide their own real identities. The name and identity code of both parties will be checked and recorded. No bank account is allowed to be opened unless the identity card is provided. Any detected violation by the financial institutions will receive administrative and criminal sanction. Little information suggests how the authorities know if violations have occurred and if financial institutions have actually received sanctions for above violation.

The Administrative Rules for Financial Institutions on Customer Identification and Record Keeping of Customer Identity and Transaction Information (CDD Rules) became effective on the 1st August 2007. These rules require all financial institutions to identify and verify their customers, including the beneficial owner. Specific requirements relating to the identification of legal persons (e.g.

requirements to verify their legal status by obtaining proof of incorporation) have been extended to all financial institutions. The CDD Rules also introduce specific requirements for financial institutions in relation to foreign Politically Exposed Persons (PEPs), including having to obtain approval from senior management before opening an account and determining the source of funds. This is in conformity with the FATF.

On the 8th December 2007 the PBC disseminated the Guidelines for Commercial Banks on Internal Control Systems. The guideline 73 states that commercial banks should vigorously comply with the bank account management regulation and carefully check the depositors' identity and authenticity, legitimacy and valid of account information. A regular inspect should be undertaken in the context of opening, changes and cancellation of bank accounts to prevent the bank account holders from renting, lending, or abuse bank accounts for the criminality. The guideline 83 articulates that commercial banks should vigorously comply with the principle of the KYC, carefully check the authenticity and legitimacy of monetary resource, improve the ability to identify suspicious transaction. The suspicious transactions should be handed to their superiors when identified for the purpose of money laundering.

3.3.4 Enforcement

3.3.4.1 Predicate crimes

The crime situation has changed significantly in recent two decades. The rampant increase of native and outside organised crime (mainly violent offences committed

by criminal syndicates), terrorist activities, smuggling, drug trafficking and corruption have appeared to become the concerns of Chinese government. In 1997, Chinese legislation only classified four types of predicate offences of terrorism, organised crime (mainly violent offences committed by criminal syndicates), smuggling and drug trafficking. By 2006 the number of predicate offences has been extended to cover all serious crimes. The AML law particularly specifies important predicate offences of terrorism, organised crime (mainly violent offences committed by criminal syndicates), smuggling, drug trafficking, embezzlement and bribery, financial fraud and violating the Socialist market economic order. This indicates that these offences are the contemporary large scale money driven offences, and the current political concerns in terms of the harm of these offences on the national security, economy and society. Different countries define predicate offences of money laundering according to their priorities. The following are the examples to illustrate the current situation of predicate offences in China.

A: Organised crime

Since the economic reform, criminal groups in China have appeared to become more organised. This presents with many traditional characters such as having a hierarchical structure, detailed individual roles, collective goals, and code names and language. Members of these groups simulate feudal secret society by establishing worship on bended knees and allied with each other. To increase their power these organised groups recruit members, expand the coverage to other towns,

cities, and provinces. They raise funds from crimes and increase their assets via business investment. They equip the organisations with transportations and weapons. They have infiltrated into economic field. They also seek to bribe the Police, Prosecution and Judicial sector to escape punishment or reduce the penalty. They bribed local governmental officials to seek protection and further to gang up with them for their own purposes. For example, in August 1990, the Police cracked down three organised criminal groups led by Yong Jia Song, Wei Fan Wang, and Wei Tao Hao respectively in the city of Ha Er Bin. A total of 47 members of triads were arrested, among which 5 were Police Officers. A number of 26 firearms, 12 offensive weapons and cash of ¥1,510,000 (£100,000) were confiscated. A total of 131 offences including kidnapping, grievously bodily harm, rape, robbery, burglary, gambling, and bribery were convicted. Their offences were committed during a period of 6-7 years without being interfered. The reason behind this was these organised criminals bribed local governmental officials and the Police. For instance, a number of 62 Police Officers ranging from the sergeant to a high ranking level were involved in this case (He, 2002).

According to He (2002) organised crime rapidly expanded all over China in the 1990s. In 1991, China destroyed 134,000 criminal groups comprising 507,000 members compared with 100,527 triads groups and 368,885 members in 1990. Thus, efforts were made against 33,473 more triads groups and 138,115 more members within one year. In 1994, the number of triad groups 'attacked' reached over 150,000 with over 570,000 members. I have been unable to obtain more recent

data in regard to the figures of triads groups: however, a number of detected cases are found that, if generalised, suggest that these groups were profit-oriented and had generated a large amount of proceeds. One of the examples could reveal the extent of criminal groups' financial gains. According to Sun (2006) in a district named Yi Shun of Bei Jing, a group of triads was convicted for offences of illegally digging sand for profit whilst running a garage business as a front during a ten year period. A couple of key members among 34 members received a financial penalty of ¥2.62 million (£170,000) respectively, along with their long term imprisonment sentences.

In the early 1980s, outside organised criminals began to enter mainland China to develop when China opened its gate to embrace the rest of the world. However, due to a strict travel and migration policy, and procedures and controls, outside organised crime were mainly represented by triads from Hong Kong, Macao, and Tai Wan. Those triads have some Chinese ties and their numbers were limited. In the late 1980s, outside organised criminals' activities in mainland China intensified. A number of 119 opening up ports in 1989 compared with 55 in 1979 provided an opportunity for triads to arrive in mainland China. He (2002) indicated that 124 members of Hong Kong and Macao triads were arrested between 1987 and 1988 in Guang Dong Province and 46 Hong Kong and Macao triads comprising 280 members were found in 1989 in Shen Zhen, a city of Guang Dong province. In the late 20th century, there were increasing concerns about the propensities of organized crimes, which include a clear hierarchical structure, the use of violence to protect their business interests, diversified industrial interests, and capital accumulation.

B: Drug trafficking

Geographically China is important for drug trafficking worldwide. In the south, China borders the Golden Triangle. It shares a 2185-kilometer border with Burma, as well as smaller but significant borders with Vietnam 1281km, and Laos 423 km. In the west, China is close to the Golden Crescent. It borders with Afghanistan 76 km, Pakistan 523 km, Russia (northwest) 40 km, Tajikistan 414 km, India 3,380 km, Kazakhstan 1,533 km, Kyrgyzstan 858 km, and Nepal 1,236 km.

After opium entered China in the 17th century, Chinese people suffered greatly from drug use and abuse. After the foundation of the People's Republic of China in 1949, the Chinese government launched a nationwide anti-drug movement throughout the country. Between 1949 and 1953, a number of 220,000 drug cases, involving 80,000 criminals were sentenced, and 800 criminals received a death penalty (He, 2006). The harsh and severe penalty for drug offences received an unprecedented achievement. Drug offences were almost eradicated, and this situation lasted for almost 30 years.

The resurgence of drug offences in mainland China took place in the 1980s. A number of 517 foreign drug traffickers were arrested in 1988 and 750 in 1989. In the recent years, the number of drug related crime has significantly increased in terms of quantity and seriousness. For example, He (2002) indicated that in the early 1980s drug offences mainly occurred in Yun Nan Province and less than 1,000 drug offences were detected nationally every year. In the late 1980s, drug

offences expanded to all over the country. Although the Supreme People's Court announced in the 1990s that drug traffickers could receive a death penalty in provinces of Yun Nan, Guang Dong, Guang Xi, Si Chuan, Gan Su, and Gui Zhou in their provincial High Court rather than in the Supreme People's Court (He, 2006), it still could not curb the rise of drug offences. More than 14,000 and approximately 64,000 drug trafficking cases were detected in 1992 and 1999 respectively. In 1999, a total of 57,000 drug traffickers were arrested, and 5.3 tons heroin and 16 tons amphetamine were confiscated. In 2000, China cracked down a number of 96,000 drug offences, which was 48.7% more than those in 1999. A range of drugs including 6.3 tons heroin, marijuana 2.4 tons, amphetamine 20.9 tons, ecstasy tablets 24,000, ecstasy powder 200 kg, and 215 tons drug making chemicals were seized. A Chinese report to the UN suggests that the heroin confiscated averaged 3644.7 kg each year, which was 25.5% of the international heroin confiscated and was the number one in quantity in the world between 1991 and 1994. The UN Office for Drug Control and Crime Prevention 2000 report suggests that between 1994 and 1998 the heroin and morphine confiscated in China was between 2,488 kg and 7,504 kg. The average was 4897.6kg each year, which was the third highest country in the world and contributed to 10.4% of the total. At mean time, drug additives increased from 70,000 in 1990 to 681,000 in 1999 and 86,000 in 2000. Drug offences also caused other serious social problems. In 2000, drug related other offences reached a number of 80,000. More than half of prisoners in the labour camp were drug additives. The number of prisoners in the labour camp in the

South West, North West and coastal areas were 70-80% higher than the rest of China. Drug abusers were unfit for work and transmitted with various diseases. In 2000 China identified 22,517 people having HIV, among which 15,965, amounting to 70.9% of the total, were infected via sharing the device whilst injecting the drugs. The economic loss from drug misuse was significant. Take these 86,000 drug abusers as an example, approximately ¥140 billion (£9.33 billion) will be spent on taking illicit drugs, subtracting the cost of anti-drug actions paid by the Chinese government. The dramatic increase in the number of drug offences has caused an increased level of social problems. The cost of campaign on drugs has become a burden pressurising the Chinese government.

In 1999, the number of drug traffickers (57,000) arrested was up eight percent from a year earlier, and at least 100 people are reported to have been executed for drug trafficking in 1999 (Hewitt, 2000). Yang Feng Rui, the head of the Narcotics Squad of the MPS, said that “the recent seizures of the designer drug increased tenfold last year - and the police believe the 16 tonnes they got their hands on may be only the tip of this particular ‘iceberg’”. Chinese police have in recent years begun tentative cooperation with neighbouring governments, as well as with international anti-drug agencies. But drugs continue to flow into the country, either for shipment to markets in Asia and the west, or for Chinese consumers - last year five tons of heroin were seized, while ecstasy and other designer drugs are also spreading. The number of registered drug addicts in China is 680,000 - almost three

quarters of them users of heroin. The figure represents a 15% increase during 1999 alone (Hewitt, 2000).

In 2003, drugs produced in the Golden Triangle reached 70 to 80 tons, most of which entered China mainland across the border between China and Myanmar. Chinese officials state that the majority of heroin entering China comes over the border from Burma. This heroin then transits southern China through either Yun Nan or Guang Xi Provinces to either Guangdong or Fu Jian Provinces to Chinese south-eastern coastal areas, and then on to international markets. Heroin is transported by various methods to ports in south-eastern Provinces of Guangdong and Fu Jian. Increasing quantities of heroin are transported to Guangdong Province and to the cities of Xia Men and Fu Zhou of Fu Jian Province for shipment to international drug markets. Traffickers are taking advantage of expanding port facilities in such northeast cities as Qing Dao, Shang Hai, and Tian Jin to ship heroin along maritime routes (DEA, 2004). At the end of last century, the Golden Crescent replaced the Golden Triangle as the world's largest opium exporter. According to statistics from the United Nations, trafficking in opiates continues to be concentrated along three major routes. One is from Myanmar/Laos to neighbouring countries of South-East Asia, (notably China) and to the Oceania region (mainly Australia). Though the bulk of opiates found on the Chinese market is still from Myanmar, there have been reports of shipments of heroin from Afghanistan via Pakistan to China. The heroin is being shipped either directly (mainly by air) from Pakistan to various Chinese destinations (UNODC, 2009).



C: Smuggling

China has a vast coastal line (18000 km), which is seriously exploited by smugglers. The strict planned-economy system in China made that the phenomenon of smuggling crime was not a serious problem prior to the economic reform. However, smuggling began rising rampantly with both speed and scale in the 1980s. As a result, the SCNPC issued “the Decision Regarding the Severe Punishment of Criminals Who Seriously Sabotage the Economy” in March 1982, which raised the maximum statutory punishment for smuggling from a 10 year imprisonment sentence to a death penalty. In addition, in January 1988, the SCNPC issued the Supplementary Provisions Concerning the Punishment of the Crimes of Smuggling, which stipulate various smuggling crimes in terms of different objectives and provide diverse statutory punishments. Smuggling falls under the category of economic crimes, and few countries impose capital punishments on economic crimes. Despite this fact, the death penalty has not had a deterrent effect on smugglers in China. In 1989, Tai Wan triads headed by Wen Xin Wu were detected for smuggling several hundreds firearms to Tai Wan from Xia Men city in mainland China. In addition, smuggling routes have progressed from south east costal cities to north costal provinces such as Shan Dong and Liao Ning.

Between 2003 and 2006, the Chinese Customs Office tracked down 46,528 smuggling cases with a total value of ¥40.32 billion (£2.688 billion). The smuggling cases had resulted in approximately ¥8.29 billion of revenue loss and 11,809

arrests. Among these smuggling cases, some 520 smuggling cases had the goods worth of exceeding ¥10 million each. There were 59 cases with goods at a value of over ¥1 billion. Smuggling were committed in various forms including commercial deceit smuggling, smuggling through processing trade channel, smuggling of goods with tax being reduced or exempted, smuggling of goods in small batches, and the smuggling of sensitive goods such as refined oil, ox skin, frozen goods, fruits, used ships, offset printing machines, pavers and cotton, frozen products, cigarettes, and automobiles (Chinanews, 2007).

D: Terrorism

The “September 11” terrorist attack aroused the universal concern of the international community, including China. The Hizb-e Tehrir (HT) or Party of Liberation, as the largest and the most popular Islamic Movement, is active in Uzbekistan, Tajikistan and Kyrgyzstan. It has been fighting to establish an Islamic Caliphate in the historical region once known as Turkestan, which encompasses the Xinjiang-Uighur Autonomous Region (XUAR) of China. In China the HT is often referred to as “Eastern Turkestan”, which has been considered as a terrorist group by the Chinese government since 1950s. The “Eastern Turkestan” is also reported to have links with the Islamic Movement of Uzbekistan, which, according to Russian media reports not independently corroborated, has re-named itself since June, 2001, as the Hizb-i-Islami Turkestan, or the Islamic Party of Turkestan. This terrorist group poses a significant threat to China, because it has re-formulated its objective

as the creation of an Islamic republic out of the five Central Asian Republics and the XUAR of China (Raman, 2003). In recent years, terrorist activities including explosions, assassinations, arson, raids, and so on, in Xin Jiang Province of China have notably increased, and constitute a real threat to China's peace and development. It was reported that from 1990 to 2001, more than 200 terrorism activities committed by East Turkey organizations took place in Xin Jiang Province, during which 162 people were killed and 440 people were injured (China News Services, 2002).

On 11th September, 2002, the UN Security Council formally included the "East Turkistan Islamic Movement" on its list of terrorist organizations. This has placed the legitimacy of China's initiatives of combating Eastern Turkestan within a global context.

E: Corruption

"We must face up to the serious nature of corruption within the party. Things have become so serious and pernicious that they are not only disturbing and undermining the party's central tasks, but are also threatening party leadership. If we do not gear up to fight corruption and eradicate it, the party will probably lose people's support and its foundation deteriorate and go under. This is entirely possible."

-The Secretary General of the Communist Party (1978-1993)-

Xiao Ping Deng (1989)

“We cannot underestimate the seriousness and harm of corruption, which is like a virus invading the body of the party and state. It will bury our party, our people’s regime, and socialist modernization if we do not attack it seriously and [if we] allow it to spread unchecked.”

-The Secretary General of the Communist Party (1993-2003)- Ze Min

Jiang (1989)

Between the mid 1960s and the end of the 1970s, corruption was not a central theme in Chinese political discourse and was rarely mentioned in the mass media. However, the extent of corruption has increased dramatically since the economic reform, and has become one of the most serious public concerns together with the unemployment in China. Although the Chinese Communist Party was warned from “the 1989 Tiananmen Square event” and has strengthened anti-corruption framework, the situation of anti-corruption, however, has improved with little effect. Embezzlement, bribery, extortion, smuggling and financial fraud have become even worse in frequency and scale since 1990s. According to the 1996 Corruption Index of Transparency International, international business executives and journalists ranked China a dismal fifty out of fifty-four countries in terms of corruption —worse than Colombia or Russia (Lancaster and Montinola, 1997). Between 1998 and 2002

nearly 850,000 party cadres were punished for corruption (Liu and Ansfield, 2004).

In addition, corruption has appeared with the following new characteristics.

The economic reform has improved people's lives considerably and also commercialized Chinese society. The desire to obtain material goods such as three big objects (watch, bicycle, and knitting machine) before the economic reform has become history. The lavish banquets, extravagant office facilities, luxury personal accessories and expensive cars were pursued at the beginning of the reform. The corruption of ranking seeking (to seek a higher rank) and rent-seeking (to use political power to seek personal gain) surged during the period of post-reform in China. As Peng observed in 2000 that compared with the periods between the 1980's and the 1990's, rent seeking from price differences of material goods has shifted to price differences in capital goods, such as stocks, real estate, and state property shares by using their personal administrative power and connections, and to areas where huge returns are available, such as construction projects, smuggling of high-duty goods, land deals or sex-oriented service industries.

In the early 1980s, "large scale cases" referred to amount over ¥10,000 (£740.7), but the standard has been raised to ¥100,000 (£7407). According to official statistics, large-scale cases over ¥10,000 (£740.7) investigated by the procuratorates of various provinces from January to September 1993 accounted for 59.7% of the all cases investigated. Of these, large-scale graft and bribery cases involving over half a million yuan (£37,037) doubled and those and those involving more than a

million yuan (£285,714) money embezzled becomes greater and greater, and in special cases comes to over ¥10 million (£740,740). For example, the proceeds of vice-mayor of Shen Yang- Xiang Dong Ma reached to ¥20 million (£1.5 million); the corrupt proceeds of the Deputy Commissioner of NPC- Ke Jie Cheng - were about ¥40 million (£2.96 million). Corruption is generally rampant in Chinese cities. Indeed, even the Chinese government has admitted that smuggling is hardly limited to Xia Men or Fu Jian; when the top 10 multinational corporations in Shanghai were polled earlier in 2008 they counted China's smuggling and pirated goods problem as their biggest corporate headache. China's Cabinet has labelled corruption as the nation's No. 1 problem, and over the year of 2007 Beijing has launched a massive anti-graft campaign in an effort to renew business confidence. More than 80% of Chinese university students believe China's biggest companies are corrupt, according to a recent online poll (Beech, 2008).

Wealth without an obvious source raises suspicion. Maintaining secrecy has always been essential for corruption. The detected corruption cases have informed uncovered corruptive officials that hiding the illicit proceeds simply under the bed to diminish the chance of being caught is at risk of being caught. Displaying illegal proceeds at home is an adventure nowadays for Chinese officials who had witnessed the deadly fates of their corrupt colleagues' (see the case XXI: The corruption case of Da Bin Yan in chapter five). Bribed or embezzled proceeds need be laundered with a legitimate appearance. For these brainy bureaucracies, laundering money might not appear as hard and sophisticated as the way to commit

corruption. For normally paid bureaucrats, being visibly rich is impractical and risky, which will incur attention from the law enforcement authorities, Party Disciplinary Inspection Committee (PDIC) and the general public. For example, Jiu Geng Zhou, the head of a District Housing Estate Management Bureau of Nan Jing City, was reported by the media for smoking expensive cigarettes (the value of a pack is approximately £10) and wearing a valuable watch (approximately £10,000) in a meeting. As a result, he was investigated and convicted for an offence of embezzlement. The proceeds were reported of approximately £133,333. Zhou received an imprisonment sentence eventually (Sinanews, 2009). Money with its characters- small size, without identity, and digital version has replaced the conventional tangible consumptions as a preference. Keeping money in the bank is a safeguard against burglary and loss from natural hazard. Another most important aspect is that money is convertible; money could purchase anything officials like.

Corrupt officials' embezzlement contributes to the loss of state assets. Out of China's total state assets of ¥500 billion (£37 billion), the annual loss may well be over ¥50 billion (£3.7 billion) in the 1980s, and ¥50 billion – ¥100 billion (about £7.41 billion) in the 1990s, much of it due to corruption (LI, 2003). Russell Smyth also cited: “‘rough estimates’ of the daily loss of state assets at between ¥100 million (£7.5 million) and ¥300 million (£22 million)” (Hart-landsberg and Burkett, 2004). Other studies provide additional support for the conclusion that asset stripping is a serious problem: In 1994 the People's Bank of China prepared a survey titled ‘Research Report on the Loss of State-Owned Assets’ based on a sample of 50,000 state-run

industrial enterprises. It found that just 5% of state-owned capital increased in value, while 62% decreased in value and 23% lost all of its value entirely. According to a separate survey of 124,000 State-owned Enterprises (SOEs) conducted by the National Administrative Bureau for State-Owned Property in 1994, asset losses and unaccountable expenses amounted to 11.6% of total assets in the sample firms. The situation has got much worse since the Fifteenth Congress in September 1997 (Magdoff and Forster, 2004). According to statistics from “China daily”, China invested US\$7 billion in about 6,000 projects in 160 different countries. This investment only accounts for 0.15 percent of foreign investment worldwide in 2000. However, according to unofficial media, the actual Chinese investment totals are almost certainly significantly higher than Beijing’s official investment statistics, because Chinese companies increasingly circumvent official foreign-currency controls by investing through offshore entities (Anon, 2002). China had approved overseas investments of 6,849 domestic companies by the end of September 2002, with a combined contracted investment of US\$13.5 billion. But the lack of a tracking system, among other reasons, caused some of the investments to perform badly. Academic research has found that less than half of the foreign Chinese-invested operations are making a profit (Gorni, 2003).

Corrupt officials have no structural incentives to work hard to implement developmental plans and policies, whereas they do have a structural incentive, namely, personal monetary gain, to selectively implement such plans and policies (see the case XV: The embezzlement case of Chao Fan Xu in chapter five). The

heaviest loss is widely blamed on the seizure of state assets, through various schemes of official covert privatization or outright theft of state ownership enterprises' properties. Some even argue that a "nomenclatura privatization" of the Russian type has already been occurring in China this way (Ding, 2000).

"The Rules on Income Declaration of Leading Party and Government Officials above the County (Division) Level" were adopted in 1995. In 1999, "the Regulation of Individual Deposit Accounts under Authentic Name" was implemented. All of these measures make it difficult for corrupt officials to conceal the nature and source of illicit funds in financial institutions. The simple way of hiding the proceeds is outdated and not safe any more. Corruption does not only have its basic character of being profit driven, but also can have a character of being transnational. Public officials are the beneficiaries of the economic reform. They are the representatives of China to tour Western industrialized countries aiming to learn Western advanced science and technology. They are inspired by the high quality life style and advanced civilization. Some of them are loyal Communists and cadre party members with strong Communist beliefs; however, they do expect their children to study and reside abroad rather than to live in China like themselves. Their younger generations are unable to afford the expensive tuition fees, accommodation and the cost of living. Thus, financing their younger generation is public officials' responsibility. Of course there is another consideration that in case they are disciplined or prosecuted because of corruption, transferring money abroad could financially compensate their future imprisonment without threat from Chinese

law enforcement authorities. Because their assets are out of the control of China and welcomed by certain host regimes. Furthermore, if they escape from China, they would have plenty of capital already on their foreign bank accounts or estates for their hiding and living. As in China, the arranging of back routes by public officials is commonly known. Laundering money to overseas destinations appears more secure to keep their proceeds, despite the 2005 United Nations Convention Against Corruption (UNCAC) to promote the prevention, detection and sanctioning of corruption, as well as the international cooperation between States Parties. However, this organising framework might not be widely known by corrupt officials in China, and sometimes, international co-operation is not as satisfactory as it is supposed to be.

Shocking statistic from the National Prosecution Bureau Tracing Absconder Meeting in 2004 revealed that between 1998 and the end of July 2004 there were over 7,160 public officials charged with the commission of corruption, bribery and so on who have escaped China. Those arrested before absconding amounted to some 1267; and 411 went missing during their bail. Among these officials were 681 in Chinese foreign branches of trade and financial institutions including Hong Kong, Macao and Tai Wan with proceeds amounting to about US \$5.82 billion (Ma and He, 2008). According to the South Urban Newspaper in 2005, about 200,000 high ranking governmental officials were penalised within the last five years and there were at least 4000 corrupt Chinese governmental officials who fled abroad taking away approximately £33.3 billion (¥50 billion) in governmental funds laundered

abroad previously. By 2007, China established extradition treaties with 29 countries, but only three -- Spain, Portugal and France -- are developed countries..

Current corruption tends to involve enormous sums of money and cause huge damage to the state treasury. The money can not vaporize; it flows from the nation's account into individuals' accounts with legitimate disguises such as the failure of management. Party discipline, ideology, and moral education as existing anti-corruption measures do not control officials effectively any longer. Increasingly the central government is recognizing the importance of monitoring capital flow. In his report to the 15th Party Congress in late 1997, the Secretary General of the Communist Party Ze Min Jiang put new phrasings on fighting corruption: "to uphold a policy of curing the symptom as well as the root; to use education as the foundation, rule of law as the guarantee, and monitoring as the key (Sun, 2001)".

Without a wider international cooperation, China has found it is difficult to extradite corrupt officials to China efficiently and effectively. According to the China Insight (2007) that the deputy head of the international cooperation bureau of the Supreme People's Procuratorate (SPP) Yun Tao Gao stated that approximately 10 officials were returned to China each year between 2000 and 2007. The enactment of money laundering laws and regime in China will help China to provide the legal basis for extradition with respect to corruption in accordance with international anti-money laundering provisions. In addition, defining corruption as a

predicate offence of money laundering will provide a legal base for utilising mutual legal assistance in identifying, tracing, freezing, seizing and forfeiting proceeds of corruption covered by the international anti-money laundering co-operation. The co-operation can take place with regard to collecting evidence or any other aspect of investigating and prosecuting corruption in the enforcement of domestic criminal law of corruption. Furthermore, international anti-money laundering will provide mutual technical co-operation support by taking the form of arrangements between the competent institutions as well as at grassroots level.

3.3.4.2 Investigation

The MPS Anti-Money Laundering Division and Anti-Terrorism Bureau lead anti-money laundering and counter-terrorist finance-related law enforcement efforts. The MPS is China's main law enforcement body, responsible for following up on Suspicious Transaction Reports (STRs) and for guiding and coordinating public security authorities across China in investigations involving money laundering and the seizure, freezing and confiscation of proceeds of crime. Most of these responsibilities are concentrated in the AML Division of the MPS Economic Crime Investigation Department (ECID). The Anti-Terrorism Bureau of the MPS is responsible for investigating general crimes relating to terrorist financing. Crimes against state security (including terrorism and related crimes) are the responsibility of the Ministry of State Security (MSS).

In the 1980s, China instigated three times “harshly suppressing crime” campaigns aiming to curb the sudden increase in the number of public order cases, crime and gangsters. Each campaign lasted for three years. According to He (2002), in these three anti-crime campaigns a total of 197,000 criminal groups were disrupted and 876,000 members of these groups were convicted. Among these criminal groups, the mugging group was accounted as posing highest risk of serious harm to the general public, drug trafficking criminal groups came the second, human smuggling and racketeering were the next. Since the beginning of the campaign the annual average number of recorded crimes remained at approximately 500,000, and the upwards trend ceased. However, the effect of harsh suppression of crime strategy appeared temporary. When the “harshly suppressing crime” campaigns ended, the number of crimes in 1990 dramatically reached a figure of 2,216,997, which were 245,000 more cases than those in 1989. It is interesting to see the crime figure recorded during the period of above campaigns was amazingly low, even considering China’s relative poverty. There may be several reasons for such calculations. First, it could be the reason that the campaign participating party officials need to show their success to keep their jobs or get promoted. As a result, the data was politically produced. The reliance was further assisted from the media. Second, the data could be made up by the Police. For example, Levi and Maguire (2002) asserted the 1970s mugging data issued were highly unreliable and the scare was fuelled by the Metropolitan Police. My experience of working in the Police in China also suggests the data could be generated by dividing one case to a number of

cases for the purpose of achieving the target. Third, certain types of crimes such as trafficking and corruption are unlikely to be recorded except where offenders are caught. Fourth, it could be the result of the changes of the laws over the time. The new types of crime have been criminalised or the minimum criteria for cases to be accepted for investigation have been lowered. It also could be the improvement in the crime reporting service or the public confidence and awareness. Nevertheless, the differential of the data can show the data explosion in China's crime field, although there is a question about what reliance we can place on such recorded crime data.

In addition, according to official statistics, crimes registered by the police for investigation in 2000 rose by 50 percent over 1999. Gang crimes with Mafia features handled by Courts across the country increased seven fold, with many involving high-ranking Party and government officials. The number of offences of possessing explosives has risen by 2.6 times over the past two decades (People Daily, 2001). It will be interesting to know if the offences of possessing explosives mean as a proxy for terrorism; however, it has not specified it. Chinese authorities uncovered 6.3 times more crimes involving criminal groups in 2001 than in 2000, according to a progress report completed by the head of Supreme People's Procuratorate Zhu Bin Han and presented to China's ongoing, two-week National People's Congress (NPC) parliamentary meeting. The number of prosecution rose by 19.2% in 2001, involving 845,306 people. Meanwhile, Supreme People's Court President Yang Xiao claimed that the number of crimes involving the use of

offensive weapons and explosives increased by 81.6%, involving 12,005 people (Asian Economic News, 2002).

There are difficulties of assessing crime trends in the absence of victimisation and self-reported criminality surveys. However, the crime figures since the post-reform period indicate that the hard strike on crimes has had limited effects in the longer term.. An alternative anti-crime strategy is needed to help to address this issue. The past two decades have witnessed a shift in crime control policy towards more emphasis on taking the profit out of crime. It has been triggered by the real and/or perceived increase in the profitability of criminal activity, especially drug trafficking and other forms of, often transnational, organised crime. This has resulted in a proliferation of the use of confiscation and forfeiture mechanisms against the proceeds of criminal activity. International anti-money laundering efforts have further strengthened the international efforts in combating drug trafficking by promoting forfeiture of both illicit drugs and the profits of crime. Asset forfeiture, criminalization of money laundering, mutual legal assistance, and extradition have become an international criminal law aspect of combating money laundering and serious predicate crimes. This has provided an opportunity for China to target domestic and international money launderers, who commit money laundering in China. China has recently sped up implementing its money laundering regime. The underlying reasons can be analysed as its intention to take the profit out of profit driven crime and to follow the money trail in order to detect and prosecute predicate offences of money laundering.

3.3.4.3 Prosecution and Punishment

The SPP supervises and directs the approval of arrests, prosecution, and supervision of cases involving money laundering crimes. The SPC supervises and directs the trial of money laundering crimes. Both can issue judicial interpretations. Law enforcement agencies are authorized to use a wide range of powers, including special investigative techniques, when conducting investigations of money laundering, terrorist financing and predicate offences. These powers include seizing articles relevant to the crime, including all (customer) records held by financial institutions. Reportedly, law enforcement and prosecutorial authorities currently focus on pursuing predicate offences, to the exclusion of AML/CTF.

Internationally, China has signed the five major international conventions combating money laundering:

- (1) the United Nations Convention Against Illicit Traffic in Narcotics Drugs and Psychotropic Substances 1988 (the Vienna Convention) and submitted the instrument of ratification in 1989;
- (2) the United Nations Convention Against Transnational Organized Crime 2000 (the Palermo Convention) submitted the instrument of ratification in 2003;
- (3) the International Convention on the Suppression of the Financing of Terrorism 1999;

- (4) the Shanghai Convention on Combating Terrorism, Separatism and Extremism along with Kazakhstan, the Kyrgyz Republic, the Russian Federation, Tajikistan and Uzbekistan in June 2001 and ratified it in October 2001; and
- (5) the UN Convention against Corruption 2003.

In addition, China has ratified the Vienna Convention on 25th October 1989, the Palermo Convention on 23rd September 2003, and the UN Convention against Corruption in 2005.

According to the FATF (2007), China has signed 40 Mutual Legal Assistance (MLA) treaties with other countries and three treaties on the transfer of sentenced persons. China is obliged to provide mutual legal assistance in Anti-Money Laundering / Combating the Financing of Terrorism (AML/CFT) investigations on the basis of bilateral MLA treaties and international conventions that China has signed. There are two channels of communication for MLA in China; depending on what basis the MLA is being provided. The Ministry of Justice is the central authority designated in international conventions and bilateral treaties on MLA as the correspondent for China. The Ministry of Justice will make a preliminary review of the request for judicial assistance according to the related treaty and domestic law. Provided that it complies with the conditions set out in the treaty, the request will be passed on to the authority that is competent to take the requested actions according to Chinese laws. Besides, the Ministry of Justice is responsible for following up the implementation and giving guidance if necessary, or

communicating with the requesting state on difficulties met in the process of enforcement. If the request does not comply with the provided conditions, the Ministry will return it and giving reasons for doing so. The other channel is the Ministry of Foreign Affairs (MFA), which is responsible for dealing with requests from countries that have not had MLA with China. The MFA reviews the request, forwards it to the appropriate law enforcement authorities and channels the reply. MLA is then granted on condition of the requesting state making a commitment of reciprocity to China that complies with Chinese law and judicial practice.

Consistent with its international commitments under the conventions and agreements, China explicitly criminalised different forms of manipulating criminal proceeds in three separate articles of the Criminal Law (Penal Code). In 1979, Article 312 of the Criminal Law criminalized the offence of receiving and handling illegally acquired goods generated from all crimes. This Article was amended in 2006 to cover illegal acquired proceeds and gains derived from crimes. In 1990, Article 349 criminalised the offence of handling or laundering of proceeds generated from drug-related offences. In 1997, Article 191 first criminalized money laundering under 1997 Chinese Criminal Law, which was amended in the Third Amendment of the Criminal Law in 2001. This article did not and has not established money laundering as an offence in itself. Instead, the article only introduced that any person who knowingly engages in laundering funds generated from four predicate offences- drug trafficking crimes, organized crime (mainly violent offences committed by criminal syndicates), smuggling, and the offence of

terrorist activities, may be punished for the crime of money laundering. Money laundering is defined as providing fund accounts, conversion of property into cash or other financial instruments, transferring capital through transferring accounts or any other form of settlement, remitting funds to foreign jurisdictions, and covering up or concealing nature or source of the illegally obtained proceeds and the gains derived there from. The Article indicates that it would include the acts of aiding and abetting, or attempting to commit, the offence. The penalty for the offence is 5-10 years' imprisonment, plus a fine of not less than five percent but not more than 20 percent of the amount laundered. Where an entity commits the crime, the penalty is a fine imposed on the entity, but only a maximum of five years' imprisonment for those persons responsible unless the circumstances are serious. In 2006, this Article was further amended to extend the category of predicate offences as crimes related to drugs, terrorist activities, organised crime (mainly violent offences committed by criminal syndicates), smuggling, embezzlement and bribery, financial fraud, and violating the Socialist market economic order. Article 174 criminalised the establishment or operation of a commercial bank or any other banking institution without the approval of the PBC. The aim of this Article is to prohibit illegal money-transmission activities and to reduce the risk of fraud on depositors. The crime stipulated in Article 174 of the Criminal Law is punishable by imprisonment of up to 10 years and a fine of between ¥ 20,000 (£1,333) to ¥500,000 (£33,333). This Article is amended to require the licensing and regulation of money transmissions

services as called for explicitly by FATF 40 (Recommendation 23) and FATF 8 (Recommendation VI).

3.3.4.4 Civil and Criminal Confiscation/Forfeiture

Legislation in relation to controlling criminal proceeds in China was made earlier than the promulgation of formal anti-money laundering laws. Four stages of criminal legislation development in regard to money laundering in China can be seen. First, the stage prior to international anti-money laundering to against drug trafficking. The earliest legislation of criminalising manipulating criminal proceeds was Article 312 of the Penal Code (PC) made on the 1st July 1979 before money laundering was criminalised in the West. It criminalised receiving and handling illegally acquired goods on the basis of an all crimes approach (i.e. harbouring, transferring, purchasing, selling, or disguising or concealing). The Article was extended on 29th June 2006-i.e. in the post –criminalisation of laundering period- to cover all “income or proceeds Therefrom” and certain money laundering activity (disguising or concealing).

Second, is the legislation stage of combating drug related proceeds. After “the UN Convention against the Illicit Traffic in Narcotic Drugs and Psychotropic Substances” in 1988, the Standing Committee of the National People’s Congress issued the Decision on the Prohibition against Narcotic Drugs on 28th December 1990. It supplements several new kinds of drug crimes and increases statutory punishment. Article 349 PC was introduced to criminalise the handling or

laundering of proceeds generated from drug-related offences. The Criminal Law (1997) eventually adopted these amendments.

Third, is the stage to clearly criminalise money laundering in the PC (1997) and to seek international co-operation. Article 191 PC was introduced on 14th March 1997 to criminalise the act of laundering proceeds generated from four broad categories of offences- drugs, smuggling, organised crime (mainly violent offences committed by criminal syndicates) and terrorism. It was last amended on 29th June 2006 to add three additional broad categories of predicate offences of corruption/ bribery, violating the Socialist market economic Order and financial fraud. In addition, Article 174 criminalizes the establishment of an unauthorized financial institution. According to Article 174 of the Criminal Law, it is a criminal offence to operate an illegal financial institution or provide financial services illegally in China. In the same year, China also made efforts to seek international co-operation. In a Joint Statement at the Presidential Summit in May 1998, China agreed and signed a MOU with the United States to establish a Joint Liaison Group for law enforcement co-operation in specific areas, including combating international organized crime, narcotics trafficking, alien smuggling, counterfeiting, and money laundering. China also began consultations aimed at concluding a mutual legal assistance agreement. In June 2000, the United States and the PRC signed a mutual legal assistance agreement (MLAA), which is the first major bilateral law enforcement agreement for China with other countries. In March 2001, the MLAA entered into force and can provide a basis for exchanging records in connection with narcotics and other

criminal investigations and proceedings. In April 2001, an Anti-money Laundering Investigation Department was founded in the MPS. According to the US Bureau of International Narcotics and Law Enforcement Affairs (US BINLEA, 2003), the Federal Bureau of Investigation (FBI)-staffed legal attaché office was opened at the U.S. Embassy in Beijing in October 2002. China also held a China-ASEAN Workshop on Law Enforcement Cooperation against Transnational Crimes in Beijing (People daily, 2003). The Standing Committee of the National People's Congress formally ratified the UN Convention against Transnational Organized Crime in its fourth meeting and took effect in on 29th September (Xinhua, 2003).

Fourth, is the stage to criminalise offences of financing terrorism. After the September 11 terrorist attack, the Security Council of the United Nations responded quickly and on 28th September 2001, adopted Resolution 1373, calling on member states to urgently work together to prevent and suppress terrorist activities and calling for increased cooperation and full implementation of the relevant international conventions related to terrorism. To meet the need to combat terrorist activities both at the national and international level, the Twenty-fifth Session of the Ninth Standing Committee of the National People's Congress adopted the third amendment to the Criminal Code, which increases the punishment of the crime of organizing, leading, or actively participating in an organization engaged in terrorist activities. Terrorist financing has become a criminal offence in China and the government has the authority to identify, freeze, and seize terrorist financial assets. China is able to use international instruments to deal with domestic problems. The

Chinese authorities began to participate in United States and international efforts to identify, track, and intercept terrorist finances, specifically through implementation of United Nations Security Council anti-terrorist financing resolutions. Beyond searching the names on the Office of Foreign Asset Control (OFAC) lists, China has also strengthened control of hazardous substances like explosives, tightening border controls, intensifying security measures at airports, ports and major infrastructures (China Daily, 2003). On 13th November 2001, the PRC signed the UN International Convention for the Suppression of the Financing of Terrorism and attempted to identify any terrorist assets in the PRC based on the UN 1267 Sanctions Committee's consolidated list. China and United States have established a Working Group on Counterterrorism that meets on a regular basis. In December 2003, China ratified the UN International Convention for the Suppression of the Financing of Terrorism, and listed seven individuals and East Turkistan groups as terrorists, and requested that domestic and foreign financial entities freeze their financial assets.

3.4 Conclusion

China is willing to incorporate itself into the global market to pursue its economic goals. As a precondition to engage in international market and become a world player, China has to compromise itself and obey the international rules including anti-money laundering. Efforts have been made to ensure its standards to be in line with the requirements of powerful states, the FATF and global institutions. There

are also internal factors such as combating proceeds crime including corruption that China needs to adopt an AML regime. China has developed a series of laws in regard to money laundering step by step. Prevention and enforcement pillars of money laundering control have been rapidly implemented. On the one hand, China has adopted AML regulation by establishing a FIU to receive and analyse suspicious and large value transactions. China has set up a regulatory and supervision framework, updated a CDD procedure, and implemented the areas of administrative and regulatory sanctions. On the other hand, China has expanded its scope of predicate offences. The definition of money laundering has been expanded as widely as possible in Chinese Criminal Law, although there are particular concentrations on certain type of predicate offences. The selection of key money laundering predicate offences is on the basis of contemporary Chinese crime circumstances. China also strengthened its money laundering investigation, enhanced its prosecution and punishment, and amended its confiscation and forfeiture law on money laundering. An AML regime in China has been formed.

Chapter IV: Research Methods

4.1 Introduction

Money laundering became a controversial topic in China in the early 21st century. Prior to the adoption of the AML regime in China, there were a great number of media reports (a) condemning money laundering activities and (b) quantifying the harm of money laundering with an astonishing estimated amount of money involved at the time. There is no evidence that this was stage-managed but it may have been more than coincidence. There have been many Chinese academic works describing Chinese money laundering issues in the Mandarin language. However, little research has critically analysed Chinese money laundering issues compared with international experience. I have not come across any empirical research analysing China's money laundering. Few articles discussing money laundering or its control in China are written by native Chinese in the English language, and have been internationally published. The examples of the studies conducted within China and available to the public in English include "Money Laundering in China" written by Song Yang, who revealed Chinese money laundering methods and discussed some major problems encountered by Chinese AML agencies in 2002. Ping He also has undertaken some research on the predicate offences, efforts to combat money laundering, criminal suppression and administrative prevention on money laundering in China. Studies conducted from those outside China on the subject of Chinese money laundering include German based academics such as Heilmann and

Schulte-Kulmann (2007) who analyse the peculiarities of the Chinese national anti-money laundering regulatory regime and its specific design. My study is intended to systematically identify the reasoning being behind Chinese recent AML initiatives, to critically discuss China's AML regulation compared with international experience. It also will assess – as far as is possible at present - the impact of China's AML regulation and its effectiveness. This chapter reveals how I designed the research by utilising my strengths. It talks about the ethical considerations. It also states the difficulties of getting access to data in practice and the ways of communicating with participants. The extent of primary and secondary data is explored.

4.2 Research Design

I planned to find out the differentials between Chinese money laundering methods and international experience on the basis of data I collected. I considered conducting a cost and benefit analysis of the effectiveness of Chinese AML regulation. The design prior to the research was centred on quantitative, qualitative and combined multi research methods. The primary qualitative method I intended to use is interviews with money laundering control stakeholders and convicted money launderers. Those stakeholders include the Police, Prosecution Service, Court, and financial institutions. I wanted to gather information on how they perceive the difficulties of implementing AML regulation in a Chinese context, and their view of the effectiveness of China's AML regulation. The quantitative method would be

used to analyse the most popular money laundering methods, and cost and benefit analysis of the promulgation of AML. The plan of the utilisation of combined research methods was because either quantitative or qualitative method has flaws and could not produce sufficient evidence to testify my hypothesis on its own. Take the quantitative method as an example, one of the disadvantages is the loss of the details about each money laundering case. People commit money laundering offences in different ways. There are many different factors affecting each situation and motivation of each money launderer to engage in money laundering activity. These important variations are lost in quantitative analysis. The research result from such quantitative method would gloss over the fact that criminals are more likely to apply different money laundering methods in different areas, due to the significance of the local predicate offences and cultural background. The advantage of losing these details is that we arrive at structural variables that can be accurately generalized across a number of different situations. In my opinion, the AML regulation to address money laundering must be regulated on a country-by-country, and case-by-case basis. However, there are overarching issues including why criminals commit money laundering in particular situations during a particular period, or why they prefer certain types of money laundering methods, that should be addressed. The use of quantitative methods alone also limits the amount of theorising that can be tested about particular variables. For instance, I could argue both that traditional Chinese local culture facilitates money laundering and that the new money laundering methods constitute a breakdown of traditional culture. Both

arguments sound reasonable, and in fact both may be true in different situations. However, it is difficult to conclude the positive or negative role of traditional local culture in the commission of money laundering, whether the culture supports it or not. It is difficult, if not impossible, to render judgment about which variables are more important than others based on non-quantitative analysis alone. The most important way that this analysis varies from case studies is in searching for structural causal variables. I intended to find out the answers on the basis of information gathered.

At the beginning of the research I sought to gather secondary data and undertake a literature review. I conducted historical research on the topic of Chinese money laundering on the basis of historical documents including textbooks and records. The aims were to explore my research questions. To understand and summarise the relevant work in the area of money laundering, I also looked at the up-to-date literature including relevant articles, books, and any documents that could inform my research. I expected to find out problems, answers, details of money laundering in an international and Chinese domestic context. I worked to identify what related questions and problems have been addressed, and why the academics have different arguments. I also looked for if, how and where my own ideas and assumptions are related to existed research materials.

4.3 Ethics

I considered several issues whilst designing the research. The primary concern was the risk posed to the research participants. I have considered the issue of harm that the potential research participants would suffer in the future. I made sure that every single participant had received a full disclosure of the nature of the study, the risks, expected benefits and alternatives, along with an extended opportunity to ask questions. I have ensured the confidentiality or anonymity of each participant. I have ensured to inform my interviewees that the interviews would be undertaken without disclosing their personal information or any information that might lead to the disclosing of their identity. I informed the research participants how I would keep privacy and confidentiality. For example, I have explained how information would be protected from unauthorised observation and getting access. In addition, I have also asked how they would be notified of any unseen findings from the research that they may or may not want to know. Informed consents were obtained prior to the interviews.

4.4 Participants and Access

In terms of research population, I considered the size of the population should not be too big or too small. On the one hand, I understood that the larger the example were selected, the more accurate the result I would have. On the other hand, I also considered the restriction by time and money to ensure the number of interviews to be manageable, given the circumstance that participants were in the UK and my

research would be undertaken in the UK. I designed to interview the majority of the participants from the AML financial institutions and law enforcement agencies. Other important interviewees include policy makers, politicians, academics, financial service users and convicted money laundering offenders. Due to previous working experience, I understood that it was not easy to get response from Chinese politicians and law enforcement agents without knowing them in advance. In addition, people's jobs could change over time. On the basis of the cost and dynamic population, the strategy of convenience sampling was utilised. I considered contacting my previous colleagues, university lecturers, friends working in financial field. I also would like them to introduce their contacts as my research population. Some people selected worked in the Police, Police University, banks, and security companies. Some entrepreneurs who had both domestic and international businesses were also selected. I assumed those people should have some knowledge and experience of money laundering control due to their jobs and businesses.

I selected 20 participants for interview. These people include two money laundering Compliance Officers from the Bank of China at a city level, three principal security officers in three different security companies based in Bei Jing and Shang Hai, four Police officers working in the Economic Crime Investigation Department at a city level, five entrepreneurs, and six members of the general public, who are regular financial service users. The interviews were semi-structured and focused on their knowledge and experience on the issue of money laundering and its regulation.

Obviously, it cannot reasonably be claimed that these were statistically representative of the population in a country as large as China, or of any normal sized country either. However, general public members apart, I consider that these are at worst not highly atypical for the following reasons. First, those interviewees are selected from key AML stakeholders including state owned banks, security companies, the Police, and financial service users, who have working experience of investigating money laundering, or implementing AML regulation, or the knowledge of money laundering. They are able and willing to provide information I need. Second, the interviewees are geographically selected from large and developed cities, where there are relatively developed financial systems and the AML regulation is in place. Third, some interviewees are team leaders in organisations or running cross-bordering businesses, and they have more experience and awareness of the AML regulation. However, there are limitations of research methods used in this thesis. First, the coverage of the interviewees is not comprehensive. Money can be laundered in a range of areas or economic sectors. Due to the resource and time limit, I have not interviewed people from other banking sectors including commercial banks, non-bank financial institutions such as insurance, and profession such as solicitors or accountants. In addition, no Chinese underground bankers have been interviewed, although Chinese underground banks are believed to have assisted money laundering activities. Second, although 23 money laundering cases illustrated in chapter five have a wide coverage; however,

the limited number of cases is far too small to fully reflect the whole picture of Chinese money laundering status.

The interviews, apart from with the general public, were all undertaken in restaurants. It is because Chinese people feel comfortable and less formal in an informal environment, which served to break the ice and to build up trust. Fees were paid for the interviewees from the banking and security sectors and the Police. Small presents were provided as a Chinese tradition to demonstrate my respect, appreciation and sincerity. The costs of greeting at restaurant with entrepreneurs were paid by the interviewees, as they considered my financial circumstances of being a student. There was also a reason that I would help to translate or check their companies' profiles on their companies' English websites, as reciprocation for their assistance with my project.

Pseudonym	Sector/ Identity	Gender	Length of working experience/ history of using financial institutions (years)
A – Yan Li	Banking	F	14
B – Li He	Banking	F	9
C – Xiao Yang	Security Company	M	16
D- Qian Ming Li	Security Company	M	5
E- Ling Zhang	Security Company	M	5
F- Wei Wan	Police	M	20
G- Jun Liang	Police	M	21
H- Yang Yu Liu	Police	M	12
I- Jian Kang	Police	M	13
J- Yi Long	Entrepreneur	F	25

K- Hua Xiao	Entrepreneur	F	26
L- Dong Wang	Entrepreneur	M	20
M- Dan Li Yu	Entrepreneur	M	17
N- Guang Yin	Entrepreneur	F	21
O- Zhi Huang	the General Public	M	29
P- Tong Yun Zhu	the General Public	F	34
Q- Hong Li	the General Public	F	30
R- Zhong Da Liu	the General Public	M	27
S- Jing Wan	the General Public	F	29
T- Mei Lu	the General Public	F	8

Originally, I believed that it would not be too difficult to get access to the data because of my previous working experience as a Police Officer, and a social network of having friends working in a variety of key AML sectors including financial institutions, Police, Prosecution Service, Prison, Court and commercial sectors. I planned to undertake semi-structured interviews on these professionals and entrepreneurs from different perspectives to examine their professional opinions about money laundering and the effectiveness of its counter measurements. I considered undertaking interviews with convicted money launders to understand their viewpoints of money laundering prevention and enforcement status. I also considered disseminating questionnaires to the public to have their views about money laundering. For the purpose of data collection, I have also planned to attend relevant conferences with money laundering issues as many as possible to update my knowledge, meanwhile to get access to experts or people might be helpful in my research. I attended an Economic Crime Symposium organised by Professor Barry Rider, a noted world authority, held in Cambridge University and got to know Chinese delegates who delivered a speech about Chinese money laundering. I have also been to a British Criminology Society Conference to look for the

postgraduates' research experience. I was greatly encouraged by the academic environment and different people's viewpoint of money laundering from an international level.

In reality, however, I have realised how hard it is to get access the data. First, there were few academic or official publications available on the topic of money laundering in a Chinese context between 2003 and 2008. Massive media reports on money laundering appeared contradictory to each other and inconsistent. These data were unreliable, not valuable and quoted without reference. The research was lack of sufficient secondary data. Since 2007, the situation has slightly improved and basic statistics could be obtained from the website of the Central Bank of China. Second, problems occurred in my personal network (*guan xi*) for the research. Some people who I had provisionally planned to interview had left their posts by the time when I approached them. Others appeared to be reluctant to participate in my research, although they had demonstrated to fully support me previously. There could be many reasons. Probably the topic was too sensitive at the beginning period of the legislation and Chinese people have experienced suffering from criticising Chinese government in their formative years, especially the Cultural Revolution period. Their concerns about the subsequent negative consequences after disclosing information could be seen by their hesitation and refusal. Censorship was an issue that people were worried about what they should say and should not say, and who they should speak to and to what extent. It could be that they really did not know what the money laundering and anti-money laundering regime were at the initial

stage and did not want to reveal their ignorance. It could be that people are changing all the time and the way I approached them was inappropriate as the circumstances have changed. Or it could be that I was not important and my research did not interest them. When I actually turned up for the scheduled interviews, a number of reasons were given to decline the interviews.

I had an experience when I flew back to Bei Jing China for a scheduled interview, but the interviewee cancelled the appointments without informing me in advance. I was disappointed. I am a postgraduate student and the interviewee was a high level governmental official. I felt the power imbalance, personal disrespect and political complexity. I found time was wasted and I was unable to afford unnecessary financial cost. In addition, in the initial stage, the quality of the interviews was undermined whilst the interviews were undertaken at the interviewees' offices. It was because the interviews appeared too formal at the office, where they did not feel relaxed or comfortable to talk about their real feelings. Bureaucratic attitudes, language and behaviour were overwhelming. The visits were registered at the workplace, which could be traced and found out if sensitive information was disclosed. They might feel that information provided could infringe the Political interests and would result in disciplinary punishment. Most interviewees rejected telephone interviews or interviews via emails. They were probably concerned about the security issues of being recorded to get back to them should problems occur. I tried a number of telephone interviews at the outset of my research; the answer was almost the same that "it is hard to talk on the phone".

Therefore, I changed my research design and methods. I began to concentrate on “black and white” paper research in the United Kingdom. Published articles in regard to foreign countries’ money laundering issues were resources that I usually gathered as a reference to compare with China. It has been difficult to gather useful information in relation to Chinese money laundering predicate offences, given the direct information on Chinese money laundering abroad. A number of Chinese academics appeared politically oriented and showed a lack of academic independence in their research findings. Their descriptive research papers did not match my research questions. The data allowed to be published was mostly outdated. Newspapers and websites - both in Mandarin and English - appeared to be good resource to gather up-to-date information, although they were unreliable. Additional data were provided by one of my supervisors, who always sent me useful information in relation to China that he had come across.

It was until the late 2008, I decided to undertake another round of interviews as I did need to verify my hypotheses. Surprisingly the interviewees were willing to talk about the issue of money laundering further. I then returned to China two times in 2008. There are many reasons to probably explain such changes. The interviewees have become more aware of money laundering activity and their knowledge has improved. The issue of money laundering may have become less sensitive. The strict censorship status may have been loosened. The Chinese AML regime may have become more confident to receive criticism openly due to its AML implementation to an international standard. China may have become more

responsible for its action. It could be that I utilised an appropriate way to conduct interviews.

4.5 Primary Data

Primary data in my research was obtained from face to face semi-structured and telephone interviews. Primary data has both advantages and disadvantages. In terms of the advantages, data gathered is up-to-date and is usually obtained quickly, e. g. telephone interviews. Questions have been designed specifically for the purpose. Data collected is confidential. There are also disadvantages. For example, the data collection process was time consuming and data was difficult to collect. In my research it took approximately five years to get access to the data. The data collection has a financial implication of being expensive. Each time the cost of physically returning to China was considerably expensive for me. The cost of travel, accommodation, and socialising with the interviewees are not financially sponsored or covered by scholarship. In addition, the analytic results from the data collected might be misleading, because the samples I chose were not large enough and did not have a full coverage of Chinese AML stakeholders. This was the reality of empirical research that I encountered, and I now realise that this is not rare in white-collar or economic crime research.

4.6 Secondary Data (government reports, Chinese university data)

I have been collecting the secondary data throughout my research. This has enabled me to understand a useful background, and to identify key questions and up-to date issues that will need to be addressed by the forthcoming primary research.

The secondary data I have used include government reports, magazine and newspaper articles, academic publications, university library sources, internet, and bibliographies of published articles. The use of the secondary data needs to be critically assessed. The advantages were many. First is time efficiency. The secondary data could be collected within a short period of time, thanks to the advanced development of internet. The required data could be extracted from available data straight away. In addition, the cost of gathering information was much less than the collection of the primary data. I did not need to spend much money on interviews, but only paid for the online data access when needed. And I did not need to spend time designing questions, preparing interviews skills, and socialising with people in the way of consuming alcohol. Chinese people believe the more alcohol you consume; the more respect you demonstrate. However, the disadvantages could not be neglected. As previously mentioned, secondary information pertinent to the research topic of Chinese money laundering is either not available, or is only available in insufficient quantities. I found it was hard to get access to a secondary database that I would like to use. In addition, some secondary data such as magazine and newspaper articles were unreliable and

inaccurate. For example, in regard to the figure of money laundered in China, different resources suggest very different numbers for money laundered. (Though this is a universal issue – see Levi and Reuter, 2006.) Some government reports such as the financial institutions reported statistics appeared to lack citation where and how the data was collected. Another significant problem is that the data available was not up-to-date. Much secondary data I gathered are outdated and do not correspond with the current money laundering situation.

4.7 Conclusion

Eventually I have managed to gather some primary and secondary data for my research. However, there were a number of limitations in data collection. First, the research has a regional character. The interviews were mainly conducted in the regions that I am familiar with. The data cannot present the whole of China. Second, the interviewees from banks were not from senior management. The interviewees were not selected from the top level of the AML structure due to my limited personal network. No interviewees were selected from the Chinese Central Bank or the head office of the Public Security Ministry, although they are from the major Chinese cities. Third, no interviewees were high ranking governmental officials from the central government. The information gathered was lack of reliable and powerful political consideration. Fourth, the population of interview is small and not a valid sample to cover all AML agencies. No interviewees from certain AML sectors such as commercial banks, customs, insurance sector, the Prosecution

Services and the Court have been interviewed. Fifth, no interviews with money launderers have been undertaken, because no offenders were convicted in the areas that I was able to get access by the time I completed the interviews.

The experience of data collection suggests a research study could be well designed, but it may not be easily implemented. There are a number of factors that need to be considered and a contingency plan will be helpful to deal with unexpected difficulties. In China, the data collection is difficult. Certain knowledge of cultural and social background and personal network will be extremely helpful for primary data collection.

Chapter V: Analysis of Contemporary Money Laundering Cases

5.1 Introduction

The importance of understanding the methods of laundering money is four fold.

First, it is useful to help policy makers understand the operational characteristics of money laundering, though there is always the problem that cases identified may be representative only of the less competent techniques of concealment. Second is to inform law enforcement agencies for the purpose of generating criminal intelligence and to enhance their anti-crime strategies. Third is to increase the knowledge and ability of operational staff to identify money laundering activities or at least suspicious transactions through their financial institutions. Fourth is to improve the awareness of the public conception of money laundering. It is hard to combat money laundering effectively without knowing mostly how it is being carried out.

Despite the lack of systematic attention to methods used in particular countries (Levi, 2009), numerous studies have well illustrated diverse methods used internationally, and these methods appear to have geographic characteristics along with their prevalent local predicate offences. Some methods reported appear complex and sophisticated, involving a number participants and financial transactions across borders. Sometimes a number of methods are combined to launder a single transaction. Others – the great majority of prosecuted cases – use relatively simple techniques (Van Duyne and Levi, 2005). Money laundering appears to be a complex concept both from its nature of the offence and diverse

recognitions of predicated offences. However, some methods seem simple enough to confuse people who consider money laundering a myth with sophistication by thrilling fiction, exacerbated media reports and purposeful political discourse.

This chapter will examine twenty-three (N=23) China's money laundering cases in relation to Naylor's (2003) typology for profit-driven crimes. The cases were selected from open resources including the media, academic articles and reports that I could get access to. Some cases have not been charged with or convicted for money laundering but clearly have the elements of money laundering activities. I intend to select cases having a wider coverage in terms of quantities of money involved, the severity of adverse effects, reliance on cash and victims they affected. The cases were selected to have relative distribution of the cases reviewed by Reuter and Truman (2004). Over 70% of my cases are market-based and commercial offences including drug trafficking, fraud and smuggling. Predatory offences represent a small percentage. The methods used for laundering proceeds are discussed after the description in each individual case. A hybrid character of money laundering predicate offences will be identified from the cases analyses. The data will be used to create a table and chart to facilitate the analysis of the characteristics of money laundering methods in contemporary China. The finding will be compared with the international samples of Reuter and Truman (2004). The reasons for the differences and similarities will be speculated.

5.2 Cases Examples

Naylor (2003) points out the limitation of traditional profit-driven crimes classification, and helps to clarify the economic logic behind profit-driven crimes with a tri-partite model: predatory, market-based and commercial. This model is devised to better understand the contemporary profit-driven crimes on the basis of their function, process, and application.

Predatory offences are “purely transferral” given the involuntary nature of bilateral property extraction from victims. Predatory offences involve involuntary transfers which generally use stealth or force (or its threat), redistribution of existing wealth from one party to another, the losses from which are relatively simple to determine, except where the victim has acquired the assets criminally. Typical predatory offences in general include theft, burglary, robbery, banditry and piracy. Case I and II are typical violent offences involving forced wealth transfer from the victims to the predators. There are clear victims and they are the private citizens. The transfer takes place in cash and the losses are simple to determine.

Market-based offences are “partly functional” given the (more-or-less) voluntary nature of multilateral exchange for illicit goods or services. Market-based offences involve evasion of regulations, taxes and prohibitions, although the types of market based offences are different. There are three types of market-based offences, which are relative contraband, fiscal and absolute contraband. The following cases from III to XII have covered all three types of market-based offences. Sometimes one

type of market-based offence applies, and sometimes one case has a combination character of covering two types. For example, goods smuggling cases VIII and XI fall into the category of relative and fiscal contraband. The case IX is absolute contraband. These offences involve production and distribution of illegal goods or human should they voluntarily pay for smugglers for the purpose of improving their living standards. The victims are more like society as a whole rather than a defined victim. Some offences involve an institutional context which consists of an underground network such as underground banking system in the case XII and criminal network. The transfers are voluntary and take place mainly in cash or bank instruments.

Commercial offences are apparently voluntary given the multilateral trade in legal goods and services, but also involuntary given the illegal (fraudulent) methods of manipulating market values to the disadvantage of victims. Commercial offences can be further subdivided into those involving fraud against suppliers of inputs, deception against customers of output and externalisation of costs at the expense of the larger society. Those offences are committed by otherwise legitimate entrepreneurs, investors and corporations. The cases between XIV and XXIII (excluding XIX) are listed below and are examples of such offences.

Despite the tri-partite model given above, the cases XIII and XIX suggest that there are crimes involving characteristics of predatory, market-based and commercial crimes. A hybrid type of crime emerges. In the case XIII, Liu dominated the market

by force and transferred wealth by violent means. He then monopolised the tobacco market, where the market management order was breached. He also bribed corrupt officials and obtained business contracts at an unfair market value. The case XIX indicate the corrupt officials committed embezzlement from companies' purchasing accounts, which would fall into the predatory category. The purchase was fraudulently completed with their foreign business partners. It was a superficially voluntary exchange with a hidden and involuntary aspect. When the proceeds were laundered "white", the corrupt officials then invested the money into China as a foreign investment to obtain favourable tax benefits.

5.2.1 Predatory Offences

Case I: Zi Qiang Zhang and Ji Huan Ye kidnapping

Money laundering began emerging in mainland China as an accessory of infiltration by outside organised criminals. In 1998, a triad group run by Zi Qiang Zhang and Ji Huan Ye was cracked down by the mainland China Police. Both Zhang and Ye were Hong Kong citizens. Their crimes included armed robbery, kidnapping, killing and smuggling bombing materials. One of significant characteristics of their crimes was strongly monetary oriented. They robbed gold and jewellery shops and banks a number of times. In 1983 and 1996, Zhang and Ye organised two cases of kidnapping, targeting wealthy business people for redeeming a significant amount of cash. Their crimes became more frequent and violent in the 1990s. On the 22nd February 1990, Zhang organised and committed armed robbery and took a bunch of

Rolex Watches, which was worth up to HK \$250 million (approximately £17 million) in Hong Kong Qi De International Airport. On the 9th June 1991, Ye organised eight members equipped with rifles, pistols and hand grenades and robbed five Goldsmiths, stealing gold jewellery worth HK \$6 million (approximately £4 million). On the 2nd July 1991, Zhang led other members of the group who robbed cash carriers and stole HK \$160 million cash and US dollars in Hong Kong Qi De International Airport. On the 10th March 1992 Ye robbed two Goldsmiths in Hong Kong and stole gold jewellery equivalent to HK \$ 1 million (approximately £66,666). On the 23rd May 1996 and 26th September 1997, they kidnapped two businessmen and redeemed HK \$1.638 billion (approximately £109 million). On the 7th January 1998, this triad group illegally smuggled 800kg explosives, over 2000 percussion caps and 12,500 meters of percussion cord and other chemicals from mainland China into Hong Kong. The plan was to commit terrorist bombings. The number of crimes generated a very large amount of proceeds, the disposal of which became a concern of these criminals. The triads chose to launder their proceeds through a Casino in Macao and housing estate agencies in mainland China. Members of the group purchased over 60 properties in mainland China cities such as Guang Zhou, Shen Zhen and Zhu Hai, which were worth HK\$130 million (approximately £86 million). When those cases were detected, over 40 members of triads were arrested. Proceeds, assets, properties and a number of firearms worth of several hundreds of millions yuan were confiscated (Baidu, 2007). In this case, Zhang purchased properties in mainland China and

shops and casinos in the names of his siblings. Zhang's strategies of managing his criminal proceeds and his siblings' involvement clearly suggested their commission of money laundering. However, none of them was charged with or convicted for money laundering.

Case II: Fujianese kidnapping gang

According to Finckenauer (2001) alien smuggling, human trafficking and kidnapping are the main transnational crimes of the Fuk Ching. Chin (1996) found that Chinese gangs were quite active in legitimate businesses in New York City's Chinatown. For example, they owned or operated restaurants, retail stores, vegetable stands, car services, ice cream parlours, fish markets, and video stores. On a higher, more professional level, they also owned or operated wholesale supply firms, factories, banks, and employment agencies. The United States federal investigators uncovered an IVTS in New York, which they believe was responsible for remitting millions of dollars a year to China. The system was discovered during an investigation of a Fujianese kidnapping gang. This gang kidnapped Chinese immigrants in Washington DC, and used the fei ch'ien system to transfer ransom from the victims' families residing in China — in one particular kidnapping case, the ransom was set at \$10,000, suggesting that the families were not very wealthy. The ransom would be picked up at a clothing store, which served as a front for this IVTS in New York's Chinatown (De Stefano, 1995).

5.2.2 Market-based Offences

Case III: Ping Yuan drug trafficking

One of the best examples to illustrate the seriousness of drug trafficking in China was the Ping Yuan case in Yun Nan province. The Ping Yuan area belongs to Wen Shan Region and consists of three towns. There are 228 villages with population of 10,327, and occupying 903.4 square km. Ping Yuan area is the central point for Kun Ming (the capital of Yun Nan Province), Guang Xi Minority Autonomous Region and Vietnam. In the 1980s, local drug traffickers utilized their minority and religious status as a front and developed an organised criminal group run by Hui Chun Ma, Guo Bao and Hong En Lin. The local government and power of mosques were controlled by these criminals. The local Vice Governor in charge of Public Security, Communist Party Secretariat and Vice Secretariat, and religious leaders were key members of this organised group. They allied 23 mosques secretly and planned to take over the religious power in the whole Yuan Nan Province. They smuggled firearms and controlled drugs and transformed Ping Yuan as a drug transmission centre for international organised crime. Between 1989 and August 1992, 834 drug trafficking cases were detected by the Wen Shan Police, and 113.38 kg heroin, and 491.22 kg opium seized were from Ping Yuan area. Between 1988 and 1991, 159 military firearms and over 20,000 bullets, 160 hand grenades, 1440 other type firearms were confiscated. Ping Yuan area became a military base for drug trafficking. In some properties, the house was designed and converted with tunnel, hidden cells, and interlayer for defence purposes. At home they put their machine guns, submachine guns, pistols at the best positions just in case there was a

raid by the Liberation Army or the Police. In 1987, hundreds of gangsters attacked the Police station by throwing two hand grenades; 15 Police Officers were attacked, Police cars and files were burnt and five detained offenders absconded. On the 16th June 1989, 20 Police Officers were attacked by over 2000 people when they were making arrests of the local drug traffickers. On the 20th March 1992, Police Officers were attacked on their way to arrest a criminal suspect, two Officers were killed and three were seriously injured. A total of 31 times, Police stations were attacked, robbed and smashed. A number of law enforcement agents were killed and over 40 were injured. A significant phenomenon was that these triads accumulated enormous assets and proceeds. The masterminds of the criminal group did not directly commit drug or firearm trafficking themselves, but manipulated their relatives and younger generations as fronts and organised their activities and laundering proceeds underground. To accumulate and launder drug proceeds for their future activities, the criminals invaded the business field such as taking over the ownership of brick factories via violence, collecting 'protection' fees from mines, bridge tolls and road trafficking charges. They also concealed over 200 registered well-known serious crime perpetrators in the Ping Yuan area. Between the 31st August and 20th November 1992, the Police arrested 854 members of this organised criminal group, seized heroin 1074kg, 964 firearms (353 military firearms including five machine guns, 119 submachine guns), 40,000 bullets, 278 hand grenades and landmines, proceeds amounting to approximately ¥104.7 million

(£6.98 million), 2.5 kg gold, 14.4 kg silver, 60 cars, 34 motorbikes and 54 luxury properties.

Case IV: The drug money laundering case of Zhao Wang

It was the first money launderer offence and was convicted on 5th March 2004 in China. Zhao Wang, an unemployed person who nevertheless had a strong “Guan xi (social and personal relations)” network, who assisted drug trafficker Neng Wei Qu to launder cash HK\$52 million (£3.47 million) and US\$100,000 from Canada into China. Qu was a transnational drug trafficker in Hong Kong, Canada and South-east Asia. In August 2002, Wang left the above cash in the car boot and drove through Shen Zhen City Customs on the ground of his strong personal “Guan xi” with the leaders of Transportation Bureau and Customs of Shen Zhen city. Thus, the drug money was smuggled into mainland China from Hong Kong. Although knowing the money was derived from the offence of drug trafficking, Wang suggested to use the drug proceeds to buy a timber manufactory aiming to launder the proceeds into “white”. The money was then used to purchase 60% share of “Guang Zhou Bai Ye Timber Ltd.”, and then changed the name of this company into “Guang Zhou Teng Sheng Timber Ltd.”. Wang became the company director as a return. Thus the process of money laundering was completed. However, laundering money was not the only aim: with the company being under the control of drug trafficker, the plan was also to open a new drug trafficking route from Myanmar through Laos and

finally to the Guang Zhou city of China by putting drugs inside the timber (China Youth Newspaper, 2005).

Case V: A series of drug trafficking cases in Yun Nan Province

Yun Nan Province is bordered with the Golden Triangle and is the mayor drug trafficking route to Hong Kong and the rest of the world. According to a report (Liang et al, 2003) from Yun Nan Province anti-drug squad in 1999, some banks in Yun Nan have become the ideal places to launder drug money. Drug money transactions were able to be completed among banks like ordinary trade money without having any trouble. It is astonishing that there was over several hundred of million cash and monthly transactions reaching over tens of million yuan in a small bank of a small village. The village had only agriculture other than other industries and consists of a few hundred residents. A great number of luxury houses were built in these areas, which contravened the local legitimate income. The drug money had one common character whilst entering financial institutions: an amount of ¥49,000 (£3.267) was deposited into various local banks to evade the check on cash exceeding the threshold of the amount of money regulated by the “Large Amount of Cash Deposit and Withdrawal Register Rules”. The names of bank accounts were unreal by providing anonymous/pseudonym identity cards bought via streets. It is like smurfing, a money laundering method used by drug trafficker used in western countries, that Chinese drug traffickers deposited a similar amount of money in various local banks. The lack of control in financial institutions and co-operation

between financial institutions and the law enforcement agencies have contributed to the seriousness of drug trafficking. No cases were detected in the context of money laundering or drug trafficking because no disclosures were made to the Police as the deposit was under the reporting threshold and there was no AML in place at that time. This indicates although placement is most vulnerable or fragile stage of the money laundering, the vulnerability can be bypassed. In addition, the lack of control also attractive neighbouring countries' drug traffickers to deposit their dirty money into banks in Yun Nan province. The money was then used to invest in cash intensive businesses such as hotels and restaurants. When the buildings were built up and then drug traffickers sought bank loans by using premises as a guarantee to the banks. The loans were able to be spent without any concerns, along with their illegal gains mixed together. The bank loans were also able to be used as criminal funds to expand their drug businesses. Sometimes the bank credit guarantee was used by drug traffickers for purchasing drugs abroad. It is reported that almost every drug dealer has their own trade company as a front. A large order of drug trade is not completed by cash exchange at present. A false trade contract was made and then the money for purchasing drug was remitted from the bank. Or a false unfair contract was made and then one party claimed the deposit (drug money) as compensation by accusing to their partner's breaching the contract. Thus, the money was successfully transacted to the drug suppliers.

Case VI: Overseas Chinese drug trafficking

The United States' State Department has reported that ethnic Chinese groups and members of the 14K group, in particular, have sought to pave the ground for illegal drug and money laundering operations in this country, years before the return of Hong Kong to China. It has been suggested that the aim was to infiltrate Latin American banking systems. At the same time, the report speculates that, since these groups run IVTS elsewhere, such methods may be used in Paraguay too (Bureau for International Narcotics and Law Enforcement Affairs, 1993).

The US Drug Enforcement Administration (DEA) has suggested that IVTS have become the preferred method of drug money movement in certain regions. They specifically note that Chinese IVTS handle most of heroin proceeds within Asia (US DEA, 1994). Although this is an arguable finding (Passas, 1999), there is certain some elements of underground banking that have contributed to the fund transferring and money laundering by drug traffickers.

Case VII: The gambling case of Wei Long Feng

In 2003, a withdrawal of cash of HK\$1.14 million (£76,000) at a single transaction from Zhe Jiang Branch of the Bank of China drew attention of the bank. Through the inspection of the record of this bank account, an astonishing fact was identified that there were a number of large transactions with monthly transaction over several million Yuan through this account; for instance, one transaction was recorded over HK\$7.7 million (£0.513 million). The case was investigated by the Police. The account owner Wei Long Feng was found having 43 accounts in this Branch

dealing with foreign currency exchange on a daily basis. Another suspicious account was identified and the Police established that the account owner Yang teamed up with Feng in their business. Yang and Feng worked as a hub serving casino owner Chen in Macao and gamblers in Zhe Jiang Province. When the gamblers lost their money in casino, they return to mainland China and pay their debts to Feng in Chinese currency, which was then sent to Yang, who would be responsible for exchanging Yuan into Hong Kong dollars. The converted Hong Kong dollars were then returned to Feng, who would hand them to Chen's agent Shen. Shen would send money to Chen eventually. When Shen was arrested, approximately HK\$5 million cash was found in his home (Hu and Zhou, 2004).

Case VIII: The case of Xia Men Yuan Hua smuggling

The case of Xia Men Yuan Hua Company smuggling, tax evasion and money laundering could be seen as the trigger that the Chinese government took a serious view and action to initiate the campaign against money laundering. According to the report conducted by Hannah Beech in 2008, Change Xing Lai, the mastermind behind China's largest-ever smuggling ring, was accused of having run a smuggling operation that racked up \$6.4 billion in revenues from 1996 to 1999. \$3.6 billion in unpaid tax revenues was lost from Lai's activities, and China's state oil companies lost \$360 million a year because of his smuggled oil. Lai is accused of smuggling billions of dollars worth of luxury cars, crude oil, rubber, cigarettes and other goods into Fu Jian in the 90s, when ten thousand of his associates were detained and

approximately 1,000 imprisoned, and fourteen were sentenced to death, among them the minister for borders and the head of military intelligence. It was the largest and most expensive criminal case in the history of China. For more than a year since he escaped to Canada, state newspapers were filled nearly every day with the sordid details of Lai's alleged crimes, making him the greatest symbol of the country's mounting smuggling and corruption. Lai bribed dozens of government officials with cash over the years. In the mid-90s, for instance, he lent the wife of Deputy Minister of Public Security Ji Zhou Li \$121,000 to open a restaurant in Beijing. A year later, he lent Li's daughter \$500,000 while she was living in San Francisco. Lai also bribed Xia Men Vice Mayor Pu Lan with \$250,000, for his son to build a house in Australia. Although there have reports stating that Lai was so generous and interested in sponsoring public activities; however, from the view of money laundering there seems to be a good strategy to launder his illegal proceeds into legitimate income. For example, Lai constructed a \$17 million replica of the Forbidden City in the outskirts of Xia Men as a giant set for future movies. He also bought the city's football team.

It was reported that at least ¥12 billion (£0.8 billion) had been laundered to Canada through "underground banks" over the years (Li, 2002). When his arrest was tipped off, Lai followed his wife and children, who were waiting in Hong Kong in a speed-boat before flying to Canada.

On arriving in Canada, Lai bought a home for CAD\$1m (Canadian Dollars) in cash in Vancouver's exclusive South Granville district. His children went to private school and his wife opened a bank account with an initial deposit of CAD\$1.5m. Lai moved around in a chauffeur-driven CAD\$90,000 sports-utility vehicle. he started visiting Canada's casino capital Niagara Falls. On the 28th August 2007, Lai was charged by Canadian police with money laundering. They had watched him stake millions of dollars worth of chips, and when he seemed not to mind losing, they had become suspicious. Canadian police also found two bank cards of other people in Lai's wallet, and his wife Ming Na Zeng had six bank accounts and two fixed deposit accounts in the Hong Kong and Shanghai Banking Corporation (Li, 2002).

To recover some of the losses, government officials tried auctioning Lai's holdings, including the five-star Yuan Hua International Hotel and the Forbidden City film studio. But by 2008, there have been no takers for his major holdings. Although there have been efforts made to liaise with the USA and Canada, there have been difficulty in the extradition of criminals. The AML mechanism will help China to extradite criminals like Lai on the basis of international mutual legal assistance.

Case IX: Smuggling

A diesel smuggling ring was detected in Guang Zhou city of Guang Dong Province in 2003. The ring leader Hong Jun Zheng utilized the price margin between Hong Kong diesel and smuggled 540,000 tons of diesel into mainland China within five

years. The proceeds involved in the smuggling was worth of ¥1.4billion (£93.3 million); and tax evaded was up to ¥350million (£23.3million). The foreign currencies including US Dollars and Hong Kong Dollars for financing smuggling were exchanged in and remitted through underground banks (Yi and Wang, 2003).

Case X: Smuggling of illegal immigrants

In 2007, two members of a Chinese immigrant-smuggling ring were arrested for running an underground bank. Xin Rong Chen and Hua Mei Jiang, were charged with sending over 2 billion yen (£133.33 million) to the Fu Jian Province of China from Japan for 5000 illegal Chinese immigrants brought into Japan during a three-and-a-half year period. Chen and Jiang allegedly charged commissions of up to one percent of the money they remitted. The underground bank's clients deposited the money to be transferred in Chen's bank accounts. Chen withdrew the money using an ATM card and arranged for a broker in China to dispense the money to the local recipients. Chinese gangs received payments for immigrant smuggling activities and to launder money related to theft rings (Yomiuri Staff Writer, 1997).

Case XI: Smuggling case of Guang Rui Huang

According to Wen Qing Zhong's report (2006), China's Anti-Money Laundering department announced on the 4th December 2006 that China had broken up one of Shanghai's largest underground money laundering cases since the founding of the

People's Republic of China, involving as much as ¥5 billion (£33.33 million). The predicated offences were smuggling, which was organised by Xi Tian Huang. The case looks like a film depicting a string of organised crimes. This criminal group was consisted of reliable members, which were Xi Tian Huang's fifteen siblings. They committed smuggling between China and Vietnam. They had advanced equipment of five engines airship smuggling selected name brand cigarettes, such as Southern Comfort and 555 (popular cigarettes in China). This criminal group owned the shrimp farm. Radar had been installed on the roof of the shrimp farm's office building, used specifically to monitor the patrol status of the Customs, Coast Guard and other police unit. After the goods had been safely unloaded, they were loaded onto trucks and transported to Guang Zhou, Shen Zhen, Kan Jiang and other places, to be sold to buyers. This group smuggled from Vietnam over 47,000 cigarette cartons and had ¥170 million (£11.33 million) in hand. The large amount of dirty money made this group anxious. Guang Rui Huang was a genuine money god for them. Only through him could the money become Xi Tian Huang's legal income. Guang Rui Huang has a profound background in the banking area. He studied at the Guangdong International School of Finance for three years and spent five years working in a bank branch in Shenzhen. After resigning in 1998, with inside-out knowledge of the way banks move money, he became an expert money launderer. He opened tens of accounts in the local branches of two banks under many anonymous/pseudonym names. These accounts were patently preposterous. A few were opened using the altered IDs of his cousins. As an example, the account

name of “Juan Hua Huang” was opened with a copy of photographs taken from an ID of Guang Rui Huang’s wife Hai Xuan Huang and sister-in-law Xiao Yan Huang, but with altered ID names, addresses and other pertinent information, The account name of “Hui Juan Huang” used Hai Xuan Huang’s photograph, but the ID name and number did not match hers. Kan Jiang’s “Boss Chen” shipped smuggled cigarettes into Guangzhou, Shenzhen and other designated stores, included cigarette counters and tea shops. Then those who were responsible for selling the smuggled cigarettes would figure their total revenue, and using banking institutions over a wide area, deposit that money over computer networks into the accounts Guang Rui Huang had established with falsified documents. From July 1, 2003 to Feb. 27, 2004, the deposit account of “Rui Juan Huang” received 73 deposits for total of ¥38.35 million (£2.56 million). On 8th August 2003, however, that account showed 5 transactions amounting to over ¥4 million (£266,667).

When Guang Rui Huang set up an anonymous/pseudonym account, the deposit would usually come in and go out on the same day or the following. Xi Tian Huang and the others would split up and deposit money in the accounts set up by Guang Rui Huang. Guang Rui Huang would then move it on the same day or the following into the accounts of Zhan Kun Gao, Li Mei Wang and others, leaving a small balance in the transmitting account. Thereafter, the money would be transferred to Guang Rui Huang’s Hong Kong Xin Xing International Trade Company and Yong Xing International Trade Company accounts. Once wrung dry, the dirty money had been washed clean, becoming the money that Xi Tian Huang could make use of

without worry. An important middle man, called “A-Nan,” who exchanged Chinese Yuan for Hong Kong dollars and has not yet been made part of this case, moved Guang Rui Huang’s Chinese currency across the border, completing the important step of wringing the money dry. Actually, before the end of 2000, Guang Rui Huang didn’t know who A-Nan was. Later, he was introduced to A-Nan, who, through his gang, made money from the forex spread across the border. But in the beginning, when the amount of Chinese yuan was small, A-Nan was never directly in touch with Guang Rui Huang. The turning point came after 2002. The amount of smuggled money that was wired had become rather large, so Guang Rui Huang began direct contact with A-Nan so that Chinese Yuan could be exchanged into Hong Kong dollars. Between them, Guang Rui Huang and A-Nan established a fixed fee schedule. Xi Tian Huang and Chu Dong Huang called Guang Rui Huang to ask the daily rate (not the official rate, higher than the bank’s officially announced rate, and based on the supply of Hong Kong dollars at the time of the transaction), and paid Guang Rui Huang in Chinese currency based on the rate Guang Rui Huang had provided. Guang Rui Huang would pay A-Nan based on the rate provided by A-Nan, making money off the forex spread. Changed into Hong Kong dollars, A-Nan would then transfer, via underground money-lending networks, to the Hong Kong Xin Xing International Trade Company and Yong Xing International Trade Company accounts.

Judiciary organs have said that, since A-Nan has not been made part of this case, the exact methods of those who use underground money-lending networks to move

money across border remain a mystery. Moreover, the details of the transactions between Guang Rui Huang and A-Nan are impossible to prove, as there is so little evidence. Guang Rui Huang said that he only wished to give Chinese currency to A-Nan. He guessed that A-Nan, in order to exchange currencies, may have had a relationship with a joint venture factory, to which A-Nan would have provided Chinese currency in cash, in return for the joint venture (or foreign invested company) would have placed the equivalent in Hong Kong dollars into the Hong Kong accounts. In addition, Guang Rui Huang disclosed the activities of several other underground money lending networks – which directly exchanged Chinese yuan for Hong Kong dollars in cash and then moved it out into Hong Kong accounts. Chinese who gambled and won Hong Kong dollars on horse racing or the lottery in Hong Kong would give over their cash to A-Nan, who would then pay Chinese currency to them in China. Outside of China, criminal elements who received smuggled goods would take Hong Kong dollars and within China pay Chinese currency at a certain rate to people of a similar ilk.

Just like Xi Tian Huang and the others who profited from laundered, smuggled cash, there was still the originator of the smuggling – a Vietnamese trader name Ze Chun Zhang. For ease of moving money from one account to another, Guang Rui Huang and Ze Chun Zhang settled accounts via cell phone messaging that would send money from the Hong Kong accounts to Xi Tian Huang, and then to Guang Rui Huang. Block amounts of HK\$500,000 (£33.333) or HK\$1 million (£66.667) were moved into Zhang's Hong Kong accounts. The money arrived the same day.

Zhang only shipped product once he had the money in hand. Well over ¥100 million, dirty money earned through the smuggling efforts of Xi Tian Huang and 15 of his brothers and sisters, had been washed clean.

This is a complicated money laundering case, which began prior to the establishment of Chinese anti-money laundering regime. It is unreasonable to strongly blame that the banks failed to be sufficiently alert for Guang Rui Huang's laundering activities, as there were no effective laws or regulation in regard to money laundering in the first place and, when anti-money laundering laws and regulation took place, it is hard to justify these activities as they became routine financial transactions, and nothing suddenly became suspicious. In addition, even though the laws and regulation were in place, it still needs a period of time to be applied in practice in regional areas. The regional financial branches were probably in the position of digesting the regulation and training their staff. Furthermore, at that time in developed areas such as Guangzhou and Shenzhen, a single account with flows exceeding several tens of millions and even over 100 million is not that unusual (Zhong, 2006). This provided a good disguise for Guang Rui Huang's activities. It also maybe depended on what information Huang gave about the nature of his business and whether anyone checked. In this case, a variety of money laundering methods such as cash smuggling, underground banking and gambling was well used to launder illegal proceeds derived from the offence of smuggling.

Case XII: Currency control violations

In 2003, an underground bank was discovered in Fu Qing city of Fu Jian Province. The underground banker Chen opened an underground bank dealing with foreign currencies in Lan Tian Shopping Mall in Long Tian Town with his wife and son. He opened 33 bank accounts with a number of his relatives' and friends' identification cards in the local branches of the Bank of China, Industrial and Commercial Bank of China, Construction Bank of China, and Agriculture Bank of China. Chen's wife Lin hired her two nephews to work for her. Lin bought foreign currencies from other areas in Fu Jian Province by depositing money into other dealers' accounts and then picked up the cash. Her two co-defendants were arrested on the way back to their premise by the Police which led to the breakdown of this business. According to the Police this underground bank traded foreign currencies over ¥17 million (£1.13 million). During the period of being on bail, the defendants still continued to commit the same offences by reregistering business telephone, opening bank accounts, renting premises and co-operating with another co-defendant in Japan to trade foreign currencies (Zhang, 2003).

5.2.3 Commercial Offences

Case XIV: The fraud case of Ming Chang Feng

According to the New Century of China in 2004 the National General Auditor Jin Hua Li revealed a series of illegal bank loan cases to a private entrepreneur Ming Chang Feng. The total amount of the bank loan reached ¥7.421billion (£495million). Approximately ¥2billion (£133.33 million) had gone missing before

the case was exposed. It was later found out that the vast majority of missing public money had been laundered abroad. The offence and laundering were well planned. Feng's company- Nan Hai Hua Guang - obtained ¥1.027billion (£68.47million) and additional US\$25 million loan from the Nan Hai Branch of Industrial and Commercial Bank of China since 2001. ¥823 million (£54.87million) of the loans was withdrawn in cash and was deposited to personal accounts, among which ¥14.49million (£0.966 million) was deposited to Feng's personal account. The record of the company of Nan Hai Hua Guang states that ¥2.8 billion (£186.67million) was borrowed from seven financial institutions, among which ¥600million (£40million) was used for running the business; ¥660 million was illegally utilised for purchasing high value fixed assets, investing in real estate and security market; and approximately ¥500million (£33.33 million) of the fund was transferred to enterprises which did business with the Nan Hai Hua Guang company. The money was then cashed and eventually laundered abroad through underground banking. The rest of ¥1billion (£66.67million) was unable to be traced by the auditors. In total, about ¥2billion had gone missing (£133.33 million).

The crime was well plotted by the Finance Director of Nan Hai Hua Guang- Xu Huo. Huo also had another identity of being the Deputy Director of Nan Hai City Treasury. With Huo's political influence and manipulation, Feng was loaned from seven financial institutions for his three companies- Hua Guang Company, Nan Hai Yue Hua Decoration Material Factory, and Nan Hai Hua Tai Wood Product

Company. Feng was responsible for signing the loan contract under the instruction by Huo, although Feng knew little about uses of these loans.

A majority of missing money was laundered abroad. How was this done? The missing money was transferred from Feng's companies to over ten offshore companies run by Treasury of Nan Hai City. Among these offshore companies, three played the key roles in this case. These companies were Hong Kong Hua Sen Company, Xing Ye Holding Company of China (0312.HK) and Hong Kong Guo Rui Company. Feng's Hua Guang Company was a Sino-foreign joint venture, and Hong Kong Hua Sen is its largest stakeholder of foreign companies. Hong Kong Hua Sen was registered in Hong Kong Stock Market in 1996. Three stakeholders were Feng, his wife Bi Ru Lu and Yan Hui Sun. Sun owned 40% company share was a Hong Kong residence. Indeed Sun is the son of Bo Huan Sun- the Director of Nan Hai City Treasury.

According to a disclosure of staff of Hong Kong Hua Sen Company that Hua Sen was the major company that received the fund transfer from Feng's Company of Nan Hai Hua Guang. This staff did not know how the Chinese Currency- Yuan was exchanged into Hong Kong Dollars in mainland China and deposited into Hua Sen's bank account in Hong Kong. Usually when the money was transferred successfully to Hong Kong, the manager would notify their counterpart in Hong Kong. The investigators eventually found out some moneys were laundered through underground banking in the city of Shan Tou and Shen Zhen.

Although some details of the case are unclear, we can still see that the mastermind utilised a wide variety of methods for laundering the proceeds of fraud and embezzlement. One is self-laundering. Two is to establish a number of businesses with a puppet or money laundering participant as a 'front man' general director disguise the real ownership, and the real money launderer behind as the financial director. Three is to speculate in financial market including security market and non-financial market such as real estate. Four is to use political power to defraud loans from financial institutions for the purpose of further embezzlement. Five is to withdraw the cash and then deposit it into personal accounts. Six is to establish a company and to have it listed in Hong Kong Security Market and to launder money. Seven is to work with foreign currency exchange dealers. Eight is to distract the money trail by transferring money to offshore companies, beneficial owners of which are the corrupt government officials' relatives. Nine is to employ underground banking to transfer funds. There may be more methods have been used, such as purchasing fixed assets, although the details have not been fully exposed.

In this case, corrupt officials appear to have one body with two identities and one family with two managements. Corrupt officials or the head of state enterprises have two identities; one is a governmental official, who has power to access and manipulate financial resources. The other is the owner or real operator of a private enterprise. Huo in this case has two identities: Nan Hai governmental official and the real operator behind the money laundering; whereas Feng was actually the

puppet in the context of his role in the commission of these offences. Two identities enable these public officials to embezzle public funds and launder their proceeds by transferring funds to their private business accounts with the explanation of conducting legitimate business transaction as a disguise. If their own business works well, they will make a profit through their operation. Corrupt officials work in the government at front to embezzle the public funds and their family members at behind to disguise their suspicious wealth. Family members usually set up a business individually or jointly with others to launder proceeds. A family type money laundering network is created. Yan Hui Sun in case I is the son of Bo Huan Sun- the Director of Nan Hai City Treasury. The role of senior Sun has not so far been mentioned; however, his deputy director and son's roles in the offences suggests the likelihood of his involvement, or at least that his influence was used (with or without his knowledge) to manipulate the financial resource to lend money, embezzle public funds and assist money laundering.

China's economic reform and its open door policies have greatly encouraged Chinese trading corporations from various levels such as the central government, ministries, provinces, cities, towns and individuals to establish companies and subsidiaries to attract foreign investment or promote export. Meanwhile, a large number of enterprises and governmental authorities have established unofficial companies abroad to evade controls of foreign exchange and foreign trade. These companies have become the channels for corrupt officials to launder their bribed or embezzled proceeds. Hong Kong, as China's window to the rest of the world,

having stricter property rights and more freedom of capital movement compared with mainland China, has become a hot destination for corrupt officials to launder their illegal gains or at least as the first step to move their funds through these companies. According to Sung (1996), Hong Kong has been the number one destination of Chinese outward investment. In this case, Nan Hai City Treasury has certain number of official companies in Hong Kong, the accounts of which have been used to transfer embezzled and fraudulent money freely out of China by corrupt officials under the disguise of trading.

Case XV: The embezzlement case of Chao Fan Xu

This event occurred at the Kai Ping branch of the Bank of China in Guangdong province of China. A group of bank executives in Cai Ping allegedly diverted millions from this bank over a 9-year period between the early year of 1992 and the end of 2001. The loss totalled US\$480 million. Only about US\$75 million has been accounted for, and much of that appeared to have been lost in the crash of the HK SAR real estate and stock markets after 1997. In setting up their operation, the Cai Ping gang allegedly used a scam common among Chinese companies in the 1990s, when China-linked stocks boomed on the Hong Kong Special Administrative Region (HKSAR) markets. Many mainland Chinese set up so-called “window companies” to speculate in stocks and real estate in HKSAR. In local parlance, window companies that indulged in such speculation were “stir-frying” investments. Some of the window companies were legal, but many were not. All

had to contend with strict Chinese laws against moving money from the mainland. Usually, funds were diverted from companies and banks in mainland China by employees who wanted to play the markets. Those who borrowed this way would pay their employers back if they made profit. If not, the borrowers relied on creative accounting to cover their tracks.

The chief member of the Cai Ping gang, Chao Fan Xu, had a principal window company in HKSAR, named BB Joint Properties. It was founded in 1993. Much of the money deposited at BB moved on to other accounts at elite financial institutions. Xu and his partner had deposit and brokerage accounts at the branches of certain banks and certain broking securities in HKSAR. Xu and his company invested millions of dollars in HKSAR stock with disastrous results in 1996. BB Joint's biggest stock position was in Leading Spirit High- Tech Holding Ltd., a China stock that plunged 99% from its 1997 high. This group also bought a stake in tycoon Richard T. K. Li's Pacific Century Cyber Works Ltd. worth US\$4 million when the stock peaked in 2000, the stock is now valued at US\$321,000.

The losses the Bank of China had not been discovered until the three main suspects, including Xu and his bank cohorts, fled China to Canada in October 2001. Canadian bank accounts containing a total of US\$3.8 million have been frozen. Accounts in HKSAR, containing an unknown amount of money, have also been frozen. In this case, immediate family members were the money launderers, who were convicted of money laundering and jailed in Hong Kong (Yu, 2006). The United States

Ministry of Justice announced on the 31st January 2006 that Chao Fan Xu, Guo Jue Xu and other five co-defendants were arrested and charged for theft over US\$485 million and money laundering through casinos in Las Vegas. Currently only Zhen Dong Yu has been extradited back to China. Chao Fan Xu and Guo Jiu Xu received 25 and 22 years imprisonment sentence respectively in the US (Sinanews, 2009).

The above three people established a number of shell companies in Hong Kong, and then transferred proceeds to these companies with the name of bank loans. The proceeds were laundered abroad such as the United States through investing housing market, stock exchange, future market, and gambling in casinos.

In this case, Xu, a corrupt bank executive, and his gang embezzled an extraordinary amount of public money. They manipulated these funds by transferring them to their offshore company and speculated the criminal proceeds in the security market in Hong Kong. Meanwhile they had laundered a proportion of their embezzled proceeds to abroad for future expense in case they would be discovered and have to flee abroad.

Case XVI: The case of bribery committed by a city secretary- Huo Gui Qi

According to the China Death Penalty Log January- December 1998 (Amnesty International, 1999), Huo Gui Qi was the former Communist Party chief and Chairman of the People's Congress Standing Committee of Don Fang City. He was convicted by Hai Kou City Intermediate People's Court of accepting ¥1.88 million in bribes (US\$226,000) from 14 people. Qi's wife, Rong Ying Fu, former director

of the Bank of China's Dong Fang branch, was sentenced to 16 years' imprisonment. The court also found the couple guilty of illegally amassing cash and property valued at more than 10 million Yuan (US\$1,190,476) (Xinhua News, 1998). On one occasion, Mr. Qi took a bribe of ¥230,000 (£19167). Then he was helped in opening a bank account of ¥230,000 under an anonymous/pseudonym name and with the password 777777 in the Chinese Industrial and Commercial Bank (Liu, 2000)

Case XVII: The case of bribery committed by a Vice Provincial Governor- Fu Kui Cong

Fu Kui Cong, former vice governor of He Bei Province was convicted of taking bribes totaling ¥9.36 million (US\$1.17 million) between the beginning of 1997 and June 2000. Cong's downward spiral into disgrace can be traced back to 1996 when he first met up with self-appointed "clairvoyant" Feng Zhen Yin. Targeting Cong as having considerable potential to be fraudulently exploited, Yin lured him into believing in his own corrupted version of Buddhism. Over a period of a couple of years Cong misused his position to the tune of over ¥17 million (roughly US\$2 million). In Cong's case, the pretext of Buddhism also served as an avenue for money laundering as ill gotten gains were disguised as funds raised for Buddhist services (Li and Shao, 2004).

Case XVIII: The corruption case of Ke Jie Cheng

Ke Jie Cheng, the Deputy Head of National Congress Standing Committee, who committed bribery with proceeds of approximately £2.79 million (¥41.09 million). Cheng hired a professional money launderer- a Hong Kong businessman, Jing Hai Zhang. Zhang opened a shell company Cheng and his lover as owners. The bribes were transferred to Zhang's business account and then transferred to the shell company's account. Zhang manipulated the company and made false businesses. The shell company paid company and personal tax to Hong Kong tax office. Thus, bribes were laundered into white as they seemed from legitimate income. The laundered money was then transferred to the bank account instructed by Cheng. As a result, Cheng had to pay Zhang a commission up to 25% of the total money laundered (Xin Hua News, 2006).

Case XX: The case of bribery committed by a government official

In one celebrated case in Hong Kong, a government official received bribes amounting to HK\$ 3 million (US\$ 386,600). This money was laundered through IVTS. The official received one half of a \$10 note; the other half was sent to Singapore. He went to Singapore carrying his half of the note, had it matched to the other half, and the money was paid out (Carroll, 1995).

Case XXI: The corruption case of Da Bin Yan

According to the Sinanews (2008), the case of Da Bin Yan was the first convicted money laundering case in relation to corruption. Da Bin Yan was the director of Wu

Shan Town Traffic Management Bureau of Chong Qing City. Between 2001 and 2008, Yan received bribes amounting to ¥22.26 million (£1.48 million) in cash. Yan handed the case to his wife Ms. Shang Fan Fu, who was responsible for laundering the cash. She purchased properties with their own and other relatives' names; opened bank accounts with her and her relatives' names; and then saved and invested in financial products; and purchased insurance products. There is no information recorded in regard to Fu's relatives' criminal liabilities. It is unsure if Ms. Fu had lied to her relatives and had their ID cards without their knowledge for money laundering or they had been prosecuted as co-defendants.

Case XXII: The fraud case of Shi Ming Yang

According to a report (Australian news, 2008), on the 27th August 2008, the largest Chinese money laundering case was sentenced. Yang was the director of Si Chuan Shu Gang Investment co.. He provided bank accounts for depositing, transferring and withdrawing cash of ¥65 million for the fraudster Jiang Feng Yang, who committed a series of frauds, involving proceeds amounting to ¥240 million (£16 million).

Case XXIII: The fraud case of Ru Min Pan, Su Zhen Zhu, Da Ming Li, and Yuan Ming Gong

According to the Jiangsunews on the 23rd October 2007, the above four persons laundered approximately over one million US dollars of proceeds for fraudsters in

Shang Hai. Those four people provided 27 bank accounts for fraudsters and used the internet to conduct fund transactions, depositing and withdrawing money in the paying in machine and cash point, and transferred between their accounts to evade investigation.

5.2.4 Hybrid Type of Offences

Case XIII: Yong Liu gangs

A number of the top communist party cadres and Police Officers in the city of Shen Yang were involved in the case of Yong Liu organised criminal group. Liu was alleged to have twenty six businesses with his personal asset over £47 million. He monopolised the businesses through violence. On one occasion, Liu's gangs murdered a tobacco dealer for the purpose of monopolising the tobacco market. On another occasion, Liu's gang kidnapped a businessman and forced him to agree to sell his business premises to him in an undervalued market price. He also attacked his components using Police power and obtained business contracts by bribing the governmental officials. In return for having a close relationship with the local governmental officials, he was nominated as a member of Shen Yang People's Congress, a member of Shen Yang He Ping District People's Political Consultative Committee, a member of outstanding private entrepreneurs, and a local precursor of poverty alleviator (Sinanews, 2003). With these honourable titles and "business achievement" Mr. Liu was able to obtain local political support and launder his illegal proceeds with legitimate appearance.

Case XIX: The embezzlement case of two chief public employees

Two of the chief public employees in a provincial agency in China collected US\$5 million of dirty money by doing business with foreign enterprises or foreign capital corporations. They were in collusion with these foreign merchants. They bought equipment and raw materials from the foreign merchants at higher prices and sold them at lower prices. The margin part was remitted to their private overseas accounts. They arranged for their children or relatives overseas to set up a company. They deposited the dirty money in the company's account in an overseas bank. The company would create false financial reports and false operating profits every year. Laundered money was legitimised by paying taxes and insurance premiums. Sometimes they exported the capital by arbitrage transaction. They owned the capital outside of China, and then they invested money back in China to earn more on the false pretences of foreign capital (Yang, 2002).

This case was initially the governmental officials, who forged alliance with private entrepreneurs, committed corruption in the forms of bribes and kickbacks on government contracts. Then it involved in falsification of prices on import transactions in order to generate a percentage or even a multiple of the value of the trade that is then paid into a foreign bank account beyond the government's reach. Further they created false financial reports, disguised laundering by paying taxes and insurance premiums, and finally integrated funds into legitimate economy by investing money back to China as foreign investment, which will be very

welcomed, protected and better treated with tax free or reduce and other favourable trade policies. As a result, China suffered triple jeopardy of losing revenue, importing poor quality goods because the outdated equipment or poor quality materials has the biggest price margin in a deal, and dirty money evading tax controls when returned into China.

Accounting techniques under which the difference between the artificially high invoice price and the real price of the goods and services is deposited offshore. This is used also by those who wish to avoid taxes and duties. Unofficial Chinese companies have to evade foreign exchange controls to invest in Hong Kong or bordering regions. The classic means of evading foreign exchange control is through under-invoicing exports and over-invoicing imports. A lot of evasion occurs through Hong Kong due to geographic and cultural proximity. The easiest way to misinvoice is for a Chinese company to trade with its Hong Kong subsidiary. The Chinese company exports to (imports from) its subsidiary at an artificially low (high) price, and the resulting profit of the subsidiary is deposited overseas.

5.3 Analysis of Laundering Methods and Predicates

There is a widely accepted analysis that money laundering is usually described as having three sequential elements -placement, layering, and integration, although this process does not very helpful in understanding laundering related to some predicate offences. For example, fraud, where the proceeds of crime may have been

generated within the financial system, layering may occur after the proceeds are generated or during the process of generating the proceeds. In regard to the model of drug activity, Levi and Reuter (2008) illustrate that placement is the introduction of illicit funds into the financial institutions. Important methods include the use of bank current accounts, postal money orders, traveller's checks and other commonly circulated instruments. This is the initial stage for the criminal to physically disconnect the money and funds. This stage is crucial both for criminals to disguise the connection between money and themselves and for financial institutions to recognise criminal money and report for investigation. In terms of risk management, this stage should be tiered the highest level of risk should there be a tiering system both for criminals and financial institutions. Given the estimates of laundering activity and predicate offences, combined with the inevitable limitation of financial intelligence and investigative resources, most of the laundering that takes place is never detected, let alone subject to investigation, seizure and confiscation. However, compared with these three stages of laundering, placement appears to be the most fragile, easily detected and risky stage because the money launderers need to contact gatekeepers directly (depositing the funds themselves) or indirectly (e.g. smurfing or the use of intermediaries) and expose themselves to inspection. For financial institutions this stage is most likely to be manipulated by criminals and to be sanctioned with criminal and administrative liabilities for their non-compliance with AML regulations. Metaphorically speaking, this stage is like the forefront of the battle between the two parties. If criminals successfully pass the

entry check, it is less likely that criminal proceeds will be discovered at a later stage. The method of putting money into financial institutions mainly refers to cash deposit. There might be an issue at this stage that criminals will bypass financial institutions with sound anti-money laundering regulation by depositing criminal funds in financial institutions with less regulated or supervised anti-money laundering regulation. These financial institutions targeted by criminals may be local or may be abroad. Criminals may choose financial institutions based on the availability of these financial institutions, the level of familiarisation with and the relationship with these financial institutions, and immediate money demand by criminals. It should be noted that this method would typically tend to catch more of those involved in drugs and smuggling activities that generate large amounts of bulk cash and the need to move these into the financial system to make them easier to manage. This may be less useful where the laundering is related to fraud and embedded in business practices that are already integrated into financial systems.

Layering is the second stage, which was depicted as moving the deposit in more complex and diverse methods in financial institutions compared with the first stage of placement in the process of money laundering. Theoretically, money needs to be moved in and out of accounts in as many different locations as possible or holding companies the money launderers establish. This will create a complex web of financial transactions that disturb auditing and move the dirty money farther away from the criminal headmaster. The aim of floating the money is to 'clean' its 'dirt' and to confuse the money trail. It could be said that the more transfers are made, the

further distance from the original crime gets, the more difficult it is for law enforcement to trace and the more legitimate the illegal proceeds look like. In practice, it is also possible that a flurry of transactions that do not appear to have an economic basis may also attract attention, notwithstanding that the former may take more investigative effort to unpack once suspicion has been aroused. The ways of moving dirty money are unable to be demonstrated fully due to the dynamics of money laundering methods and current limited knowledge on this part. The use of shell companies and offshore financial institutions are commonly believed as typical activities of diverting money around.

The so-called final stage is integration, which works to finish off the journey of moving funds in financial institutions. After layering process, criminals become more confident to claim the legitimacy of the funds, meanwhile the money appears qualified to integrating into the legitimate economy. This might be a concern at this stage for the criminals to consider which legitimate business they would run or where to consume (they might still consider the side effects of unreasonable expenditure on luxury assets). The future returns of investment whether in real estate or business venture is still risky for criminals to manage their funds. Suendorf's study of laundering in Germany in 2001 interestingly illustrates the variable success (Levi and Reuter, 2008). For instance, a bankrupt construction firm with a suspicious Italian infusion of money compared with an expanded greengrocer business invested by a drug trafficker.

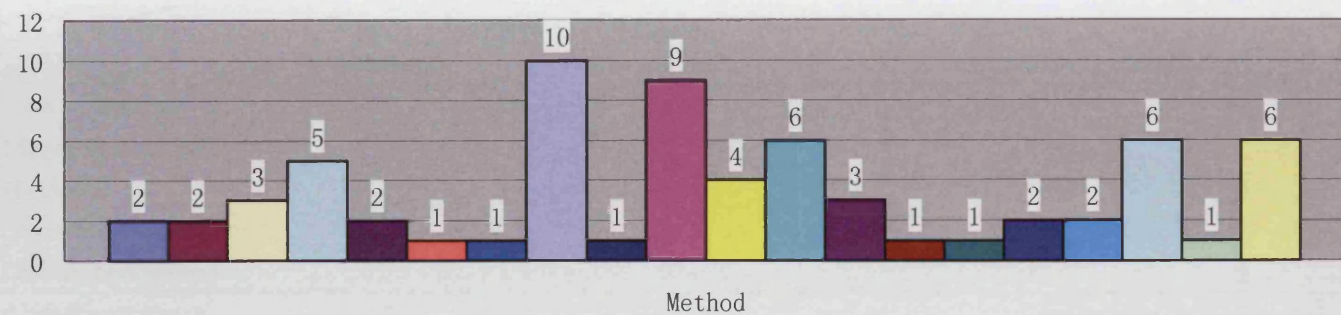
These three stages have clearly demonstrated the basic money laundering process although there have been critiques around. It also needs to bear in mind that these consequential stages do not apply to every money laundering case. Some money laundering cases are only involved in two stages. The ways of laundering proceeds and the assessment on the workability are up to money launderers to make their decisions and take their actions on the ground of their experience and adventure. Of course there have more cases with more complicated stages than these three, but the overall aim is the same, which is to conceal the true owner of the criminal proceeds; to disrupt the money trail followed by law enforcement agencies; and to utilise these laundered funds eventually with a number of purposes including illegal and legal. In addition, these three stages do not appear to fit well the process of terrorist financing, as some funds supporting terrorists are from legitimate people who are religious extremist rather than of criminal origin. As a result, the placement stage as the most likely stage to detect criminal funds does not work for detecting terrorist financing in this regard. Moreover, the final stage is the financing of the terrorist act rather than the return of the proceeds to the original owner (Levi and Reuter, 2008).

The above three-stage classification is a simplified structure to understand the complex money laundering process. With regard to Chinese circumstances, it appears that some money laundering methods apply the above three stages (case V, XI, XII, XIX). However, not all money laundering transactions engage in the whole three phases distinctly. For example, case I, II, and XVIII have laundered criminal

proceeds with less than three stages. Cases such as VIII involve more than three phases in order to launder money.

The below table shows the money laundering methods used in each case reviewed in the category of Naylor’s profit-driven crime model and hybrid type. The chart is a matrix matching the above 23 Chinese cases with their money laundering methods.

		Naylor's Tri-partite Model																				Hybrid		Total	
		Predatory		Market-Based										Commercial											
Case	Method	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	XIV	XV	XVI	XVII	XVIII	XX	XXI	XXII	XXIII	XIII	XIX	23
	Cash smuggling				v							v													2
	Structured deposit/Smurfing											v										v			2
	Casino	v						v	v																3
	Currency exchange control							v	v	v		v	v												5
	Wire transfer									v		v													2
	Credit cards									v															1
	Price transferring/ false																							v	1
	Front company/organisation			v	v	v			v			v	v	v			v				v		v		10
	Purchase of high-value goods													v											1
	Underground banking		v				v		v	v	v	v	v	v					v						9
	Real estate	v												v	v					v					4
	Offshore accounts							v						v	v			v	v					v	6
	Securities/Insurance													v	v					v					3
	Charity								v																1
	Shell corporations																							v	1
	False trade/false financial					v																		v	2
	Internet transactions											v													2
	Professional money launderers								v			v						v		v	v	v			6
	Back to back loans					v																			1
	Anonymous/pseudonym					v		v				v				v				v		v			6
	Total	2	1	1	2	4	1	3	7	4	1	9	3	6	3	1	1	2	2	4	2	4	1	4	68



- Cash smuggling
- Casino
- Wire transfer
- Price transferring/ false invoices/receipts
- Purchase of high-value goods
- Real estate
- Securities/Insurance
- Shell corporations
- Internet transactions
- Back to back loans
- Structured deposit/Smurfing
- Currency exchange control violation
- Credit cards
- Front company/organisation
- Underground banking
- Offshore accounts
- Charity
- False trade/false financial report
- Professional money launderers
- False/Pseudo identification/Other people's accounts

Table 3.1 Frequency of predicate offences and methods

Method	Drug trafficking	Blue-collar	Smuggling (non-drug)	Counterfeiting	Bribery/corruption	Tax evasion	Fraud	Terrorism	Crime unknown	Total
Cash smuggling	6	1	1				1	1		10
Money orders, cashiers' checks	12	1	6			3	4	3	2	31
Structured deposits	10	5	1		2	2	2	2	2	26
Casinos/bookmakers		1					3			4
Currency exchange										
bureaus	13	1	5				2	4		25
Wire transfers	33	5	22	1	7	4	30	18	11	131
False invoices/receipts	5	2	6		1	4	4		3	25
Credit cards			1			1	1	2		5
Front										
company/organization	18		15	1	3	5	19	6	6	73
Purchase of high-value goods	14		9		2		5	3	1	34
Insurance policies	5		1						3	9
Alternative remittance systems	4	2	6					4		16
Real estate	13	2	5	1	2		5		3	31
Lawyers	11	2			1	2	10		3	29
Accountants/financial officers	11	5	4	1	3		10	1	1	36
Offshore accounts	8	2	4		3	3	7	1	3	31
Securities	10	2				1	8		1	22
Trusts	4		1		1		2		1	9
Shell corporations	8	1	5		2	2	12		3	33
Total	185	32	92	4	27	27	125	45	43	580

Reuter, P. and Truman, E. (2004) Chasing Dirty Money: The Fight against Money Laundering. Washington, DC: Institute for International Economics. P.33

Although the above cases are not sufficient enough to cover all Chinese money laundering cases and their methods, they do have the value of exploring exposed money laundering methods and reflect the different techniques used in different type of predicate offences in contemporary China.

The chart indicates that often more than one money laundering method has been used in a single money laundering case. A single money laundering method has been used in seven cases compared with 16 cases having more than one money laundering method. Nine money laundering methods have been identified in the case XI and eight in the case VIII. Both of these two cases are involved in smuggling. The case XIV comes third with six money laundering methods, involving the offences of fraud and corruption. Only one money laundering method is used in the case II, III, VI, X, XIII, XVI, and XVII, the predicate offences of which are drug trafficking, kidnapping, currency exchange control violation, extortion, human trafficking, and corruption. It seems that commodity smuggling and fraud committed by public officials in contemporary China involved in large amounts of proceeds and needs extra preventative work to disguise the provenance of funds to avoid investigation.

In addition, the above cases indicate that the most commonly used money laundering methods were to use a front company, and the underground banks presenting ten and nine times respectively in the total of 23 cases. In general, the use of a front company is as popular as Reuter and Truman sample. However, the difference is Reuter and Truman samples suggest wire transfers is the most popular money laundering method and mine is the use of a front company. There are many reasons to account for the difference. First, there may be other cases that I could have not collected from open resources to best represent Chinese money laundering problems. Second, it may be because money launderers do not need to continue the second stage of layering to further confuse the detection, as Chinese AML regime may be more capable of identifying criminal proceeds at the stage of placement. This could reflect the current Chinese AML priority or difficulties of tracing the money trail. Third, the data could reflect China's current economic development. There is a speedy establishment and development of

businesses in China's economic reform. There have been massive rises in new enterprise establishment. Take one province of Guang Dong as an example, in the first eight months in 2008, newly registered private enterprises and individual businessmen amounted to approximately 76,100 and 322,300 respectively (SAIC, 2008). It can be predicted that the total number of existing and newly registered enterprises in the whole country (34 provincial level administrative regions) would be enormous. The large number of businesses has contributed to the rapid economic development. However, criminals are able to manipulate the opportunity to launder criminal proceeds by establishing a company with a disguise to prosper economy. Fourth, the State Administration for Industry & Commerce (SAIC), which is responsible for registering and managing companies has a less vigorous AML system compared with financial institutions. As does Companies House in the UK, which likewise has been criticised for not doing enough to prevent fraud and laundering, according to the Humpton Implementation Review Report completed by the Department for Business, Innovation and Skills of the UK in 2009 (Better Regulation Executive, 2009). The SAIC is a member of Chinese AML agencies. However, the content of AML has not been added in its duties, although the SAIC has both a prevention and enforcement function in regard to crime control. The main tasks are required combating smuggling, unfair commercial competition, and commercial bribery.

Using offshore accounts, professional money launderers and anonymous/pseudonym identities come the second with six times and followed by currency exchange control violation representing five times. Money laundering involving advanced technologies represents a small number. The popularity of high-tech and sophisticated money laundering methods such as online laundering is questionable in China. On the contrary, traditional money laundering methods such as the use of underground banking appear to be more prevalent. Current Chinese financial institutions are unable to fully support all type of financial needs due to its limited capacities including fund transfer and other financial services. Underground banking could supplement its absence and work as an alternative for desperate needs. The use of anonymous/pseudonym identification is also a concern and often used to deposit criminal

proceeds in financial institutions in the stage of placement. Anonymous/pseudonym identities are cheap to buy. According to the Chong Qing News (2008), the cost to buy a real stolen ID card is only between ¥10-20 (£0.67-1.33). The cost for a forged ID is approximately ¥80- 100 (£5.3-6.7) and it could take 24 hours to complete (Hongbonet, 2009). The cheap value of ID cards will almost cost nothing to buy compared with the gains from using these ID cards to commit crimes. In addition, the situation was further aggravated by the fact that approximately five million manually issued first generation ID cards have duplicated numbers (FATF, 2007).

The use of credit cards and trust companies in China concurs with international experience and represent a small number of percentages.

5.4 Predicate offences and money laundering methods

The literature review indicates that predicate offences in China have their characteristics, which could affect the money laundering methods used accordingly, along with Chinese cultural and social characteristics. These features that may affect money laundering are as follows. First, predicate offences have a geographic character. China is bordered with the major drug production centres in the Golden Crescent (Afghanistan) and the Golden Triangle (Burma/Myanmar, Thailand, Laos). Secondly, there is a high level of use, for both legitimate and illegitimate transactions, of underground banks. Thirdly, Chinese people have a tradition of the frequent and customized use of cash, and the willingness to conduct large cash transactions. Fourthly, many existing criminal organisations in mainland China have a link with neighbouring areas such as Hong Kong, Macao, and Tai Wan. Fifthly, Chinese large coastal lines, bordered with relatively developed countries, and thirsty development demand for raw materials and other commodities provide a great opportunity and incentive for smuggling. Sixthly, the restrictive currency control policy has confined Chinese legal and illegal business and foreign investment companies to meet their both foreign and Chinese currency demand, creating opportunities for 'black peso exchange' equivalent money transfers. And finally, Chinese

corruption has not only collaborated with criminals and facilitated profit-driven offences' growth, but also appears to have become part of a trend to commit money laundering themselves to launder their proceeds derived from bribery or embezzlement.

It is difficult to gauge the proceeds from which type of crime amounted to the largest part of the illegal money being laundered in China; however, the sources of illegal proceeds are for the most part generated in China and can be categorised into four broad areas: (a) the smuggling of drugs, alcohol, tobacco, motor vehicles, and natural resources such as oil, petrol, diesel, natural gas and rare metals; (b) proceeds from traditional organised crime activity such as extortion, kidnapping, robbery; (c) white collar crimes such as bribery, the embezzlement of state property and public funds, fraud, currency control violation, and illegal capital flight; and (d) profits from reinvestment by criminals.

The range of money laundering methods that have been observed being used in China largely concurs with those in other states or FATF members. Money launderers use banks, non-bank financial institutions and non-financial businesses to launder criminal proceeds from a variety of predicate offences.

5.4.1 The Banking Sector

Banks are commonly used by money launderers to dispose of their criminal proceeds in China, although some money launders have appeared to be aware of the potential suspicious transaction reporting mechanism if they deposit large sums of cash into bank accounts without some explanation. This may be expected to vary over time, and some of our case studies relate to periods prior to the AML regime. Case V suggests that criminals took preventative steps by depositing the maximum amount of drug proceeds under the reporting threshold to distract attention and avoid being reported to the law enforcement agencies. In addition, the technique of "smurfing" or structuring has been used. It was also aggravated by the use of anonymous/pseudonym names, or the name of relatives, and or

associates to open bank accounts or the third party accounts. This can be seen in cases V, XI, XII, and XVI. Furthermore, the cases III, IV, XIV, XV, XVII and XIX suggest criminals seek to register other person as the business owners as a cover or use other persons operating on their behalf. Some criminals such as in cases IV, V, XIV, XV, and XIX used shell companies and combined many layers of transactions in various accounts aiming to disturb the money trail. It is because the companies are offshore or run anonymously by professionals who can remotely give instructions. As a result, the identity of the beneficial owner of the funds is concealed and the company records are difficult to access. These shell companies are the channel to receive deposits at the placement stage. Transactions between accounts were then undertaken at the stage of layering. Sometimes, criminals bypass the layering stage and purchase property by using deposits, which refer to the integration stage. Shell companies have also played an important role to divert fraud funds or disguise the funds from fraud as an investment for the purpose of laundering money.

Foreign experience indicates that some money laundering methods such as the shell corporations are widely facilitated by lawyers, accountants or company agents. In China for small business, no solicitors or accountants are needed to complete a transaction. It is unsure if there were no records of such information, or these professionals have not been involved. However, no involvements of above professionals have been reported in the above cases.

Capital reinvestment is a technique used in China, often in conjunction with fraud and corruption (see case V, XI, XIV, XIX). By this technique, the launderer usually transfers the illegal proceeds to another country or jurisdiction, and then deposits into financial institutions. The capital is transferred through financial institutions and then reinvests in China as foreign investment or joint venture or purchasing property. Sometimes, the criminals used their proceeds as a security or guarantee to gain the bank loan. This method not only gives the laundered money the appearance of a genuine loan, but often provides tax advantages.

Case V, VII, XI, XII, and XVI suggests that large cash deposits are still being made in some areas, especially by persons and interests connected to Hong Kong, Macao, and Golden Triangle and Crescent areas. Fraud, smuggling, drug trafficking, illegal gambling and currency exchange control violation make significant cash deposits. Often the cash deposit was transferred to different accounts for the purpose of further offending and reducing the risk of investigation and seizure.

5.4.2 Non-Bank Financial Institutions

Banks hold the largest share of the financial market with a wide range of financial products, which provide opportunities for money laundering activities. However, non-bank financial institutions are becoming more attractive venues for introducing criminal proceeds into conventional financial channels because the anti-money laundering regulation in the banking sector becomes increasing effective relative to them. In addition, China continues to see a significant use of underground banking system to facilitate both legitimate business and illegal enterprises. This is evidenced by identified money laundering cases above, in which they are involved.

The cases XIV and XV indicate that money launders have committed their offences in the securities sector. Proceeds were deposited in securities or transferred to criminals' securities accounts; even they could hold a percentage of ownership of a share. Criminals were even able to speculate in securities market if their finances were large enough. Most likely they would be able to make further profits (via insider dealing or not) from the stock market as they were the key stakeholders.

Internationally other sectors such as insurance sector and futures market have been reported to have become a channel for money laundering. It is hard to conclude there is no such money laundering method in China; however, it could be an area that needs further investigation as money launderers may seek to launder criminal proceeds in those sectors with less attention.

The above cases indicate that traditional Chinese money remittance business - underground banking system - is commonly used for fund transfers between countries and regions. Chinese underground banks are capable of conducting large amounts of transactions and play a significant role in financing crimes outside the legitimate financial institutions. It remains popular in certain areas and serves for a number of money laundering predicate offences. These offences include smuggling, drug trafficking, human trafficking, and corruption, which would generate large criminal proceeds or demand large foreign or Chinese currency within a short period. Chinese underground banking provide a variety of services including currency exchange, cash smuggling across national borders, and the smurfing of cash deposits followed by telegraphic transfers and other financial derivatives such as hedge fund between jurisdictions. Underground bankers may set up a retail shop as a front cover or may work behind the scenes as businesses are introduced 'by word of mouth. They may also develop a number of subsidiaries to expand their businesses.

5.4.3 Non-financial Businesses or Professions

As anti-money laundering regulations have increased in China, criminals may seek to resort to professional money launderers or money laundering facilitators. Case XI, XVII and XIX verify that accountants and financial advisors are reported as being employed to assist in the disposal of criminal profits in China. However, we should not assume the money laundering methods and trends without empirical research. Possibilities are many. It is also possible that people continue to do what they know, even though risks rise. Maybe knowledge of professionals is not so easy for many people. Those elasticities of supply of money laundering services are precisely what we know little about anywhere, including the west. As Levi and Reuter (2006) comment that despite regular intergovernmental reviews of "money laundering typologies" at FATF and regional gatherings—which at least stimulate some communal thinking about vulnerabilities—there are no systematic studies of how criminal offenders turn their incomes into usable assets or of how AML

controls affect this. Little evidence gathered to date indicates that lawyers, notaries, secretarial companies and other fiduciaries have been utilised by criminals to launder criminal proceeds, although this non-discovery may be due to defects in financial investigation.

Professional money launderers can be seen as employed to launder money. In the Case IV, the offence of money laundering was committed by a professional money launderer Zhao Wang. Wang smuggled the cash through the border and then purchased a legitimate business and changed the company's name to disguise the true ownership of the business. Thus, drug money was further able to be mingled with legitimate business income and to be laundered into white.

Shell companies and trading or other front real companies have also been used to launder criminal proceeds in China. They provide a ready made excuse for recently acquired wealth with no apparent legitimate source. Case IV, XI, XV, XVII, and XVIII suggest that these two methods are prevalently used by corruption, fraud, and drug trafficking. Techniques used in conjunction with these businesses included the use of false import/export declarations, false invoicing, letters of credit, commingling of legal and illegal moneys, a wire transfer of funds in foreign currency to a front company abroad for a commercial transaction, a fraudulent purchase contract presented to the bank as proof of the commercial need for wiring funds or loan, the use of loan back arrangements and layers of transactions through offshore shell companies. The laundered proceeds would then be invested through the real company into high value assets or cash intensive businesses such as real estate or hotels.

A significant phenomenon of Chinese money laundering is to have a link with Hong Kong. On the one hand, criminals from cases VIII, IX, XI, XIV, XV, and XVIII mainland China use Hong Kong as a step stone to launder money abroad or launder criminal proceeds eventually in Hong Kong. These cases appear to have been involved in large amounts of proceeds and corruption and smuggling predominant. Although Hong Kong is better equipped with a longer experience of modern AML

history compared with mainland China, however, mainland criminals have contradicted the conventional belief that criminal proceeds will be laundered in less regulated states or regions. The reasons for such money laundering could be analysed as follows:

(i) Historically Hong Kong has been a part of Chinese territory and has been having connections with mainland China. Especially, during the period that China sealed itself from the rest of world, Hong Kong was the only bridge connecting China and the rest of the world. Since the economic reforms, in recent years, Hong Kong has been the number one destination of Chinese outward investment, the PRC surpassing the United States and Japan to become the largest investor in Hong Kong in the early 1990s (Sung, 1996). China has encouraged Chinese state companies to open their companies to attract foreign investment to develop mainland China's economy. As a result, the number of official and unofficial companies has increased significantly. There is no reliable evidence to indicate the number of Chinese companies who have invested in Hong Kong, but there was estimated to be around 14,000 by the end of 1993 (Ni, 1994). One of the consequences was that a number of unidentified funds had a legitimate ground to flood into Hong Kong. The case XV could be regarded as an example to reveal this phenomenon. Corrupt officials would have opportunities to embezzle and manipulate public funds. Meanwhile, international companies are also attracted by China's potential market and chose Hong Kong as the base to enter the Chinese market. As a result, Hong Kong has become the preferred business centre for both mainland China and foreign companies. Especially since the 1997 handover to China from the United Kingdom, China made further efforts to boost the Hong Kong economy to ensure its stability and development promised previously. For example, a free-trade agreement- the Closer Economic Partnership Arrangement - to allow goods to pass freely between Hong Kong and the mainland without tariffs (Chan, 2003). Mainland tourists have been allowed to visit Hong Kong as individuals rather than as members of tour groups. These also provide a good chance for cash smuggling.

(ii) Hong Kong is well-known for its large banking centre and foreign exchange market, and a major offshore financial centre in Asia. It has more developed legal, fiscal and infrastructural services. Hong Kong has no currency controls, which meets the great demand of mainland Chinese companies and criminals who need foreign currencies to purchase raw materials or commodities. In addition, Hong Kong has a more restricted financial secrecy regulation compared with China, which bars insight by mainland Chinese law enforcement agencies. Compared with mainland China, the beneficial ownership of companies is more effectively hidden, and lawyers and accountants are more experienced and competent to handle the movements of large amounts of money through their various bank accounts. Mainland criminals will psychologically believe or physically find much easier to integrate their proceeds into international circuits via or in Hong Kong.

On the other hand, according to the State Department of the United States (1994), Hong Kong serves principally as the organizational and financial centre for the region's heroin trade. The financial industry acts as a conduit for drug money being moved from North America, Australia and Europe to Hong Kong (Gaylord, 1997). Cases I and IV indicate international and Hong Kong criminals seek to launder proceeds derived from drug trafficking, robbery, and kidnapping in mainland China as an additional route other than to the other states or regions.

5.5 Conclusion

The cases above illustrate the example cases of money laundering identified in mainland China. It can be seen that the predicate offences of Chinese money laundering are various and include internationally recognised serious crimes such as drug trafficking. The imbalance between speedy economy explosion and limited material resources has pumped the growth of smuggling. The amount of proceeds of smuggling is very large. Corrupt officials are not only seen as facilitating serious crimes including drug trafficking and smuggling, but also as participating in serious crimes committed by themselves. Additionally, corrupt officials also commit fraud and embezzlement, which requires

laundering their illicit gains to eliminate evidence and make it hard to recover the money. The Chinese traditional underground banking system continues to provide prominent methods for money laundering. The Chinese traditional underground banking system has been seen as the key hub to serve a variety of money laundering predicate offences and is capable of conducting large amounts of financial transactions with advantages of being fast, reliable, inexpensive, and anonymous. Money has been laundered in banks, non-bank financial institutions and non-financial business and professions.

Compared with international experience, no significantly new methods of money laundering in China have been identified. However, the popular Chinese money laundering methods I have reviewed differ from the international sample of Reuter and Truman (2004). First, a large number of Chinese money laundering cases appear to involve professional services rather than opportunistic laundering. This completely contradicts to the finding of Reuter and Truman in 2004. The reason perhaps could be explained by Chinese tradition of alternative banking system and current economic and social challenges. Underground banking has greatly contributed to such differences. China has a long history of using underground banking as an alternative to official financial institutions. Underground bankers appear not to deliberately serve criminals for the purpose of evading AML law and regulation, but their nature and operation of service just break the newly regulated AML law and regulation when they serve a considerable amount of legal customers. Certainly some underground bankers prefer to serve criminals, who will pay a higher commission for their fund transfer or foreign exchanges businesses.

In addition, Chinese current economic development was prospered by the massive amount of businesses. The use of a front company is not only to disguise laundering activity with the cloak of running an ordinary business, but also to easily mix their proceeds up with legitimate income to launder criminal proceeds. The situation of the use of front business being the most popular laundering method in China other than the wire transfer internationally identified by Reuter and Truman is further

attributed by China's AML system. The main reason could be that China's wire transfer rules require verifying customer identification only for payments in excess of ¥50,000 (US\$6,300). However, the threshold for the verification of customer identity required by the FATF is no more than US\$1000. China just began building up its AML preventative and enforcement framework. Financial institutions still lack profound experience to recognise money laundering activities through funds transaction monitoring. The capacity of identifying criminal finance is less than the states who have established AML regime for a longer period. Meanwhile, the Chinese law enforcement agencies are more likely to crack down tangible underground banking than detect wire transfers within financial institutions conducted by criminals, if there are insufficient crime leads from the financial institutions.

The type of predicate offences of money laundering also has an implication for the fate of criminal proceeds. According to Naylor (2003) predatory offences purely redistribute wealth and do not generate new goods and services, and do not directly increase income flows. Therefore, restitution will apply to restore the property to the victim. Market-based offences, however, involve the production and distribution of new goods and services. Forfeiture to the government is eligible to apply, as profit will be generated and there is no victim to whom restitution is due. For prohibited goods, taxation does not apply. For commodities sold in legal market, other crimes such as failure to pay income tax, excise, sales and value-added taxes will result in different fiscal implications. Both restitution and forfeiture will apply for commercial offences as there are mixed elements of legal property defrauded and illicit profits. China needs to apply appropriate fiscal enforcement on proceeds crimes on the basis of the type of predicate offences.

Chapter VI: The Impact of AML Regulation

6.1 Introduction

According to Majone (1994) regulation refers to sustained and focused control exercised by a public agency over activities that are socially valued. Regulations include laws, formal and informal orders, subordinate rules issued by all levels of government, and rules issued by non-governmental or self-regulatory bodies to whom governments have delegated regulatory powers (Parker, 2000). In China there are principally two sources of authority with regard to money laundering: primary legislation (Statutory Instruments) and the Money Laundering Regulations. In recent years China has drastically developed and amended laws and rules to criminalise, combat and prevent the offence of money laundering in the legal system and financial institutions. The major steps and achievement that China has made in regard to regulating money laundering include a number of regulations and laws:

- the Amendment of the Law of the People's Republic of China on the People's Bank of China in December 2003,
- the Sixth Revision to the Criminal Law of the People's Republic of China in June 2005,
- the adoption of the Law of the People's Republic of China on Anti-Money Laundering in October 2006,
- the Rules for Anti-Money Laundering by Financial Institutions in November 2006,
- the Administrative Measures on the Reporting by Financial Institutions of Large-Value and Suspicious Transactions in November 2006,
- the Implementation Rules for On-Site Inspections (for Trial Implementation) in May 2007,
- the Administrative Measures on the Reporting by Financial Institutions of Transactions Suspicious of the Financing of Terrorism in June 2007,

- the Administrative Measures on Anti-Money Laundering On-Site Inspections (for Trial Implementation) in June 2007,
- the Administrative Measures on the Safe-Keeping of Customer Identification Materials and of Transaction Records by Financial Institutions in June 2007,
- the Guidelines for Commercial Banks on Internal Control Systems in July 2007.

There is a challenge worldwide to evaluate the effectiveness of AML regulation. Cautious academics have expressed their concerns about the accuracy of the true magnitude of money laundering and the success of AML regime. Reuter and Truman (2005) argued that large numbers [economic analysis of money laundering] are frequently thrown around without serious support. Levi also stated that “...we lack more than a modest understanding of the incidence and prevalence of current techniques [of laundering] even from the systematic analysis of detected cases, let alone from those that are undetected. Levi and Gilmore (2002) commented that it was never clear that such monitoring [of financial institutions] and confiscation [of criminal proceeds] constituted a sufficient as well as a necessary condition for success. The above remarks indicate the difficulties in gauging the true nature of money laundering and effectiveness of its counter strategies internationally. Much guess work and little empirical work have been completed to examine the effectiveness of AML work in China. Little work has been undertaken to address the issues of the link between the AML regulation and the reduction of predicate offences. The cost and benefit analysis of financial institutions’ compliance with AML regulation and the extent of non-compliance of AML regulation on the reputation of financial institutions are also lack of reliable research. The issues of the quality of STRs, the impact of AML regulation on targeted populations, and asset recovery are also questions that need to address. This chapter discusses the money laundering prevention and enforcement status on the basis of Levi and Reuter’s (2006) generic AML structure to assess the Chinese AML regime and previous chapters’ finding. It seeks – as far as feasible – to evaluate the effectiveness of the current Chinese AML regulation in respect of its prevention and enforcement functions. In the context of prevention,

administrative and regulatory sanction, regulation and supervision, reporting and customer due diligence will be critically assessed. In regard to enforcement, the impact of AML regulation on the predicate offences, investigation, prosecution and punishment, and civil and criminal confiscation/forfeiture will be analysed. The data used for discussion include the FATF 40 recommendation, The First Mutual Evaluation Report on China's Anti-Money Laundering and Combating the Finance of Terrorism, Chinese AML reports conducted by the PBC and data gathered through interviews. The interviewees are highlighted in this manner throughout this chapter for ease of reference.

6.2 Prevention

Given the unique role of financial institutions in financial transactions, The CFIAMLR will inevitably have a significant impact on financial institutions. Such an impact originates not only from the financial institutions' anti-money laundering duty of monitoring suspicious cash flows to identify criminal assets, but also from the need to manage reputational and operational risk meanwhile to achieve business objectives of profit growth. The Basel Committee (2001) suggests that financial institutions have some straightforward incentives to take AML measures seriously, mainly to do with reputational and legal issues. The statutory duties of banks require systematic and comprehensive monitoring and analytical approach on each individual client of these financial institutions at the beginning of opening an account to the end of closing the account. The impact on these regulated financial institutions is clearly seen by China aggressively implementing the AML regulations, and the regulatory, administrative and criminal sanctions imposed on responsible financial institutions and individuals to punish non-compliance.

6.2.1 Administrative and Regulatory Sanctions

At the initial stage of AML regulation in 2003, Chinese AML regulation was not defined with criminal liability. Regulatory punishment of money laundering, such as fines and administrative sanctions, is less punitive compared with those in the Chinese Criminal Law.

Since 2005, the PBC's supervision and punishment on AML activities has been intensified by law. The PBC is required to severely penalise the financial institutions and related liable individuals who fail to comply with their obligation to apply AML regulation. Suspicious (or, more accurately, suspected) financial transactions will be reported to the law enforcement agencies for criminal investigations. China has implemented the Recommendations 2 and 17 of the FATF that the penalties including criminal, civil, or administrative sanctions should be effective, proportionate and dissuasive, and stipulates the criminal sanctions on non-compliance.

The article 46 of the regulation on the PBC states that “where any act in violation of the related anti-money laundering regulation provisions and subject to the punishment defined by the laws and administrative sanctions, it will be punished in light of such laws and administrative regulations. If there is no a provision on punishment, the PBC will issue warnings, or confiscate illegal gains, and or impose a fine in accordance with individual circumstances. If the illegal gains are more than ¥500,000, the fine will be ranged between one and five times of the illegal gains. If there are no illegal gains or the illegal gains are less than ¥500,000, a fine of between ¥500,000 and ¥2 million can be imposed. If the regulation is breached, the responsible directors, senior managers, and liable staff will be given warnings, or a fine of between ¥50,000 and ¥500,000. If a crime is committed, above parties will be subject to criminal liability in line with the laws”. The reputational damage may have a long lasting effect to both expanding business and maintaining current clients. Senior managers are the responsible persons for financial institutions' criminal liability. These controls enable financial institutions to adopt AML regulation and methods and implementing AML control mechanism voluntarily or forcefully. In the context of money laundering, financial institutions have to establish and maintain

internal control; to enhance the AML preventative measures; and to integrate a risk-based approach to AML compliance.

The effectiveness is also reflected by China's action to deal with the issue of conflict between liability and confidentiality and bank secrecy. Without sound protection under the legal provision from criminal and civil liability for breach of any restriction on disclosure of information imposed by contract or by any legislative, regulatory or administrative provision, the motivation to comply with AML regulation is low. Prior to the adoption of the AML regulation, the value and culture of Chinese financial institutions were of privacy and confidentiality. The Article 29 and 30 of the Commercial Bank Law of the People's Republic of China promulgated in 1995 was not amended to make clear that the reporting of large and suspicious transactions by financial institutions is exempt from those rules. In recent times, China has also drawn a clear boundary between the liability of AML and the confidentiality and bank secrecy rules in line with the FAFT Recommendation 14. China has amended the bank secrecy provisions. A clear provision to exempt financial institutions, their directors, officers and employees from criminal and civil liability for financial institutions and their staff reporting large-value and suspicious transactions when acting in good faith has been amended. However, there is still a scope that China needs to improve. For example, the compensation for any violation of these rules by financial institutions and their staff has not been detailed.

The administrative and regulatory sanctions have greatly improved the effectiveness of China's AML regime. According to the 2006 AML report (Chinese Anti-money Laundering Bureau, 2007), between 2004 and 2006, the PBC completed an intensive AML on site inspection of all financial institutions nationwide. In 2006, some 725 PBC branches conducted on site inspection on 3378 banking institutions, which suggested 13.92% increase in the number of the PBC branches and 1% increase in the number of inspected banking institutions compared with 2005. A total of 662 banking institutions – around a fifth of the total - were fined, warned or administratively penalized by 257 PBC branches.

The fine reached a total of ¥40.5223 million, which was 28% less than that in 2005. There was an 11% increase in the number of the PBC branches in 2006 executing administrative power compared with 2005. An increase of 10% in the number of banking institutions acted against for violations was also reported between 2005 and 2006. In line with FATF evaluations, the PBC also adjusted its inspection focus from purely checking on the establishment of the AML regulation to inspecting the implementation of large and suspicious transactions, CDD and record keeping. Among the banking institutions inspected and penalised in 2006, 76% were linked to non reporting on large and suspicious transactions; 32% were for lack of CDD checks; 18% were for failure to keep customer identifiers and transaction records. Only 10 banking institutions were identified as not having completed AML internal control system. The number of these banking institutions was considerably reduced from 74 in 2005. The statistics indicates China's determination to take up the AML campaign at the beginning period of the AML initiatives. China did continuously carry out AML inspection led by the PBC within a three year period and greatly affected local PBC branches. More branches of the PBC participated in the AML work. More and more banking institutions have been inspected year by year; the number of banking institutions without an AML internal control system in place has been reported decreased. The CFIAMLR appeared effective in general to enhance banking institutions' internal AML control system by threatening and imposing punishment. Although it can be seen that the punishment was only defined within warning, fine, and other administrative penalty, which appeared to suggest the major aim of the inspection is not to punish badly regulated banking institutions, but to improve the general AML control system at the first round national AML inspection. However, no criminal punishment has been reported in relation to a breach of the CFIAMLR. It is difficult to estimate whether the administrative punishment has the same deterrent effect with that derived from criminal sanction.

6.2.2 Regulation and Supervision

6.2.2.1 Structural effectiveness

China has a clear AML structure (see table below). The CFIAMLR confirms the leading role of the PBC in the AML work by law. Article 8 of the AML refers to “the administrative department of the State Council in charge of money laundering issues- alone or together with the relevant organs of the State Council in charge of financial institutions”. The administrative department of the state council in charge of money laundering issues refers to the PBC, which is verified by the Article 3 of Rules 2006- “the People’s Bank of China is the administrative department of the State Council in Charge of anti-money laundering, the People’s Bank of China monitors and supervises the anti-money laundering work of financial institutions according to the law”. Thus, it appears that the People’s Bank of China is the sole body in the regulation which has the power either to issue regulation alone or to co-work with other bodies. The PBC has been given more power to make the regulation and set up rules, supervision and inspection, administrative investigation to combat money laundering. The CFIAMLR stipulates that the PBC is the AML responsible administrative department in the State Council, and plays the role of supervising financial institutions by law. The CFIAMLR requires the PBC to co-operate and share work with other organizations of the State Council and law enforcement agencies (The Anti-Money Laundering Bureau of the People’s Bank of China, 2006). The responsible work of the PBC is also required in the CFIAMLR. The PBC is required by the CFIAMLR to perform the legal duty of “making inspection and supervision over the anti-money laundering activities of financial institutions and other identities or individuals”.

Communist Party (CP)																				
National People's Congress (NPC)/Standing Committee of the National People's Congress(SCNPC)																				
Anti- Money Laundering Joint Ministerial Conference (AMLJMC)																				
		Ministry of Public Security (MPS)	Ministry of State Security (MSS)	Supreme People's Procuratorate (SPP)	Supreme People's Court (SPC)	General Administration of Customs (GAC)	Ministry of Supervision (MS)	State Administration for Industry & Commerce	People's Bank of China (PBC)	China Banking Regulatory Commission (CBRC)	China Securities Regulatory Commission (CSRC)	China Insurance Regulatory Commission (CIRC)	State Administration of Foreign Exchange (SAFE)	State Post Bureau (SPB)	Ministry of Civil Affairs (MCA)	Ministry of Construction (MC)	Ministry of Justice (MJ)	China Notaries' Association (CNA)	China Institute of Real Estate Appraisers and	Ministry of Foreign Affairs (MFA)
State Level		✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Provincial Level		✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	
City Level		✓	✓	✓	✓	✓	✓	✓	✓				✓	✓	✓	✓	✓	✓		
Town/District		✓		✓	✓		✓	✓	✓					✓	✓	✓				

The first is to undertake desk inspection (off site), which means that the PBC deals with a number of AML statistical tables, data sources, and audit reports provided by financial institutions without face to face communication. The second is to conduct the on site inspection. The PBC are allowed to inspect financial institutions on site and conduct a number of checks, which include interviewing staff; checking computer systems; assess and copy account information, transaction records and other related documents; and even to seize documents, which it considers may possibly be removed, hidden, changed and destroyed (discussed below). The content of the inspection includes (i) the establishment of the AML internal control regulation and liability system, AML operational procedures, designated

AML unit, designated AML staff, and AML management on their subsidiary branches; (ii) CDD compliance status; (iii) reporting compliance; (iv) record keeping compliance; and (v) other work regulated by the CFIAMLR. The third is to undertake interviews with board members and senior management of financial institutions and to require them to provide explanations about their major AML events. Meanwhile, the techniques of how to conduct such AML administrative inspection, procedures and results are also required. At least two people are required to conduct inspections on site with valid identification and notification of inspection from the PBC or its provincial level branch when suspicious transactions were identified. Staff can be interviewed to answer the queries. The fourth is to freeze the files and documents with the authorization from the top management of the PBC and its provincial level branch when there is a ground to suspect that these files or documents are likely to be removed, hidden, changed and destroyed. The fifth is when the suspected account holders would like to transfer funds abroad, the PBC can take action to freeze the funds for a period of maximum of 48 hours with the authorization from the bank governor or the vice bank governor. The sixth is that the PBC needs to immediately make the account active should it receive the notification from the law enforcement agencies that there is no need to continue freezing. The seventh is the PBC will take immediate action to unfreeze the bank account should no notification be received from the law enforcement agencies. The above work has inevitably increased the PBC's AML awareness, enhanced their AML ability, and improved their AML measurements.

On site inspections between 2004 and 2006, however, indicate that China needs to undertake a comprehensive approach. The banking institutions were inspected were more focused on:

- State Owned Commerce and Corporate Banks (58.61% of the total number of banking institutions being inspected),
- Rural Credit Association and Rural Co-operative Banks (15.41%),
- Postal Saving Offices (12.99%),

- Foreign Investment Banks (1.51%),
- Urban Credit Association (3.93%),
- Urban Commerce Banks (5.74%) and
- Policy Banks (1.9%).

The reasons for this uneven number of checks on different banking institutions might be considered as affected by the smaller number of these banking institutions, and relatively comprehensive AML regulation such as in Foreign Investment Banks. There are concerns in regard to the less concentration of AML inspection of these banking institutions. The first is that not all Foreign Investment Banks have a better AML regulation than their Chinese counterparts, and they are not free from money laundering. Second is that Urban Credit Association and Urban Commerce Banks are not reported to be equipped with better AML countermeasures than other banking financial institutions. The number of branches may not be a guide to the selection of a bank as a money laundering vehicle. Third, usually the customers of the policy banks appear relatively stable; their origin and use of funds appear clear; and the risk of money laundering is relatively low. Therefore, the number of Policy Banks being inspected is the lowest. However, in respect of Chinese circumstances, a number of these customers were from the state owned enterprises. It is far from rare to see corrupt heads of state-owned enterprises being investigated and convicted. Therefore, the Policy Banks should also be looked at with more attention in the future.

In addition, the AML law (Article 15) and the CFIAMLR (Article 8) fundamentally require financial institutions and their branches to establish and implement AML internal control systems and to establish internal AML operational procedures and prepare control strategies. A specialized organ or assigned an existing department is needed to be responsible for AML activities. They require financial institutions to provide reports on large and suspicious transactions, to comply with CDD checks and to keep customer and transaction records. The AML staff training programme or events to increase their

awareness and workability are required. The key leader of both the headquarters of financial institutions and their branches are required to effectively take on AML campaigns. Altogether, it appears that AML regulation has been largely implemented, the scope of AML measures has been extended, and AML knowledge in financial institutions has improved.

Chinese financial institutions are seen have taken steps to implement the AML regulation. For instance, the BOC is clearly giving priority to establishing the structure, organization, staffing and training elements of such arrangements. For a start, it has established an Anti-Money Laundering Unit in its Security Bureau, and a Payment Transactions Monitoring Division in its Payment and Settlement Office to analyze large and suspicious transaction reports. The BOC has taken several concrete internal measures to develop an internal AML system based on the clients' information, transaction reports and records. These include delivering training programs; issuing the Handbook on Money Laundering; implementing customer identification procedures and formats for reporting large value and suspicious transactions; maintaining transaction records for at least five years; and monitoring its overseas branches' compliance performance to against the PRC laws and the PBC's policies. The SAFE has also initiated similar arrangements, including the issuance of some guidelines and reporting forms in March 2003. With the adoption of these three rules, the BOC and SAFE now assume shared responsibilities for the prevention of money laundering in banking-type financial institutions supervised by them. It is too early to make any assessment of these institutional arrangements, especially given access difficulties referred to in my methods chapter. What is clear, however, is that PBC and SAFE should closely coordinate their efforts to ensure that the new anti-money laundering rules are applied uniformly and with equal effectiveness. Furthermore, at this critical institution-building phase, the PBC and SAFE would benefit greatly from early donor support in the training of their staff and in establishing needed new systems.

In respect of AML initiatives at a local level, the AML efforts also appear to be made accordingly. Local level financial institutions are liable for verifying identification documents of customers in carrying out their banking activities, including opening of accounts, settlement, deposit taking, making a loan, issuing a debit card, issuing travellers' cheques, and sending and receiving instructions on electronic funds transfers. Local financial institutions are required to examine and analyse large and suspicious transactions and reporting in line with standard and requirements if they appear linked to criminal activities. They are responsible for reporting large and suspicious transactions to the PBC or SAFE. Local financial institutions need to keep account information and transaction details for at least five years, and comply with confidentiality rules not to disclose any anti-money laundering information to irrelevant persons and agencies. In addition, the local branches of the PBC have improved the working relationship with local government, financial regulatory bodies, and law enforcement agencies. A provincial level AML cooperative mechanism has been established across the country. For example, the mechanism of suspicious information exchange and case conference between the PBC branches and the Police has been established in most provinces. The MSS have disseminated liaison officers to the PBC and established a liaison office. Between January and December 2006, 14 meetings between the MSS and PBC were held. In the meetings, a total of 40 suspicious transactions involving ¥130.19 billion and US\$450 million were discussed, 86% of the clues provided by the PBC were verified as being linked to crime, and 35% have been investigated and convicted. There is, however, no evidence about how important such reports were to the investigation and conviction process, nor to the amount of assets recovered.

However, there is a concern about the effectiveness of the AML structure within the financial institutions. Although China has announced the leading role of the PBC in AML regulation, Article 9 of the AML states that "the relevant financial regulatory organs of the State Council participate in the adoption of anti-money laundering rules for financial institutions qualified for the regulation". It suggests that other regulatory organs are obliged to participate in regulation making. Articles 8 and 9

contradict each other, which confuse the competence and capacity of the AML entities other than the PBC. A possible consequence may be they cause conflicts among these organs and undermine the co-operation among the AML bodies. Therefore, it is necessary for the AML law to clarify the role and responsibilities of AML in financial institutions to ensure a harmony co-operation.

6.2.2.2 Chinese FIU

In China, the CAMLMAC and AML Bureau jointly work as the counterpart of a foreign FIU. The FIU has three key functions: receipt of reports submitted by the financial institutions, analysis of above reports, and dissemination of information to the relevant judicial and law enforcement agencies. There is a concern of current Chinese FIU structural flaws that may undermine the effectiveness to perform such functions as described above. There is no a clear provision in regard to the leading role between above two organs. The CAMLMAC undertakes the first two functions of receipt of reports submitted by the financial institutions and analysis of above reports. The AML Bureau is responsible for disseminating information to the relevant judicial and law enforcement agencies. The collaboration of two organs in China currently appears to work as a proper FIU. The law has not clearly explicated which organ will be regarded as the FIU and play a leading role. The flaws here could lead to operational difficulties such as bureaucratic irresponsibility, the delay of information exchange to the law enforcement agencies, and the conflicts between these two organs on the topic of the legitimacy, competence and responsibility of the FIU. Both of the above two agencies belong to the PBC, and their integration would result in a more efficient bureaucracy and responsible FIU in terms of AML. In addition, the two agencies, for example, are joined together to form a single FIU, but there is an argument about the independence of the FIU directly under the supervision of the State Council or of the PBC. The pro argument is that the FIU is able to strengthen the PBC's influence in terms of managing AML regulatory work. The con is the separation of the FIU from the PBC, which will

enhance the autonomy of the information gathering and analysis, and contribute to the more objective construction of AML regulation.

Chinese financial institutions are required to submit large-value and suspicious transaction reports to their responsible superiors. The reports are then passed on to the FIU. There are concerns about the efficiency of the above approach. For example, these superiors may not be competent in terms of analysing these reports, resulting in the delay of information dissemination and missing important information. **Interviewee C and D** tell me that they usually calculate the data and forward suspicious information to their superiors without much of their own analyses, although they are supposed to analyse suspicious and large value reports in the first instance. They have their concerns about the quality of conducting analyses and subsequent consequences should something go wrong due to their incorrect or inadequate assessments. They believe as long as they hand in the data before the deadline, they would have accomplished their task. They disclosed they hardly had direct contact with the Police. They also asserted that they did not know who covered the area of money laundering investigation in the local Police. In this sense, it seems that much work still need to be completed by the FIU. Two interviewees inform me that they hardly speak English and very few people from their bank could communicate in English fluently. On the basis of information gathered above, the requirement that financial institutions submit multiple reports of large or suspicious transactions to various agencies at various levels is undesirable. There is also a lack of symmetry in the reporting provisions among the three rules. This process should be simplified and streamlined to provide for a single line of reporting to an autonomous FIU, consistent with Recommendation 26 of the FATF, which requires highly skilled experts. Those experts need to have specialized skills to analyze suspicious transaction reports, and to coordinate action by all concerned agencies including law enforcement authorities. In addition, those experts need to be capable of cooperating with the FIUs in other countries in the investigation and prosecution of money laundering cases, the freezing and

confiscation of laundered assets, and the extradition of suspected money launderers. A single reporting line will also better preserve the confidentiality of such reports and reduce the risk of “tipping off”.

The Chinese FIU consists of both administrative and law enforcement agencies, which has a number of advantages. One, preventative and investigative measures could be used at the same time. The FIU has legal powers such as requesting additional information to obtain evidence. There will be less delayed action in applying law-enforcement measures such as freezing suspicious transactions that a solo administrative FIU is unable to undertake. Two, expertise in both finance and law enforcement agencies can be applied in analyzing financial transactions. Three, the investigative process can be speedy. A formal investigation requires a legal approach crossing agencies to access data base, which is more time consuming than that within an agency. The internal information exchange is much easier than that on multi agencies approaches.

The Chinese FIU regulates the fundamental principles to address international co-operations. The CAMLMAC also clarifies Chinese agency AML duties, mutual legal assistant procedures, and Intelligence exchange procedures in regard to international co-operation with foreign government and justice agencies, international bodies, and financial intelligence unit. The PBC is responsible to co-operate with other government, international bodies and financial Intelligence units. In the context of international cooperation, China examined more than 30 domestic banking accounts opened by foreign criminal organizations and individuals as a result of foreign requests. **Interviewee C and D** confirmed that the BOC has co-operated with foreign requests, and distributed a list of suspicious accounts, which may have links to terrorism. They confirmed that they had been required to monitor and report suspicious account holders’ business activities as a high priority, although the results of these particular actions and details of the co-operation are unknown.

China’s AML co-operation is centred at a regional level. In practice, China has become a regional regulatory body. In October 2004, the PRC together with Russian Federation, Kyrgyzstan, Republic of

Belarus, Kazakhstan, and Tadzhikistan founded the Eurasian Group on Combating Money Laundering and Financing of Terrorism. The PBC has also established a working relationship with eight Financial Intelligence Units. These eight countries are South Korea, Russia Federation, Malaysia, Ukraine, Indonesia, Mexico, Belarus, and Georgia. The majority of these FIUs are in Asia. Even in Asia, China has not established a formal information exchange mechanism with major financial centres such as Japan and Singapore. In addition, China has not established a close working relationship with larger financial centres worldwide including the United States and United Kingdom, although there are economic and financial connections between the US and China, and between the UK and China. Therefore, a formal mechanism of the exchange of intelligence has limited coverage. In this regard, China's effectiveness of international commitment to combat money laundering is limited, to the extent that money laundering is transnational. Political considerations seem to have played an important role in the establishment of co-operation mechanisms. China has closely allied with Russian Federation to counterweight the influence of Japan, the United States and the European Union and to maintain its regional power. For this purpose, China will have to demonstrate its commitment to combat money laundering and work to achieve an effective AML result.

In addition, a transnational characteristic of the money laundering crime frequently involves the rapid movement and conversion of money or value between jurisdictions. China joined in the Egmont Group at the Qatar meeting on the 28th May 2009. The benefit from advice and technical assistance in establishing and strengthening its FIU from group members is still limited due to being a membership for a short period of time. China needs to improve its international cooperation and mutual assistance for its own benefits of tracing and obtaining laundered proceeds abroad and extraditing criminals back to China for sentence. For the purpose of fighting international money laundering activity, China needs to increase the co-operate with the FIUs in other countries in the investigation and prosecution of money laundering cases, the freezing and confiscation of laundered assets, and the extradition of suspected money launderers.

6.2.2.3 The Coverage of the Supervision

As the laws and regulations governing financial institutions have been gradually implemented, money launderers are likely to seek alternative ways of laundering their funds. An effective financial regulatory and supervisory framework needs to closely monitor all financial institutions and other persons and entities that provide financial services that could be misused for money laundering. Thus, the wider coverage will require more suspicious and large-value financial transaction reports from more obligatory agencies or individuals. This will promote better effective sanctions and penalise both individuals and institutions which breach the AML regulation.

Prior to the implementation of Chinese AML law and regulation, the definition of “financial institutions” in Article 2 of the AML Regulation covered only banking-type institutions. In recent years, China has broadened its AML coverage both in law and regulation. Article 34 of the AML Law has redefined the coverage of financial institutions and Article 3 of the AML Law has extended the AML bodies to include designed non-financial institutions. Thus, the current Chinese AML responsive institutions include banking type institutions, non-bank financial institutions such as securities firms and insurance companies, and non-financial institutions. According to the “Rules for Anti-Money Laundering by Financial Institutions” that financial institutions comprise banking institutions of commercial banks, city credit cooperatives, rural credit cooperatives, postal savings institutions, policy banks and other financial institutions specified and announced by the People’s Bank of China. Non-banking financial institutions include securities companies, futures brokerage companies, fund management companies, insurance companies, and insurance asset management companies, investment companies, financial asset management companies, finance companies, financial leasing companies, auto finance companies and money brokerage companies. Non-financial institutions include trust. The Article 34 of the AML Law states “Financial institutions” as mentioned in the present Law refer to the policy banks, commercial banks, credit cooperatives, post savings institutions,

trust investment companies, securities companies, futures brokerage companies, and insurance companies. It also include any other institution which have been determined and publicised by the competent department for anti-money laundering of the State Council to engage in financial undertakings.

However, the above law and regulation have not defined the coverage of non-financial institutions, which could lead to difficulties in operation. The ambiguous scope could be understood to cover all businesses, which appears impossible to implement in terms of unaccounted operational cost. The undefined term here could be explained as the lack of experience with the AML in the area of non-financial institutions; or the unclear impacts, such as the obligations, confidentiality, and responsibility, on the non-financial institutions if defined. In future, China should consider an explicit reference of certain non-financial institutions and designated non-financial businesses and professions such as lawyers, notaries, and other independent legal professionals, accountants, trust and company-services providers, real estate agents, and dealers in precious metals and stones. In addition, pawnbrokers are not under the above the category of non-financial institution. Chinese pawnbrokers can offer collateral loans, which are likely to be exploited by money launderers. Therefore, pawnshops should be regulated and establish preventive measures against money laundering.

Although China has updated the entities of AML, there is still a gap compared with international requirements. The international standards define financial institutions under thirteen categories of persons or entities that conduct business in or provide financial services. Internationally recognized such above entities usually refer to leasing companies, portfolio management firms, Bureau de Change or Foreign Exchange Bureau (FEB), and informal money-transmission services or alternative remittance systems.

It should be noted that in China, money changers, and informal money-transmission services or alternative remittance systems-underground banking are illegal in China. However, the above services

are playing an important role in the financial transaction in the contemporary China. Previous chapters suggest that Chinese underground banking system has a long history of being used by both the general public and criminals in their financial transactions and a number of advantages compared with conventional financial institutions. China should adopt provisions of integrity standards or fit-and-proper tests to ensure those criminals or their associates are prevented from holding or being the beneficial owner of a significant or controlling interest or holding a management function in financial institutions. There is a necessary to ensure that all financial institutions are subject to adequate regulation and supervision. All financial institutions are required to adopt a clear provision in line with Recommendation 8 and 23 of the FATF and the FATF 8 Recommendations on Terrorist Financing to regulate Chinese Underground Banking in respect of ML. Particularly actions need to be undertaken on the licensing and regulation of alternative remittance systems, closer monitoring of international wire transfers, and closer monitoring of non-profit bodies such as charities.

6.2.2.4 Converting Chinese Underground Banking

China should consider the appropriate regulatory options and public policy for underground banking in China. IVTS may occasionally have stabilizing effects on certain economies, given that they operate as a safety valve and provide liquidity in times of crisis (Miller, 1999). The effects of IVTS have drawn the attention of law and policies makers. Criminal involvement in Chinese underground banking is considerably large, although its true extent may not be fully understood. As Professor Barry Rider commented, no intelligence organisation - except the Directorate of Revenue Intelligence in India, perhaps - has ever effectively cracked the (hawala) system (Toyne and Scott-Joynt, 2001). Without addressing the solutions for underground banking, money laundering through underground banking is unable to be challenged. Solutions should be applied in line with an individual nation's circumstances and reality. There have been many studies to discuss the strategies of dealing with the side effects of IVTS. In the context of Chinese circumstances, the so-called effective regulatory

options and public policy for underground banking appear subtle. However, in general, the appropriate interventions should focus on the problems that China has: government over-regulation, discrimination against underground banking, and the deficiencies (inflexible bureaucracies, high taxes, unfriendly, inefficient, expensive or lacking banking services, lack of confidence in banks) of Chinese financial service.

China should speed up the reform of economic and financial services. It has been argued that the best way to significantly reduce the volume of informal transactions is the orderly liberalisation of the economy. The more the government restricts imports and rations foreign exchange, the more important informal systems become (Buencamino and Gorbunov, 2002). China is a country with currency controls, trade restrictions, high tariff and tax. The difference between official and black market exchange rate provides an incentive for the growth of underground banking. China has taken the black market exchange rate into account when setting the official rate, because they fear that if rates differ drastically, then people will take money out of banks and send it through the black market (Ding, 1998). In addition, import restrictions stimulate foreign goods smuggling, which requires the outflow of funds to settle the accounts through underground banking. However, rampant currency control and customs laws violations indicate the economy needs to be further liberalized to reduce the incidents of the use of underground banking for illegal trade.

The suggested reform approaches are as follows. First, small enterprises and non-state economy need to be encouraged, which will curb the development of underground economy and reduce the number of use of underground banking. The incentives include reduced policy discrimination, giving preferential tax, loan, foreign exchange policies. Second, financial services need to be developed. Problems of financial services include inflexible bureaucracies, high taxes, and unfriendly, inefficient, expensive or non-existent banking services: there is a lack of confidence that banks need to address, though AML checks can alienate the public. The financial network needs to be implemented and

service scope needs to be extended. The dependence, flexibility, and adaptability will be developed to meet a variety of demands from a variety of people. Third, the reform of foreign currency management needs to be further deepened. The rate gap between official and black market needs to be reduced, making underground banking less attractive. It is likely that legitimate capital could be absorbed by legitimate financial services. Fourth, the government needs to take action to convert underground banking into legitimate business. Underground banking has been developed for such a long history; it is hard, indeed impossible, to abolish it with immediate effect. Since underground banking exists and they do contribute to the economic development at some degree, it is possible to utilise their strength to facilitate Chinese economic development by providing special services that conventional banking are unable or inadequate to serve. Laws need to change to legitimise underground banking which serves legitimate trade with foreign currency demands for their business purposes rather than criminal groups.

China needs to further implement legal and regulatory framework in line with international standards. A crackdown on the foreign exchange black market and unregistered banks in China has demonstrated that their activities are extensive, although it is unclear whether this crackdown targeted IVTS too or only illegal banks (Liang, 1998). China has undertaken a number of anti-underground banking campaigns to punish underground bankers. However, the efforts are not enough to suppress the surge of underground banking. It might also be the result that criminals are forced to launder their proceeds via underground banking due to the increasingly tightened scrutiny and oversight of the formal financial services. It is a trend that underground banking is becoming more popular for criminals to launder criminal proceeds nowadays. The boundary between underground banks who serve criminal and legitimate enterprisers was unclear. Cases suggest that some underground banking serves both legal and illegal purposes at the same time. China should instigate actions to challenge underground banking, at least to oversight and appropriately supervise their financial activities provided that China would like to remain the situation to use underground banking as a fund resource to offset its

inadequate financial services. A common consent has been drawn that the underground banking needs to be regulated for prevention from crime. The FATF (2005) Special Recommendations on Terrorist Financing No. 6 “Alternative Remittance” states:

“Each country should take measures to ensure that persons or legal entities, including agents, that provide a service for the transmission of money or value, including transmission through an informal money or value transfer system or network, should be licensed or registered and subject to all the FATF Recommendations that apply to banks and non-bank financial institutions. Each country should ensure that persons or legal entities that carry out this service illegally are subject to administrative, civil or criminal sanctions.”

In this regard, China may need to implement its regulations and laws to be in line with the requirements of the FATF. The implementation includes identifying underground banking services and informing operators of their registration and/or licensing obligations; meanwhile licensing persons that provide underground banking with its financial intelligence unit or financial sector regulatory body. Background checks on the operators, owners, directors and shareholders of underground banking systems need to be carried out if they are granted licences. Liaison work needs to be undertaken with the formal banking and financial sector to identify and monitor possible underground banking activities (given that many underground bankers may use formal banking accounts as part of their primary businesses). Enforcing co-operation between regulatory authorities and law enforcement agencies, including information sharing on the compliance performance of registered underground banking, should be put in place.

China needs to further enhance international co-operation especially with the Hong Kong Autonomous Region. China has made its efforts to combat underground banking domestically by consistent and aggressive law enforcement interventions of investigation and prosecution of violations of laws and regulations in the context of utilizing underground banks. Laws and regulations were issued. For

example, “disciplinary sanction provisions for financial institution officers responsible for violating laws and regulations” was issued by the People’s Bank of China and the “Regulations Outlawing Illegal Financial Institutions and Illegal Financial Services” was issued by the State Council in 1998. Detected cases suggest that the settlement process has always occurred abroad when the fund are transferred out of China. Thus, international co-operations are needed to combat the illicit transactions. In the West, underground banking related policies are closely linked to the issue of money laundering, and governments have not taken any specific action against underground banking. Chinese underground banking abroad is less monitored and targeted, although there is regulation and supervision in place in some jurisdictions. In the United Kingdom the advertisements of underground banks could be easily seen in the newspaper in Chinatown. These underground banks serve illegal migrants who transfer funds back to China. It is not hard to imagine that criminals are able to access these underground banks to launder their proceeds internationally.

There could particular difficulties for foreign countries in regulating Chinese IVTS facilities. For example, first, very few Western law enforcement agents speak and read Chinese languages and few of those agents have a Chinese appearance. They could not be allowed to stay closely to utilise their investigative skills and techniques due to their race and cultural distinctiveness. When they approach the suspects, the latter will keep their mouths shut and be alerted. Even in the interrogation stage, the Police will find it is hard to get first hand data, as a translator does not always fully express and interpret the investigator’s meaning. Or these suspects deliberately mess things up by resorting to blaming communication difficulties. Second, these Chinese IVTS is usually covered with a shop or company in the front, which are not easy to identify. Third, the service users are usually illegal migrants and they are afraid to report to the Police even if they were victimised from underrate payment or fraud. Fourth, it will be hard to find evidence: few Chinese witnesses will stand out as the potential revenge is serious. The foreign Police will not find easy to get a crime report. Fifth, when the suspect is bailed, they may escape as some of underground bankers are actually illegal migrants and

they are mobile and have no fear of further punishment. The aim of their residence is to make money and then return to China when they save enough money for their rest of lives. Extradition hardly works as they would never report their real names and home address in China. China will not accept an extradition unless the identification is confirmed. Sixth, Chinese may be less involved in terrorist activities and pose less serious harm to the foreign regime.

In addition, it is essential to co-operate with Hong Kong, which is a strategically important place to control Chinese underground banks. According to Carroll (1995), Hong Kong is particularly attractive for money laundering because of its physical proximity to the Golden Triangle, the secrecy legislation, the culture of cash deals and the presence of IVTS. There are even cases where a transaction in a country in which a given remittance provider does not have a network can be completed through another remittance centre; “The second business will offer their service at a discount to the trader, who absorbs all of the additional costs”. There are no accurate data on the number of Hong Kong underground banks, but the figure of about 300 remittance agents and more than 150 money changers estimated by Oldfield (1998) could reveal the potential scale. In June 2000, Hong Kong enacted legislation requiring money transfer agents to register with the authorities and establishing internal control system, including establishing the identity of their customers, reporting suspicious transactions, and keeping the records of transactions over HK\$ 20,000 for six years. However, the detected cases in mainland China suggest that Hong Kong is not immune from these supervisory regulations, and mainland underground banks are closely linked with their counterparts in Hong Kong.

6.2.2.5 Anti- Money Laundering Media Influence, Training Programme and Conference

Media censorship is largely seen as a measure to maintain the rule of the Community Party and to influence the public to achieve its goals. In 2006, to echo the establishment of the CFLAMLIR and then to promote its importance, the PBC has taken a systematic approach to carry out AML campaign. In central PBC office organised conferences by inviting the CCTV and other TV media to attend,

produced a series of articles with detailed explanations on terminology on the Financial Daily Newspaper. The PBC has also regularly issued AML money laundering circulars. The pace has sped up and influence has been increased. Since 2006, the PBC has issued a circular every two weeks and each circular consists of 40 pages. These circulars have also been sent to relevant AML joint working agencies including security, insurance, finance trade centre and banking union. The local PBC branches organized various events in line with their economic and cultural distinction to best increase the money laundering awareness of financial institution staff and all levels of the general public. These events include AML promotion day in the community, hanging an AML notice board and flag on the main road, handing AML leaflets to the public, establishing AML information website, organizing AML quiz for the public and knowledge competitions among financial institutions, printing AML calendars and present cards, and organizing AML comedy shows and local cultural operas. According to the 2006 AML report, the PBC organised 2334 AML events attracting 1869 media reports. A total of 55680 members of the staff participated in the events and 12,154,924 copies of materials were issued to the public. In the same year, commercial banks meanwhile organized 13,399 AML events with 16,037 media reports. 304,089 staff attended the events issuing 15,279,853 copies of materials (Zhong, 2006).

China intends to develop its own AML experts and human resource. According to the 2006 AML report (Zhong, 2006), the PBC organised approximately 1900 AML training events internally, and 17,000 AML training events with other financial institutions. Approximately 60,000 PBC staff and 650,000 staff in total from financial institutions were trained. The trainers were from the PBC, the Police, Prosecution Service, Court, Foreign Affair Office, Custom, Tax Office, and banking, insurance, security supervision authorities. The content of the training is not only defined within the banks, but also involved in the areas of security, insurance, non-financial institutions. In addition, the PBC also invited international AML experts to deliver training in China and assigned staff to attend training programmes abroad. For example, in February 2006 the CAMLMAC organized two series of

Large and Suspicious Transaction training events, which was supported by the United Kingdom. Approximately 100 participants from various AML team in the PBC attended the training. In June 2006 the PBC organized AML residential training on city and above level AML compliance officers for a week. The training was centred on the issues of laws and regulation, AML inspection, investigation assistant, and cooperation. The PBC assigned a group to attend American Securities Association AML training, which focused on the American Securities and futures market AML plans, relevant law and regulation, inspection and sanction. One month later, the PBC AML investigation assistant training event was held in the Inner Mongolia Autonomous Region. A number of 50 senior AML managers attended the training. The issues of AML administrative investigation, civil investigation, large and suspicious report reporting and collection, and AML criminal investigation were discussed. In October 2006, the senior AML officer of the PBC attended training events organised by Hong Kong Finance Management Bureau and the IMF.

On the basis of AML training programmes, the PBC has also attempted to gather international experience by organizing conferences and inviting foreign experts and Chinese academics to attend. China was also committed itself to attend international seminars and workshops in various countries and actively sent AML key staff to attend training programme abroad. In June 2006, the PBC and the IMF held an AML and Anti-Terrorist Financing conference for a week in Da Lian of Liao Ning province. A number of experts from a variety of background including the IMF, Austrac, FBI, and Northern Ireland Prosecution Service attended. The topics of investigation, analysis, research, legal issues and operational problems were explored. Over 50 staff from the PBC participated in this. The CAMLMAC held a conference focusing on AML information system management with the IMF in June 2006. Over 50 participants from the IMF, Austrac, Malaysia, Canada and Italy, along with Chinese Disciplinary Committee, Ministry of Justice, Ministry of Trade, Central Tax Office and Central Customs, attended. In September 2006, the CAMLMAC and the IMF held a conference in the context of Suspicious Transaction Analysis in Bei Jing. Experts from the IMF and various AML

Intelligence Units such as the USA, Australia, Thailand and Israel attended. In November 2006, the PBC and the University of Fu Dan jointly organized the first AML Theory and Practice conference in Shang Hai. Academics from a number of top Chinese universities attended. The academics are from various backgrounds and specialized in economy, law, finance and social science.

To summarise, in 2006, a total of 60,672 members of staff from the PBC staff, 582,065 from other financial institutions, and 12,549 people from other AML agencies attended a total of 1912, 14,583, and 704 AML training events and conferences respectively. In China, there are 27,877 banking institutions, 237 security companies, 2081 insurance companies. On average, approximately 21 members of staff from one financial institution have attended the training and conference. The proportion and number of people and training events are apparently large and staff of financial institutions' AML knowledge and skills should have increased in general as a result. However, the training events and conference seem to be confined mainly within financial institutions and other major members of AML agencies. Little source suggests that non financial institutions, finance companies, business firms and other service users who suffer with implementing the cost of AML actions have been involved in AML training and conference. It is reasonable to conclude that the staff of key non financial institutions, which may have a link with money laundering activity, would benefit from the provision of training programs. Particularly the programme is designed to familiarize their staff with the unique features of money laundering and the methods of detecting and preventing the crime. The public participation in AML events appeared limited due to the large number of population in China as a whole. The awareness of the firms and public in regard to money laundering needs to improve.

6.2.2.6 A Risk-based Approach to AML Compliance

With regard to AML regulation, there are two basic models- rule-based and risk-based- that are currently used worldwide. The rule-based approach means a tick box approach (Hanley, 2007) to specification of detailed regulations rather than the more open principles based approach, which later developed into the risk-based approach. It involves a rigorous check of current practices against established AML policies and procedures. A rules-based approach is designed to detect certain known laundering behaviours rather than suspicious transactions. Professionals apply a set of rules in all contexts and all cases: if something meets the conditions specified in the rule, then the action —also specified in the rule— is taken (Ross and Hannan 2007). The drawback is that the rule-based approach in the AML framework produced insufficient information to fight and prevent the money laundering phenomena (Reuter and Truman 2004). For example, a rule-based approach may generate excessive unnecessary SARs.

The adoption of the risk-based approach is part of a general trend towards risk based regulation arising from the shortcomings that characterized the traditional rule-based approach (Ross and Hannan 2007). According to the Wolfsberg Group (2010), a reasonably designed risk based approach will provide a framework for identifying the degree of potential money laundering risks associated with customers and transactions and allow for an institution to focus on those customers and transactions that potentially pose the greatest risk of money laundering. A risk based approach is important to the effectiveness and efficiency of the fight against money laundering, not least by reducing over-reporting.

The FATF (2007) suggests a risk-based approach to AML compliance will allow competent authorities and financial institutions to be able to ensure that measures to prevent or mitigate money laundering and terrorist financing are commensurate to the risks identified. The principle is that resources should be directed in accordance with priorities so that the greatest risks receive the highest

attention. It promotes the prioritisation of effort and activity by reference to the likelihood of money laundering and reflects experiences and proportionality through the tailoring of effort to risk. The different approaches add complexity and cost, both economically and practically, to implement AML compliance programmes. Financial institutions are subject to a number of onerous reporting obligations such as undertaking customer identification procedures and reporting suspicious matters – obligations that will radically change the nature of their practice. Financial institutions are no longer confined of following rules of recognise what is (and is not) ‘suspicious’, but are required to develop professional expertise to probe beneath the surface and to develop suspicions which are not ‘natural’ or obvious. Financial institutions will have to adapt an AML model to undertake a money laundering and terrorism financing risk assessment on their existing business functions and develop and implement risk assessment systems to identify high and medium risk customers. A system to register risks such as product risk, area risk, service risk, customer risk and system risk into categories needs to be developed. To monitor financial activities and develop a sophisticated way of identifying and reporting ‘suspicious transactions’, systems and processes for collecting and retaining both identification and transaction related records need to be established. AML compliance programmes and an assurance of sufficient staff training need to be implemented.

Internationally, AML regulations have moved from a rule-based approach to a risk-based approach. China is in the preliminary stage of its AML compliance approach and this appears to be rules-based in the main. Global enforcement activity and the Chinese circumstances require China to adopt a risk-based approach. China also needs to clarify the breach of rules against tipping-off and the liabilities that flow from this. Multi agency risk management frameworks to share information, manage risk and co-operation need to be further strengthened.

Despite the blizzard of initiatives, legislation and empire-building associated with the global AML regime, there is a pronounced knowledge deficit concerning the costs and effectiveness of the standard

package of rules and regulations propounded by international organisations and adopted by states (Levi and Gilmore 2002). There is also no reliable systematic analysis in relation to the costs of Chinese AML system, however, as a result of above tasks which financial institutions need to comply with, the cost is logically considered as significant. International experience has already indicated the large cost of implementing AML system. Research commissioned by the Ministry of Justice (New Zealand) suggests that proposed anti-terrorism and money laundering legislation will cost business \$112 million in start-up expenses and \$43 million each year for banks, jewellers and other institutions (Thomas, 2008). A UK study has put the cost of AML compliance at more than \$500 million for the financial services sector (Fagg, 2007). In addition, these costs are constantly rising. KPMG's 2007 Global Anti-Money Laundering (AML) Survey, which covered 224 banks from 55 countries, found that banks' spending on anti-money laundering (AML) systems and processes has risen by an average of 58 per cent over the last three years. In North America, spending has increased by 70 per cent or more (KPMG, 2008). Furthermore, compliance can be costly. These institutions often have the burden of reporting potential violations of statutory provisions and face severe penalties for non-compliance. For example, according to Harvey (2007):

“the Abbey National plc breached money laundering rules in 2003, for which it received a fine amounting to £2 million. Similarly the Bank of Scotland received a fine of £1.25 million for breaching money laundering rules in 2004. Northern Bank Limited was identified as having inadequate KYC and identity verification and it was fined a total of £1.25 million in 2003”.

In January 2009, Aon Limited (Aon Ltd) (Aon Corporation's principal UK subsidiary) received a financial penalty amounting to £5.25 million for failing to take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems (FSA, 2009).

The failure of reporting or tipping off such types of reports will be penalised with administrative and criminal sanctions. Financial institutions have had imposed on them a new role of law enforcement and crime detection. Changes in corporate culture and corporate management techniques are often required. The responsibility for spotting suspicious transactions is placed most immediately on often under-paid, under-trained clerks and tellers. Corporate compliance calls for masses of paper work and complex computer operations, all of which are costs imposed on a private party who in all likelihood, will simply pass them on to its customers. This mechanism began first in banks and now has spread into other financial institutions and – in Europe – car dealers, jewellers, and other high value dealers.

It is far more challenging to for China to establish an effective AML system due to a large number of financial institutions and clients, enormous territory, and a poor financial regulatory foundation. As of the end of December 2005, China's banking sector had a total of 27,877 financial institutions. There were 7 foreign-invested securities companies, more than 3 000 securities trading outlets and 90 representatives of foreign securities institutions in China (FATF, 2007). These financial institutions are located in different areas within a proximity to their bordered region or states, or serve different types of clients (e.g. ordinary public in remote areas and wealth condensed High Net Worth individuals in coastal and southern areas), or are influenced by different local policies such as favourite foreign investment policy and political pressure. To understand the ownership and control structure of the customer, a formal routine physically checking and recording a client profile, and analysis of data based on actuarial factors other than dynamic factors need a great deal of work to satisfy the Recommendation 5 of the FATF. The pressures on Chinese financial institutions from direct cost of implementing AML measures in such a short period for a crime prevention purpose, meanwhile protecting themselves from administrative and criminal sanctions, are also challengeable. The task of collecting the required information on their customers, recording the information, and data analysis needs a great deal of physical and computer based work. Financial institutions are obliged to produce Large Value and Suspicious Transaction Report both in Chinese and foreign currency.

Financial institutions have an obligation to record all transactions above the threshold. It is particularly difficult for China, as the reporting system in a majority of Chinese financial institutions is less automated and needs a more detailed manual verification of customers compared with its Western counterparts today. (Though 20 years ago, many American and British banks were likewise manually oriented, with no centralised computing systems: see Levi, 1991). A cheaper and equally effective solution for financial institutions to comply with domestic AML regulation and to enter into international financial market is urgently needed.

The CDD procedure needs to be a simplified procedure in China to cope with the enormous workload incurred from the standard CDD procedures. Different clients will be treated differently according to their risk level. In correspondent banking, resource needs to be used efficiently according to risk levels. A new approach with certain flexibility, proportionate resources allocation, and minimum cost to achieve a good compliance with AML regulation should be seriously considered in China. Internationally, AML regulations have moved from a rule-based approach to a risk-based approach. In 2003, risk was introduced in the revised FATF Forty Recommendations. A risk-based approach is considered as cost effectiveness and value for money to combat money laundering in active AML nations. Risk-based approaches will enable financial institutions flexibly to monitor fund transactions in accordance with their risks. Like threat assessments, risk-based approaches are not necessarily systematic and objective processes. Actuarial prediction may be helpful, but professional over-ride will usually be necessary. Risk may well be a more difficult process to manage in the specific context of China, an emerging economic (if not political) superpower, with a curious and fascinating blend of ancient life and practices (including IVTS) alongside the modern, rapid economic growth and social upheaval over short spaces of time, and increasingly tied into the global economy not just in terms of manufacturing but also financial and other areas.

Risk-based approaches are also allowed to prioritise financial institutions' tasks in the stage of KYC/CDD. Unnecessary resources will be saved at the time reducing false alarms while preventing important information from slipping through. The above benefits will provide an incentive for a nation including to develop its own risk-based approach to minimise compliance cost. In 2005, the risk-based approach was adopted in the Third Directive on money laundering by the European Commission. By adopting a risk-based approach, at least in theory, competent authorities and financial institutions are able to ensure that measures to prevent or mitigate money laundering and terrorist financing are commensurate to the risks identified (FATF, 2007). With the recent years practice the risk-based approach has been highly appraised – not least by bankers - for being best suited to the fight against money laundering (BBA, 2007). These features are essential for a regulatory regime that seeks to deliver value for money while successfully disrupting the criminals who would seek to use our financial system (Financial Service Authority, 2009). Risk management is a powerful weapon that organisations can use to ensure that the organisations' objectives are met resulting in quality and efficient services, good and friendly image, and services which are of value for money (National Probation Service, 2004).

For the PRC, a risk-based approach means that a series of strategies, guidance, and standards of risk management should be in place that are commensurate with levels of risks of money laundering and terrorist financing. Different level of risks needs different level of intervention and resource. A higher risk posed by money laundering requires a higher level of control and resource. Five steps can be a reference to manage the risk.

Step1: Clarify Objectives

Risks are derived from business objectives. Chinese financial institutions need to consider their capacity, the medium to long-term goals, objectives and strategies. Some useful questions will help to clarify business objectives. What is the nature of your business/service? Do financial institutions want

to extend their business to other markets domestically, neighbouring countries or worldwide? What do they need to be done? When will it be done? Who will be accountable for the delivery? What is the nature of the risk to the service? How will it impact on the organisation if the risk occurs? What is the risk management scope? Clarified objectives will set up a strategic direction.

Step 2: Identify Risks

To identify the risks it is essential to understand risk factors. Some facts such as previous history, client risk, country and jurisdiction, type of business or entry, products and service are internationally recognized risk factors.

A: Risks from country and jurisdiction

Some customers are located in countries or jurisdictions with a higher risk of money laundering. Countries or jurisdictions have been or are subject to sanctions, embargoes or similar measures issued by universally recognized bodies and law enforcement agencies from powerful states. These bodies and agencies include the United Nations, the United Nations Security Council Committee, European Union, the World Bank, the IMF, the FATF and the FATF style regional AML bodies, the United Kingdom's Financial Services Authority, the United State's Office of Foreign Assets Control, and the United States Financial Crimes Enforcement Network (FinCEN) (Section 311). These countries or jurisdictions have been identified by above sources as lacking appropriate money laundering laws and regulations, or providing funding or support for terrorist activities, and or having significant levels of corruption, or other criminal activity (Deloitte and Touche, 2007). For example, being on the "Non-Cooperative Countries and Territories" list, politically unstable regimes, high levels of public or private sector corruption, widely known of drug production and drug transit regions are all significant risk factors that need to assess. Useful resources can be referred to the U.S. State Department's "International Narcotics Control Strategy Report," and Berlin-based Transparency International's

yearly Corruption Perceptions Index. In addition, an offshore financial centre is an also important risk factor that needs to be considered (Rietbroek, 2009). The PRC could monitor these publications and tier the risk level accordingly. For example, Chinese geography of bordering with drug production countries and regions such as the Golden Triangle, Golden Crescent, and North Korea suggest a special awareness of the potential risk of associating with financial institutions in those areas, and conducting financial activities with them. In addition, the financial activities in Xi Jiang Province of China might raise alarm, as international terrorists previously mentioned above actively conduct their criminality in Xi Jiang Province, which is bordered with central Asia. Coastal cities will be vigilant about the large and unusual financial activities, as they have been identified as posing a high risk of smuggling, as they offer more convenient access to commodities or goods from their neighbouring countries or regions such as Tai Wan, Hong Kong, South Korea and etc.

B: Risks from customers

Customers of financial institutions can be the general public, listed companies, private companies, joint ventures, partnerships, charities, stated ownership companies, foreign investment companies, and financial institutions and so on. A number of indicators need to be considered whilst assessing the risk attached to these customers in China.

- Previous history of profit driven criminality. The individuals or key members of companies who have conviction for offences such as deception, drug trafficking, smuggling, which are able to generate large amount of proceeds. For example, when an individual wants to deposit a large amount of money and he/she has been identified with previous convictions for profitable offences, this customer is assessed as posing a higher risk of money laundering than other customers who deposit the same amount of money and have no criminal record.
- Political exposed persons (PEPs) and their family members. Conventionally, the PEPs only cover foreign nationality. Currently no AML requirements in relation to foreign PEPs have been

established. In light of Chinese circumstances, China could well use this FATF recommendation to deal with domestic corrupt politicians, as some other countries do, in the interests of the country as a whole. In China, exposed corruption cases indicate that all levels of governmental officials across different sectors are capable of committing profit-driven crime. Officials working in the following key sectors and industries should be identified as posing a high risk of money laundering. These sectors and industries include land administration, taxation, construction administration, and financial institutions, large and medium size state owned enterprises, and governmental agencies having overseas businesses and offices. In addition, officials who are able to get access to certain power and resource should also be included. For example, officials who are able to distribute large governmental funds. Officials who have power to decide governmental projects' contractors. Officials who have power to recruit and promote officials. Officials who have power to authorize loans. Officials who have power to reduce or exempt tax. Officials who have power to influence policy making. Furthermore, for public officials whose family members run businesses or reside overseas will be closely monitored and fall in a high risk category.

- Individual customers require undue levels of secrecy with a transaction, or are unwilling to give their real names or unwilling to disclose information requested by financial institutions.
- Company representatives are unwilling to give the names of the real owners and controllers of their companies or companies' structures where it is difficult to identify the beneficial owners.
- Cash intensive businesses such as retail or corner shop and entertainment businesses. Chinese people are used to spending in cash. Credit systems in Chinese financial institutions have not been developed to a level that their foreign counterparts have. For example, the bank credit or debit card facility in China is limited to a small number. Related facility to serve these card consumers is limited and constrains the use of bank cards. Online shopping appears to lack credit and confidence. Chinese people do not trust plastic cards and do not like debt. People also do not

spend more than what they have. It is quite common to see that people buy their property and business is completed in cash, although the amount of transaction sometime can reach six or seven figures. Cash is used more intensive and China has more intensive business than those identified in the west in general. It also should be noticed that China does not have certain cash intensive businesses recognized by the West. For instance, gambling is illegal in China and strictly prohibited, although it is legal in some countries. In this regard, when regulating cash intensive businesses in China, the appropriate coverage need to be fully considered.

- Dealers in high value or precious goods (e.g. jewels, gem and precious metals dealers, art and antique dealers and auction houses, estate agents and real estate brokers). For instance, Chinese people have been more than enthusiastic to collect high value and precious goods in recent years. Antique collection is not only a hobby, but also an investment to keep value and with an expectation of increased value in the future. The demand on the Chinese antiques has pushed up the price and there have been news about Chinese antiques reaching highest antique selling records in the world. Another reason that has contributed to the soaring price of Chinese antiques is that the demand for the antiques is not only limited in the scope of antique collectors. A considerable amount of demand for antiques is to use antiques as bribes. With the increasingly tough measures against corruption, bribers and corrupt officials are more concerned about the cash exposure to law enforcement agencies. A way of meeting the requirements of both parties - restoring value and less likelihood of being prosecution evidence - is needed. Antiques are not as obviously criminal as cash or other luxury gifts that can attract law enforcement agencies' attention. In addition, possession and display of antiques at home suggests the owner of having a certain high level of cultural knowledge and a high level of art merit. Nowadays the quality of Chinese people's lives has improved significantly. People are not only satisfied with plenty of food in their stomach but also financially pursue their cultural lives. Several interviewees who work in public service tell me that antique is a kind of soft gold. More and more public servants

are interested in antiques, art and precious stone or gem collection and some higher level public officials have become antique experts to estimate the value and quality. Some public officials claimed they were rich because they inherited antiques and sold pieces as a result. My interviewees assert that they are more comfortable to meet their superiors with these gifts, which are also more welcome to be accepted. This kind of bribery has the same effect with that from bribery with cash or luxury goods. My interviewees indicate that it is easier to deny the prosecution allegations due to their apparent ignorance of the value of the antiques when questioned. Antiques appear to be abused by corrupt officials to launder their bribed proceeds.

- Underground bankers. Underground banking is vulnerable to be abused by criminal proceeds, given some underground banking deliberately facilitate criminals to launder money. Previous chapter discussed the operational characters that are easily misused by criminals. Known underground bankers such as Huang Niu need certainly to be identified as high risk individuals.
- Individuals whose origin of wealth and/or source of funds cannot be easily verified or where the audit trail has been deliberately broken and/or unnecessarily layered. For example, in China there is a fairy story about a very well known Chinese wealthy man, which or similar stories should be considered as a high risk of money laundering case. The story was an aged ex Hollywood female star had a dream to meet a Chinese man, which drove her to come to China to meet a former Chinese prisoner. He was then taken to the United States. Eventually he was married to her and he inherited enormous wealth when she passed away. He returned to China and became a very rich and lucky man. He runs his own business of dealing antiques across the border. He never disclosed the name of the lady and no trail has been able to trace her. A good story may well be an entertainment for the general public; however, it may still not be effective if the investigators carefully build their case. The authorities have not pursued those fictions to investigate the provenience of the wealth.

- Unexplained, or unusual, and or significant amount of funds transferring between different financial institutions cross various locations. It is likely that the account holder tried to disrupt money trail, which indicate a high risk of money laundering or terrorist financing.
- No apparent commercial or other rationale, and or unnecessary to increase the complexity of transactions or to reduce the transparency of transactions.
- Import/export companies who import/export products with no commercial rationale and whose price appears unreasonably expensive/cheap.
- Unregulated charities and other non profit international organisations.
- Foreign investment on entertainment facility such as five star hotel or large restaurants by a private company other than a large corporation. It is because the indicators of a small private company are less developed than those of a large corporation.
- Use of intermediaries within the relationship who are not subject to adequate anti-money laundering regulation and who are not adequately supervised. The intermediaries who introduced a particular type of customer are also a determining factor to assess the risk of money laundering. It is like international correspondent financial institutions. Adequate AML is necessary to prevent the misuse from money launderers.
- Gatekeepers such as accountants, lawyers, notaries or other professionals acting on behalf of their clients where the designated body places unreasonable reliance on the gatekeeper. It is reported in China that it is not hard to obtain a proof from the notaries by a payment of a small amount of fee.

C: Risks from Products/Services

New or innovative products or services in financial institutions may present the potential risk. Attention should be particularly paid to those, which have been identified by governmental authorities, regulators or other credible sources as being potentially higher risk for money laundering. For

example, international correspondent banking services have been identified by the FATF as a higher risk scenarios requiring enhanced CDD (FATF, 2007). To develop Chinese banking services, China needs to develop its correspondent banking services to broaden its international market and to achieve maximum profit. However, China should treat this service with greater care as these services present higher risk due to its service character. For instance, correspondent banking services involve transactions such as commercial payments for non-customers (for example, acting as an intermediary bank) and pouch activities. According to Bankers Information Service (2009) pouch activity entails the use of a carrier, courier or referral agent employed by the courier, to transport currency, monetary instruments and other documents from outside the U.S. to a domestic bank account. Pouches pose an AML risk because, among other purposes, they can be used to structure monetary instrument purchases of money orders, traveller's cheques or bank checks in order to avoid reporting requirements. Another service/product that China should employ improved CDD is private banking services. International private banking services provide a number of operational characteristics such as services involving banknote and precious metal trading and delivery, services intended to render a customer anonymous, products which allow/facilitate payments to third parties, and internet based products or products that facilitate easy non face to face access (Deloitte and Touche, 2007) that would attract money launderers' attention.

Private banking services are a new service and were just introduced in China in the last two years. Along with international competitors, Chinese financial institutions including Industrial and Commercial Bank of China, Construction Bank, Bank of Communications, Bank of China are increasingly eager to grab a market share. As Jun Liu, an analyst from Chang Jiang Securities stated that major domestic banks are vying for a slice of the private banking market in China. This will not only bring enormous profit, but also boost the brand image of a commercial bank, which is of great note during an economic downturn (Wang, 2009). The speed of securing these clients appears to be a priority for these banks to work on. According to Lei Wang, general manager of BOC's private

banking sector, that the outlet received some 20 clients on the opening day. Li Hui Li, president of BOC, is confident about the business potential by stating “We expect to develop 10,000 clients in one year, with an ideal target of 50,000 in the initial stage” (China Daily, 2007). As a cost of fast speed developing customer data base, lack of adequate controls over private banking activities is of a concern. The FATF indicates that private banking is higher risk scenarios (FATF, 2007). Chinese financial institutions should take preventative measures in place to mitigate the abuse by criminals. Some questions, such as high transaction volume supporting their business profile, crossing border transactions, requirement of high speed movement of funds, need to be frequently asked to financial institutions themselves.

Step 3: Assess Risk

The aim of risk assessment is to gain an understanding of the risk in order to respond to it effectively. This involves a qualitative description of the likelihood of a risk coming about and the severity of the impact should this occur. According to the FATF (2007) that risk is addressed in four principal areas: (a) Customer Due Diligence measures (R.5-9); (b) institutions’ internal control systems (R.15 & 22); (c) the approach to regulation and oversight by competent authorities (R.23); and (d) provision for countries to allow Designated Non-Financial Businesses and Professions (DNFBPs) to take the risk of money laundering or terrorist financing into account in a similar way to financial institutions (R.12, 16 & 24). In each principle, questions need to be asked such as what could trigger the risk? Or what could make it more likely to occur? And what will be asked in the context of risk assessment? Good practice includes appropriate policy and procedure in place that can be followed, specific action or measures in place to manage the risk and updated preventative measurement. For example, identification ID and Know Your Customer (KYC) should also be carried out on a risk-sensitive basis. For instance for a retired pensioner opening a basic bank account is unnecessary to follow extensive KYC procedures to investigate the nature of the account opened, provided sufficient monitoring measurements are in

place afterwards to ensure that these are not merely ‘mules’ for funds transfers. In regard to risk management practice in other areas, a mechanism of risk calculation might be useful for China to develop a systematic analysis. Setting aside inherent ambiguities, risk could be scored and ranked, which will be easier for practitioners to assess the risk and follow up with appropriate resource to manage the risk accordingly. Risk also needs to be divided into different categories such as risk of offending and risk of harm. It will contribute to risk management plan by informing strategies of whether to reducing risk of offending or reducing the risk of harm.

Step 4: Evaluate Risk

After the risk assessment is completed, an evaluation needs to be undertaken to assess the suitability of the risk assessment. A list of questions in the Appendix Two will provide basic measurements to evaluate the quality of risk assessment.

Step 5: Respond to Risk

By adopting a risk-based approach, competent authorities and financial institutions are able to ensure that measures to prevent or mitigate money laundering and terrorist financing are commensurate to the risks identified (FATF, 2007). Following evaluation, there are a variety of ways in which risks can be managed including acceptance, transfer, elimination and reduction. Risk management should be balanced against cost. If an action plan to reduce the risk is decided upon, responsibility for this should be assigned and a timetable agreed. A follow-up methodology will also need to be implemented. The Appendix Three list the questions to help to address the risk responses.

Step 6: Review Risk

Once identified, analysed and evaluated, all risk needs to be recorded in a standard format as a part of internal control. The record should include minimum information as detailed in the Appendix Four.

If an institution develops a program to monitor and identify risky customers and transactions, the chances of being harmed both from criminals' penetration and government sanctions and penalties are decreased. Chinese financial institutions need to classify their business relationships in accordance with risk factors and to develop risk categories and correspondent risk management plan in the international financial market. Some key risk factors such as the origin and nationality of the client, the place where the transactions need to be conducted, the beneficial owner, type of businesses, and transaction related risks will be clearly clarified and will be referred in light with international experience. For instance, if the country or region is on the Non-Cooperative Countries and Territories (NCCT) list or they are designated under Section 311 of the USA Patriot Act, this can be a key factor contributing to risk assessment. Chinese financial institutions will implement their risk-based approach in accordance with their own circumstances. For large and resource rich financial institutions with a large number of customers, customer monitoring software will be a good option to monitor customers' financial activities. For smaller financial institutions with fewer customers, a low technical solution could be a better option temporarily. Appropriate internationally recognized preventative measures will be undertaken to reduce the risk imposed by individual clients, services or products, and internationally identified higher risk countries and regions.

6.2.3 Reporting

Prior to 2003, Chinese financial institutions were not obliged to report large-value and suspicious reports. Even the first version of AML regulation took effect in 2003; there were still gaps between Chinese and the FATF standards such as the Recommendations 5-12 of the FATF 40 Recommendations dealing with Record-Keeping and Reporting of Suspicious Transactions (Recommendations 13-16). The requirements for reporting of large-value and suspicious transactions for financial institutions were formulated in a general manner. The rules do not give clear and precise guidance to financial institutions on how to comply with them in different financial institutions in

comparison with international standards. In specific, the requirements for reporting of large-value and suspicious transactions for financial institutions are not specific enough.

Since the 6th November 2006, China has formulated the Administrative Measures on the Reporting of Large-Value and Suspicious Transactions by Financial Institutions. These measures are categorised and illustrated in specific prescriptions. A detailed guidance has been set out. The CFLAMLRL has set up a threshold for large value transactions and has provided a number of methods to identify suspicious transactions. For example, financial institutions will closely monitor large value transactions such as any daily transfer exceeding US\$ 500,000 for companies or US\$ 100,000 for individuals; any single transfer between business entities exceeding ¥2 million or US\$200,000; and any single cash transaction exceeding ¥200,000 / US\$ 10,000. Financial institutions are instructed to identify suspicious transactions. Usually suspicious transactions have the following characteristics:

- frequent deposits and transfers of money within short intervals;
- frequency and amount of money received and transferred not matching the scale of account holder's operations;
- large and frequent payments for cancellation of insurance policies made by an insurance company to the same overseas insurance policy holder;
- frequent donations or advertising expenses not matching the account holder's business scope.

The CFLAMLRL has generated a number of methods to identify suspicious transactions including 18 methods being applicable to banking financial institutions, 13 methods for securities and futures market, and 17 methods for insurance industry.

The Administrative Measures apply for institutions involved in the business of currency exchange, payment and settlement, and fund sales. On the one hand, confidential content of report of suspicious transactions are required to be kept and disclose to any other institution or individual is regarded as in

violation of regulations. On the other hand, the version of Suspicious Transaction Reports (STRs), the time scale of completing and submitting STRs, the criteria of meeting reporting threshold for different type of financial institutions, the ways to identified STRs, the quality of the STRs, and the responsible department of receiving such report have been specified. In addition, 30 elements of A Large-Value Transaction Report, 40 Elements of Banking Institution's Suspicious Transaction Report, 34 Elements of Securities and Futures Institution's Suspicious Transaction Report, 40 Elements of Insurance Institution's Suspicious Transaction Report are needed to check against. These amended regulations are centred on the defined FATF's five obligations of financial operators. First is to identify the immediate client based on official identities. Second is to increase diligence on complex, unusual large transactions or unusual pattern of transactions having no apparent economic or visible lawful purpose. Third is to record and retain information for at least five years. Fourth is to report STRs to competent authorities. Fifth is to develop in-house compliance by training employees and introducing an audit function to test the system.

In the context of fund monitoring and case investigations, the CAMLMAC has expanded the AML monitoring scale nationally. A total of 296 banking institutions have handed in reports via the intranet. In addition, the PBC has begun carrying out administrative investigation, established and strengthened co-operation system with law enforcement agencies. In 2006, the PBC has conducted 1599 administrative investigations, provided 1239 crime clues, facilitated law enforcement agencies to carry on 2750 crime investigations, and helped to crack down approximately 100 cases involving money laundering (Chinese Anti-money Laundering Bureau, 2007).

According to the 2006 AML report (Zhong, 2007), the large value and suspicious transaction reports sent to the CAMLMAC have increased. 296 out of 314 bank institutions provided large and suspicious transaction reports. It is reported all State Owned Commerce and Corporate Banks, Rural Co-operative Banks, Postal Saving Offices, Urban Commerce Banks, and Rural Commerce Banks

have all contributed to the large value and suspicious transaction reporting mechanism. Most of Foreign Investment Banks Rural Credit Association and Urban Credit Association have also begun to report. In 2006, the CAMLMAC received approximately 134 million large value transaction reports, among which 124 million were Chinese currency transaction reports compared with 102.06 million in 2005 and 4.5 million in 2004. A total of 10.2359 million in contrast to 9.3525 million in 2005 and 4.1499 million in 2004 were foreign currency. Both of Chinese and foreign currency reports have increased by 21.78% and 9.44% respectively in 2006 compared with those in 2005 (see chart 5-3 and 5-4). In terms of suspicious transaction report, 1.535 million Chinese currency suspicious transaction reports in 2006 have been disseminated to the CAMLMAC, which was 5.42 times more than those (283,400) in 2005 and 42 times more than those (36,100) in 2004. Whereas foreign currency suspicious transaction reports were 4.2268 million, this was 112.51% higher than those (1.989 million) in 2005 and over 42 times more than those (98,400) in 2004 (see chart 5-6 and 5-7). In addition, in respect of assessing the received reports, the CAMLMAC had identified over 1070 reports on suspicious transactions for administrative investigation or for dissemination to the MPS (683 of which had been identified by the end of 2005) by the end of September 2006. These involved RMB 137 billion in domestic currency, USD 1 trillion in foreign exchange, about 80 000 transactions and 4,926 accounts (FATF, 2007). Furthermore, in regard to STRs dissemination, 57 files containing 82 suspicious transaction dossiers involving about 80,000 suspicious transactions have been transferred to the MPS for investigation (7 in 2004, 14 in 2005, and 36 in the months in 2006) (FATF, 2007). Nine of those disseminations resulted in cases being filed for investigation and one of these has been transferred to the SPP for prosecution. More than 10 suspicious transaction dossiers have been transferred to other agencies, including five to the MSS since October 2005. Four of those cases are still being investigated by the MSS. The other one was closed after investigation.

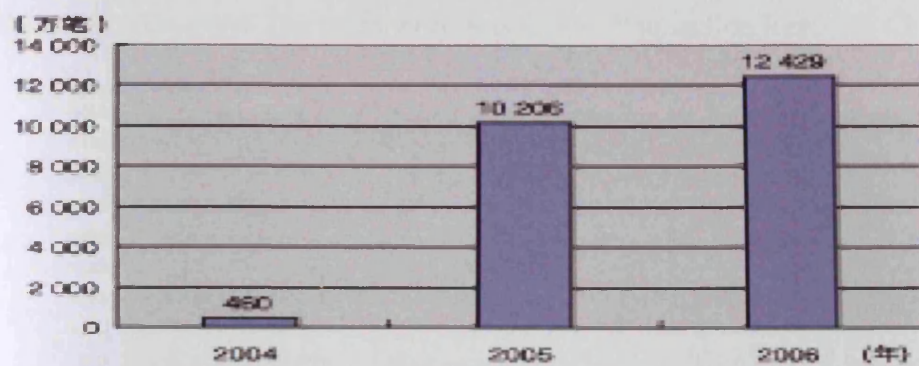


图 5-3 2004 ~ 2006 年人民币大额交易报送量

注：2004 年数据为当年 8 月至 12 月的数据。

Chart 5-3 2004-2006 The Number of Large Transaction Report in Chinese Currency

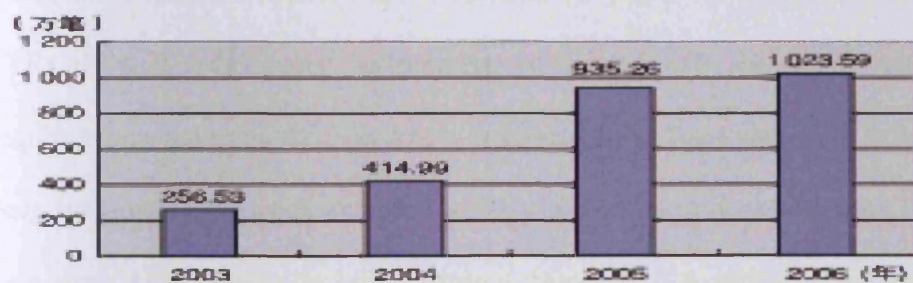


图 5-4 2003 ~ 2006 年外汇大额交易报送量

注：2003 年数据为当年 3 月至 12 月的数据。

Chart 5-4 2003 -2006 The Number of Large Transaction Report in Foreign Currency

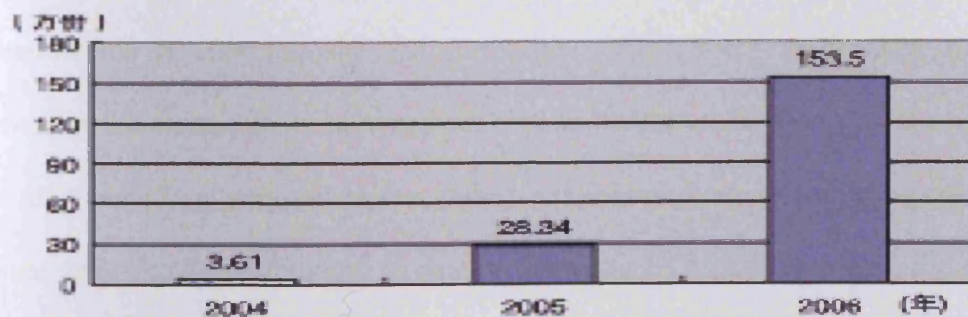


图 5-5 2004 ~ 2006 年人民币可疑交易报告量

Chart 5-6 2004-2006 The Number of Suspicious Transaction Report in Chinese Currency

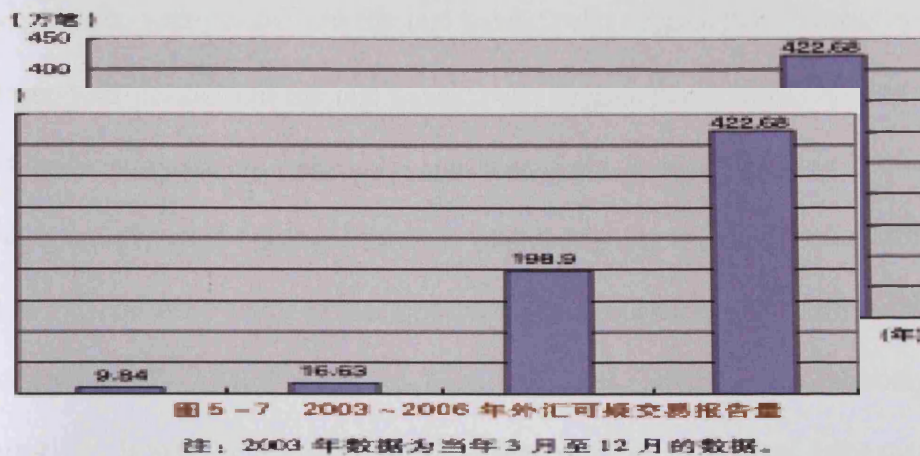


Chart 5-7 2003-2006 The Number of Suspicious Transaction Report in Foreign Currency

However, the supervision on AML reporting should improve further. AML reporting in Chinese financial institutions appears to be focused on paper work and lack of enthusiasm. The number of STRs through individuals' assessment is limited and appears to comply with AML regulatory requirements and to cover their likely responsibility. **Interviewee B** indicates AML regulation has not been integrated into front line staff's daily work. The priority of front line staff is to undertake their own work rather than checking criminal proceeds. A routine data reporting on a monthly basis is produced wholly on the basis of actuarial data automatically collected by the computer. A minimum number of STRs is reported with limited information to address where and why and how the concerns are. The report is purely completed because the transactions of the suspects breach the standards made by their superiors. The fund transaction monitoring is passively conducted as requested from the "top". **Interviewee B** tells me she did not know who ("top") made such instructions. A proactive investigation on suspicious transactions beyond the standards and unusual fund transactions is needed. In this regard, a comprehensive report including money laundering responsible persons' own assessment should be required to ensure reporting STRs and recording the transactions with quality assurance.

It can be seen that the number of large and suspicious transaction reports have increased significantly during a three year period. On the one hand, it can suggest that Chinese financial institutions' AML awareness have increased considerably and they have actively fulfilled their responsibilities by demonstrating an increased number of money laundering reports. On the other hand, the high number of AML can indicate the quality of the reports might be questionable. According to the FATF (2007) that The CAMLMAC/ AMLB does not have sufficient staff to effectively manage the very high volume of STRs and other reports that it receives and does not have (timely) access to other bodies' information. It may be a result of a defensive strategy to prevent from receiving administrative and criminal sanctions. The high number of large and suspicious reports will inevitably carry a significant pressure on the shoulder of the CAMLMAC. Although there have been AML software programmes in place, the efficient time spent on analysing these reports is questionable due to the large quantity and limited human resources. As a result, the quality of the analyses is also a concern. In addition, the First Mutual Evaluation Report on Anti-Money Laundering and Combating the Financing of Terrorism completed by the FATF (2007) records that the CAMLMAC mainly receives reports on suspicious transactions that were submitted by banking institutions, postal deposit and remittance institutions across the country. It is uncertain to predicate the reasons behind such statistics. It is maybe the reason that money launderers prefer to use the conventional banking system other than sectors such as securities or insurance, although vigorous AML counter measurements in banking system has been improved. It could be the reason that other sectors such as securities or insurance sectors were not as enthusiastic as the banks to implement AML law and regulation, therefore, resulting limited number of the reports. It could be because those sectors were unable to implement AML regulation in practice due to their inadequate AML knowledge, resource and facility. The number of Large Value Transaction Reports and Suspicious Transaction Reports from securities and insurance sectors appeared also limited. As a result, the likelihood of identifying laundering money through securities and insurance sectors was relatively low.

There are other concerns in regard to transaction reports. According to the First Mutual Evaluation Report on Anti- Money Laundering and Combating the Financing of Terrorism- People’s Republic of China (FATF, 2007), there is no legal obligation for insurance companies and securities companies to pay special attention to all complex, unusual large transactions, or unusual patterns of transactions, that have no apparent or visible economic or lawful purpose except when the transactions are done in foreign currencies. There is no requirement to give special attention to business relationships and transactions with persons (natural or legal) from or in countries that do not, or insufficiently, apply the FATF Recommendations. China does not have a mechanism to implement countermeasures against countries that do not sufficiently apply the FATF standards.

6.2.4 Customer Due Diligence

At the level of the banking institutions, there is little evidence to suggest that the majority of the banks in China, especially smaller banks, have been implementing the customer due diligence requirements prior to the adoption of AML “one rule and two measures” in 2003. “One rule and two measures” refer to the Rules for Anti-Money Laundering by Financial Institutions, Administrative Rules for the Reporting of Large-value and Suspicious RMB Payment Transactions, and The Administrative Rules for the Reporting by Financial Institutions of Large-Value and Suspicious Foreign Exchange Transactions. They only applied to the banking, trust and finance sectors. Since 2007 that the AML Law and the "Rules for Anti-Money Laundering by Financial Institutions" and the "Administrative Rules for the Reporting of Large-Value and Suspicious Transaction by Financial Institutions" took effect, the coverage has been extended to cover all financial institutions. All financial institutions and some non-financial institutions are obliged to comply with AML regulation.

In recent years, China has implemented the CDD procedures to combat money laundering in line with Recommendations 5-16 of the FATF 40 dealing with Customer Due Diligence. Article 6 of the AML Law and the Article 9 of the CFLAMLR stipulate that financial institutions are obliged to establish

and implement a comprehensive CDD system. Financial institutions are required to verify the identity of their clients and to collect and update additional information immediately. Financial institutions are required not to deal with clients under the circumstances of anonymity or pseudonymity and no financial services should be offered to clients who do not provide their real identities. A better practice is to develop client business and risk profiles to identify suspicious transactions. Information gathered from a meeting with the Bank of China officials from its Legal and Compliance Department (Morais and Young, 2003) and my interviews with **interviewees C** and **D** suggest that was very encouraging, insofar as it revealed that this major bank had taken several concrete internal measures to sensitize its staff on the problem. These measures include conducting training programs, issuing a detailed “Handbook on Money Laundering”, and implementing strict customer identification procedures. The BOC has also designed formats for reporting of large value and suspicious transactions, meanwhile required record keeping for at least five years. In addition, the BOC works to monitor its overseas branches’ compliance with the laws and the BOC’s policies.

Chinese rules on customer identification were primarily developed for banks including policy and commercial banks, urban and rural credit co-operatives and their unions, and postal saving institutions. Other financial institutions (securities companies, futures brokerage companies, fund management companies, insurance companies and insurance asset management companies, trust and investment companies, finance companies, financial leasing companies, auto finance companies and money brokerage companies) were also implemented at a later stage. However, the FATF 40 definition of financial institutions includes thirteen categories of persons or entities that conduct business in or provide financial services. Within the framework of the PBC’s powers, amendments would therefore be needed to cover such more entities such as portfolio management firms. In addition, the scope of AML regulation should be extended to cover risk prone professions and businesses such as lawyers, accountants, notaries, real estate agents, and company service providers. For example, according to the National Bureau of Statistics, real estate investment in 2006 in China, including Hong Kong and

Macao, was about US\$18bn. Overseas capital investment in mainland real estate was nearly US\$8.25bn, a 51.9 per cent increase from 2005. The National Development and Reform Commission reports, moreover, that foreign investment in real estate during the first quarter of 2007 was US\$1.7bn, up 154.4 per cent from the same period the previous year (Tomlinson and Eich, 2009). The influx of foreign investment in the housing market, along with previous criminal proceeds investments in the Chinese housing market (see the case of I), means that KYC needs to be applied to assess the risk by identifying the real owners of the investors.

The first Chinese regulation requiring the use of real names to open bank accounts was in 2000. In 2003, the use of real name to open accounts was extended to other non bank financial institutions. The requirement of opening a bank account in a real name provided an essential foundation to prevent criminals to use anonymous/pseudonym names to open a bank account and then use a number of bank services to launder their proceeds in a variety of financial institutions. According to Article 16 of the AML Law, financial institutions are prohibited from opening or maintaining anonymous accounts or accounts in fictitious names. Additionally, financial institutions are not allowed to provide services to or conduct transactions with any customer whose identity is yet to be clarified. In China, the KYC procedures appear ineffective due to the checks being superficial and the information gained being only general. **Interviewee A** suggested that the banks only requested the information about the true ownership of the funds verbally and recorded inconsistently. Sometimes, the front line staff even provided the answers, such as the funds of being from the relatives, to the customers when they were stuck to give an answer. In addition, **Interviewee A** indicated that the CDD check on legal persons is less vigorous compared with individuals. She asserted that they assumed the majority of companies are legitimate. She also stated sometimes they were told the companies may have a strong social and political background, which should not be disclosed. She stated if somebody (colleagues) had informed them in advance to 'be careful', they may not take the risk to ask too many questions. **Interviewee A** stated they feared that big shots could be behind the companies and would punish them

for asking tough questions or non co-operation in the future. The account could be opened without the presence of authorised representatives of the legal persons. The ID could be brought and shown by the accountants without many or specific questions. Due to the frequency of the use of anonymous/pseudonym or forged ID cards, the real identify of the legal persons could not be verified should the accountants be willing to facilitate money laundering. Designed CDD/KYC procedures need to be followed and details will now need to be set out. For example, more detailed customer due diligence requirements including identifying specific situations of high and low risk, establishing the true owner, and the true identity bank accounts and policy holders.

Individuals who would like to open accounts in banks, stock market and future market are requested to provide their legitimate identification. However, the issues of how to monitor the existing customers, who opened their accounts prior to the input of CDD policies, need to address. The majority of these existing customers who early entered the market were relatively rich and their wealth was accumulated when the market was less regulated. Nowadays, looking back their history, a number of these people became rich through the ways that have violated the law. Some people are still generating the proceeds in illegitimate ways. If you check the first group of richest people in China listed by the Magazine- Fortune, you will find that a large number of the top Chinese wealthy men were arrested, prosecuted or convicted for a number of reasons such as tax fraud, smuggling, embezzlement, bribery, manipulating the market and etc. It is not news to see giant entrepreneurs, who were rich enough to compete with internationally wealthy people, have fallen. Although a number of then richest Chinese including Zuo Min Yu, Qi Zhong Mou, and Bin Yang nominated by the American Magazine "Forbes" have been penalised for economic crimes, numerous publicly unknown entrepreneurs who became rich from illegal businesses are still at large and unnamed. These criminals took the advantage of their adventures at the early stage of the economic reform. They received special treatment such as the use of financial services that the ordinary people were denied access to. For example, at the beginning period of the establishment of stock market, the rich people were able to open accounts without

queuing to apply for as the public did. They were also able to open accounts with anonymous/pseudonym names or open anonymous accounts without providing legitimate or fictitious identities. The AML KYC procedures do not fit the purpose for these people. The ongoing issue for China is how to manage these accounts in the future to prevent financial institutions from being misused by undetected criminals including the PEPs. **Interviewees A and B** assert that their bank is required by internal policy to apply the same CDD measures to all customers, rather than classifying customer types by risk. Enhanced due diligence for higher risk categories of customer, business relationship or transactions is under performed.

In addition, a concern about the effectiveness of the CDD has been raised. A proportion of Chinese investment is from private equity funds, which require a high level of confidentiality. This contradicts the CDD procedures to identify the beneficial owners and will risk the future investment and business in China. Whether firms will strictly comply with CDD principle to risk the business or turn a blind eye is questionable.

Chinese financial institutions mainly serve Chinese businesses, which have ambitions to enter the international market. These financial institutions are required to comply with international standards and to develop a dynamic compliance programme to enhance their accountability. With the development of the business, it is inevitable that Chinese financial institutions will have a number of international non-personal customers, such as limited companies, partnerships and trusts, locate overseas. The verification of identity requirements for the non-personal customers appears more difficult than that domestically. In addition, the requirements should be generally more onerous than those for individuals, as the number and complexity of the documentation required is significantly greater. Chinese financial institutions will enhance their AML methods due to business opportunity and challenge. As a result, the preventative methods in the context of CDD/KYC need to be improved.

The requirements of setting up AML framework in financial institutions have caused a series of difficulties for new service users. First, prior to the adoption of the AML regime, Chinese citizen could open a bank account without providing their valid identities and they also could deposit money into an anonymous account without being questioned. With the introduction of AML regulation, it is impossible to practice as above. The imposition of the AML regulation does limit the options of their financial activities, although a majority of people are law abiding citizen.

Second, the burden of regulatory compliance will be shifted to customers by increasing the service charges onto them. A report in the Economist (2004) suggests that the direct costs of enforcing AML/CFT regulations to US and European financial firms have been estimated at over US\$5 billion. According to the FATF (2009) money laundering ranged between US Dollar (USD) 590 billion and USD 1.5 trillion. Despite the fact that there is no reliable and updated estimate of the size of the money laundering in recent years, the phenomenon' is stated to be escalating. (Indeed, if one includes the stock of past proceeds as well as the flows, given the tiny amounts confiscated in past and present, the total stock of laundering must be increasing.) The compliance cost as a corresponding consequence also appears to be increasing, though this depends on annual running costs as well as how common system creation costs are. The cost of implementing AML system is modest compared with the size of the worldwide money laundering problem estimated. However, the cost of implementation falls upon firms who are not generally committing or suffering from the predicate crimes directly. Some might argue that this means that it is cost effective to tackle money laundering problems; however, the real seizure of criminal proceeds is far less than the total amount of criminal proceeds estimated. The cost- effectiveness issue is a question that the academics and regulatory authorities would like to find out the answer. Harvey (2008) has conducted a sophisticated approach to evaluate the effectiveness of the measures of reputation, Suspicious Activity Reports (SARs), prosecution and asset recovery. She suggests that there is a difficulty in establishing whether the diligent application and enforcement of rules and regulations has any appreciable impact on money

laundering activity. She also concludes that there is no clear association between compliance and reduction in money laundering. Although it cannot verify that the benefit from the AML regulation outweighs its cost, the AML regulation still works to hamper the activity of money laundering. The AML system is still necessary to reduce the likelihood of financial institutions from being contaminated by criminals. There has been no research identified in regard to the cost to customers in China; however, foreign countries experience can be a useful reference to predicate the total cost of AML requirements to Chinese customers as significant. In pure money terms, customer costs may be modest in ID card systems such as China, but in a country where most people have little disposable income.

Third, individuals will find it is hard and costly to open bank accounts. In China, few financial institutions offer customer services such as free of charge making photocopies for customers, and accepting mail containing documents. The cost of stamps and envelopes will be self provided or charged. Fourth, the practice of following AML check procedure cost people's time. **Interviewees K, L, M, and N** assert that even a brief interview to know your customer will take a longer period of time than previous process. Fifth, the AML regime has made it harder for customers to transfer money across borders. It is a common knowledge that Chinese migrants spread all over the world. It is a tradition that overseas Chinese will always regularly send money back to China for their parents, children, and relatives as a way of caring for their elderly parents, paying for their children's care, improving their family living standards, showing off their achievements in front of their friends or neighbours, and gratitude for their help. Usually, the money might be most of their income and savings, because they do not have much social life or time to spend money in foreign countries. The amount appears large due to the frequent remittance. The AML regulations will increase their difficulties for their family to receive the funds in China. The receivers will provide necessary valid documents to claim the money. If the amount is large and transaction is irregular, which warrants further investigation and even being frozen if the suspicion is strong enough. If such circumstance

occurs, it could take longer time for the receivers to claim the money. AML in China has particularly caused difficulties for illegal migrants in a regulated AML country, who have the same purpose of remitting money back to China. Their transfers are treated the same as if they were sending home money from crimes such as counterfeit product sales and drugs. Illegal migrants do not have legitimate identities in foreign countries to open accounts. They are afraid to seek help from foreign financial institutions or other organizations due to their illegal status. Their poor use of foreign language and isolated status force them to seek alternatives such as Chinese underground banks to complete the transactions. The anti-underground banking campaign in China has increased the commission charges on their transaction and the risk of losing their money if the underground banks are cracked down upon by the Chinese authorities.

Sixth, the AML procedure will delay or put off some legitimate people, who intend to establish some types of businesses such as charities, investment companies, and cash intensive businesses due to the CDD checks and the worries in case they are wrongly suspected of becoming involved in money laundering activities. **Interviewee J** asserts that she is from Shen Yang and opened an account in a future company in Shang Hai in 2006. At that time she was not required to present herself to the company to hand in documentation. The documentation only referred to her identification card. What she did was to fax a copy of her identification card and an account was opened. However, in 2008 she was contacted by the future company and she was told to submit a number of forms, which she should have completed, back-dated and signed when the account was opened. In addition, because that future company does not have a branch in Shen Yang, she was told she must present herself to hand in these documentations in Shang Hai along with her real identification card in line with AML regulation. The cost of travelling to Shang Hai is expensive and time consuming (approximately 2106km). She told me that she eventually was allowed to post these documentations via recorded delivery after she managed to get help from a friend through “Guan xi (relationship)”. However, she was requested to post a photo of her in real life rather than an identification photo. She claimed that she is lucky and

saved some money and time to hand in all her documents backdated. The experience of **interviewee J** indicates that individual customers have been affected in terms of meeting AML regulation. The financial impact from implementing AML regulation on individuals exists and sometimes could be large. This is exaggerated by some factors such as location, the cost of travelling, travelling time and accommodation, the cost of paying for the help if an official approach is not pursued, the cost of postage and photocopies, and the worries about the cancellation and other psychological impact on customers. However, the impact of the AML regulation on a long period of existing service users appears small. **Interviewee J's** experience also indicates that there is a problem in terms of CDD in the securities sector, when the "Guan xi" between the securities companies and their clients is good enough. According to the AML law, financial institutions are not allowed to perform reduced or simplified due diligence with regard to any kind of customer, business relationship or transaction. In addition, financial institutions are not allowed to provide any services to (such as opening an account) or conduct transactions with any customer whose identity is yet to be clarified.

Interviewee C suggests that **interviewee J's** experience was linked to the establishment of China Future Margin Monitoring Centre on the 19th May 2006. This centre began working immediately by issuing a circular of the "Notification of the Service of Saving and Withdrawing Deposit and its Related Issues" on the 26th June 2006. In this circular, five forms in the Appendix Five are required to be completed and stored in customer's file accordingly. In addition, this circular requires the futures company is only to accept funds from bank accounts opened in five state owned banks, namely the Industrial and Commercial Bank of China, Agriculture Bank of China, Bank of China, Construction Bank of China, and Communication Bank of China. The hypothesis is that these banks appear to have strong AML experience and appear safe to work with. It maybe equally big is the fact that **Interviewee J** was not a wealthy or politically connected customer they were afraid to lose. However, **interviewee C** did not react to the above tightened rules in relation to the AML law. He also informs me that for a long term existing customer, the backdated materials are not always required. His

explanation contradicts the requirement of the treatment of existing customers, although it maybe a calculation about expected low checking by regulators. In 2005, the Payment and Settlement Department of the PBC began a verification of all existing “settlement” accounts throughout China to ensure the authenticity, completeness, and compliance of the account information so that this information could be entered into a customer identification system (RMB Settlement Account Administration System). It also breached the securities sector’s obligation to keep updated and ongoing due diligence (Article 24 SRC measures).

The experience of **interviewee J** suggests that the China’s AML initiatives were taken into effects in the security sector only a few years ago. The Regulations of Securities Account came into force on the 1st of June 2002, and has strong control over the opening of securities accounts. It requires that an ID card and other official documents be presented when opening a security account. There is a concern that opening accounts under an authentic name is not the same as trading with true identification. Further complicating the situation, transactions taking place through the Internet and over the telephone are growing rapidly. It is hardly possible to require shareholders to deal with securities with authentic identification in such instances. Thus, in case criminals may make use of the securities market to launder money, investigators must devote a great deal of attention to this aspect of the problem. Given the fact that China just commenced its AML initiatives in such a short period and it would be reasonable to conclude that the AML actions will focus on the new customers who open accounts in security and other financial institutions. With the increase in operational experience, resource, accountability, reference of international experience, and along with a series of scandal of ML committed by existing customers in the future, the work on reviewing existing customers can be adequately developed.

Meanwhile international recognized methods for CDD check need to be absorbed critically. For example, international initiatives allow CDD checks resorting to third party information. It is,

however, unlikely to work in China. Client resource is the highest commercial secret in Chinese firms due to challengeable competitions in China. It is easy to conclude that information exchange among these commercial firms is hard to occur. In addition, different firms have different CDD procedures and risk assessment in line with the nature of the businesses. They focus on different customers with different risks and their information might be useful for other firms to rely on.

Interviews with **interviewees B, C, D, E and F** have drawn a similar conclusion that the majority of financial institutions have complied with the basic requirements of the CFLAML, although the degrees of compliance vary. Client identity verification; suspicious transactions and large transactions reporting; records of client information and transactions record keeping for at least five years have been implemented in banks, investment banking, fund management, security and future companies. In comparison, banks appear more active by implementing the CFLAML in a relatively comprehensive approach. According to **interviewees A and B** the Bank of China is the earliest bank taking action to combat the crime of money laundering as it is the first Chinese bank with overseas branches, which need to meet the host countries' AML regulation and law. They assert that the BOC has been engaged in AML campaign. The campaign was particularly active in 2003 when the banks were first required to take the action to against money laundering. One of the vice bank governors took the lead in the AML campaign in 2003. The issue of AML was always mentioned in the remarks made by bank senior managers in staff meeting at the initial campaign stage. The BOC provincial branch has integrated AML work into its Supervision Department and established a permanent AML Administrative Office. There are regular staff training and internal circulars instructing how to identify suspicious transactions and requesting to monitor particular individuals' bank accounts. The BOC has also taken social responsibility by promoting AML campaign on the street. They have provided information to the public and disseminate AML leaflets during a period of time. In recent, these actions appeared to slow down. The frequency of the topic on Money Laundering and the number of AML internal circulars have decreased. Anti-money laundering has been integrated into normal

business process. They inform me that two permanent staff in city level of the BOC currently work to monitor and provide a report monthly to the AML Supervision Department of provincial level of the BOC. The AML regulation is hung on the wall in the clients' waiting and service areas, leaflets are also available to be picked up. When required, the staff will be able to provide information about the AML regulations. The BOC also receives regular inspections from the PBC, also undertakes regular or random inspections on district level of the BOC in the context of the AML regulation compliance status and the effectiveness of preventative measurements. It can be seen that there is a withdrawal in terms of the attitudes towards AML initiatives and motivation in recent years, although in general the BOC has been making consistent efforts to address money laundering issues.

Non bank financial institutions, however, appear inconsistent to address the issue of AML.

Interviewees B, E and F assert that before the adoption of the CFLAMLR, there was lack of internal control system to address criminal accounts and proceeds. The transaction office was even buyable from these companies. The funds were accepted by cash and could be transmitted to any accounts required by their clients without CDD check and control. For example, funds from the accounts of companies could be transferred to individual accounts and from individuals to companies' accounts. However, the input of the CFLAMLR has not only required non-bank financial institutions to build up their internal control system to combat money laundering, but also has changed the way that these companies to receive funds. No these companies are allowed to accept funds in cash any longer and the funds must be transferred from the bank. At the beginning stage of the announcement of the CFLAMLR, these financial institutions were very active and the CFLAMLR was implemented in a short time. The AML work has been led by the chief risk manager, who has an equivalent level to a deputy director of the company. However, there have been no designated money laundering compliance officers. The interviewees also suggest that the AML work is not a new task for them any more and has become their routine activity in their work. The situation of AML has calmed down and remained stable. The above situations in banks and non-bank financial institutions indicate that both

banks and non bank financial institutions began combating money laundering. The incentives appeared reduced and the impact of the CFLAMLIR on financial institutions was immediate and aggressive initially have begun to be buffered. Chinese banks have been mostly and throughout affected as they have taken the overall task and responsibility of the initiatives of AML, although non-bank financial institutions do contribute to CDD process. As a result, the internal control system is largely addressed by banking institutions at the moment, which plays a major role in keeping updated to meet international standards requested by the FATF.

The increased preventative work has not driven an increased AML supervision and enforcement, but also improved internal risk control mechanism in financial institutions. The Spokesman of the People's Bank of China Zhao Wen Wang (2005) commented that 31 bank governors or vice governors were sacked within one year special campaign. A total of 3045 bank staff were penalised for their criminal offences and breach of regulations and rules. A number of 65 Bank Fraud cases were discovered and ¥494 million (£32.93million) were recovered. According to the 2007 Chinese Anti-money Laundering Report released by the People's Bank of China, 4,533 financial institutions were subject to on-site inspection by the central bank, and 350 of these were punished for infringements of the regulations with the total fines amounting to RMB26.52 million. Of the 350 institutions, a total of 341 are banking financial institutions, four are in the securities and futures industry, and the other five are in the insurance industry. Of these 347 institutions failed to verify customer ID or to report large-value transactions and suspicious transactions in accordance with relative regulations, and three failed to set up anti-money laundering internal control system. 54.55% of all the punished institutions are state-owned and joint-stock commercial banks; and 97.95% of the 350 institutions are Chinese-funded (PBC, 2008).

6.3 Enforcement

In China, law enforcement agencies comprise the MSS, the MPS, the Department of People's Procuratorate (DPP), and their subordinate bodies of provincial, municipalities, regional, city, town and village levels. The MSS is not only an intelligence body, but also has law enforcement powers. The MSS is responsible for investigating terrorist crimes threatening state security, terrorist financing crimes and related money laundering. The DPP has the functions of (1) undertaking the prosecution of money laundering and terrorist financing, and (2) law enforcement agency role of investigating corruption and bribery, and their related money laundering. The MPS is the major AML law enforcement body, investigating ML cases on the basis of intelligence from the FIU and clues from other resources, along with their other anti-crime commitments such as combating drug trafficking and smuggling. The Penal Code, AML Law and have required each law enforcement agency to have an AML responsibility. Internal regulation and rules in regard to AML investigation have been circulated within the law enforcement agencies. According to "the Regulation of Economic Crime Investigation and Prosecution Standards" made by the DPP and MPS, five scenarios meet the criteria of money laundering investigation and prosecution. First is to provide fund and bank accounts. Second is to assist to turn the assets into cash or financial coupon. Third is to assist to transfer proceeds through accounts transfer or other financial transaction methods. Fourth is to assist to transfer money abroad. Fifth is to use other methods to hide criminal proceeds, profits and origins.

There are two direct costs, namely compliance and enforcement cost, associated with money laundering enforcement. There is no doubt that Chinese Police have a long history of investigating many of the predicate offences of money laundering (even though the financial aspects of the predicate offences may not have been emphasised in the past). However, in regard to money laundering, China just began to develop its specialised knowledge and skills of investigation and prosecution. It needs a considerable time and efforts for China to develop its own AML enforcement

system. As a result, a considerable human resource and financial input to address money laundering issue in law enforcement agencies are convincible. It also could be subject to pressure of AML needs. The introduction of AML law has brought a number of changes in the law enforcement agencies. These include the establishment of a designated unit to combat money laundering, the development of specialised money laundering investigative knowledge, skills and techniques. Computer experts needed to be recruited. Related AML training programmes for all level of AML agents need to be organised. Prosecutions against money laundering need to be launched. Co-operation with international and regional law enforcement agencies in the context of combating money laundering needs to be strengthened. For example, in early 2002, the MPS established an AML Department in its central Economic Crime Investigation Bureau. A similar Anti-Crime Force was also required to be established in various levels of the Police Force. Money laundering investigation Police Officers were assigned to attend international law enforcement meetings in France, Russia, Indonesia and Hong Kong to gain experience (People daily, 2003). According to a report from the National Economic Crime Force Development Meeting in 2006, approximately 80% of the Police Force at the level of town, city and province has established an Economic Investigation Force to combat economic crimes. The number of investigators increased from approximately 25,000 when the Economic Crime Investigation Department (ECID) was established in 1998 to approximately 36,000 in 2006. In addition, the strategies of crime prevention, management and co-operation have been updated in accordance with the increasing number and type of economic crimes including money laundering. At the end of 2005, the ECID was structurally reformed. The number of departments was reduced on the basis of best gathering criminal intelligence, directing, instructing and co-operating various level Economic Investigation Departments' investigation on serious economic crimes (ECID, 2008). The law enforcement bodies to combat money laundering have been established.

6.3.1 Predicate Offences

Prior to the adoption of the AML Law, there was only one Article (Article 191) that defined seven categories of predicate offences. It has not fully corresponded with the 20 categories of designated FATF categories of predicate offences. In this sense, the scope of clearly identified predicate offences of money laundering in Article 191 has not matched international standards of “40+9 recommendations” required by the FATF, which request the states to “apply the crime of money laundering to all serious offences, with a view to including the widest range of predicate offences. Predicate offences may be described by reference to all offences, or to a threshold linked either to a category of serious offences or to the penalty of imprisonment applicable to the predicate offence (threshold approach), or to a list of predicate offences, or a combination of these approaches” (FATF, 2008).

The coverage of predicate offences is important to ensure the effectiveness of AML efforts. In the preparation stage of the AML Law, a consideration of extending certain serious offences with great profitable margin as money laundering’s upstream offences was evident. It is reported that there is a delay in the promulgation of the Chinese AML law due to the disagreement on predicate offences. According to The Legal Daily in 2005, there is a dispute about the coverage of money laundering predicate offences between members of the AML Law drafting group and the CNPCSC Legislation Committee responsible for drafting the revision to the Criminal Law. The former intend to adopt comprehensive categories of predicate offences in line with some jurisdictions such as the United Kingdom, which has extended the list to the proceeds of all crime. The latter held the view that seven categories of money laundering were sufficient to address the contemporary Chinese money laundering problems. The dilemma is if the coverage is too wide, there is lack of priority and it will result in costly compliance; and if the coverage is too narrow, it is likely to miss other serious predicate offences and undermine the whole AML effectiveness. As a result, the Chinese AML Law was finalised with a compromise of both echoing international experience and reflecting domestic priorities. The definition of AML has amended in Article 2 of the AML legislation, which adds “and

other crimes” along with the seven predicate offences defined in the amendment of the Criminal Law in 2006. The FATF suggests states combat the proceeds of all serious offences. There is, however, a level of discretion with respect to the list of crimes countries would like to adopt. This approach has not conflicted with international standards, even if it does not meet the higher ones.

The Chinese 2006 AML report reveals the effectiveness of those defined predicate offences. The Chart 5-16 shows that the highest number of detected predicate offences of money laundering was the offence of violating the Socialist market economic order, which presented 43%. The second highest number of money laundering predicate offence was tax offences amounting to 15%. Financial fraud came the third occupying 9%. The offences of drug trafficking, smuggling, embezzlement and bribery were 6% respectively. The data suggests that drug trafficking and smuggling seem not to have played an as important role in laundering money through financial institutions as previously assumed. It could be the reasons that these offences need a considerable amount of cash to purchase their materials or products and do not need to or have spare money to be laundered into white for their savings or they have laundered their criminal proceeds abroad without entering Chinese financial institutions. New problem areas of the link between tax offences and gambling and money laundering have been identified and need attention. The table, however, does not suggest the link between money laundering and Terrorism.

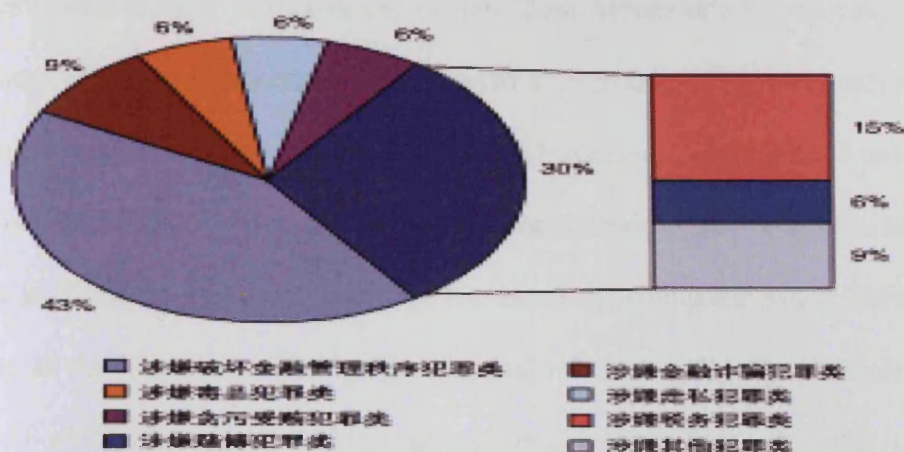


图 5-16 2006 年洗钱案件涉嫌上游犯罪类型分布

Chart 5-16 The Typology of Predicate Offences of Money Laundering in 2006

In addition, in 2002, People Daily Newspaper reported a consensus figure estimated from the predicated offences of money laundering as that money laundering in the Chinese mainland must be up to a yearly sum of ¥200 billion (£20 billion). The loss from money laundering could be divided into three parts: ¥70 billion (£7 billion) of smuggling gain, ¥30 billion (£3 billion) of embezzlement, and a transferred amount of tax evasion from foreign-funded companies. It can be seen that the pie chart does not concur with the assumption on the predicate offences of money laundering defined by China prior to the adoption of the AML Law. The report in 2002 and data gathered in 2006 clearly contradict each other. The difference suggests that the new AML Law promulgated in 2006 has a wider coverage of money laundering predicate offences and appear to better address key contemporary China's money laundering predicate offences than the previous AML articles in 1997 Penal Code and 2003 AML regulation. The result from the pie chart suggests that the newly defined predicate offences in 2006-violating the Socialist market economic order, financial fraud, and corruption- have corresponded with the major contemporary Chinese profit-driven offences and indicate the extent of these crimes.

The Chinese market is notorious for fraud and market abuse, among which the biggest problem is price manipulation and insider trading (Cheng, 2008). The amount of profit from manipulating

securities prices is vast. For instance, in the China Motorcycle Group case in 1999, the Securities Department of China Motorcycle Group traded ¥5.8 million Ji Nan Motorcycle shares, based on the inside information of annual earnings of Ji Nan Motorcycle, and realized unlawful profits of ¥25.42 million (Cheng, 2008). The Socialist market economic order has been breached by these insiders. In China it is illegal to trade securities on the basis of having the inside information of a securities company. In the Yin Chuan Guang Xia case in 2002, Guang Xia Co., fabricated a huge sum of ¥745 million of profit by way of making up export contracts, fabricating the list of exports, boosting performance, creating false annual reports and disclosing phoney information. When the frauds surfaced, the company quickly collapsed, leaving 14,245 shareholders with millions of dollars in losses (Cheng, 2008). Social instability and the Socialist market economic order are undermined. The 1997 Penal Code criminalized insider trading in its Article 180 that

“insider traders shall be sentenced to not more than five years in prison or criminal detention provided the circumstances are serious. They shall be fined, additionally or exclusively, a sum not less than 100 percent and not more than 500 percent as high as their illegal proceeds. If the circumstances are especially serious, they shall be sentenced to not less than five years and not more than 10 years in prison. In addition, they shall be fined a sum not less than 100 percent and not more than 500 percent as high as their illegal proceeds”

The article stipulates that the punishment is linked to the amount of illegal proceeds. To prevent their criminal proceeds from being identified and seized, laundering these criminal proceeds with legitimate appearance appears to be ideal option. The newly identified predicate offences in the AML law seemed to be evidence based or sensibly defined rather than those assumed previously. The evidence indicates that Chinese AML system may have become more effective for some offences; however, it is hard to know how the AML regulation affects offending levels.

Furthermore, it is worth noting that apart from Chinese defined predicate offences including organised crime (mainly violent offences committed by criminal syndicates such as racketeering, kidnapping, robbery) drug trafficking, smuggling, fraud, and corruption, other indicative crimes such as human trafficking and illegal gambling evidenced by the chapter five, have also involved in money laundering activities. In reality, there are many other serious offences or profit-driven offences including sexual trade, counterfeiting, environment crimes, copyright and intellectual infringement should not be discounted in terms of the amounts of criminal proceeds generated. These crimes are capable of generating substantial financial rewards for criminals. Therefore, a consideration should be taken to further list these crimes into the categories of predicate offences in the AML Law. It is useful to guide law enforcement agencies to focus on more serious and harmful predicate offences. The proper extension of money laundering predicate offences may increase the deterrent influence, achieve a better effectiveness of confiscating criminal proceeds, and may suppress profitable crimes as a whole.

Indeed, there are issues that China needs to consider to improve. One, there is an issue of overlap on the money laundering predicate offences defined among three Articles 191, 312 and 349 in Chinese Criminal Law (see Appendix Six). The Article 349 specifically targets drug-related crimes as money laundering predicate offences. The Article 191 applies a list of seven categories of predicate offences, including drug offences. In a whole, Article 312 takes an “all-crime” approach and can be used to fill in the gap that Article 191 and 349 cannot cover. In terms of brevity, the provisions to govern money laundering need to be unified.

Second, the Terrorist Financing Offence of Article 120 PC does not explain the definition of terrorist activities and difference from separatism. In China, separatism is viewed as terrorism and judgment of terrorist activities is subject to judicial authorities’ decision on the basis of referring to Terrorist Financing Convention. The Article also does not cover a sufficient range of activities compared with

the FATF standards required. For example, the law criminalises supplying funds, but has not criminalised the collection of terrorist funds.

6.3.1.1 The Impact on Drug Trafficking

Money laundering as a term originates from combating drug trafficking. Due to China’s geographic character, China has been identified as the transit route of drug trafficking internationally. The AML measures have been actively applied in the campaign against drug trafficking in China. Apparently the efforts were concentrated in the Province of Yun Nan, which is well-known for drug trafficking due to its proximity to the Golden Triangle. According to the 2006 AML report, the PBC provided great support for its special anti- drug campaign in Yun Nan Province. Approximately 600,000 suspicious reports involving ¥150 million (£15million) were gathered in 2006. The PBC instigated 20 administrative investigations on money laundering; provided 43 suspicious clues to the local Police; assisted the local Police to monitor 876 suspicious bank accounts; and helped to detect two money laundering cases in relation to drug trafficking, although only one money laundering case has been convicted in relation to drug trafficking. According to the First Mutual Evaluation Report on Anti-Money Laundering and Combating the Financing of Terrorism completed by the FATF (2007) between 2002 and 2006, a total of 130 cases were convicted for breaching the Article 349 of “Harbouring, transferring or covering up narcotic drugs or their pecuniary and other gains” in the Criminal Law and 146 offenders were convicted, 17 offenders received imprisonment sentences of more than five years, and 91 offenders received custody of less than five years. Compared with the new anti-drug methods of following drug money to offenders and conventional anti-crime methods, the latter is more effective than the pursuit of the money trail to track down drug trafficking.

6.3.1.2 Impact on Underground Banking

According to the 2006 AML report, over 70 underground banks were cracked down involving US\$3.031 billion, among which US\$6.6551 million cash was recovered and ¥41.4428 million was

confiscated. A total of 746 bank accounts were frozen and 102 suspects were arrested. However, no conviction rate was reported and the proceeds confiscated appeared minor in the total of reported proceeds involved. The chart 5-17 shows the highest number of underground banks detected and money launderers arrested was in 2004, after the first AML regulation was announced in 2003. The AML regulation at that time appeared effectively to suppress the activities of underground banking before 2004. The number of detected underground banks and underground bankers arrested was then falling. The fluctuation could mean that the 2003 AML regulation was so effective and underground bankers' incentive to operate their businesses was diminished. It could be the result of increased underground bankers' vigilance and secrecy when operating their businesses. It could be the result of underground bankers having adopted new skills and measurement to counter law enforcement investigation without being identified. It could be the result of improved official financial services to reduce the public's incentives to use underground banking service, and or the result of the priority of the law enforcement agencies having changed after a successful intervention within one year. The fluctuated number of detected underground banks and arrested underground bankers reflects the evolution of AML regulation. Each time when the regulation was made, the figure rose. The table could indicate that underground banking activity is dynamic and changes in accordance with the changes of the regulation and law. Conversely, the regulation and law are amended to suppress these activities following the new problem areas identified. It is difficult to predict the practice of underground banking and too hard to make an effective AML regulation and law without changes. The 2006 AML report, however, did not mention how much money was laundered through underground banking and even if it had done so, it might well have been wrong. The extent of the impact on money laundering by punishing underground banking is unclear.

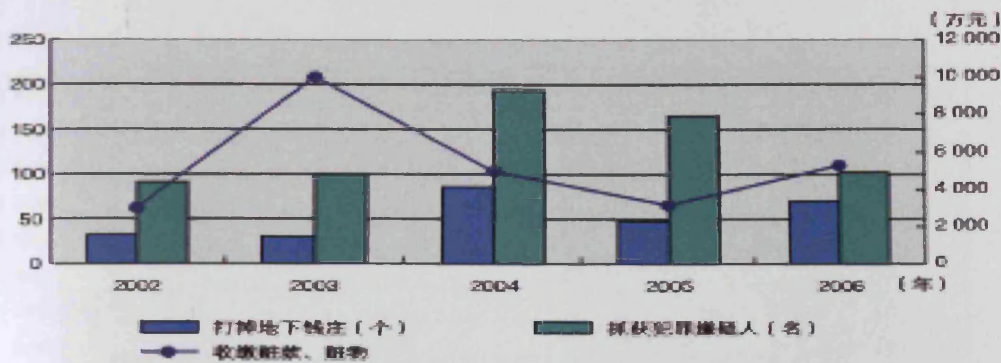


图 5-17 2002-2006 年全国打击地下钱庄情况

Chart 5-17 2002-2006 The Information on Investigating Underground Banking

6.3.2 Investigation

According to the three stages of money laundering, if money launderers want to launder their proceeds in financial institutions, financial institutions is the place will most benefit money laundering investigation by providing information on criminal accounts and transactions. According to the 2006 AML report, the PBC and its Branches have provided 1,239 crime clues involving in proceeds worth of approximately ¥387.13 billion (£25.8 billion) in 2006. From the chart 5-13 below, it can be seen that the number of crime clues fluctuated, which increased sharply between 2003 and 2006, but fell down dramatically in 2007. The reasons for such differences could be the political pressure to pursue the CFLAMLR prior to its announcement before 2006. It could be because money launders were unaware of the operation of China's AML programme before 2005, but developed counter AML strategies due to their suffering in one year. It could be financial institutions' increased skills, knowledge, and experience in assessing the level of risk of money laundering. It could be an improved co-operation mechanism between the PBC and law enforcement agencies to work on the quality issues of crime intelligence. In addition, a significant increase in the number of proceeds involved in these crime clues suggests improved knowledge and skills on identifying high risk cases.

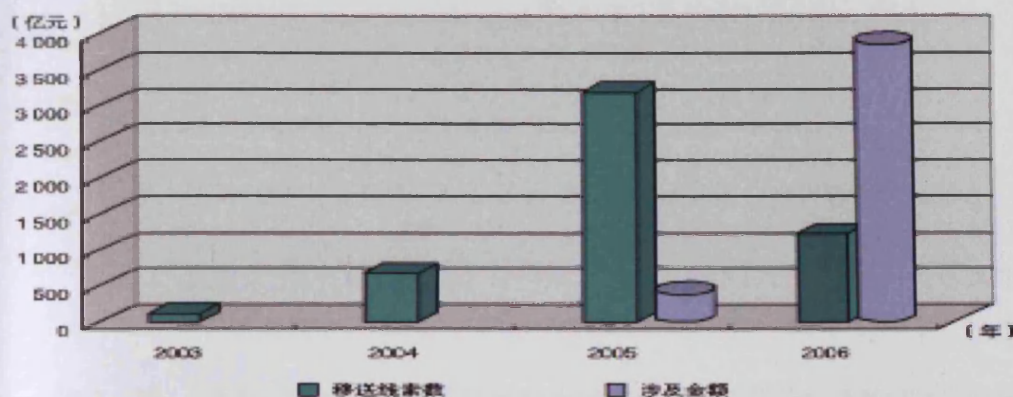


图 5-13 2003 ~ 2006 年中国人民银行向侦查机关移送涉嫌洗钱犯罪线索

注：2003 年数据为国家外汇管理局向公安机关移送线索情况统计。

Chart 5-13 2003-2006 The Number of Crime Clues Provided by the PBC

The chart 5-15 indicates a steady increase in the number of detected money laundering cases, although the number in 2005 is not far off that in 2006. In addition, the proceeds involved in the detected money laundering cases are seen to rise stably between 2003 and 2005, but radically increased in 2006. The reason for the sudden increase in the number of proceeds could be the effects of the input and implementation of the AML regulation. The new regulations enabled financial institutions to increase their money laundering awareness, and to improve the quality of their risk assessment. It suggests that the cases picked up were prone to be higher risk and were involved in large amounts of proceeds, although the numbers of cases detected were similar between 2005 and 2006.

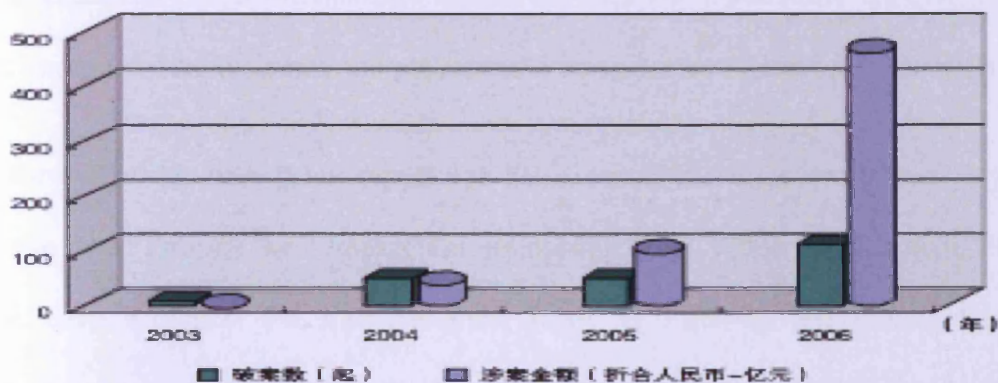


图 5-15 2003-2006 年中国人民银行协助破获涉嫌洗钱案件数量和涉案金额
注：2003 年数据为国家外汇管理局协助公安机关破获涉嫌洗钱案件数据统计。

Chart 5-15 2003-2006 The Number of Detected Money Laundering Cases and the Amount of Proceeds Involved with the Assistance of the PBC

According to the First Mutual Evaluation Report on Anti-Money Laundering and Combating the Financing of Terrorism completed by the FATF in June 2007, between 2002 and 2006 a total number of 23 cases were investigated, three cases were prosecuted, and four defendants were convicted. All four convicted offenders received both fine and custody for no more than five years. The total number of fines was ¥6.78 million (£0.678 million). ¥1 million (£66,667) and a car were confiscated. The number of convictions, severity of punishment, and confiscated proceeds on these money laundering offenders within four years period appears far less than the cost of implementing AML regulation obviously due to the abovementioned efforts made, although the actual cost of implementing AML regulation is unknown. In general, the low number of investigations, the prosecution and convictions rate, and proceeds confiscated suggests that the effectiveness of AML regulation is limited. The poor AML result compared with the massive media reports on the seriousness of money laundering indicate an ineffectiveness of Chinese AML regime due to the fact that only few money launderers have been deprived from their proceeds. The majority of criminals still enjoy their proceeds without being seriously undermined. The positive achievement is that China has gradually built up an AML network

to in accordance with international standards. Financial institutions' awareness of money laundering has improved over the years and preventative measurements have been put in place.

According to the 2006 AML report, the PBC identified a large number of suspicious transactions in certain areas through their transaction monitoring 2006. These areas include Guang Dong Province, Zhe Jiang Province, Fu Jian Province, Shan Xi Province and Chong Qing city, where 1599 administrative investigations took place. Resource should be used in line with the level of risk. The higher risk area has required higher level of resources. The above areas are the places with higher frequency and dense of drug trafficking, organised crime (mainly violent offences committed by criminal syndicates), smuggling and violating financial administrative order. The heroin from the Golden Triangle area was trafficked in southern China through either Yun Nan or Guang Xi Provinces to either Guangdong or Fu Jian Provinces to Chinese south-eastern coastal areas, and then on to international markets. Increasing quantities of heroin are transported to Guangdong Province and to the cities of Xia Men and Fu Zhou in Fu Jian Province for shipment to international drug markets (DEA, 2004). In addition, approximately 20 percent of the heroin from the Golden Crescent area that goes into areas in northwest China, like Xin Jiang, Gan Su and Shan Xi. Economic reforms and openings to the West encouraged criminal groups based in Hong Kong, Macau, and Taiwan to expand into the southern China provinces of Guangdong, Fu Jian, Zhe Jian, and Yun Nan (DEA, 2004). Having established narcotics connections in the Golden Triangle adjacent to Yun Nan Province and a strong demand for migrant trafficking in Fu Jian and Zhe Jian provinces, these groups now constitute a third source of transnational Chinese crime (Curtis et al, 2004).

Furthermore, smuggling is active in the coastal areas of Shi Shi, Jin Jiang of Fujian Province, Dong Xing, Fang Cheng along the China-Vietnam border in Guangxi, as well as areas near the Bei Bu Bay, Bei Lun He River, Zhu Jiang River, eastern Guangzhou and northeast China. The typology of commodities smuggled is oil, cigarette, medical and chemical products along Zhu Jiang River; rubber,

cigarette in Bei Lun River and Bei Bu Bay; autos and drugs in border areas of northeast China (People Daily, 2002). The areas that China actively monitored were the areas where the predicate offences of money laundering were more active. The intensive inspection in these areas would have strengthened and benefited the local AML campaign programme against money laundering. Although the 2006 AML Report did not provide additional information other than that mentioned above. It can still be seen from the table below that China also particularly acted in an aggressive manner in the area of Xin Jiang and Yu Nan, which are well known for terrorism and drug trafficking respectively. The below chart also suggests that some areas need more proactive approaches with more resources, although the suspicious transactions appear less problematic. These areas include Ji Lin Province, which is bordered with North Korea and at risk of drug trafficking, and where the number of the administrative investigation is between 0 and 1. Gan Su Province is the drug transit route from the Golden Crescent, and where the administrative investigation is between 0 and 1 as well. A concerning point is that money launderers seek to launder criminal proceeds in the areas, where the AML regime is weak. The aggressive actions in some areas might drive money launderers to seek the areas with weak AML control. The white areas in below table could be the potential new markets and needs to draw an attention.

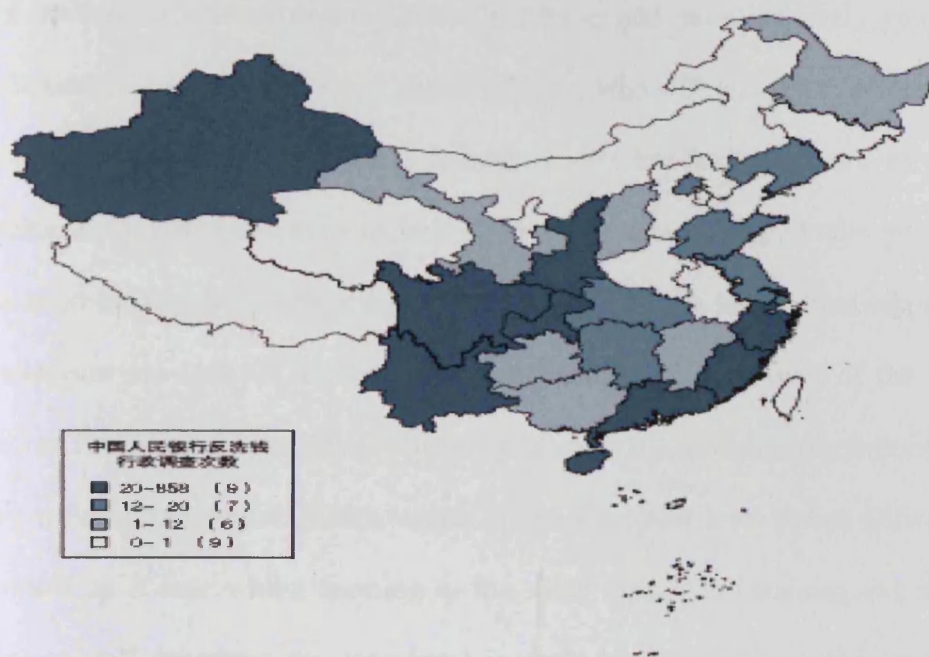


图 5-11 2006 年中国人民银行及省一级分支机构反洗钱行政调查地区分布情况

注：括号内数字表示省（自治区、直辖市）的个数。

Chart 5-11 The PBC and Provincial Branch AML Administrative Investigation Typology in 2006

The impact on the law enforcement agencies would be the integration in the institutional framework whilst conducting ordinary policing work. The interviews with Chinese Police Officers **F**, **G**, **H** and **I** indicate that the traditional law enforcement investigative methods face challenge in regard to investigating money laundering cases due to the differential between money laundering and conventional crimes. First, there is lack of identifiable crime scene whilst money laundering is committed. The Police find it is difficult to put their hands on. Second, there is lack of identifiable victim and intangible consequences. The Police find it is difficult to complete victim or witness statements and to press charges. Third, money laundering cases usually involve in breaching a number of laws and regulations and crossing a number of sectors, which will increase the difficulties on crime investigation due to the need of having various specialized knowledge and undertaking liaison work among multi-agencies. A number of law enforcement agents originate from retired army officers and relatively old police officers, as the Economic Crime Investigation Department is professionally recognized as a place unsuitable for young investigators. Conventional beliefs are that the younger

you are, the less experience and resilience you have, and the more likely you will be corrupted in future. Senior managers prefer experienced officers, who will take more responsibility towards their behaviour and make less trouble for their management and liability. However, due to their ages and experiences, these officers appear to have more difficulties compared with young Police Officers to accept new knowledge and technologies. Four Police Officers interviewed admitted that a number of their colleagues are lack of interest and understanding on the extent of the changes of laws and regulations. They do not have time voluntarily to study the laws and regulations, and are hardly been provided with training opportunities, especially on the lower level Police Officer. They asserted that they worked on a case whilst learning at the same time. Even training events are available; most enforcement staff members are immersed in their heavy workload and therefore find little time participating in these training opportunities. The lack of updated knowledge and up to date training opportunities has become a disadvantage of money laundering investigation.

Fourth, perpetrators are from various social backgrounds and some are highly respected individuals on occasions. **Interviewees F and G** disclosed that they found it was easily to target professional criminals, but due to the nature of money laundering, they found their previous working experience did help a lot. Their informants appeared not to be able to provide money laundering crime clues. On occasions they were unable to continue the investigation as the instruction from the top management due to political interference and a consideration of social impact. For example, the state council requires 75 percent of new listed securities companies must be state owned companies. Should these companies be involved in money laundering cases, the Police find it difficult to complete investigation due to political concerns.

Fifth, money laundering cases sometimes are complex and sometimes are straightforward and easy to be detected. Notwithstanding research evidence from Western prosecutions to the contrary (Levi and Reuter, 2009), money laundering is commonly believed as a crime with secrecy, advanced

professionalism, and complex operation. Money laundering is a planned crime and its goal is to make criminal proceeds appear legitimate by using various methods. This, at the same time, increases the difficulties of following the money trail. **Interviewees F, G, H, and I** had consent that the investigation usually takes a long period of time due to the monitoring and analysis of financial transactions, given some complexity cases including intermingling funds from crime and legitimate businesses. They also indicated sometimes they felt the cases could not be followed up by the Prosecution Service and the Court. They assert that most money laundering cases they are aware of were conducted by those individuals who were involved in the predicate offending, rather than being committed by professionals who are engaged in laundering as a separate criminal activity that is not clearly connected to the underlying predicate offending. Also, money laundering on occasions does appear simple and easy to be detected. **Interviewee G** tells me that on one occasion, a money launderer was arrested when he was smuggling a large amount of cash.

Sixth, the investigation may be politically interfered with where cases involved key members of the Communist Party, key taxpayers either state owned enterprises or individuals with strong political background, foreign investment, and etc. Chinese law enforcement agencies sometimes lack investigative independence when information gathered is believed to have negative impact on the Communist Party and public; or the alleged offences will lead to the disclosure of state or business secrets, and should not be disclosed to the public or foreign countries. Instead of executing policing, prosecuting and sentencing power, administrative sanctions such as educational and disciplinary measures are used as a less punitive punishment and alternative. As a result, these sanctions can be arbitrary or manipulated by corrupt government officials. One of the examples was provided by the **interviewee I** that a high level government official who committed corruption first and then laundered their criminal proceeds. The case was requested to be transferred to the Anti-Corruption Bureau and no information of prosecution has been heard since. According to an interview conducted by Cheng (2008), a senior regulator explained the reason for lack of power to investigate discovered insider

trading cases as “actually we did discover a large number of cases through our detection efforts. But the Party disciplinary committees wanted to deal with them through the Party and government’s internal disciplinary measures, because they didn’t want those cases to dilute the reputation of China, the stability of Chinese capital markets”.

Seventh, detected cases indicate that criminals are prone to collaborate with corrupt law enforcement agents and bankers to jointly launder criminal proceeds. For example, the largest financial fraud case of “7.28” in Tai Yuan of Shan Xi Province in Chinese history was reported in 2005 (Wang, 2005) that only Industrial and Commercial Bank of China out of four state owned banks was not involved in the scandal. A number of commercial banks including Jiao Tong (Communication Bank of China) and Guang Da banks, security and trust companies, along with other three state owned banks were all involved in fraud and money laundering. Convicted bankers worked with outside criminals to transfer state asset through making false seals, and fake cheques to transfer funds to other accounts and then used a number of methods such as withdrawing cash to launder money. The alleged money involved was over ¥2 billion Chinese (£133.3 million). The Director of Anti-Corruption Bureau in Tai Yuan City Ju Ying Jia was arrested for tipping off, assisting criminals to abscond, disrupting investigation, bribery, and money laundering. The Police interviewees suggest that the majority of senior Police officers have connection with local criminal gangs or wealthy business entrepreneurs. They should have some awareness of investigating cases linked to these suspects. Certainly the delayed investigation and likely tip off would undermine the money laundering investigation.

Eighth, the trend of money laundering is to search using high technology and involving more specialized professionals. These professionals have more investigative prevention awareness and strategies, and are capable of innovating new ways to try to beyond the reach of AML investigation. As the Financial Action Task Force on Money Laundering, the international organisation concerned with strengthening AML provisions in the global financial system, has observed:

“As anti-money laundering measures are implemented in financial institutions, the risk of detection becomes greater for those seeking to use the banking system for laundering criminal proceeds. Increasingly, money launderers seek out the advice or services of specialised professionals to help facilitate their financial operations. Solicitors [and] accountants...provide advice to individuals and businesses in such matters as investment, company formation, trusts and other legal arrangements, as well as optimisation of tax situation. Additionally, legal professionals prepare and, as appropriate, file necessary paperwork for the setting up of corporate vehicles or other legal arrangements. Finally, some of these professionals may be directly involved in carrying out specific types of financial transactions (holding or paying out funds relating to the purchase or sale of real estate, for example) on behalf of their clients (FATF, 2004)”. The interviewees were concerned about professionals, who assisted money laundering but they had not come across a case in their jurisdictions. They also informed me that money was not necessary to be laundered abroad, but might cover a couple of cities and neighbouring provinces.”

The money laundering investigation requires multi-agencies approach such as liaising with financial institutions to monitor and block financial transactions, and to freeze bank accounts. The new requirement has changed the way of the Police's gathering crime clues from being the receiver to a proactive crime clue collector. In 2005, “The Co-operation Rules of Verification of Suspected Transaction Clue” was jointly published by the MPS and the PBC. In addition, the MPS assigned an AML Liaison Officer, who permanently works to examine criminal clues of money laundering in the PBC at the end of 2005 (Schulte-Kulmann, 2007). The Police and banking interviewees all agreed that there had been an improvement in terms of the working relationship between the Police and financial institutions, although it was a problem to access the data kept by the financial institutions in the past. They believed it was part of the effect of the AML law and regulation promulgated and responsibility of the PBC required in the role of combating money laundering. One of the interviewees

(**interviewee F**) stated that he would not need to solely rely on his own personal relationship with financial institution staff to resolve work related issues. However, another **interviewee G** expressed his concern that the easier and quicker way to access the information and assistant is to use his own personal contacts within the financial institutions. It can be seen there is lack of an established procedure in terms of AML co-operation between financial institutions and law enforcement agencies. These two sectors have different values and priorities. Financial institutions focus on self-regulation, internal control, and supervision. Law enforcement agencies; however, concentrate on crime investigation, prosecution, conviction, confiscation, and punishment. China needs to further work on the co-operations among deferent departments and sectors. China needs to develop a positive working relationship to reconcile two AML goals of compliance and results.

Ninth, a concern has been raised in terms of police co-operation among different regions. The regional and local police forces are organs of the regional and local Councils, who pay the Police salary or largely contribute to the Police budgets. The budget is from local tax revenue, which depends on the local economic situation and the number of taxpayers. Due to the Police action involving in asset freezing and confiscation, **interviewees F** and **G** gave their experience of having difficulties in a money laundering investigation. They assert that the suspect was well-known as being one of the largest tax payers in the area, where they made a request to the local Police Bureau for assistant. These two interviewees expressed an unpleasant co-operation between two Police Bureaus. The requested Police Bureau was not co-operative and declined to provide Policing support including search, evidence collection, interrogation and arrest, although the Freezing Asset Order was made by the Court from the requesting area. The suspect was never caught and the enterprise was still running but with a different name. The interviewees strongly believed the suspect was tipped off and protected by his local government. Asset freezing or confiscation on an enterprise will be detrimental to the area, which relies on its tax revenue to support local economy. The ownership of the asset confiscated, the financial contribution of criminal proceeds to the local economy, the structural deficits in finance

distribution, and political interference undermine the power of the police in investigating money laundering cases.

Chinese conventional police methods such as undercover agents, searches, seizures, arrests, and interrogations are not enough to deal with money launderers due to its secrecy and complexity. Special investigative techniques such as telephone wiretap may be needed. Another potential effective method to detect money laundering in China is to use civilian informants and media reporting.

Police interviewees assert that media is a good source to obtain crime clues. He stated he had an experience of having drawn attention to a news report. A local newspaper reported how a security guard became an owner of a large luxury restaurant in a short period of time. It states that only the decoration costs a few million yuan. The speedy successful story led the interviewees to look at the life history of this owner. An investigation was undertaken and eventually the owner was identified as a member of a gang, who generated a large quantity of criminal proceeds by committing racketeering in the south of China. Another example was the use of the *Cai Jing Magazine* to reveal insider trading and market manipulation in China's stock market. Cheng (2008) noted that through a news report in *Cai Jing* that the Yin Guang Xia (Tian Jin) case came to the attention of the CSRC. The director of the Chinese Securities Regulatory Committee (CSRC) Enforcement Bureau stated in the interview that when he read the news report he immediately met with a deputy director in charge of securities trading illegalities and a principal investigator. Within nine days initial evidence was found that the company made false financial statements and been involved in illegal insider trading. In addition, the Chinese state council has a department dealing with public complaints, which appeared to work well in terms of providing profit-driven crime clues. According to the CSRC in 1998 (Cheng, 2008), within one month of the opening of the CSRC Chairman's Hot Line and Chairman's Mailbox to the public, the CSRC received 2,973 calls and letters, 38 percent of which provided tips about illegalities including insider trading violations. Due to previous experience of detection of official corruption through

public reporting and media influence, these means can be used to provide crime clues and to help money laundering investigations. Given that public understanding and support is critical for the success of anti-money laundering programs, the Government should give high priority to undertaking outreach activities with civil society. Holding workshops and seminars in different regions or beaming special television documentaries would be helpful in this regard. Although AML was a relatively new conception, the public has demonstrated their increased awareness of the harm of money laundering and its prevention actions. According to the CAMLMAC, a number of 98 money laundering clues were reported by the public in 2006, which were 12.25 times the 8 reports in 2005. Social control of money laundering could be an option for China to resort to money laundering detection. The Government should also develop stronger public-private partnerships in fighting money laundering. The private sector should be enlisted as a key ally in the fight against money laundering.

International AML Co-operation

In the context of mutual legal assistance, the Ministry of Justice applies the Chinese Criminal Procedure Law and the Chinese Extradition Law. By the end of 2006, China signed mutual legal assistant agreements with over 40 countries, among which 28 have been brought into effect effective (see Appendix Eight). According to the 2006 AML report, the Chinese Ministry of Justice has received six legal assistance requests and made one legal assistance request to an outside jurisdiction. In respect of Police cooperation, China has signed over 70 co-operation agreements with over 40 countries. China has established a co-operation mechanism with five countries including the United States, Thailand, and Canada, with an agreement to assign their Police co-coordinators to each country. Since 1998, the Chinese Police has assisted foreign law enforcements to investigate over 300 criminal and 20 terrorist financing clues, and gathered evidence for a number of countries such as the United States, The United Kingdom, and Canada. The PBC actively co-operate with international bodies or countries to receive technical support. The PBC has liaised with the International Monetary

Fund, the American Security Association, the Central Bank of Germany, the Central of France, Hong Kong Finance Management Bureau to organize AML and Anti- Terrorist Financing conference and training events.

In 2007 China became a formal member of the FATF, which suggests Chinese AML extent has achieved international standards. The fundamental principles of Chinese AML co-operation are five major international conventions and treaties that China has signed. China has worked with many countries in the area of exchange of financial intelligence and judicial co-operation to combat money laundering. China has signed, implemented, and ratified a number of legal documents in relation to AML and Anti-Terrorism Financing on the level of international, regional and individual countries. China also expresses willingness to co-operate on the basis of equality and mutual benefits, should the co-operation be beyond treaties and agreements.

However, there are issues in terms of international operation that need to be addressed. For example, the extent of bilateral judicial assistance agreements on criminal matters is still not wide enough to meet Chinese requirements and ambitions. China needs to sign more memorandums on information exchange with other countries and regions. The matter of international co-operation in this regard needs to update to meet international standards with a provision of sharing the asset confiscated by its foreign counterparts.

6.3.3 Prosecution and Punishment

The FATF's first Mutual Evaluation Report on China's Anti-Money Laundering and Combating the Finance of Terrorism in 2007 states that only four people were convicted for money laundering offences. I have been unable to obtain up to date data in regard to the total number and details of money laundering convicted. The data used below is confined with the cases studies in the chapter five.

1. In the case of Da Bin Yan (case XXI), Yan received a death penalty. Money launderer Ms. Shang Fan Fu received three years imprisonment sentence suspended for five years. She was also fined for ¥500,000 (£33,333). This sentence was made on the basis of her capability, attitudes and responsibility towards her offending behaviour, and the consideration of the welfare of their 13 years old son.
2. In the case of Shi Ming Yang (case XXII), Yang received nine years imprisonment sentence and was fined of ¥5.10 million (£340,000). Fraudsters Jiang Feng Yang received a death penalty suspended for two years, and a confiscation order of confiscating all of his assets. Other three fraudsters received a death penalty suspended for two years, life sentence, and 15 years imprisonment respectively.
3. In the case of Ru Min Pan, Su Zhen Zhu, Da Ming Li, Yuan Ming Gong (case XXIII), Pan received two years imprisonment sentence with a fine of ¥60,000 (£4000), Zhu received 16 months imprisonment with a fine of ¥20,000 (£1333), Li and Gong received 15 months imprisonment with a fine of ¥20,000 (£1333) respectively.
4. In the case of Zhao Wang (Case IV), Wang received 18 months imprisonment and a fine of ¥275,000 (£18,333). In addition, Wang's car was confiscated.
5. In the case of Guang Rui Huang (case XI), Huang received five years imprisonment, a fine of ¥6 million (£400,000). The illicit profit of ¥1million (£66,666) was confiscated. Smugglers Xi Tian Huang, Ji Ming Zheng received a death penalty suspended for two years and life sentence respectively. Both of their assets have been confiscated.

The above cases indicate the predicate offences generating money laundering convictions include organised crime (mainly violent offences committed by criminal syndicates), corruption, smuggling, fraud, and drug trafficking. These predicate offences are from two categories of commercial and market-based offences. No data can be used to analyse the trend of money laundering prosecution and punishment due to limited number of examples. The above convictions and punishment, however, do suggest that the seriousness of the sentence is assessed on the basis of the amount of proceeds

involved. The larger amount of proceeds involved, the more serious punishment will apply. The sentence does not link to the risk of harm and the actual money that has been laundered. The case XXII involved in ¥240 million (£16 million) proceeds derived from fraud and Yang was responsible for laundering a total of proceeds of ¥65 million (£4.3 million). Yang received nine years imprisonment sentence and was fined of ¥5.10 million (£340,000). However, the case IV involved in the proceeds from drug trafficking amounting to HK\$52 million (US\$6.3 million, £3.5 million) and US\$100,000 (£55,555), Wang received only 15 months imprisonment and a fine of ¥20,000 (£1,333). Wang's imprisonment sentence is as similarly serious as money launderers in the case XXIII; however, the proceeds laundered in the case XXIII are far less than those in the case IV. The inconsistent sentences indicate Chinese government's view on the seriousness of laundering proceeds derived from fraud and drug trafficking. Drug trafficking is the central theme of the AML initiatives and drug offences are conventionally regarded as posing a high risk due to the nature of the offence and the social impact. However, completely harmonized AML approaches in line with international standards may not be appropriate for all countries. Different countries may face different risks and particular political or cultural traditions which will impact upon the efficiency and effectiveness of AML initiatives. The scenario in China is an example. The AML priority in China appears to target financial crimes posing higher risk to the national interests and Socialist Economic order rather than conventional crimes such as drug trafficking, which appears to have wider social impact.

Money launderers received far less severe punishment than their co-defendants, who committed predicate offences, even where the money launderer was actually involved in commission of predicate offences (see case XI). The above cases indicate money laundering sentence averages between suspended sentence order and nine years imprisonment, compared with sentences on predicate offences including a death penalty and life sentence (see case Xi, XXI, and XXII).

The proceeds laundered all above cases are over a figure of one million Chinese Yuan and are very large. The time span between the beginning of the commission of money laundering offences and detection is very long, which indicates financial institutions have long been abused by criminals. So far no employees from financial institutions have been convicted for money laundering and punishment has been confined within administrative sanctions.

In addition, the Police interviewees suggested that they were sometimes confused and unsure what charges against suspects should be determined during an investigation. When they feel it is likely to be a case of money laundering, they were unsure how to pursue money laundering cases as they did conventional crimes. They had suspicions about some foreign invested enterprises as money laundering venues, but they found money laundering was not the first priority to be targeted due to the demands of participating in other economic crimes, given the issue of the political pressure on the investigation on the foreign investment away. In this sense, the co-operation among the Police and Prosecution Service and the Court needs to be improved. Enough investigation resource needs to be allocated. Furthermore, consideration should be given to provide prosecutors and judges with relevant AML training programmes. As Rider (2007 a) stated

“Of course, our police and prosecutors are generally very able to pursue cases involving crimes associated with corruption, albeit not always using the specific offences relating to corrupt practices. Indeed, as even bodies such as the famous Independent Commission Against Corruption in Hong Kong has learnt, it is often more efficacious to utilise other offences which are more easily proved and understood by juries - and judges, and in recent years particularly those relating to the laundering and concealment of illicit wealth”.

6.3.4 Civil and Criminal Confiscation/Forfeiture

The 2007 Chinese Anti-Money Laundering Report states that the PBC assisted the Police to investigate 328 cases suspected to have a link with money laundering involving proceeds amounting to ¥53.72 billion (£3.58 billion) in 2007. Some 89 cases were detected having involved in money laundering with proceeds reaching ¥28.8 billion (£1.92 billion). Given the nature of money laundering and above statistics about the proceeds involved, the government is likely to seize the money laundered and forfeit other assets involved in crimes the convictions are successful. The financial penalty for these offences could be substantial. According to Xiao (2008) the number of cases that have been subject to financial penalties imposed by the Chinese Courts is high; however, as was the case in the UK (Levi and Osofsky, 1995), the execution of financial penalties is unsatisfactory and a large number of cases have not been in the process of enforcing financial penalties; and financial penalties in some cases could be not be enforced. There are many reasons for such problems. For example, confiscation of proceeds, although mandatory, is not systematically pursued and imposed by the Courts, indicating a lack of awareness and implementation that needs to be addressed. The fundamental reason is the asset recovery legislation needs to be amended to increase the percentage of the stake of participating agencies when criminal assets are confiscated. For example, the assets confiscated could be more returned to the enforcement agencies for the further use in operation and staff development training especially focusing on asset confiscation. Consideration should be given to removing Magistrates Courts from the process of enforcing Confiscation Orders and leaving enforcement to the police service, who would be funded accordingly (Levi and Osofsky, 1995).

In China, there are a few provisions in regard to criminal asset recovery in the Chinese Criminal Law, the Criminal Procedure Law, the AML Law and others (see Appendix Six). The Chinese Criminal Law is an overall guidance in this regard. Under the Chinese Criminal Procedure Law, the courts, the prosecution and the police have the power to seize, freeze, and confiscate assets while a case is under investigation. The Order needs to be issued by the Court prior to the actions undertaken. It is important to note, however, that these provisions are general in nature and apply to all crimes. They

have not been specially tailored to address some of the unique features faced in the money laundering situation such as the conversion of the criminal proceeds into other forms of assets, capital flight of such proceeds to other jurisdictions, protection of the rights of bona fide third parties, and confiscation without criminal conviction (civil forfeiture). Equivalent value seizure and confiscation are not features of the seizure and confiscation regime. To ensure that criminals do not obtain their unlawful gains and to make it easier for law enforcement agencies to recover the proceeds of crime from convicted criminals, it is necessary for China to amend and implement legislation in regard to freezing, seizing and confiscating criminal proceeds, and further to develop criminal proceeds recovery measures systematically.

In addition, the confiscation regime should include clear provisions and procedures on how to deal with the assets in case the proceedings come to a halt before a conviction was pronounced. A breakdown of the number of cases and amounts confiscated pursuant to administrative or criminal procedures, and should differentiate between the criminal sources of the assets frozen, seized or confiscated. Consideration should be given to the issue of how to manage criminal assets prior to confiscation. For example, in the UK it has incurred considerable costs (approximately £16 million) for the receiver in managing property owned by criminals pending final determination (Rider, 2007b), a financial effect that has led to a reduction in the use of professionals to conduct them.

Furthermore, the Government should seriously consider the provision of suitable incentives to financial institutions to cooperate more effectively, including making arrangements for the sharing the proceeds of seized and confiscated assets with them.

Given the transnational characteristics of money laundering and Chinese reality, some money launderers or criminals who committed predicate offences, are prone to escaped to abroad. It is important for the Government to expand its bilateral cooperation and mutual assistance agreements to facilitate the investigation of money laundering cases and the seizure and confiscation of criminal

proceeds. The arrangements for the sharing of seized and confiscated assets with other cooperating jurisdictions need to correspond with international tradition and convention. However, the absence of such agreements in the meantime should not prevent voluntary cooperation in view of the common interest of all countries to stamp out money laundering. In addition, no assets have been reported in China within the context of the UN Security Council Resolutions on freezing terrorist funds or on the basis of the domestic terrorist list currently. Consequently no such terrorist assets have been seized on the basis of the “Country of Particular Concern” (CPC). As for the other terrorist related assets, no seizure or confiscation figures are available.

The ultimate aim of AML initiatives is to reduce crimes, although a number of researches suggest that the ANL regime has not achieved its aim considerably. The AML does facilitate investigation and prosecution of some criminal participants and also permits the readier recovery of funds from core criminals and from financial intermediaries (Levi and Reuter, 2006). The impact of any AML regime is not only judged on the number of convictions, but more importantly on effectively depriving the criminals of their proceeds. Theoretically, AML legislation is sound and matches their moral value of suppressing crime. However, it will depend on a cost benefit analysis to assess its success in practice. The success or failure of asset seizure and forfeiture, on its own terms depends on very complex efficiency analysis based on a mass of detail about profits, losses, costs, benefits, risk-preference, risk-aversion, insurance etc (Fraser, 1992). In regard to these terms it is almost impossible to provide a systematic and scientific analysis of the current asset forfeiture status in China. The lower convictions resulted in the less assets confiscated. The goal of confiscating criminal assets did not achieve as a whole, because it did not make a majority criminals operate at a loss, did not reduce the profit margin of crime significantly, and did not put a majority of criminals out of businesses. Given reported large sums of criminal profits, sophisticated money laundering skills, undetected and unknown criminal proceeds, the enormous cost of compliance, legislation flaws and operational incompetence, it is implausible to speculate that the asset forfeiture strategy will unlikely terminate the profitable

businesses of illegal market. It seems reasonable to conclude that as long as crimes emerge, the finance to support crime will be most likely needed, and the asset confiscation strategy will never appear effective enough to end the crime on its own.

6.4 Conclusion

China has basically formulated an AML legal and regulatory framework, and institutional arrangements. It can be seen that the foundation of AML has been established, although it is still in an early stage compared with the United States and some EU countries. There is little doubt that China has undertaken preventative strategies and enforcement action to combat money laundering. China has implemented AML law and regulation and developed its AML investigative and preventative measures, including criminalising money laundering from all serious crimes, implementing regulation, conducting supervision, establishing large-value and suspicious transaction reporting mechanisms, and carrying out CDD procedures. However, there are some areas that China needs to improve to further prevent and investigate money laundering. For example, some other important monitoring measurements such as the computer-based payment systems and bank account management systems need to be developed. In addition, the transaction characteristics of securities industry, insurance industry and high-risk non-financial industry need to be studied and analysed; and related monitoring systems and reporting arrangements need to be formulated. China needs to further amend and implement the problematic areas that differ from the FATF 40 Recommendations and 9 Special Recommendations as detailed in the Appendix Eight.

Chapter VII: Conclusion

Inspired by the lack of systematic and detailed knowledge of contemporary Chinese money laundering and its countermeasures, I have offered in this thesis an examination of China's particular circumstances and constitutional work in the implementation of AML policy. This thesis introduced the historical antecedents of money laundering and its current nature and scope in China. It then explored the contemporary internal and external pressures upon China to adopt AML control system in recent times. Empirical research was undertaken to analyse contemporary Chinese money laundering methods and compare those selected Chinese money laundering cases with international examples. Chinese AML regulation is compared with the FATF standards. The problems of Chinese AML regulation are identified and discussed from the perspectives of prevention and enforcement.

Data were gathered through a number of research methods including literature review, case study and interviews in both English and Mandarin. The data were critically analysed. The findings are also compared with international experience (e.g. FATF) and examples (Reuter and Truman (2004)). The thesis follows the Levi and Reuter (2006) generic AML structure. A number of issues in AML enforcement and prevention pillars have been identified. This chapter identifies the major themes that emerged from the research. It provides recommendations for China AML improvement on the basis of the finding, and it suggests future research to better understand China's AML policy.

7.1 Major Themes Emerging From this Work

According to Garland (2001), the crime control changes of the last twenty years were driven not just by criminological considerations but also by historical forces that transformed social and economic life in the second half of the twentieth century. In addition, changes that were experienced to a greater or lesser extent by all Western industrialised democracies after the Second World War and which

became most pronounced from the 1960s onwards. In the Chinese context, China has experienced dramatic social and economic changes in recent decades, which have generated or at least increased a number of modern crimes, including profit-driven crime. There is a divergence between the sustained stagnation of political and legal institutions and the economic and social conditions such as 'responsibilisation and accountability that modern crime control relies on. Political institutions have undergone significant changes during the reform years, but today these political and legal institutions are strained and barely able to adapt to the vibrant economy and society (Fu, 2002). As a consequence, social problems including crime have risen. The Chinese authorities are motivated to tackle the inequality between the poor and the illicit wealth to ensure its own political stability. Unresolved corruption involved in large bribes, unstable economic activity, and capital flight across borders have attracted Chinese government to monitor public officials' financial activities and to improve financial transparency. The apparent surge of money laundering and the scope and extent of money laundering predicate offences, particularly the newly defined three money laundering predicate offences of violating the Socialist market economic order, financial fraud, and corruption, have increasingly drawn the attention of Chinese government to look at alternative ways to address these issues, alongside conventional anti-crime strategies,.

My research suggests that criminals are capable of abusing both contemporary financial institutions and traditional Chinese underground banking to launder criminal proceeds in China. Indeed, it would be extraordinary if this was otherwise. The techniques and methods of laundering generally concur with international awareness and knowledge, although Chinese money launderers may have different preferences. Chinese money laundering methods reflect the particular political and economic circumstances of China and its associated problems of AML system. The use of front and underground banks are the most common *identified* methods utilised by money launderers, who may well take the opportunities offered by pro-business environment under the economic reform as a cover, especially when compared with the earlier era in which private enterprises were forbidden. Market-based and

commercial offences (Naylor, 2002) present a large percentage of predicate offences to which are attributed the accumulation of sufficient criminal proceeds to require laundering in China.

International pressure led by industrialised nations such as the USA and global power organisations including the FATF has significantly impacted Chinese foreign policies and its crime control policy including money laundering. China's political commitment has enabled the AML legislative and regulatory framework to be adopted to largely meet international standards within a short period. Much resource, such as the establishment of a Chinese FIU, has been put into place to support the AML initiatives. The traditional Chinese philosophy of "gradual approach" to adapt international experience into its own way appears not to have been applied in regard to the AML campaign. The radical adoption of the AML regime in China has construction flaws. In the context of AML prevention, many inefficient aspects have been identified. For instance: first, administrative and regulatory sanctions that can be imposed are not detailed. Limited information on the administrative and criminal sanctions on liable financial institutions is available.

Second, the performance of regulation and supervision are undermined by the inadequate coverage of the AML/CFT control programmes in non-financial businesses such as dealers in precious metals and stones, lawyers, notaries, real estate agents and company service providers. In addition, the internal control environment is not set up to address terrorist financing risks. Furthermore, risk-based approaches have not been systematically developed to manage massive AML preventative work in financial institutions. Risk-based money laundering is difficult to apply in this setting, but poses cultural problems for Chinese staff who – like bankers everywhere – may be more comfortable applying rules than making judgments.

Third, reporting appears passive rather than actively monitoring funds transactions; no obligations and responsibility are clearly made. Many money laundering compliance officers appear to have inadequate risk assessment capacity. Reporting standard forms designed by the CAMLMAC are not

focused and lack demands for the reasoning underlying the reports (and non-reports). Reporting standard forms designed by the CAMLMAC are not focused and lack demands for the reasoning underlying the reports (and non-reports). No requirement for institutions to retain business correspondence and related documents.

Fourth, there is lack of a specific and comprehensive legal requirement to conduct ongoing due diligence or reviews after bank accounts have been opened. The backdated materials are not always required. There is a prevalent use of anonymous/pseudonym, or forged ID, and the duplication of numbers on about five million manually issued first generation ID cards; meanwhile there is a lack of vigorous CDD checks. The threshold for the verification of customer identity for wire transfers is higher than US\$1000 (the threshold required by the FATF). Guan xi (relationship) can be used to avoid CDD checks. The true ownership of the funds are sometimes required verbally or recorded inconsistently from CDD checks. Individual staff appear to facilitate clients who are unable to answer the questions at the time of opening bank accounts or undertaking financial transactions. No legal obligation and comprehensive requirements to identify and verify the beneficial owner in financial institutions. Only the banking sector (which includes foreign exchange and MVT services) is subject to specific requirements relating to the identification of legal persons (e.g. requirements to verify their legal status by obtaining proof of incorporation, names of directors).

With regard to AML enforcement, problem areas identified include four aspects of predicate offences, investigation, prosecution and punishment, and civil and criminal confiscation/forfeiture. First, AML legislation in regard to criminalising predicate offences is less comprehensive. There is no definition of the difference between terrorist activities and separatism movements, so the latter may be rolled up into the former. The knowing acquisition and use of criminal proceeds are not criminalized. Self-laundering is not criminalised. No corporate criminal liability is provided for the offences covered by article 312 and 349 PC. Criminalisation of Financing Terrorism (FT) and ability to provide

mutual legal assistance are not fully in line with the UN International Convention for the Suppression of Terrorist Financing, 1999 (the TF Convention). Collection of terrorist funds is not criminalised.

Second, there are operational difficulties in ML investigation. Law enforcement agencies lack training programmes designed to improve money laundering/Terrorist Financing investigator knowledge and skills. Investigators find it difficult to target the financial aspect of criminal offences. Some investigators are not fully aware of the legal elements of ML. There are difficulties in operational co-operation between the Police and the Prosecution Service and the Courts. There are difficulties in the cooperation between the Police in different regions. The investigations are sometimes subject to intervention by politicians.

Third, a low number of convictions (four people were convicted for money laundering by 2007) indicates the difficulties or inefficiency of implementing AML law or other laws having AML content. It is not persuasive that the AML prosecution and punishment works compared with the number of money laundering cases and the seriousness of money laundering and its predicate offences problems reported in China, and the size of Chinese economy and its growth. Fourth, in terms of civil and criminal confiscation/forfeiture, there is lack of an equivalent value confiscation measures (substitution of confiscation targets). In addition, there is insufficient enforcement power to pursue the proceeds confiscated, although imposed.

Although the above problems suggest that there is a gap between Chinese and the FATF standard, we need to further consider that some internationally recognised money laundering countermeasures may not fit China's reality and may not work effectively in China's circumstances at this stage. For example, there are difficulties in creating SARs in some financial institutions in China. Banks in some of remote and economically underdeveloped areas do not have as many computer facilities or intranet facilities as those in modern cities. Data processing largely relies on manual practice. The large client population of financial institutions has severely increased financial institutions' workload to monitor

suspected fund transactions, to manually complete SARs, and to analyse data without advanced technology.

Indeed, it is hard to comment on the effectiveness of AML regulation, given that little empirical research has been completed to understand the true extent of the problem of money laundering, along with the extent of the reduction in predicate offences and for money laundering to occur in China. I believe that the emphasis on money laundering control focuses on resource inputs other than pursuing performance outputs in China. The cost of implementing these controls has not been proportionally reflected by prosecution and asset recovery. Though the benefits of money laundering control have been difficult to assess anywhere (Levi and Reuter, 2006), it appears that costs may exceed crime reduction or enforcement benefits. It is my view that even if China diligently applies and enforcing AML regulation, there will still be little appreciable impact on money laundering in a short or even maybe longer period of time, given the western experience that the impact of the AML policies on organized crime markets so far seems to be low (Levi 2002, Naylor 2002). There are some problems that suggest that the Chinese AML system does not work very effectively at this stage.

First, the number of staff in the Chinese FIU (over 100) is limited compared with the national economy, population and the massive number of financial activities, although it is an unsolved issue what percentage of the FIU per population is optimal. Second, CDD is not an effective deterrent to criminals from using the banking system. There are ways that criminals can work around the CDD check by using other people's real, anonymous/pseudonym, and forged ID cards to open bank accounts. Criminals could use their relatives' and friends' ID card to open a bank account without being questioned by the card owners, or even with their consent and help, due to the Chinese culture of family tie, neighbourhood, and ideology of friendship. In addition, high social ranking people including politicians are more likely to avoid CDD check. Governmental officials are always highly respected and remain unapproachable. At the stage of KYC, officials do not need to turn up the bank

to open an account themselves, these “minor businesses” could have been dealt with by their personal assistants or close friends as an administrative task or voluntarily. The application of KYC may not be strictly adhered to the AML regulation and the CDD process may be simplified in above circumstances. It would be brave to ask “intrusive and offensive” questions about the politician’s personal information and business. There is a conflict among the state, institutions, and individuals, as to who will bear the cost of the implementing the AML preventative procedures. The state would like the financial institutions to play an important and voluntary role in crime control. Financial institutions need to make profits and reduce costs to survive. Individual staff from banks pursue large deposits and new accounts to meet their performance targets and further to increase their bonus.

Third, my empirical research suggests that the quality of the reporting is questionable, through the number of the SARs is generally increasing. The increased number of SARs has reflected the extension of legislation, pressures to avoid risk, and performance targeting more than deriving from vigilant compliance. In addition, the awareness, confidence, willingness and capability of money laundering compliance officers and financial institutions’ front line staff to identify suspicious transaction are questionable. This has been justified through my interviews as the result of limited training schemes, incentives, and criminal sanctions for non-compliance. Fourth, the Police lack resources, motivation, capability, and incentives to work on complicated investigations, a phenomenon that is by no means restricted to China. The limited number of convictions and value of proceeds recovered is not high enough compared with the alleged high number of money laundering offences and vast proceeds involved in them. This situation may not be improved unless the law and judicial institutional structure is changed. The Police are financed by the local government, who have an administrative task to attract investment to prosper or maintain their local economy. On this basis, the implementation of AML regulation could be undermined by the local political influence; even if AML regulation is in place.

Erving Goffman emphasized that there is always a huge difference between front stage and back stage behaviour in organizational life (Drew and Wootton, 1988). With regard to Chinese AML activity, my hypothesis is that at the front stage of the AML campaign, China has been conceptually motivated to put the AML system in place. The Chinese AML system appears to more politicised and symbolised as routines than standardised expectations. Certainly there is a great difficulty to effectively combat money laundering world wide; however, there is a scope that China could make further efforts to implement the AML regulation at the back stage. This hypothesis has been justified behind the scene by the institutional and individual levels of compliance identified through literature review and empirical research in my research. There is a conflict between subjective reality and objective instances in Chinese AML circumstances. Political adaptations and social, economic and cultural forces in contemporary China have contributed to the contradiction between the impression at the front stage and social interactions at the back stage.

7.2 Recommendations for AML Policy

China faces challenges in the context of implementation, compliance, and sanctions both in law enforcement and financial institutions.

Financial institutions play an important role in the fight against money laundering. China needs to improve its financial system in regard to fund transaction monitoring capacity. The risk based approach needs to be adopted in a greater depth, which may be a challenge for a society where staff may fear punishment if they make a judgment that is later viewed as a mistake by their superiors or enforcement agencies. Chinese cultural traditions suggest that a radical approach to change them all is not ideal. A realistic and gradual reform will ensure Chinese financial institutions have sufficient time to reflect and reform in a most effective way. A number of management systems such as the bank account management system, the payment and settlement system to monitor fund movements should be incorporated into AML system. China has adopted a mixed approach from the major developed

countries to combat money laundering. Given the current acceptance as a member of the FATF, China may need to look at more relevant models from less developed and neighbouring countries or from regimes such as Hong Kong, South Korea, Thailand and Singapore. It is because these countries or regimes have cultural links with China and a number of these jurisdictions have longer AML experience or the implementation of AML controls (Hong Kong and Singapore have a long tradition of the AML regime). Their experience is useful for a country like China, which is in the early stage of establishing a comprehensive AML framework.

Given the potential largest number of bank users due to the largest population in the world, there is little doubt about the significant pressure on financial institutions. The implementation of AML regulation relies on staff awareness, knowledge, confidence, and motivation. AML staff training programmes, especially in remote and small financial institutions, need to be enhanced. Online training could be an option to reduce the financial cost and ensure the widest coverage. In addition, consideration should be given to financially assisting these financial institutions by the government, although in many countries, the idea is to transfer costs to the private sector.

The suitable proportion of incentives to financial institutions and law enforcement agencies should be considered. Sufficient levels of personnel, funds and information need to be available. The powers and procedures for obtaining evidence, freezing, seizure and confiscation of criminal proceeds in the case of money laundering investigations and prosecutions need to be detailed. Sufficient protection of the rights of bona fide third parties should be provided. The provision of sharing proceeds of seized and confiscated assets should be promulgated to achieve a better effectiveness.

In response to the analysis of 23 Chinese money laundering cases I have reviewed in chapter five, bearing in mind reservations about the limits of current knowledge, it can be seen that Chinese AML has its own preferred money laundering methods- using front companies, for example. However, the AML capacity of the SAIC is limited due to its lack of legitimate input of AML in its main duties,

although it is a member of the AML group in China. The efforts to combat money laundering in the SAIC should be further strengthened and AML should be incorporated into its main duties legally. Meanwhile, at the same time as combating money laundering, other related enforcement also needs to improve. For example, there may be needed more actions to punish people who are making forged ID cards or dealing in anonymous/pseudonymous ones, if China is to reduce the risk from opening bank accounts and other offences by criminals for the purpose of laundering criminal proceeds. (Though criminal justice actions have limited crime reduction effects.)

Although China has regulated its public sector and motivated the public via the media to combat money laundering, a gap still exists in relation to the contribution of the private sector in the fight against money laundering. Although banks are the active players in anti-money laundering, other industries in the private sector should be enrolled in the fight against money laundering. A better solution could be the collaboration between the public sector and private sector, where the private sector will benefit from technical assistance.

Chinese underground banking is currently illegal according to Chinese law. A debate on the possibility of converting underground banking into legitimate remittance systems is currently going on. If the underground banks are accepted as a legitimate financial institution in the future, provisions should be incorporated in the AML regulation. The licensing and regulation of alternative remittance systems should be in line with the FATF 8 Recommendations on Terrorist Financing.

China needs to expand its bilateral cooperation and mutual assistance agreements to facilitate the investigation of money laundering cases internationally. Especially the provisions of the sharing of seized and confiscated assets with other cooperating jurisdictions should be considered to be amended on a reciprocal basis. Meanwhile, the legal system needs to reform. The punishment of criminals who abscond abroad and could be extradited should be in line with the requirements of international conventions. The dilemma is how to extradite money launderers who could receive the death penalty

according to Chinese law from co-operating jurisdictions, where there is no capital punishment and where extradition to places that have it is forbidden. In addition, the difficulty is how to punish these offenders should they be extradited. Their co-defendant may have been sentenced to death and they cannot be treated equally due to the extradition agreement. Is law justice for everyone? It will bring difficulties in terms of convincing everyone.

With regards to regional and domestic AML co-operation, Mainland China needs to develop the AML working mechanism with Hong Kong, Macao and Tai Wan. These areas are close to the areas where money laundering and its predicate offences and underground banking are prevalent. These areas also have some links in terms of kinship, culture, language, belief, and religion. Both financial institutions and law enforcement agencies in mainland China need to work closely with their counterparts in those areas, for the purpose of achieving a double winning result. On the one hand to combat money laundering in those areas by mainland Chinese criminals, and on the other hand to punish criminals from those areas laundering criminal proceeds in mainland China.

Another important aspect in regard to money laundering control is at the same time as complying with AML requirements, meanwhile to implement other anti-corruption mechanisms. Many reported money laundering cases suggest some corrupt government officials have not only facilitated money laundering predicate offences and money laundering, but have also self laundered their bribes and embezzled state assets. Due to their political power and influence, they could easily deposit or help criminals to deposit criminal proceeds into the financial system and then increase the difficulties to identify money laundering in the first place. With the increasing actions to combat corruption, the corrupt officials may be prone to launder their illicit funds with legitimate appearance to declare their innocence if they are challenged. I predict the use of money laundering by corrupt officials will increase, although it would be arguable that the AML systems may increasingly target such behaviour and China does not want to appear to be permitting such behaviour and the related money laundering.

Chinese culture such as Guan xi and family ties also contributes to the commission of money laundering. China needs to work on how to solve a problem in line with the law and regulation other than seeking to use Guan xi to evade law and regulation. It should be a long-term issue to address and as long as the situation “it is not what you know but who you know” in China has not changed, the levels of money laundering will not reduce substantially. Family ties could be positively used in money laundering control if the general public is able to be convinced not to become the passive onlookers of money laundering. Family and social control will have a better preventative effect to prevent money laundering due to family members’ positive influence. Certainly, the precondition is the families do not gain from the crimes and corruption.

To improve AML preventative framework, China could strengthen its FIU and require all financial institutions to establish and maintain internal AML control procedures, policies and controls. China needs to provide regular training and consider converting underground banking into legitimate business and provide adequate supervision. Chinese authorities need to provide sufficient information or guidelines to instruct financial institutions to increase their awareness of conducting businesses with high-risk customers and jurisdictions. Financial institutions should be explicitly required to identify and verify the identity of the beneficial owner of a customer before opening an account, establishing a business relationship, or performing transactions, and to register this identity information. Financial institutions should be required to conduct enhanced due diligence in relation to high-risk categories of customers such as PEPs and Chinese government officials, business relationships and transactions. Financial institutions should undertake special CDD on customers who use first generation ID cards to identify persons. The check on the authenticity of ID needs to be enhanced.

With regard to enforcement perspective, self-laundering should be criminalized and corporate criminal liability should be covered to all money laundering offences. National cooperation and coordination

among AML enforcement agencies needs to be improved. Political intervention in the criminal investigation needs to be stopped. The enforcement of the confiscation provision needs to be enhanced. Equivalent value confiscation should be amended. Domestic and International confiscated proceeds sharing needs to be negotiated and formalised on the base of mutual benefits. The international co-operation with regards to the extradition of suspects needs to be enhanced and simplified.

7.3 Recommendations for Further Research

There are so many uncertainties with regards to the crime of money laundering such as the true dimension and harm, and the real impact of AML on the stakeholders including financial institutions, law enforcement agencies, and the general public. There is lack of research on the estimated financial costs of the Chinese regime to the government, financial institutions, non-financial institutions, law enforcement agencies, enterprises and individuals. Systematic research will help to generate data to inform the policy makers to make affordable and applicable regulations and laws. In addition, empirical research on the effectiveness of the current Chinese AML regime with respect to combating money laundering and its predicate offences will help to assess progress in the area of money laundering prevention and enforcement. Furthermore, the economic implication from AML action from an economic perspective will help to understand what the real relationship is between money laundering and the national economy. A potential benefit could be the creation of a market model for money laundering services. Finally, systematic research on how anti-money laundering agencies comply will help China to identify the level of implementation, assess the severity of sanctions and understand the effectiveness and efficiency of money laundering regulation. This thesis has begun to cast some light upon selected aspects of these unexplored and under-researched issues in the context of China. It has provided a historical and contemporary perspective on the problems of money laundering and the growth of the AML movement in China and what little is known so far about its

effects. It is my hope that this will stimulate other scholars and bodies to conduct and fund continuing research to address the knowledge gaps identified in this work, and to generate a fuller understanding of the complex interplay between crime, money laundering and control efforts. The growing regional and international importance of Chinese political economy highlights the need for further systematic research that aims to critically assess China's vulnerability to, and the possibilities and limitations of its responses to, the money laundering problem.

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<http://www.lse.ac.uk/collections/economicHistory/GEHN/GEHNPdf/WorkingPaper06HZ.pdf>>
[Accessed 30th March 2002]

Appendix One

The Chronological Evolution of Anti-Money Laundering System

1988-1989	<ul style="list-style-type: none"> The United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances on 19th December 1988 was the first landmark international pact that required all the parties to define money laundering as criminal offence and to crack down on violators.¹ China signed the Vienna Convention on 20th December 1988 and submitted the instrument of ratification on 25th December 1989.²
1990	<ul style="list-style-type: none"> The PRC's efforts to address money laundering began. On 28th December 1990, Article 349 PC was introduced to criminalise the handling or laundering of proceeds generated from drug-related offences.³
1992	<ul style="list-style-type: none"> The CSRC was established in 1992.⁴
1993	<ul style="list-style-type: none"> Notification on Inquiring, Freezing and Seizing Bank Deposits of Enterprises, Entities and Organizations, issued by PBC, SPP and MPS in 1993.⁵
1995	<ul style="list-style-type: none"> The confidentiality and bank secrecy rules stipulated in the Commercial Bank Law of the People's Republic of China (promulgated by the Standing Committee of the National People's Congress in 1995).⁶
1996	<ul style="list-style-type: none"> In October, China established a deadline of mid-March 1997 for the drafting of anti-money laundering legislation which is expected to be passed by the People's Congress later that month.⁷ The Criminal Law also contains authority under Article 191 for the Government to seize and confiscate proceeds and gains derived from crimes.

¹ The People's Bank of China. 2004. *PBC's AML Official Answers Questions on China's Anti-Money Laundering Campaign*. Available at: <URL: <http://www.pbc.gov.cn/english/detail.asp?col=6400&ID=412>> [Accessed on: 16 November 2005].

² FATF. 2007. *FIRST MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM-People's Republic of China*, pp.137. Available at: <URL: <http://www.fatf-gafi.org/dataoecd/33/1/39148196.pdf>> [Accessed on: 1/08/08]

³ FATF. 2007. *FIRST MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM-People's Republic of China*, pp.137. Available at: <URL: <http://www.fatf-gafi.org/dataoecd/33/1/39148196.pdf>> [Accessed on: 1/08/08]

⁴ FATF. 2007. *FIRST MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM-People's Republic of China*, pp.103. Available at: <URL: <http://www.fatf-gafi.org/dataoecd/33/1/39148196.pdf>> [Accessed on: 1/08/08]

⁵ FATF. 2007. *FIRST MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM-People's Republic of China*, pp.126. Available at: <URL: <http://www.fatf-gafi.org/dataoecd/33/1/39148196.pdf>> [Accessed on: 1/08/08]

⁶ FATF. 2007. *FIRST MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM-People's Republic of China*, pp.130. Available at: <URL: <http://www.fatf-gafi.org/dataoecd/33/1/39148196.pdf>> [Accessed on: 1/08/08]

	Under the Criminal Procedure Law of the People's Republic of China (promulgated in 1979 and amended on March 17, 1996). ⁸
1997	<ul style="list-style-type: none"> On 14th March, Article 191 PC was introduced to criminalise the act of laundering proceeds generated from four broad categories of offences- drugs, smuggling, organised crime and terrorism.⁹ 1st July, the earliest legislation of criminalising manipulating criminal proceeds was Article 312 of the Penal Code (PC) made on the It criminalise an offence of receiving and handling illegally acquired goods on the basis of an all crimes approach (i.e. harbouring, transferring, purchasing, selling, or disguising or concealing).¹⁰ In July, China participated in the initial meeting of the Asia Pacific Group on Money Laundering in Beijing.¹¹ On 15th August, the Notice on Management of Large-Value Cash Payments (issued by the PBC).¹² In September, Provisions on Control of Foreign Exchange Operations for Banks, article 29 formulated by SAFE.¹³
1998	<ul style="list-style-type: none"> The CIRC was established in 1998.¹⁴ Securities Law of the People's Republic of China, Decree No.43, 1998.¹⁵ As a guidance for the judiciary on the substance of the "funds" aspect, reference is also made to article 6 of the Rules for the Implementation of the State Security Law of China, The Chinese authorities referred to the "Interpretation by the Supreme People's Court regarding some issues in the specific application of law in the trial of theft cases" (1998), with a view to providing further clarification on the how the term "funds" is interpreted in Chinese law.¹⁶

7 FATF. 1997. *FINANCIAL ACTION TASK FORCE ON MONEY LAUNDERING, 1996-1997 REPORT ON MONEY LAUNDERING TYPOLOGIES*, FATF, Feb 1997. pp.10. Available at: <URL:

<http://www.fatf-gafi.org/dataoecd/31/29/34043795.pdf> > [Accessed on: 01/02/04]

8 Morais, H. and Yang, B. 2002. *ANTI-MONEY LAUNDERING . GENERAL ANALYSIS AND RECOMMENDATIONS*. In: ADB. 2003. *FINAL REPORT, SECTION V – AML – GENERAL ANALYSIS*. Available at: <URL:

<http://www.adb.org/Documents/Reports/TA3890/chap5.pdf> > [Accessed on: 3/02/04]

9 FATF. 2007. *FIRST MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM-People's Republic of China*. pp.21. Available at: <URL:

<http://www.fatf-gafi.org/dataoecd/33/11/39148196.pdf> > [Accessed on: 1/08/08]

10 FATF. 2007. *FIRST MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM-People's Republic of China*. pp.21. Available at: <URL:

<http://www.fatf-gafi.org/dataoecd/33/11/39148196.pdf> > [Accessed on: 1/08/08]

11 APG. 2004. *Asia/Pacific Group on Money Laundering Annual Report, 1 July 2002 – 30 September 2003*. Available at: <URL: <http://www.apgml.org/documents/docs/2/APG%20Annual%20Report%2002-03%20-%20final.pdf> > [Accessed on: 2/03/05]

12 Morais, H. and Yang, B. 2002. *ANTI-MONEY LAUNDERING . GENERAL ANALYSIS AND RECOMMENDATIONS*. In: ADB. 2003. *FINAL REPORT, SECTION V – AML – GENERAL ANALYSIS*. Available at: <URL:

<http://www.adb.org/Documents/Reports/TA3890/chap5.pdf> > [Accessed on: 3/02/04]

13 FATF. 2007. *FIRST MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM-People's Republic of China*. pp.78. Available at: <URL:

<http://www.fatf-gafi.org/dataoecd/33/11/39148196.pdf> > [Accessed on: 1/08/08]

14 FATF. 2007. *FIRST MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM-People's Republic of China*. pp.103. Available at: <URL:

<http://www.fatf-gafi.org/dataoecd/33/11/39148196.pdf> > [Accessed on: 1/08/08]

15 IBA. 2009. *LIST THE LAWS REGARDING ANTI-MONEY LAUNDERING, INDICATING WHICH LAWS ARE APPLICABLE TO LAWYERS*. Available at: <URL: <http://www.anti-moneylaundering.org/asiapacific/China.aspx> > [Accessed on: 21/10/09]

16 FATF. 2007. *FIRST MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM-People's Republic of China*. pp.31. Available at: <URL:

<http://www.fatf-gafi.org/dataoecd/33/11/39148196.pdf> > [Accessed on: 1/08/08]

1999	<ul style="list-style-type: none"> As a guidance for the judiciary on the substance of the “funds” aspect, reference is also made to article 6 of the Rules for the Implementation of the State Security Law of China, The relevant provisions of the UN International Convention for the Suppression of Terrorist Financing, 1999 (the TF Convention), it having been adopted by the NPC.¹⁷
2000	<ul style="list-style-type: none"> The Rules on Real Name for Opening of Individual Deposit Accounts (issued by the State Council on 20th March, 2000).¹⁸ Anonymous accounts will be phased out in 2005. China signed the Palermo Convention on 12th December 2000, and submitted the instrument of ratification on 23rd September 2003.¹⁹
2001	<ul style="list-style-type: none"> In 2001, Guidelines on the Supervision and Administration of Overseas Offices of Commercial Banks promulgated by the PBC.²⁰ Regulations on Trust Investment Corporations issued.²¹ In June 2001, the Interim Measures for the Control of Online Banking Operations, Risk Management for Online Banking Service, promulgated by the PBC.²² China signed the FT Convention on 13 November 2001.²³ On 29th December, article 120bis PC was introduced which criminalises terrorism financing in the sense that “any person who financially supports a terrorist organisation or an individual who commits terrorist activities” is guilty of a crime.²⁴

17 FATF. 2007. *FIRST MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM-People's Republic of China*. pp.31. Available at: <URL: <http://www.fatf-gafi.org/dataoecd/33/1/39148196.pdf>> [Accessed on: 1/08/08]

18 FATF. 2007. *FIRST MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM-People's Republic of China*. pp.127. Available at: <URL: <http://www.fatf-gafi.org/dataoecd/33/1/39148196.pdf>> [Accessed on: 1/08/08]

19 FATF. 2007. *FIRST MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM-People's Republic of China*. pp.137. Available at: <URL: <http://www.fatf-gafi.org/dataoecd/33/1/39148196.pdf>> [Accessed on: 1/08/08]

20 FATF. 2007. *FIRST MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM-People's Republic of China*. pp.98. Available at: <URL: <http://www.fatf-gafi.org/dataoecd/33/1/39148196.pdf>> [Accessed on: 1/08/08]

21 FATF. 2007. *FIRST MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM-People's Republic of China*. pp.120. Available at: <URL: <http://www.fatf-gafi.org/dataoecd/33/1/39148196.pdf>> [Accessed on: 1/08/08]

22 FATF. 2007. *FIRST MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM-People's Republic of China*. pp.79. Available at: <URL: <http://www.fatf-gafi.org/dataoecd/33/1/39148196.pdf>> [Accessed on: 1/08/08]

23 FATF. 2007. *FIRST MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM-People's Republic of China*. pp.136. Available at: <URL: <http://www.fatf-gafi.org/dataoecd/33/1/39148196.pdf>> [Accessed on: 1/08/08]

24 FATF. 2007. *FIRST MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM-People's Republic of China*. pp.31. Available at: <URL: <http://www.fatf-gafi.org/dataoecd/33/1/39148196.pdf>> [Accessed on: 1/08/08]

	<ul style="list-style-type: none"> the Interim Measures for the Control of Online Banking Operations, Risk Management for Online Banking Service, promulgated in June 2001 by the PBC.²⁵ the amendment of Criminal Law defined the terrorist actions as the predicate offence related to money laundering at the end of 2001.²⁶
2002	<ul style="list-style-type: none"> In April, the Anti-Money Laundering Division of the ECID (under MPS) was established.²⁷ In May, AML Joint-ministerial Conference: China's AM/CFT efforts are led by the AML Joint Ministerial Conference which was convened by the public security minister and established.²⁸ Guidelines on the Supervision and Administration of Overseas Offices of Commercial Banks promulgated by the PBC in 2001.²⁹ On 28th December, Extradition by China is governed by the Extradition Law, enacted on. China has signed extradition treaties with 26 countries, 20 of which are presently in force.³⁰ In late 2002, FATF Published reports indicate that money laundering in the PRC has increased to about RMB 200 billion (US\$ 25 billion) annually, representing about 2% of the nation's GDP. This is roughly equivalent to the PRC's total export earnings (US\$ 22.5-24.0 billion).³¹ Principal among these are the Administrative Regulations for Financial Institutions on Assisting in Seizing, Freezing and Confiscating Funds, issued by PBC in 2002.³²
2003	<ul style="list-style-type: none"> In January, the State Council promulgated Rules on Real Name System for Personal Bank Account and confirmed the illegality of money laundering with anonymous account.³³ The PBC promulgated the Rules for Anti-money Laundering Efforts by Financial Institutions, the Administrative Rules for the Reporting of

25 FATF. 2007. *FIRST MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM-People's Republic of China*, pp.80. Available at: <URL: <http://www.fatf-gafi.org/dataoecd/33/11/39148196.pdf>> [Accessed on: 1/08/08]

26 The People's Bank of China. 2004. *PBC's AML Official Answers Questions on China's Anti-Money Laundering Campaign*. Available at: <URL: <http://www.pbc.gov.cn/english/detail.asp?col=6400&ID=412>> [Accessed on: 16 November 2005].

27 FATF. 2007. *FIRST MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM-People's Republic of China*, pp.55. Available at: <URL: <http://www.fatf-gafi.org/dataoecd/33/11/39148196.pdf>> [Accessed on: 1/08/08]

28 FATF. 2007. *FIRST MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM-People's Republic of China*, pp.134. Available at: <URL: <http://www.fatf-gafi.org/dataoecd/33/11/39148196.pdf>> [Accessed on: 1/08/08]

29 FATF. 2007. *FIRST MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM-People's Republic of China*, pp.99. Available at: <URL: <http://www.fatf-gafi.org/dataoecd/33/11/39148196.pdf>> [Accessed on: 1/08/08]

30 FATF. 2007. *FIRST MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM-People's Republic of China*, pp.142. Available at: <URL: <http://www.fatf-gafi.org/dataoecd/33/11/39148196.pdf>> [Accessed on: 1/08/08]

31 Morais, H. and Yang, B. 2002. ANTI-MONEY LAUNDERING. GENERAL ANALYSIS AND RECOMMENDATIONS. In: ADB. 2003. *FINAL REPORT, SECTION V – AML – GENERAL ANALYSIS*. Available at: <URL: <http://www.adb.org/Documents/Reports/TA3890/chap5.pdf>> [Accessed on: 3/02/04]

32 Morais, H. and Yang, B. 2002. ANTI-MONEY LAUNDERING. GENERAL ANALYSIS AND RECOMMENDATIONS. In: ADB. 2003. *FINAL REPORT, SECTION V – AML – GENERAL ANALYSIS*. Available at: <URL: <http://www.adb.org/Documents/Reports/TA3890/chap5.pdf>> [Accessed on: 3/02/04]

33 The People's Bank of China. 2004. *PBC's AML Official Answers Questions on China's Anti-Money Laundering Campaign*. Available at: <URL: <http://www.pbc.gov.cn/english/detail.asp?col=6400&ID=412>> [Accessed on: 16 November 2005].

Large-Value and Suspicious RMB Payment Transactions, and the Administrative Rules for the Reporting of Large-Value and Suspicious Foreign Exchange Transactions by Financial Institutions, which clearly prescribed that financial institutions shall monitor and report any large-value and/or suspicious transactions and cooperate with the judiciary and/or administrative departments to fight against money laundering. It also issued the classification of the reporting of large-value and suspicious fund transactions and the punishment for any contravention.³⁴

- In terms of the institutional organizations, the State Council confirmed the leadership of PBC in AML operation of financial institutions and its responsibility in fund monitoring. The AML responsibility of PBC has been cleared in Law of People's Bank of China that amended at the end of 2003. To fulfil this responsibility, the PBC set up the AML Bureau and the AML monitoring and analysis centre. To improve the AML in financial industry, the PBC formed as the leading institution the AML coordination mechanism for financial regulatory and supervisory sector jointly with CBRC, CSRC, CIRC and SAFE, which is brought into full play in AML in financial industry.³⁵
- In terms of preventing and cracking down money laundering, the commercial banks have formed the internal AML system based on the client information, transaction reports and records.³⁶
- In January, the PBC has issued guidance via administrative regulations (secondary legislation): the Financial Institutions Anti-money Laundering

34 The People's Bank of China. 2004. *PBC's AML Official Answers Questions on China's Anti-Money Laundering Campaign*. Available at: <URL: <http://www.pbc.gov.cn/english/detail.asp?col=6400&ID=412>> [Accessed on: 16 November 2005].

35 The People's Bank of China. 2004. *PBC's AML Official Answers Questions on China's Anti-Money Laundering Campaign*. Available at: <URL: <http://www.pbc.gov.cn/english/detail.asp?col=6400&ID=412>> [Accessed on: 16 November 2005].

36 The People's Bank of China. 2004. *PBC's AML Official Answers Questions on China's Anti-Money Laundering Campaign*. Available at: <URL: <http://www.pbc.gov.cn/english/detail.asp?col=6400&ID=412>> [Accessed on: 16 November 2005].

37 FATF. 2007. *FIRST MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM-People's Republic of China*. pp.49. Available at: <URL: <http://www.fatf-gafi.org/dataoecd/33/1/39148196.pdf>> [Accessed on: 1/08/08]

38 FATF. 2003. *Annual report 2002-2003*. Available at: <URL: <http://www.oecd.org/dataoecd/12/27/2789358.pdf>> [Accessed on: 18/09/06]

39 Morais, H. and Yang, B. 2002. ANTI-MONEY LAUNDERING . GENERAL ANALYSIS AND RECOMMENDATIONS. In: ADB. 2003. *FINAL REPORT, SECTION V – AML – GENERAL ANALYSIS*. Available at: <URL: <http://www.adb.org/Documents/Reports/TA3890/chap5.pdf>> [Accessed on: 3/02/04]

40 Morais, H. and Yang, B. 2002. ANTI-MONEY LAUNDERING . GENERAL ANALYSIS AND RECOMMENDATIONS. In: ADB. 2003. *FINAL REPORT, SECTION V – AML – GENERAL ANALYSIS*. Available at: <URL: <http://www.adb.org/Documents/Reports/TA3890/chap5.pdf>> [Accessed on: 3/02/04]

41 FATF. 2007. *FIRST MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM-People's Republic of China*. pp.104. Available at: <URL: <http://www.fatf-gafi.org/dataoecd/33/1/39148196.pdf>> [Accessed on: 1/08/08]

42 Morais, H. and Yang, B. 2002. ANTI-MONEY LAUNDERING . GENERAL ANALYSIS AND RECOMMENDATIONS. In: ADB. 2003. *FINAL REPORT, SECTION V – AML – GENERAL ANALYSIS*. Available at: <URL: <http://www.adb.org/Documents/Reports/TA3890/chap5.pdf>> [Accessed on: 3/02/04]

43 Morais, H. and Yang, B. 2002. ANTI-MONEY LAUNDERING . GENERAL ANALYSIS AND RECOMMENDATIONS. In: ADB. 2003. *FINAL REPORT, SECTION V – AML – GENERAL ANALYSIS*. Available at: <URL: <http://www.adb.org/Documents/Reports/TA3890/chap5.pdf>> [Accessed on: 3/02/04]

44 FATF. 2007. *FIRST MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM-People's Republic of China*. pp.45. Available at: <URL: <http://www.fatf-gafi.org/dataoecd/33/1/39148196.pdf>> [Accessed on: 1/08/08]

45 FATF. 2007. *FIRST MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM-People's Republic of China*. pp.49. Available at: <URL: <http://www.fatf-gafi.org/dataoecd/33/1/39148196.pdf>> [Accessed on: 1/08/08]

46 FATF. 2007. *FIRST MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM-People's Republic of China*. pp.79. Available at: <URL: <http://www.fatf-gafi.org/dataoecd/33/1/39148196.pdf>> [Accessed on: 1/08/08]

47 Morais, H. and Yang, B. 2002. ANTI-MONEY LAUNDERING . GENERAL ANALYSIS AND RECOMMENDATIONS. In: ADB. 2003. *FINAL REPORT, SECTION V – AML – GENERAL ANALYSIS*. Available at: <URL: <http://www.adb.org/Documents/Reports/TA3890/chap5.pdf>> [Accessed on: 3/02/04]

48 FATF. 2007. *FIRST MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM-People's Republic of China*. pp.88. Available at: <URL: <http://www.fatf-gafi.org/dataoecd/33/1/39148196.pdf>> [Accessed on: 1/08/08]

Provisions (FIAML Provisions), the RMB-LVT/STR Rules and the FX-LVT/STR Rules.³⁷

- Between 27th and 28th March, it was the first time that international anti-money laundering congress organized by FATF was held in China.³⁸
- In March, the PRC has bilateral judicial assistance agreements on criminal matters with 24 countries and extradition agreements with 15 countries.³⁹
- SAFE initiated the issuance of some guidelines and reporting forms in March.⁴⁰
- The CBRC was established in April.⁴¹
- The National People's Congress ratified the Palermo Convention on 27th August.⁴²
- On 17th September, the PBC issued the following regulation and administrative measures (hereinafter referred to as the "three regulations"), which became effective on 1st March, establishing a set of anti-money laundering rules for financial institutions falling within the PBC's and SAFE's supervision. These three sets of rules also fall below the level of a Basic Law: (1) Regulation on Anti-Money Laundering for Financial Institutions (administered by PBC); (2) Administrative Measures for Financial Institutions Governing Large Value and Suspicious Renminbi Transactions (administered by PBC); and (3) Administrative Measures for Financial Institutions Governing Large Value and Suspicious Foreign Exchange Transactions (administered by SAFE).⁴³
- In October, the AMLB, which was established organises and coordinates China's AML affairs, and carries out administrative investigation, dissemination and policy oversight.⁴⁴
- The SAFE issued regulations and guidance in form of official papers concerning specific procedures for reporting suspicious transactions involving foreign exchange, including the reporting obligations of financial institutions, the criteria of data and the format of reporting.⁴⁵
- China signed and ratified the United Nations Convention against Corruption on 10th December 2003 and 27th October 2005 respectively.⁴⁶
- In 2002-03, the Government is well aware of the seriousness of money laundering problem and appears intent on dealing with it, as evidenced by a series of legal measures that it has adopted in recent years, most notably.⁴⁷
- International Telegraphic Transfer Service (trial) in 2003.⁴⁸

2004

- Measures have been taken to strengthen and improve the AML work. First, advancing the AML legislation. Drafting and enacting Law of Anti-money Laundering is in great necessity. Hence, the National People's Congress set up the drafting group consisting of the PBC and other over a dozen of government ministries on 22nd March.⁴⁹
- CAMLMAC was established in April.⁵⁰
- An AML cooperation mechanism was established in April 2004 by the PBC in conjunction with the CBRC, CSRC, CIRC and SAFE to coordinate, direct and

49 The People's Bank of China. 2004. *PBC's AML Official Answers Questions on China's Anti-Money Laundering Campaign*. Available at: <URL: <http://www.pbc.gov.cn/english/detail.asp?col=6400&ID=412>> [Accessed on: 16 November 2005].

50 FATF. 2007. *FIRST MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM-People's Republic of China*. pp.44. Available at: <URL: <http://www.fatf-gafi.org/dataoecd/33/11/39148196.pdf>> [Accessed on: 1/08/08]

deploy AML responsibilities in the financial industry.⁵¹

- In July, CAMLMAC established a staff disciplinary code.⁵²
- In August, the PBC issued standards for financial institutions for the development of AML monitoring and analysis systems in relation to domestic and foreign currencies.⁵³
- On 12th October, SAFE published its Implementation Rules of the FX-LVT/STR Rules to provide guidance for commercial banks.⁵⁴
- In December, the PBC issued to financial institutions the Template for the Completion and Submission Format of Reports on Suspicious Transactions.⁵⁵
- Notice of the PBC concerning the reporting standard of RMB and foreign currency transactions through CAMLMAC system (trial)(2004).⁵⁶
- Notice of the PBC General Office concerning the networking schedule of the CAMLMAC system (2004).⁵⁷
- Notice of the PBC on Observing the large-value and suspicious transaction reporting obligations (2004).⁵⁸

2005

- Since January 2005, all STRs involving RMB are reported electronically.⁵⁹
- Notice of the PBC on several issues concerning improving networking with CAMLMAC system and reporting RMB and foreign currency transactions (2005); Notice of the PBC General Office on enlarging the monitoring scope of large-value transaction and accelerating the team building of reporters (2005); Notice of the PBC General Office on accelerating networking with CAMLMAC system and reporting RMB and foreign currency transactions by urban commercial banks (2005); Circular of the PBC General Office on Work concerning Large-value and Suspicious Transactions Reports in 2005 (2006).⁶⁰
- Notice of the PBC on the Financial Institutions' Enforcing the AML Rules Strictly and Keeping the ML Risks Away (2005).⁶¹
- The MPS and the PBC jointly issued the Cooperation Regulations on the Investigation of Suspicious Transaction [Referrals] ("Cooperation Regulations") on 18th March.⁶²

51 FATF. 2007. *FIRST MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM-People's Republic of China*. pp.135. Available at: <URL: <http://www.fatf-gafi.org/dataoecd/33/1/139148196.pdf>> [Accessed on: 1/08/08]

52 FATF. 2007. *FIRST MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM-People's Republic of China*. pp.94. Available at: <URL: <http://www.fatf-gafi.org/dataoecd/33/1/139148196.pdf>> [Accessed on: 1/08/08]

53 FATF. 2007. *FIRST MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM-People's Republic of China*. pp.50. Available at: <URL: <http://www.fatf-gafi.org/dataoecd/33/1/139148196.pdf>> [Accessed on: 1/08/08]

54 FATF. 2007. *FIRST MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM-People's Republic of China*. pp.49. Available at: <URL: <http://www.fatf-gafi.org/dataoecd/33/1/139148196.pdf>> [Accessed on: 1/08/08]

55 FATF. 2007. *FIRST MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM-People's Republic of China*. pp.50. Available at: <URL: <http://www.fatf-gafi.org/dataoecd/33/1/139148196.pdf>> [Accessed on: 1/08/08]

56 FATF. 2007. *FIRST MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM-People's Republic of China*. pp.49. Available at: <URL: <http://www.fatf-gafi.org/dataoecd/33/1/139148196.pdf>> [Accessed on: 1/08/08]

57 FATF. 2007. *FIRST MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM-People's Republic of China*. pp.49. Available at: <URL: <http://www.fatf-gafi.org/dataoecd/33/1/139148196.pdf>> [Accessed on: 1/08/08]

58 FATF. 2007. *FIRST MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM-People's Republic of China*. pp.49. Available at: <URL: <http://www.fatf-gafi.org/dataoecd/33/1/139148196.pdf>> [Accessed on: 1/08/08]

59 FATF. 2007. *FIRST MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM-People's Republic of China*. pp.46. Available at: <URL: <http://www.fatf-gafi.org/dataoecd/33/1/139148196.pdf>> [Accessed on: 1/08/08]

60 FATF. 2007. *FIRST MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM-People's Republic of China*. pp.49. Available at: <URL: <http://www.fatf-gafi.org/dataoecd/33/1/139148196.pdf>> [Accessed on: 1/08/08]

61 FATF. 2007. *FIRST MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM-People's Republic of China*. pp.49. Available at: <URL: <http://www.fatf-gafi.org/dataoecd/33/1/139148196.pdf>> [Accessed on: 1/08/08]

- In 2005, the CAMLMAC published a book of cases about money laundering in China and foreign countries. CAMLMAC also publishes some general statistics on its website.⁶³
- In April, the PBC began to use the AML electronic training systems offered by ASEM and by the UN Drug Control Office.⁶⁴
- In June, Article 5 Measures of the Management of CAMLMAC Intelligence (Trial) implemented.⁶⁵
- “Baggage Declaration Form for Incoming/Outgoing Passengers” the Notice on the Declaration System for Travellers Entering and Exiting China at airports, is set out at Airports (2005).⁶⁶

2006

- On 1st January, joint-stock companies have been able to issue “unregistered stocks” or bearer shares (article 130, Company Law).⁶⁷
- In January, to remedy information deficiencies, the PBOC launched a national credit-information system. This system allows banks to have access to information on individuals as well as on corporate entities.
- On 27th March, the Prosecutor General issued binding instructions “on the Seizure and Freezing of Money and Property by the People’s Procuratorates”, that however make no reference to indirect proceeds in the form of converted and transformed criminal assets.⁶⁸
- On 19th April, China signed the FT Convention on 13 November 2001 and submitted the instrument of ratification.⁶⁹
- On 29th June, Article 191 PC was last amended on to add three additional broad categories of predicate offences (corruption or bribery, disrupting the financial management order and financial fraud).⁷⁰
- On 29th June, Article 312 of the Penal Code (PC) was extended to cover all “income or proceeds there from” and certain money laundering activity.⁷¹
- Inserted by the amendment of 29 June 2006, the inclusion of catch-all terminology such as “by any other means” in articles 312 and 191 PC was clearly intended to cover all possibilities and eventualities of laundering activity.⁷²

62 FATF. 2007. *FIRST MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM-People's Republic of China*. pp.135. Available at: <URL: <http://www.fatf-gafi.org/dataoecd/33/1/39148196.pdf>> [Accessed on: 1/08/08]

63 FATF. 2007. *FIRST MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM-People's Republic of China*. pp.51. Available at: <URL: <http://www.fatf-gafi.org/dataoecd/33/1/39148196.pdf>> [Accessed on: 1/08/08]

64 FATF. 2007. *FIRST MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM-People's Republic of China*. pp.105. Available at: <URL: <http://www.fatf-gafi.org/dataoecd/33/1/39148196.pdf>> [Accessed on: 1/08/08]

65 FATF. 2007. *FIRST MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM-People's Republic of China*. pp.94. Available at: <URL: <http://www.fatf-gafi.org/dataoecd/33/1/39148196.pdf>> [Accessed on: 1/08/08]

66 FATF. 2007. *FIRST MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM-People's Republic of China*. pp.63. Available at: <URL: <http://www.fatf-gafi.org/dataoecd/33/1/39148196.pdf>> [Accessed on: 1/08/08]

67 FATF. 2007. *FIRST MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM-People's Republic of China*. pp.128. Available at: <URL: <http://www.fatf-gafi.org/dataoecd/33/1/39148196.pdf>> [Accessed on: 1/08/08]

68 FATF. 2007. *FIRST MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM-People's Republic of China*. pp.23. Available at: <URL: <http://www.fatf-gafi.org/dataoecd/33/1/39148196.pdf>> [Accessed on: 1/08/08]

69 FATF. 2007. *FIRST MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM-People's Republic of China*. pp.137. Available at: <URL: <http://www.fatf-gafi.org/dataoecd/33/1/39148196.pdf>> [Accessed on: 1/08/08]

70 FATF. 2007. *FIRST MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM-People's Republic of China*. pp.21. Available at: <URL: <http://www.fatf-gafi.org/dataoecd/33/1/39148196.pdf>> [Accessed on: 1/08/08]

71 FATF. 2007. *FIRST MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM-People's Republic of China*. pp.21. Available at: <URL: <http://www.fatf-gafi.org/dataoecd/33/1/39148196.pdf>> [Accessed on: 1/08/08]

72 FATF. 2007. *FIRST MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM-People's Republic of China*. pp.23. Available at: <URL: <http://www.fatf-gafi.org/dataoecd/33/1/39148196.pdf>> [Accessed on: 1/08/08]

2007

- Since 1 July, all “suspicious” transaction reports (meaning both suspicious and unusual transaction reports (“STR”) and large value transaction (LVT) reporting by financial institutions have been made to CAMLMAC.⁷³
- On 1st November, China passes first anti-money laundering law.⁷⁴
- In November, the Rules Administrative Rules for the Reporting by Financial Institutions of Large-value and Suspicious Transactions.⁷⁵
- As at the end of 2006, the CSRC had signed MOUs on supervisory cooperation with 32 foreign counterparts.⁷⁶
- Notice of PBC concerning implementing the reporting standard of RMB and foreign currency transactions through CAMLMAC system (2006).⁷⁷

2008

- On 1st January, The new Money Laundering Law was introduced.⁷⁸
- On 1 March, the AML and the new LVT/STR Rules came into force.⁷⁹
- As of 1st March, article 4 of the FX-LVT/STR Rules and article 10 of the RMB-LVT/STR Rules are no longer in force.⁸⁰
- On 1st August, the Administrative Rules for Financial Institutions on Customer Identification and Record Keeping of Customer Identity and Transaction Information (CDD Rules) became effective.⁸¹
- Administrative Measures for Identifying the Financial Institutions’ Clients and Preserving Their Identity Information and Transaction Records 2007 (Joint Order of PBC, CBRC, CSRC, CIRC [2007] No.2, issued on 21st June 2007 and effective on 1st August 2007) (“Regulations on Customer Identification”).⁸²
- Administrative Measures for the on-site of Anti-money Laundering Inspections (for Trial Implementation).⁸³

- On 21st April, anti-money Laundering Work Guideline for Members of the Securities Association of China issued and effective.⁸⁴

73 FATF. 2007. FIRST MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM-People's Republic of China. pp.43. Available at: <URL: <http://www.fatf-gafi.org/dataoecd/33/11/39148196.pdf>> [Accessed on: 1/08/08]

74 UN. 2008. ANTI-MONEY LAUNDERING AND COUNTERING THE FINANCING OF TERRORISM (AML/CFT) NEWSLETTER FOR CENTRAL ASIA. Available at: <URL: [http://www.imolin.org/pdf/imolin/AML/CFT%20Newsletter%20Issue%2024%20-%20January%202008%20\(1MoLIN\).pdf](http://www.imolin.org/pdf/imolin/AML/CFT%20Newsletter%20Issue%2024%20-%20January%202008%20(1MoLIN).pdf)> [Accessed on: 09/04/08]

75 IBA. 2009. LIST THE LAWS REGARDING ANTI-MONEY LAUNDERING, INDICATING WHICH LAWS ARE APPLICABLE TO LAWYERS. Available at: <URL: <http://www.anti-moneylaundering.org/asiapacific/China.aspx>> [Accessed on: 21/10/09]

76 FATF. 2007. FIRST MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM-People's Republic of China. pp.146. Available at: <URL: <http://www.fatf-gafi.org/dataoecd/33/11/39148196.pdf>> [Accessed on: 1/08/08]

77 FATF. 2007. FIRST MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM-People's Republic of China. pp.49. Available at: <URL: <http://www.fatf-gafi.org/dataoecd/33/11/39148196.pdf>> [Accessed on: 1/08/08]

78 UN. 2008. ANTI-MONEY LAUNDERING AND COUNTERING THE FINANCING OF TERRORISM (AML/CFT) NEWSLETTER FOR CENTRAL ASIA. Available at: <URL: [http://www.imolin.org/pdf/imolin/AML/CFT%20Newsletter%20Issue%2024%20-%20January%202008%20\(1MoLIN\).pdf](http://www.imolin.org/pdf/imolin/AML/CFT%20Newsletter%20Issue%2024%20-%20January%202008%20(1MoLIN).pdf)> [Accessed on: 09/04/08]

79 FATF. 2007. FIRST MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM-People's Republic of China. pp.45. Available at: <URL: <http://www.fatf-gafi.org/dataoecd/33/11/39148196.pdf>> [Accessed on: 1/08/08]

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2009

- On 19th May, anti-money Laundering Work Guideline for Members of the China Futures Association was issued and effective.⁸⁵
- At the end of 2008, China has 15 foreign financial intelligence units and organizations have signed a memorandum of financial intelligence exchange and cooperation, expanding the scope of bilateral cooperation in anti-money laundering, and cooperation and constantly enrich the content, the international community, China has become the field of anti-money laundering and terrorist financing an important member of.⁸⁶
- On 31st December, PBC published Notice of the People's Bank of China on Further Strengthening the Anti-money Laundering Work of Financial Institutions.⁸⁷
- Insurance Law of the People's Republic of China issued.⁸⁸
- On 18th August, Standard Guidance for Classification of Client Risk Level in Anti-money Laundering for Securities Companies, (China Banking Association, Zhong Zheng Xie Fa [2009] No. 110, issued and effective),⁸⁹
- Tentative Guidance on Risk Rank Classification of Clients of Fund Management Companies for Anti-money Laundering Purposes.⁹⁰

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Appendix Two

Questions for Checking the Quality Risk Assessment

Does the risk assessment address the time scale? Is it realistic?

Does the risk assessment address the impact on the financial institutions?

Does the risk assessment address the cost of impact?

Does the risk assessment address the significance of the impact?

Does the risk assessment follow the procedures?

Does the risk assessment address the circumstances when the risk will be imminent, occur at any time without risk factors, occur with significant risk indicators, less likely occur, or very unlikely to occur?

Does the risk assessment address the positive factors need to remain and develop and further implementing work?

Appendix Three

Questions to Address Risk Responses

Who should be responsible for managing the risk?

Who should take the actions and by when?

How will you respond to the risk?

What contact work need to undertake and what are the purpose of contact?

Which agencies are involved?

What are added measures to manage the specific risk?

What factors will increase the risk?

What work will be done to reduce the risk?

What further work could be amended in the risk management plan in the future?

What is the contingency plan?

Appendix Four

The Minimum Information Needed for Record

The number of the review

The level of monitoring

Who undertakes the review?

The organisational objective to which the risk is linked

The areas concerned

The risk owner

The nature of the risk

Details of current risk management strategy

What documents used to complete the review such as surveys or self-assessment questionnaires?

Agreed remedial action

Implementation date

Review date

Adjusted score

Reporting Mechanisms

Performance indicators

Reviews by external bodies

Appendix Five

Five Forms Filed in a Customer Record in Future Company

Individual Investor Future Clearing Account Registration Form

Legal Person Investor Future Clearing Account Registration Form

Entrusted Person Registration Form of Individual Investor Future Clearing Account

Entrusted Person Registration Form of Legal Person Investor Future Clearing Account

Individual or Legal Person Investor Future Clearing Account Registration Summary Table

Appendix Six

Legislation in the Context of Money Laundering

Criminalisation of Money Laundering

Criminal Law of the People's Republic of China

Article 120

Whoever organises, leads and actively participates in terrorist organization shall be sentenced to fixed-term imprisonment of not less than three years and not more than ten years. Other participants shall be sentenced to fixed-term imprisonment of not more than three years, criminal detention or public surveillance.

Whoever commits the crime mentioned in the preceding paragraph and concurrently commits homicide, causing explosion, kidnapping or other crimes shall be punished according to the provisions of combined punishment for several crimes.

Article 191

Whoever conducts any of the following acts clearly knowing that the money is unlawful earnings and their profits obtained from drug-related crimes, crimes committed by groups in the nature of criminal syndicates or crimes of smuggling, and for the purpose of covering up or concealing its source and nature shall, with the unlawful earnings obtained from the crimes above-mentioned and their profits confiscated, be sentenced to fixed-term imprisonment of not more than five years, and concurrently or independently be sentenced to a fine of not less than 5% of the sum of money laundered and not more than 20% of the sum. If the circumstances are serious, the offender shall be sentenced to fixed-term imprisonment of not less than five years and not more than ten years, and concurrently be sentenced to a fine of not less than 5% of the sum of money laundered and not more than 20% of the sum:

- (1) providing funds accounts;
- (2) assisting in transforming the property into cash or financial bills;

- (3) assisting in transferring funds by means of transferring accounts or other means of settling accounts;
- (4) assisting in remitting funds to any place outside China; or
- (5) by other means covering up or concealing the source and nature of unlawful earnings from crimes and profits thereof.

If a unit commits a crime mentioned in the preceding paragraph, the unit shall be sentenced to a fine and persons directly in charge and other persons directly responsible for the crime shall be sentenced to fixed-term imprisonment of not more than five years or criminal detention.

Article 312

Whoever, while clearly knowing that it is booty obtained through a crime, conceals, transfers, purchases or sells it for the criminal shall be sentenced to fixed-term imprisonment of not more than three years, criminal detention or public surveillance, and concurrently or independently be sentenced to a fine.

Article 349

Whoever shields offenders engaged in smuggling, trafficking in, transporting or manufacturing narcotic drugs, or whoever harbours, transfers or covers up, for such offenders, narcotic drugs or their pecuniary and other gains from such criminal activities, shall be sentenced to fixed-term imprisonment of not more than three years, criminal detention or public surveillance; if the circumstances are serious, the offender shall be sentenced to fixed-term imprisonment of not less than three years and not more than ten years.

Any anti-narcotic drugs personnel or other state functionary who screens or shields offenders engaged in smuggling, trafficking in, transporting or manufacturing narcotic drugs shall be given a heavier punishment according to the provisions in the preceding paragraph.

Conspirators to a crime mentioned in the preceding two paragraphs shall be punished as for a joint crime of smuggling, trafficking in, transporting or manufacturing of narcotic drugs.

Confiscation of Proceeds

Criminal Law of the People's Republic of China

Article 52

The amount of any fine imposed shall be determined according to the circumstances of the crime.

Article 59

Confiscation of property refers to the confiscation of part or all of the property personally owned by a criminal. When all of the property of a criminal is confiscated, necessities of life for the criminal and his dependent family members shall be left out.

When a sentence of confiscation of property is imposed, property that the criminal's family members own or should own shall not be subject to confiscation.

Article 64

All property illegally obtained by a criminal shall be recovered, or compensation shall be ordered. Legal property of the victim shall be returned. Contrabands and possessions of the criminal that were used in the crime shall be confiscated. The property confiscated and fine shall be turned over to the State Treasury, and shall not be misappropriated or disposed without authorization.

Seizure of Proceeds

Criminal Procedure Law of the People's Republic of China (CPL)

Article 114

Any articles and documents discovered during an inquest or search that may be used to prove a criminal suspect's guilt or innocence shall be seized. Articles and documents which are irrelevant to the case may not be seized. Seized articles and documents shall be properly kept or sealed for safekeeping and may not be utilized or damaged.

Article 117

The People's Procuratorates and the public security organs may, as required by investigation of crimes, inquire into or freeze criminal suspects' deposits or remittances according to regulations. If the

deposits or remittances of the criminal suspects have been frozen, they shall not be frozen for a second time.

Article 158

During a court hearing, if the collegial panel has doubts about the evidence, it may announce an adjournment, in order to carry out investigation to verify the evidence. When carrying out investigation to verify evidence, the People's Court may conduct inquest, examination, seizure, expert evaluation, as well as inquiry and freeze.

Article 198

The public security organs, People's Procuratorates and People's Courts shall have the property, things of value of the criminal suspects and defendants, as well as the fruits accruing therefrom, that they have seized or frozen well kept for examination. No units or individuals shall misappropriate them or dispose of them without authorization. The lawful property of the victims shall be returned to them without delay. Prohibited articles and perishable things shall be disposed of in accordance with the relevant regulations of the State.

Things that serve as tangible evidence shall be transferred together with the case, but for things that are unsuitable to be transferred, their inventory and photos and other documents of certification shall be transferred together with the case.

After a judgment rendered by the People's Court becomes effective, all the seized or frozen illicit money and goods as well as the fruits accruing therefrom, except those that are returned to the victim according to law, shall be confiscated and turned over to the State Treasury.

Any judicial officer who embezzles or misappropriates or disposes of the seized or frozen illicit money and goods as well as the fruits accruing therefrom without authorization shall be investigated for criminal responsibility according to law; if the offence does not constitute a crime, he shall be given administrative sanction.

The Law of the People's Republic of China on Administrative Punishments

Article 8

Classification of Administrative Punishments:

- (1) Warning,
- (2) Fine,
- (3) Forfeiture of illegal earnings, forfeiture of illegal property,
- (4) Order to stop production and business,
- (5) Suspension or withdrawal of permits, suspension or withdrawal of licenses,
- (6) Administrative detention, and
- (7) Other administrative punishments as stipulated by law or administrative regulations.

Article 9

Various administrative punishments can be established by law. Administrative punishment which restrains personal liberty can only be established by law.

Article 10

Administrative regulations can establish whatever administrative punishments except those restraining personal liberty. Where stipulations are already formulated by law on administrative punishments for illegal acts, specific stipulations to be formulated by administrative regulations must come within the scope of acts, classification and extent stipulated by law for imposing administrative punishments.

Article 11

Local regulations can establish administrative punishments except those restraining personal liberty and withdrawing enterprises' business licenses. Where stipulations are already formulated by law or administrative regulations on administrative punishments for illegal acts, specific stipulations to be formulated by local regulations must come within the scope of acts, classification and extent stipulated by law or administrative regulations on imposing administrative punishments.

Freezing of Proceeds:

Administrative Supervision Law

Article 20

In investigating violations of the rules of administrative discipline, a supervisory organ may adopt the following measures in light of actual conditions and needs:

- (1) to temporarily seize and seal up documents, data, financial accounts and other relevant materials which may be used as proof of violations of the rules of administrative discipline;
- (2) to order the units and persons suspected of being involved in a case not to sell off or transfer any property relevant to the case during the period of investigation;
- (3) to order the persons suspected of violating the rules of administrative discipline to explain and clarify questions relevant to the matters under investigation at a designated time and place; however, no such persons may be taken into custody or detained in disguised form; and
- (4) to propose to the competent authorities that they suspend the persons suspected of seriously violating the rules of administrative discipline from execution of their official duties.

Article 21

In investigating violations of the rules of administrative discipline, such as graft, bribery and misappropriation of public funds, a supervisory organ may inquire about the deposits of the suspected units and persons at banks or other banking institutions, with the approval of the leading members of a supervisory organ at or above the county level. When necessary, it may request the People's Court to adopt preservation measures to freeze the deposits of such persons at banks or other banking institutions in accordance with law.

The Third Party Protection:

Criminal Law of the People's Republic of China

Article 60

If it is necessary to use a confiscated property to repay legitimate debts that the criminal incurred before his property is confiscated, such debts shall be paid at the request of the creditors.

Law of the People's Republic of China on State Compensation

Article 4

The victim shall have the right to compensation if an administrative organ or its functionaries, in exercising their functions and powers, commit any of the following acts infringing upon property right:

- (1) Illegally inflicting administrative sanctions such as imposition of fines, revocation of certificates and licences, ordering suspension of production and business, or confiscation of property;
- (2) Illegally implementing compulsory administrative measures such as sealing up, distaining or freezing property;
- (3) Expropriating property or apportioning expenses in violation of the provisions of the State; or
- (4) Other illegal acts causing damage to property.

Law on Property Rights

Article 105

Real estate that has been transferred to a bona fide party remains his property if certain conditions are met.

General Principles of the Civil Law

Article 58

Civil acts in the following categories shall be null and void:

- (1) those performed by a person without capacity for civil conduct;
- (2) those that according to law may not be independently performed by a person with limited capacity for civil conduct;
- (3) those performed by a person against his true intentions as a result of cheating, coercion or exploitation of his unfavourable position by the other party;

- (4) those that performed through malicious collusion are detrimental to the interest of the state, a collective or a third party;
- (5) those that violate the law or the public interest;
- (6) economic contracts that violate the state's mandatory plans; and
- (7) those that performed under the guise of legitimate acts conceal illegitimate purposes.

Civil acts that are null and void shall not be legally binding from the very beginning.

Contract Law of the People's Republic of China

Article 52

A contract shall be null and void under any of the following circumstances:

- (1) a contract is concluded through the use of fraud or coercion by one party to damage the interests of the State;
- (2) malicious collusion is conducted to damage the interests of the State, a collective or a third party;
- (3) an illegitimate purpose is concealed under the guise of legitimate acts;
- (4) damaging the public interests; and
- (5) violating the compulsory provisions of laws and administrative regulations.

Appendix Seven

Countries that have a Mutual Legal Assistance Agreement with China that is in legal effect

Belarus

Bulgaria,

Canada,

Colombia,

Cuba,

Cyprus,

Democratic People's Republic of Korea,

Egypt,

Greece,

Kazakhstan,

Kyrgyzstan,

Laos,

Latvia,

Lithuania,

Mongolia,

Poland,

Republic of Korea,

Romania,

Russian Federation,

South Africa,

Tajikistan,

Thailand,

Tunisia,

Turkey,

Ukraine,

USA,

Uzbekistan

Vietnam.

Appendix Eight

The Problems of China's AML System Identified and Amendments Suggested in Comparison with the FATF 40 Recommendations and 9 Special Recommendations

Prevention

Administrative and Regulatory Sanctions

Problems compared with the FATF Recommendations:

- The financial sanction of any violating these rules by financial institutions and their staff has not been detailed.
- A number of administrative and regulatory sanctions on non-compliant financial institutions, but no criminal punishment has been reported in relation to a breach of the CFIAMLR.

Suggested Implementation in line with FATF 40 Recommendations and 9 Special Recommendations

- Clear investigation method needs to be detailed.
- The result of sanctions needs to be published.

Regulation and Supervision

Problems compared with the FATF Recommendations:

- The CAMLMAC/AMLB has an inadequate number of staff compared with the large number of SARs received
- Co-operation with its foreign FIU is hampered due to a small number of MOU that China has signed with external countries and their departments and agencies.
- The internal control environment is not set up to address terrorist financing risks.
- No specific legal and regulatory provisions require financial institutions to ensure that compliance officers analyse STRs in the first place before making reports.
- Dealers in precious metals and stones, lawyers, notaries, real estate agents and company service providers are not required to establish internal AML/CFT control programs. They are not subject to compliance monitoring and supervision.
- Underground banking well serves as an alternative to financial institutions

- Lack of risk-based approaches to manage massive AML work load in financial institutions.

Suggested Implementation in line with FATF 40 Recommendations and 9 Special Recommendations

The Financial Intelligence Unit and its functions (R.26):

R26: Countries should establish a FIU that serves as a national centre for the receiving (and, as permitted, requesting), analysis and dissemination of STR and other information regarding potential money laundering or terrorist financing. The FIU should have access, directly or indirectly, on a timely basis to the financial, administrative and law enforcement information that it requires to properly undertake its functions, including the analysis of STR.

- A practical difficulty of how to manage the enormous volume of STRs directly from the headquarters of financial institutions to CAMLMAC, which has a relatively small number of staff, need to be worked on.

Internal controls, compliance, audit and foreign branches (R.15 & 22):

R15: Financial institutions should develop programmes against money laundering and terrorist financing. These programmes should include:

a) The development of internal policies, procedures and controls, including appropriate compliance management arrangements, and adequate screening procedures to ensure high standards when hiring employees.

b) An ongoing employee training programme.

c) An audit function to test the system

R22: Financial institutions should ensure that the principles applicable to financial institutions, which are mentioned above are also applied to branches and majority owned subsidiaries located abroad, especially in countries which do not or insufficiently apply the FATF Recommendations, to the extent that local applicable laws and regulations permit. When local applicable laws and regulations prohibit this implementation, competent authorities in the country of the parent institution should be informed by the financial institutions that they cannot apply the FATF Recommendations.

- A compliance officer should be assigned at the senior management level and be trained and required to have AML analytic skills and responsibility.
- All financial institutions are required to establish and maintain internal AML control procedures, policies and controls to manage both AML as well as CFT risks.
- Updated and sufficient training are needed and should be regularly.
- Risk-based approaches need to be developed in financial institutions. The resource should follow the risk.

High-risk management procedures will be applied when Chinese financial institutions do business with states or regions that do not apply the FATF Recommendations

Money value transfer services (SR.VI)

SR VI: Each country should take measures to ensure that persons or legal entities, including agents, that provide a service for the transmission of money or value, including transmission through an informal money or value transfer system or network, should be licensed or registered and subject to all the FATF Recommendations that apply to banks and non-bank financial institutions. Each country should ensure that persons or legal entities that carry out this service illegally are subject to administrative, civil or criminal sanctions

- China should consider converting underground banking into legitimate business and provide adequate supervision

Regulation, supervision and monitoring (R.24-25)

R24: Designated non-financial businesses and professions should be subject to regulatory and supervisory measures as set out below.

a) Casinos should be subject to a comprehensive regulatory and supervisory regime that ensures that they have effectively implemented the necessary anti-money laundering and terrorist-financing measures. At a minimum:

casinos should be licensed;

competent authorities should take the necessary legal or regulatory measures to prevent criminals or their associates from holding or being the beneficial owner of a significant or controlling interest, holding a management function in, or being an operator of a casino;

competent authorities should ensure that casinos are effectively supervised for compliance with requirements to combat money laundering and terrorist financing.

b) Countries should ensure that the other categories of designated non-financial businesses and professions are subject to effective systems for monitoring and ensuring their compliance with requirements to combat money laundering and terrorist financing. This should be performed on a risk-sensitive basis. This may be performed by a government authority or by an appropriate self-regulatory organisation, provided that such an organisation can ensure that its members comply with their obligations to combat money laundering and terrorist financing.

R25: The competent authorities should establish guidelines, and provide feedback which will assist financial institutions and designated non-financial businesses and professions in applying national measures to combat money laundering and terrorist financing, and in particular, in detecting and reporting suspicious transactions

- China should ensure that dealers in precious metals and stones, lawyers, notaries, real estate agents and company service providers are monitored or supervised for compliance with AML/CFT requirements, once such

obligations have been imposed on them.

Reporting

Problems compared with the FATF Recommendations

- reporting appears more passive than actively monitoring funds transactions, no obligations and responsibility are clearly made.
- money laundering compliance officers lack of adequate risk assessment capability.
- reporting standard forms designed by the CAMLMAC are not focused and lack demands for the reasoning underlying the reports (and non- reports).
- reporting time is scheduled on a monthly basis, which cannot ensure a timely reporting of STRs.
- No requirement for institutions to retain business correspondence and related documents.
- No Chinese currency legal reporting obligation for the securities and insurance sectors, except when the transactions are done in foreign currencies.

Suggested Implementation in line with FATF 40 Recommendations and 9 Special Recommendations

Record keeping and wire transfer rules (R.10 & SR.VII)

R10: Financial institutions should maintain, for at least five years, all necessary records on transactions, both domestic or international, to enable them to comply swiftly with information requests from the competent authorities. Such records must be sufficient to permit reconstruction of individual transactions (including the amounts and types of currency involved if any) so as to provide, if necessary, evidence for prosecution of criminal activity.

Financial institutions should keep records on the identification data obtained through the customer due diligence process (e.g. copies or records of official identification documents like passports, identity cards, driving licenses or similar documents), account files and business correspondence for at least five years after the business relationship is ended.

The identification data and transaction records should be available to domestic competent authorities upon appropriate authority.

SRVII: Countries should take measures to require financial institutions, including money remitters, to include accurate and meaningful originator information (name, address and account number) on funds transfers and related messages that are sent, and the information should remain with the transfer or

related message through the payment chain.

Countries should take measures to ensure that financial institutions, including money remitters, conduct enhanced scrutiny of and monitor for suspicious activity funds transfers which do not contain complete originator information (name, address and account number).

- Financial institutions should retain business correspondence and other related documents.

Monitoring of transactions and relationships (R.11 & 21)

R11: Financial institutions should pay special attention to all complex, unusual large transactions, and all unusual patterns of transactions, which have no apparent economic or visible lawful purpose. The background and purpose of such transactions should, as far as possible, be examined, the findings established in writing, and be available to help competent authorities and auditors.

R21: Financial institutions should give special attention to business relationships and transactions with persons, including companies and financial institutions, from countries which do not or insufficiently apply the FATF Recommendations. Whenever these transactions have no apparent economic or visible lawful purpose, their background and purpose should, as far as possible, be examined, the findings established in writing, and be available to help competent authorities. Where such a country continues not to apply or insufficiently applies the FATF Recommendations, countries should be able to apply appropriate countermeasures.

- Financial institutions and money laundering compliance officers in particular are obliged to monitor all suspicious transactions.
- Securities and insurance sectors should be obliged to take special note of business relationships with high-risk money laundering countries or regions.
- Sufficient information or guidelines need to be provided by the authorities to instruct financial institutions to increase their awareness of conducting businesses with high-risk customers and jurisdictions.

Suspicious transaction reports and other reporting (R.13-14, 19, 25 & SR.IV)

R13: If a financial institution suspects or has reasonable grounds to suspect that funds are the proceeds of a criminal activity, or are related to terrorist financing, it should be required, directly by law or regulation, to report promptly its suspicions to the financial intelligence unit (FIU).

R14: Financial institutions, their directors, officers and employees should be:

a) Protected by legal provisions from criminal and civil liability for breach of any restriction on disclosure of information imposed by contract or by any legislative, regulatory or administrative

provision, if they report their suspicions in good faith to the FIU, even if they did not know precisely what the underlying criminal activity was, and regardless of whether illegal activity actually occurred.

b) Prohibited by law from disclosing the fact that a suspicious transaction report (STR) or related information is being reported to the FIU.

R19: Countries should consider the feasibility and utility of a system where banks and other financial institutions and intermediaries would report all domestic and international currency transactions above a fixed amount, to a national central agency with a computerised data base, available to competent authorities for use in money laundering or terrorist financing cases, subject to strict safeguards to ensure proper use of the information.

R25: The competent authorities should establish guidelines, and provide feedback which will assist financial institutions and designated non-financial businesses and professions in applying national measures to combat money laundering and terrorist financing, and in particular, in detecting and reporting suspicious transactions.

SR.IV: If financial institutions, or other businesses or entities subject to anti-money laundering obligations, suspect or have reasonable grounds to suspect that funds are linked or related to, or are to be used for terrorism, terrorist acts or by terrorist organisations, they should be required to report promptly their suspicions to the competent authorities.

- Reporting should be extended to cover attempted transactions.
- Financial institutions should be regulated to report suspicious terrorist financing.
- Risk-based approaches should be implemented to apply to all financial institutions, e.g. regulation should be made clear to monitor transactions and businesses originating from or having dealings with high-risk with high-risk states and regions.

Suspicious transaction reporting (R.16)

R16: The requirements set out in Recommendations 13 to 15, and 21 apply to all designated non-financial businesses and professions, subject to the following qualifications:

a) Lawyers, notaries, other independent legal professionals and accountants should be required to report suspicious transactions when, on behalf of or for a client, they engage in a financial transaction in relation to the activities described in Recommendation 12(d). Countries are strongly encouraged to extend the reporting requirement to the rest of the professional activities of accountants, including auditing.

b) Dealers in precious metals and dealers in precious stones should be required to report suspicious transactions when they engage in any cash transaction with a customer equal to or above the applicable designated threshold.

c) Trust and company service providers should be required to report suspicious transactions for a client when, on behalf of or for a client, they engage in a transaction in relation to the activities referred to Recommendation 12(e).

Lawyers, notaries, other independent legal professionals, and accountants acting as independent legal professionals, are not required to report their suspicions if the relevant information was obtained in circumstances where they are subject to professional secrecy or legal professional privilege.

- Internal AML/CFT control and reporting obligations should be extended to all categories of DNFBP.

Customer Due Diligence

Problems compared with the FATF Recommendations

- No specific and comprehensive legal requirement to conduct ongoing due diligence or reviews when bank accounts have been opened. The backdated materials are not always required.
- The prevalent use of anonymous/pseudonym, or forged ID, and the duplication of numbers on about five million manually issued first generation ID cards; meanwhile there is a lack of vigorous CDD check.
- Guan xi (relationship) can be used to avoid CDD check.
- The true ownership of the funds are sometimes required verbally or recorded inconsistently from CDD check.
- Individual Staff facilitates clients who are unable to answer the questions at the time of opening bank accounts or undertaking financial transactions.
- Enhanced due diligence for higher risk categories of customer, business relationship or transactions is under performed. There is a burden to require banks to apply the same CDD measures to all customers, rather than classifying customer types by risk.
- No legal obligations and comprehensive requirements to identify and verify the beneficial owner in all financial institutions. Only the banking sector (which includes foreign exchange and MVT services) is subject to specific requirements relating to the identification of legal persons (e.g. requirements to verify their legal status by obtaining proof of incorporation, names of directors).

Suggested Implementation in line with FATF 40 Recommendations and 9 Special Recommendations

Customer due diligence, including enhanced or reduced measures (R.5 to 8)

R5: Recommendation 5

Financial institutions should not keep anonymous accounts or accounts in obviously fictitious names.

Financial institutions should undertake customer due diligence measures, including identifying and verifying the identity of their customers, when:

establishing business relations;

carrying out occasional transactions: (i) above the applicable designated threshold; or (ii) that are wire transfers in the circumstances covered by the Interpretative Note to Special Recommendation VII;

there is a suspicion of money laundering or terrorist financing; or the financial institution has doubts about the veracity or adequacy of previously obtained customer identification data.

The customer due diligence (CDD) measures to be taken are as follows:

a) Identifying the customer and verifying that customer's identity using reliable, independent source documents, data or information [4].

b) Identifying the beneficial owner, and taking reasonable measures to verify the identity of the beneficial owner such that the financial institution is satisfied that it knows who the beneficial owner is. For legal persons and arrangements this should include financial institutions taking reasonable measures to understand the ownership and control structure of the customer.

c) Obtaining information on the purpose and intended nature of the business relationship.

d) Conducting ongoing due diligence on the business relationship and scrutiny of transactions undertaken throughout the course of that relationship to ensure that the transactions being conducted are consistent with the institution's knowledge of the customer, their business and risk profile, including, where necessary, the source of funds.

Financial institutions should apply each of the CDD measures under (a) to (d) above, but may determine the extent of such measures on a risk sensitive basis depending on the type of customer, business relationship or transaction. The measures that are taken should be consistent with any guidelines issued by competent authorities. For higher risk categories, financial institutions should perform enhanced due diligence. In certain circumstances, where there are low risks, countries may decide that financial institutions can apply reduced or simplified measures.

Financial institutions should verify the identity of the customer and beneficial owner before or during the course of establishing a business relationship or conducting transactions for occasional customers. Countries may permit financial institutions to complete the verification as soon as reasonably practicable following the establishment of the relationship, where the money laundering risks are effectively managed and where this is essential not to interrupt the normal conduct of business.

Where the financial institution is unable to comply with paragraphs (a) to (c) above, it should not open the account, commence business relations or perform the transaction; or should terminate the business relationship; and should consider making a suspicious transactions report in relation to the customer.

These requirements should apply to all new customers, though financial institutions should also apply this Recommendation to existing customers on the basis of materiality and risk, and should conduct due diligence on such existing relationships at appropriate times.

R6: Financial institutions should, in relation to politically exposed persons, in addition to performing normal due diligence measures:

- a) Have appropriate risk management systems to determine whether the customer is a politically exposed person.**
- b) Obtain senior management approval for establishing business relationships with such customers.**
- c) Take reasonable measures to establish the source of wealth and source of funds.**
- d) Conduct enhanced ongoing monitoring of the business relationship.**

R7: Financial institutions should, in relation to cross-border correspondent banking and other similar relationships, in addition to performing normal due diligence measures:

- a) Gather sufficient information about a respondent institution to understand fully the nature of the respondent's business and to determine from publicly available information the reputation of the institution and the quality of supervision, including whether it has been subject to a money laundering or terrorist financing investigation or regulatory action.**
- b) Assess the respondent institution's anti-money laundering and terrorist financing controls.**
- c) Obtain approval from senior management before establishing new correspondent relationships.**
- d) Document the respective responsibilities of each institution.**
- e) With respect to "payable-through accounts", be satisfied that the respondent bank has verified the identity of and performed on-going due diligence on the customers having direct access to accounts of the correspondent and that it is able to provide relevant customer identification data upon request to the correspondent bank.**

R8: Countries may permit financial institutions to rely on intermediaries or other third parties to

perform elements (a) – (c) of the CDD process or to introduce business, provided that the criteria set out below are met. Where such reliance is permitted, the ultimate responsibility for customer identification and verification remains with the financial institution relying on the third party.

The criteria that should be met are as follows:

a) A financial institution relying upon a third party should immediately obtain the necessary information concerning elements (a) – (c) of the CDD process. Financial institutions should take adequate steps to satisfy themselves that copies of identification data and other relevant documentation relating to the CDD requirements will be made available from the third party upon request without delay.

b) The financial institution should satisfy itself that the third party is regulated and supervised for, and has measures in place to comply with CDD requirements in line with Recommendations 5 and 10.

It is left to each country to determine in which countries the third party that meets the conditions can be based, having regard to information available on countries that do not or do not adequately apply the FATF Recommendations.

- Financial institutions should be explicitly required to identify and verify the identity of the beneficial owner of a customer before opening an account, establishing a business relationship, or performing transactions, and to register this identity information.
- To apply based-approaches to undertake due diligence and to create risk profiles and determine the source of funds of customers.
- Financial institutions should be required to conduct enhanced due diligence in relation to high-risk categories of customers such as PEPs and government officials, business relationships and transactions.
- Financial institutions need to determine whether the customer is acting on behalf of another person and are required to carry out related CDD.
- Financial institutions should undertake special CDD on customers who use first generation ID cards to identify persons. The check on the authenticity of ID needs to be enhanced.
- The threshold for the verification of customer identity for wire transfers should be implemented in line with the FATF requirement of no more than US\$1000.

Customer due diligence and record-keeping (R.12)

R12: The customer due diligence and record-keeping requirements set out in Recommendations 5, 6, and 8 to 11 apply to designated non-financial businesses and professions in the following situations:

a) Casinos – when customers engage in financial transactions equal to or above the applicable designated

threshold.

b) Real estate agents - when they are involved in transactions for their client concerning the buying and selling of real estate.

c) Dealers in precious metals and dealers in precious stones - when they engage in any cash transaction with a customer equal to or above the applicable designated threshold.

d) Lawyers, notaries, other independent legal professionals and accountants when they prepare for or carry out transactions for their client concerning the following activities:

buying and selling of real estate;

managing of client money, securities or other assets;

management of bank, savings or securities accounts;

organisation of contributions for the creation, operation or management of companies;

creation, operation or management of legal persons or arrangements, and buying and selling of business entities.

e) Trust and company service providers when they prepare for or carry out transactions for a client concerning the activities listed in the definition in the Glossary.

- The ID records of dealers in precious metals and stones, lawyers, notaries, real estate agents and company service providers should be kept in line with FATF recommendation. When needed, enhanced requirements should apply.

Enforcement

Predicate Offences

Problems compared with the FATF Recommendations

- Collection of terrorist funds is not criminalised.
- No definition of the difference between terrorist activities and separatism movements.
- the sole and knowing acquisition and use are not criminalised.

- Self-laundering is not criminalized.
- No corporate criminal liability is provided for the offences covered by article 312 and 349 PC.

Suggested Implementation in line with FATF 40 Recommendations and 9 Special Recommendations

Criminalization of Money Laundering (R.1 & 2)

R1: Countries should criminalise money laundering on the basis of United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances, 1988 (the Vienna Convention) and United Nations Convention against Transnational Organized Crime, 2000 (the Palermo Convention).

Countries should apply the crime of money laundering to all serious offences, with a view to including the widest range of predicate offences. Predicate offences may be described by reference to all offences, or to a threshold linked either to a category of serious offences or to the penalty of imprisonment applicable to the predicate offence (threshold approach), or to a list of predicate offences, or a combination of these approaches.

Where countries apply a threshold approach, predicate offences should at a minimum comprise all offences that fall within the category of serious offences under their national law or should include offences which are punishable by a maximum penalty of more than one year's imprisonment or for those countries that have a minimum threshold for offences in their legal system, predicate offences should comprise all offences, which are punished by a minimum penalty of more than six months imprisonment.

Whichever approach is adopted, each country should at a minimum include a range of offences within each of the designated categories of offences [3].

Predicate offences for money laundering should extend to conduct that occurred in another country, which constitutes an offence in that country, and which would have constituted a predicate offence had it occurred domestically. Countries may provide that the only prerequisite is that the conduct would have constituted a predicate offence had it occurred domestically.

Countries may provide that the offence of money laundering does not apply to persons who committed the predicate offence, where this is required by fundamental principles of their domestic law.

R2: Countries should ensure that:

a) The intent and knowledge required to prove the offence of money laundering is consistent with the standards set forth in the Vienna and Palermo Conventions, including the concept that such mental

state may be inferred from objective factual circumstances.

b) Criminal liability, and, where that is not possible, civil or administrative liability, should apply to legal persons. This should not preclude parallel criminal, civil or administrative proceedings with respect to legal persons in countries in which such forms of liability are available. Legal persons should be subject to effective, proportionate and dissuasive sanctions. Such measures should be without prejudice to the criminal liability of individuals.

- Legislation should be amended to ensure that the sole and knowing acquisition and use are covered.
- Self-laundering should be criminalized.
- Corporate criminal liability should be covered to all money laundering offences.

Criminalization of Terrorist Financing (SR.I)

SR1: Each country should take immediate steps to ratify and to implement fully the 1999 United Nations International Convention for the Suppression of the Financing of Terrorism.

Countries should also immediately implement the United Nations resolutions relating to the prevention and suppression of the financing of terrorist acts, particularly United Nations Security Council Resolution 1373.

- The collection of terrorist funds should be criminalised so as to ensure that the “terrorism, including terrorist financing” designated category of predicate offence is fully covered in Article 120bis PC.
- The term “terrorist activities” should be specifically and unequivocally defined to be consistent with the TF Convention and Special Recommendation II.

Investigation

Problems compared with the FATF Recommendations

- Law enforcement agencies lack of training programmes designed to improve ML/FT investigators’ knowledge and skills. Investigators find it difficult to target the money aspect of criminal offences.
- Some investigators are not fully aware of the legal elements of ML.
- Operational co-operation between the Police and the Prosecution Service and the Court needs to be improved.
- The cooperation between the Police in different regions needs to improve.
- The cooperation with financial institutions needs to improve.
- International co-operation: Criminalisation of ML, the seizure/confiscation regime and preventative measures are not fully in line with the Vienna, Palermo and TF Conventions.

- Criminalisation of FT and ability to provide mutual legal assistance not fully in line with the TF Convention.
- The investigations are sometimes subject to interventions by politicians.

Suggested Implementation in line with FATF 40 Recommendations and 9 Special Recommendations

National co-operation and coordination (R.31)

R31: Countries should ensure that policy makers, the FIU, law enforcement and supervisors have effective mechanisms in place which enable them to co-operate, and where appropriate co-ordinate domestically with each other concerning the development and implementation of policies and activities to combat money laundering and terrorist financing.

- National co-operation and coordination among AML stakeholders needs to be improved.

The Conventions and UN Special Resolutions (R.35 & SR.I)

R35: Countries should take immediate steps to become party to and implement fully the Vienna Convention, the Palermo Convention, and the 1999 United Nations International Convention for the Suppression of the Financing of Terrorism. Countries are also encouraged to ratify and implement other relevant international conventions, such as the 1990 Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime and the 2002 Inter-American Convention against Terrorism.

SR1: Each country should take immediate steps to ratify and to implement fully the 1999 United Nations International Convention for the Suppression of the Financing of Terrorism.

Countries should also immediately implement the United Nations resolutions relating to the prevention and suppression of the financing of terrorist acts, particularly United Nations Security Council Resolution 1373.

- The knowing acquisition and use of proceeds of crime should be criminalized in line with the Vienna and Palermo Conventions.
- The seizure and confiscation of assets of equivalent value should be amended.
- Terrorist financing should be fully criminalised, as required by the TF Convention.

Mutual Legal Assistance (R.36-38 & SR.V)

R36: Countries should rapidly, constructively and effectively provide the widest possible range of mutual legal assistance in relation to money laundering and terrorist financing investigations, prosecutions, and related proceedings. In particular, countries should:

a) Not prohibit or place unreasonable or unduly restrictive conditions on the provision of mutual legal assistance.

b) Ensure that they have clear and efficient processes for the execution of mutual legal assistance requests.

c) Not refuse to execute a request for mutual legal assistance on the sole ground that the offence is also considered to involve fiscal matters.

d) Not refuse to execute a request for mutual legal assistance on the grounds that laws require financial institutions to maintain secrecy or confidentiality.

Countries should ensure that the powers of their competent authorities required under Recommendation 28 are also available for use in response to requests for mutual legal assistance, and if consistent with their domestic framework, in response to direct requests from foreign judicial or law enforcement authorities to domestic counterparts.

To avoid conflicts of jurisdiction, consideration should be given to devising and applying mechanisms for determining the best venue for prosecution of defendants in the interests of justice in cases that are subject to prosecution in more than one country.

R37: Countries should, to the greatest extent possible, render mutual legal assistance notwithstanding the absence of dual criminality.

Where dual criminality is required for mutual legal assistance or extradition, that requirement should be deemed to be satisfied regardless of whether both countries place the offence within the same category of offence or denominate the offence by the same terminology, provided that both countries criminalise the conduct underlying the offence.

R38: There should be authority to take expeditious action in response to requests by foreign countries to identify, freeze, seize and confiscate property laundered, proceeds from money laundering or predicate offences, instrumentalities used in or intended for use in the commission of these offences, or property of corresponding value. There should also be arrangements for co-ordinating seizure and confiscation proceedings, which may include the sharing of confiscated assets.

SR.V: Each country should afford another country, on the basis of a treaty, arrangement or other mechanism for mutual legal assistance or information exchange, the greatest possible measure of assistance in connection with criminal, civil enforcement, and administrative investigations, inquiries

and proceedings relating to the financing of terrorism, terrorist acts and terrorist organisations.

Countries should also take all possible measures to ensure that they do not provide safe havens for individuals charged with the financing of terrorism, terrorist acts or terrorist organisations, and should have procedures in place to extradite, where possible, such individuals.

- The enforcement of the confiscation provision needs to be enhanced. Domestic and International confiscated proceeds sharing needs to be negotiated and formalised on the base of mutual benefits.

Prosecution and Punishment

Problems compared with the FATF Recommendations

- A low number of convictions indicate the difficulties or inefficiency of implementing AML law or other laws having AML content.

Suggested Implementation in line with FATF 40 Recommendations and 9 Special Recommendations

Law enforcement, prosecution and other competent authorities (R.27 & 28)

R27: Countries should ensure that designated law enforcement authorities have responsibility for money laundering and terrorist financing investigations. Countries are encouraged to support and develop, as far as possible, special investigative techniques suitable for the investigation of money laundering, such as controlled delivery, undercover operations and other relevant techniques. Countries are also encouraged to use other effective mechanisms such as the use of permanent or temporary groups specialised in asset investigation, and co-operative investigations with appropriate competent authorities in other countries.

R28: When conducting investigations of money laundering and underlying predicate offences, competent authorities should be able to obtain documents and information for use in those investigations, and in prosecutions and related actions. This should include powers to use compulsory measures for the production of records held by financial institutions and other persons, for the search of persons and premises, and for the seizure and obtaining of evidence.

- Liaison work among the Police, Prosecution Service and the Court needs to be improved.

6.4 Extradition (R.37, 39 & SR.V)

R37: Countries should, to the greatest extent possible, render mutual legal assistance notwithstanding the absence of dual criminality.

Where dual criminality is required for mutual legal assistance or extradition, that requirement should be deemed to be satisfied regardless of whether both countries place the offence within the same category of offence or denominate the offence by the same terminology, provided that both countries criminalise the conduct underlying the offence.

R39: Countries should recognise money laundering as an extraditable offence. Each country should either extradite its own nationals, or where a country does not do so solely on the grounds of nationality, that country should, at the request of the country seeking extradition, submit the case without undue delay to its competent authorities for the purpose of prosecution of the offences set forth in the request. Those authorities should take their decision and conduct their proceedings in the same manner as in the case of any other offence of a serious nature under the domestic law of that country. The countries concerned should cooperate with each other, in particular on procedural and evidentiary aspects, to ensure the efficiency of such prosecutions.

Subject to their legal frameworks, countries may consider simplifying extradition by allowing direct transmission of extradition requests between appropriate ministries, extraditing persons based only on warrants of arrests or judgements, and/or introducing a simplified extradition of consenting persons who waive formal extradition proceedings.

SR.V: Each country should afford another country, on the basis of a treaty, arrangement or other mechanism for mutual legal assistance or information exchange, the greatest possible measure of assistance in connection with criminal, civil enforcement, and administrative investigations, inquiries and proceedings relating to the financing of terrorism, terrorist acts and terrorist organisations.

Countries should also take all possible measures to ensure that they do not provide safe havens for individuals charged with the financing of terrorism, terrorist acts or terrorist organisations, and should have procedures in place to extradite, where possible, such individuals.

- The co-operation with regards to the extradition needs to be enhanced and simplified.

Civil and Criminal Confiscation/Forfeiture

Problems compared with the FATF Recommendations

- Lack of an equivalent value confiscation measures.
- Lack of enforcement power to pursue the proceeds confiscated, although imposed.

Suggested Implementation in line with FATF 40 Recommendations and 9 Special Recommendations

Confiscation, freezing and seizing of proceeds of crime (R.3)

R.3: Countries should adopt measures similar to those set forth in the Vienna and Palermo Conventions, including legislative measures, to enable their competent authorities to confiscate property laundered, proceeds from money laundering or predicate offences, instrumentalities used in or intended for use in the commission of these offences, or property of corresponding value, without prejudicing the rights of bona fide third parties.

Such measures should include the authority to: (a) identify, trace and evaluate property which is subject to confiscation; (b) carry out provisional measures, such as freezing and seizing, to prevent any dealing, transfer or disposal of such property; (c) take steps that will prevent or void actions that prejudice the State's ability to recover property that is subject to confiscation; and (d) take any appropriate investigative measures.

Countries may consider adopting measures that allow such proceeds or instrumentalities to be confiscated without requiring a criminal conviction, or which require an offender to demonstrate the lawful origin of the property alleged to be liable to confiscation, to the extent that such a requirement is consistent with the principles of their domestic law.

- Equivalent value confiscation should be amended.
- Clear provisions and procedures on how to deal with the assets in case the proceedings come to a halt before a conviction need to be made clearly.

Appendix Nine

Interview Questions- Financial Institutions

How many money laundering compliance officers are there in your institution?

How many staff are there in your institution?

What is the level of the money laundering officer's position in your institution?

How does the management think about the importance of the Anti-Money Laundering regulation?

How often has a senior manager mentioned about money laundering in your institution?

How likely will a money laundering compliance officer be promoted?

What the background of money laundering compliance officer in your institution?

How long has it been since the first money laundering compliance officer was appointed?

How do you enjoy being a money laundering compliance officer?

How effective do you think Chinese Anti-Money Laundering law and regulation?

How effective do you think the Anti-Money Laundering in reality?

What is the most importance stage to identify money laundering?

If it is scale between 1 and 10, how does the staff in your institution think the importance of the Anti-Money Laundering regulation?

What are the incentives for front line staff to monitor money laundering activities?

What are the penalties for the staff's non-compliance with money laundering?

What are the penalties for the institutions' non-compliance with money laundering?

How many money laundering cases has your institution identified, reported and monitored?

How often is a money laundering inspection from the upper level institutions or to lower level institutions?

What activities has your institution organised to combat money laundering?

How often does a money laundering training event take place?

Who are the trainers?

How many co-operation requests has your institution received? And what actions has your institution taken?

How is the relationship with law enforcement agencies in relation to anti- money laundering?

How have the clients reacted to money laundering regulation?

How financial institutions could improve the effectiveness of anti- money laundering?

What are the weaknesses of financial institutions in regard to money laundering?

What do you predict the future of anti-money laundering?

Appendix Ten

Interview Questions- Law Enforcement Agencies

How necessary is Anti-Money Laundering Law?

What are the different in terms of investigating money laundering cases from investigating other conventional crimes?

Is there a special unit dealing with money laundering cases? What is it?

Who is in charge of money laundering cases in your organ? What is his position?

Is Anti-Money Laundering Department the place that staff would like to work for?

How difficult is a money laundering investigation?

How is the quality of large and suspicious transaction report provided?

What are the major predicate offences of money laundering?

Is there a detection rate required by your superior that needs to be completed? What is it?

How does Anti-Money Laundering Law contribute to proceeds confiscation and access criminal finance records?

How do you think the financial implication-cost compared with benefits of money laundering detection?

How do you think about the punishment on money launderers?

What are the common methods used by money launderers?

How does underground banking contribute to money laundering?

What is the best way to deal with underground banking?

How difficult is it to extradite a money launderer from abroad?

How often does a money laundering training take place?

Who are the trainers? What are their backgrounds?

What is your experience of working with financial institutions?

Appendix Eleven

Interview Questions- Service Users

How do you know about Anti-Money Laundering law and regulation?

How have you felt the difference of the service between having no Anti-Money Laundering law and regulation previously and now?

How does Anti-Money Laundering law and regulation affect you?

Do you think if the Anti-Money Laundering law and regulation have been promoted sufficient enough? And why?

How do you think about the compliance of the financial institutions staff with Anti-Money Laundering law and regulation? How have they changed over the time?

What is your experience of having difficulties to conduct financial transactions when the amount is over the threshold regulated by Anti-Money Laundering regulation?

