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The Future of Chinese Enforcement: From Corruption to AML?

On February 17, 2016, the Spanish headquarters of the Industrial and Commercial Bank of China (“ICBC”) were raided by Europol officers and Spanish law enforcement authorities, on orders of a Spanish judge investigating the alleged laundering of at least €40 million to China from criminal activities in Spain and southern Europe. Six ICBC directors and employees were also arrested in relation to potential money laundering offenses. The current raid, part of Europol’s Operation Shadow, follows previous Europol investigations which concluded that the proceeds of smuggling, exploitative labor practices and tax evasion were being transmitted to China in violation of international anti-money laundering (“AML”) regulations.

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The ICBC raid is only the latest instance of international scrutiny of Chinese banks’ AML compliance. In January 2015, Bank of China was required to improve its AML procedures in the U.S. following a case brought by the U.S. Office of the Comptroller of the Currency (“OCC”). The OCC concluded that Bank of China’s practices in its New York branch were deficient in multiple respects, including that it did not properly identify suspicious behavior by its customers, keep proper track of currency transactions, or limit the risk of money laundering or financial crime. In a similar case in July 2015, it was the Federal Reserve that initiated steps against China Construction Bank Corp. (“CCBC”) for deficiencies in the money laundering controls implemented by CCBC’s New York branch.

Bank of China is also currently being investigated over its money transfer service, Money2Money, which allegedly smuggled €4.5 billion from Italy to China, relying on Bank of China’s Milan branch to serve as its sole provider of transfer services. Italian prosecutors allege that Money2Money was operated like a mafia operation using threats and coercion to maintain a monopoly. The trial, which has named another 297 defendants who allegedly participated in the scheme, is scheduled to begin this month. The wide range of implicated entities and misconduct, and the number of different jurisdictions involved in these matters, raises questions about Chinese banks’ compliance with stringent EU and U.S. money laundering regulations.

On paper at least, Chinese law requires that Chinese banks are subject to and expected to apply stringent AML protocols. China is a member nation of the intergovernmental Financial Action Task Force (“FATF”), as well as the Asia/Pacific Group on Money Laundering and the Eurasian Group on Combating Money Laundering. China was last mutually evaluated in 2007, the year it was first granted full member status with the FATF. Due to a significant number of “partially compliant” or “non-compliant” ratings, however, China was placed on an enhanced follow-up regime at that time and was subject to enhanced reporting and review. In 2012, the FATF decided that sufficient progress had been made such that China could be released from the regular follow-up regime.

Chinese money laundering regulations establish a comprehensive system that is broadly comparable with EU rules, where money laundering controls are among the world’s most stringent. The main activities of money laundering are criminalized in China, with appropriate sanctions, including imprisonment, dependent on degree of misconduct, confiscation, and compensation. There are strict rules relating to customer due diligence, including the identification of beneficial ownership of assets, and financial institutions are also required to report suspicious activity of customers as well as large value transactions. Finally, Chinese AML law requires financial institutions to establish internal AML control programs, designate specialist AML units, establish a customer identification program, and provide appropriate staff training.

The effectiveness of this comprehensive regime could become a focal point for Chinese enforcement authorities in the coming months. In recent years we have seen a dramatic increase in domestic Chinese corruption and bribery-related investigations and prosecutions, where entire industry sectors have, much like in the United States, been subject to industry sweeps. And Chinese authorities are already looking carefully at businesses in the financial sector; indeed, the National Audit Office recently identified a number of state-owned financial institutions, including Bank of China, Agricultural Development Bank and China Investment Corporation, as having falsified revenue and profit figures. It would be in keeping with this enhanced scrutiny for Chinese authorities to expand the scope of their enforcement activities to money laundering as well.

Furthermore, money laundering risks are also likely to increase given the current economic climate in China. Increasingly, economists and market analysts are recording and predicting a Chinese slowdown. One likely consequence of this is an increase in Chinese capital outflows. On January 8, 2016, the Chinese State Administration of Foreign Exchange announced increased capital controls with banking restrictions on dollar-denominated purchases. Such tightening of capital controls may be only one of a number of steps the Chinese authorities take to stem the escape of capital. Other measures could include a more rigorous interpretation of AML regulation, again with the intention of ensuring money stays in China.

The recent wave of AML-related enforcement activity underscores the need for attention to AML compliance by any business that operates in China or interacts with Chinese financial institutions to ensure that compliance programs effectively prevent money laundering, corruption, and other international risks.