



## Combating The Financing of Terrorism and The Financial Action Task Force Recommendations (FATF): A Sri Lankan Perspective

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### ABSTRACT

*This study focuses on the implementation of the Financial Action Task Force (FATF) recommendations on countering the financing of terrorism from Sri Lanka's perspective, and further on the opportunities for enhancement of Sri Lanka's international relations. The research objectives were formulated to identify the nature of awareness of Anti- Money Laundering and Countering the Financing of Terrorism (AML/CFT) regime, and associated risks that arise as a consequence of ineffective implementation, to examine the weaknesses in the implementation process and the benefits of effective implementation of recommendations. The total study population consists of 500 employees of different institutions. A Google questionnaire was used for data collection. Accordingly, 198 participants responded and all of them were considered as the study sample by using a convenience sampling technique. The study found that Sri Lanka still must make significant progress toward meeting the technical/effectiveness aspects of recommendations. Further, it was revealed that the status of awareness of AML/CFT matters is at an average level, and issues associated with investigations and prosecutions have been identified as the fundamental weakness in the system. Poor international relations have been identified as the main consequence of ineffective implementation. Moreover, the study identifies that effective implementation of recommendations increases international acceptance, and encourages foreign direct investments in Sri Lanka. The study recommends, Sri Lanka, as a country with painful experiences of terrorism, needs to work with a proper action plan followed by high-level political commitment in effectively implementing the FATF recommendations on countering the financing of terrorism as an embedded practice.*

## **1. Introduction**

Following the September 11, 2001 terrorist attacks in the United States of America, terrorism financing was recognized as a global risk. The international community as a whole focused its attention on the essential need to combat terrorism in all its forms. They placed a high priority on counter-terrorism strategies. The consequential actions led to financial institutions being required to strictly monitor customers' transactions and behaviors, as a part of a consistently pursued due diligence process. More importantly, developed economies initiated broader counter-terrorist financing programs, introducing new laws, regulations, and monitoring processes to restrict access to funding and financial services support for those whom governments designate as terrorists/terrorist organizations.

The Financial Action Task Force (FATF), an inter-governmental body, created by G-7 countries in July 1989, was assigned the leadership role of taking steps to deprive terrorists or terrorist organizations of their ability to raise, move or access funds; and developing specific recommendations to prevent terrorist financing. The FATF recommendations are recognized as the global anti-money laundering (AML) and counter-terrorist financing (CFT) standards. The objectives of the FATF include setting standards to combat money laundering, the financing of terrorism, and the financing of proliferation of weapons of mass destruction. It promotes globally, the effective implementation of FATF guidelines and policies to protect the global financial system against money laundering, terrorist financing, and the financing of proliferation of weapons of mass destruction. FATF has 38 members including the European Commission and the Gulf Cooperation Council. It has a network of nine FATF-style regional bodies (FSRB), which together form the FATF's Global Network of 205 countries. As part of its consultation and engagement processes, FATF brings in a wide global

network made up of diverse groups of persons and institutions, including representatives from the private sector entities and other institutions most directly connected with FATF's activities (e.g. bankers, attorneys, accountants, and non-profit organizations). Along with other financial actors such as the IMF, World Bank, and the organization for Economic Cooperation and Development (OECD), FATF is a key catalyst in efforts to build a new international financial regulatory architecture to combat money laundering and terrorist financing (Nance, 2017).

Having considered the diverse legal, administrative, and operational frameworks and the different financial systems, FATF has designed its recommendations as a comprehensive framework of actions to combat money laundering, terrorist financing, and the financing of the proliferation of weapons of mass destruction. These recommendations include risk identification and risk-based approach to mitigate options to pursue money laundering, terrorist financing, and the financing of proliferation; application of preventive measures for the financial sector and other designated sectors; powers and responsibilities of the competent authorities (i.e. investigative, law enforcement and supervisory authorities); availability of beneficial ownership information of legal persons; arrangements; and international cooperation (FATF, 2012 - 2022).

The FATF recommendations which were adopted in 2012 place more emphasis on terrorist financing and weapons of mass destruction. More importantly, recommendations 5, 6, 7, and 8 under the category "C" principally target terrorist financing and financing of proliferation. Furthermore, directly and indirectly, all other recommendations address the associated money laundering and terrorist financing issues. Consequently, the FATF members, in close cooperation and coordination with the FATF-Style Regional Bodies (FRBs) and their

members, have adopted special measures to introduce new laws, establish regulatory frameworks and set up supervisory mechanisms to address the new and emerging risks (FATF, 2013-2021).

Sri Lanka is a country that has a significant vulnerability to various forms of terrorism threats. Though the Liberation Tigers of Tamil Eelam (LTTE) has been physically defeated by the Sri Lankan government militarily, some elements with LTTE ideology are still operating internationally with a large sympathetic local population base. The large pool of funds and gold perceived to have been raised by the LTTE during the period of the conflict from criminal activities, robbery, smuggling, extortion and other acts of terrorism remain unaccounted and are believed to be invested in several international cities and in business ventures operated by proxy network partners.

In addition to the LTTE, religiosity-influenced terrorist groups appear to be yet operational in the country as evidenced by the findings on the Easter Sunday attacks. In fact, it was reported in the media that there were instances of illegal fund transfers channeled via money changers and also that significant crypto-currency encashment had taken place in raising such funds. These illicit fund transfers via unregulated entities have been highlighted and identified as a prominent national security issue in the country. Effective control over terrorist financing has been identified as a major component in a counter-terrorism national strategy.

Sri Lanka has initiated several programs and actions as a part of meeting the country's obligations in accordance with relevant treaties entered into and in compliance with its international membership obligations. The government of Sri Lanka has also taken several steps to counter such threats having established a legal and regulatory framework to control possible acts of terrorism and terrorist financing (Abewardhana et al., 2020).

Sri Lanka is a founding member of the Asia Pacific Group on Money Laundering (APG), a FATF-style regional body (FSRB) established in 1997. The APG consists of 41 active members including 11 FATF members namely: Australia; Canada; India; the People's Republic of China; Hong Kong, China; Japan; Korea; Malaysia; New Zealand; Singapore; and the United States and it is the largest FATF-style regional body in the world. The APG monitors the implementation of FATF recommendations in its member countries. Since 2004, the APG has used FATF's methodology to conduct mutual evaluations. Sri Lanka was subject to two mutual evaluations in 2006 and 2015 (Financial Intelligence Unit of Sri Lanka, n.d.; Asia Pacific Group on Money Laundering, 2006; 2016-2021).

In 2015, Mutual Evaluation report highlighted significant deficiencies in Sri Lanka's AML/CFT regime. Consequently, the FATF identified Sri Lanka as a jurisdiction with strategic AML/CFT weaknesses in its Compliance Document, often known as "the Grey List," in October 2017. As a result, Sri Lanka was designated as a high-risk third country by the European Union in February 2018. Sri Lanka was given a time-bound Action Plan to rectify the strategic shortcomings, and Sri Lanka was subjected to International Co-operation Review Group (ICRG) monitoring. Through this process, the FATF continues its focus on identified jurisdictions with significant weaknesses in AML/CFT regimes. They collaborate and work closely with the targeted countries in addressing identified weaknesses. This classification made Sri Lanka and its AML/CFT control and management processes coming under a careful oversight review by the international community and this has negatively impacted Sri Lanka's international reputation and sovereign ratings. Post-addressing the identified priority weaknesses and gaps and following an effective demonstration of high-level stakeholder commitment, the country was able in 2019, to secure an upgrade in its international risk

classification (Central Bank of Sri Lanka, 2019).

Despite Sri Lanka being a member of the APG since 1997 and also a victim of painful terrorist attacks, it has failed to conduct adequate academic reviews and research from a Sri Lankan perspective on the usefulness of the FATF recommendations in combating terrorist financing risks. Having noted the knowledge gap, this study focuses on the obligations for effective implementation of the FATF recommendations on account of Sri Lanka's membership in the APG. It further analyses the opportunities for enhancement of Sri Lanka's International Relations by effective control over risks of terrorism financing as well as the ability to leverage the consequential goodwill in promoting socio-economic growth and prosperity of Sri Lanka as a sovereign nonaligned nation committed to upholding international conventions and best practices.

The term 'terrorist financing' has been defined in various ways. The International Convention for the Suppression of the Financing of Terrorism (1999) considered as one of the major international conventions which deal with the terrorist financing in article 2 (1) of the convention has defined 'terrorist financing' as "where any person commits an offense within the meaning of this convention, if that person by any means, directly or indirectly, unlawfully and willfully, provides or collects funds with the intention that they should be used or in the knowledge that they are to be used, in full or in part, to carry out: (a) Any act which constitutes an offense within the scope of and as defined in one of the treaties listed in the annex; or (b) Any other act intended to cause death or serious bodily injury to a civilian, or to any other person not taking an active part in the hostilities in a situation of armed conflict, when the purpose of such act, by its nature or context, is to intimidate a population or to compel a government or an international organization to do or to abstain from doing

any act". In addition, any person commits an offense if that person participates as an accomplice in an offense or organizes or directs others to commit an offense. Further, to constitute an offense of terrorist financing, it shall not be necessary that the funds were used to carry out an offense (United Nations, 2008).

Money laundering and terrorist financing are two concepts that are consistently mentioned together. Although there are some differences between them, they both have consequences that significantly impact a country's economy. In terrorist financing, funds may be derived from both legal and unlawful sources. In money laundering, the origin of the funds is always from illicit sources. On the other hand, money laundering is a crime that has been linked to terrorist financing.

As Schott stated, money launderers send illicit funds through legal channels to conceal their criminal origins, while those who finance terrorism transfer funds that may be legal or illicit in origin in such a way as to conceal their source and ultimate use, which is the support of terrorism. But the result is the same reward. When money is laundered, criminals profit from their actions; they are rewarded by concealing the criminal act that generates the illicit proceeds and by disguising the origins of what appear to be legitimate proceeds. Similarly, those who finance terrorism are rewarded by concealing the origins of their funding and disguising the financial support to carry out their terrorist stratagems and attacks. The techniques used to launder money are essentially the same as those used to conceal the sources of and uses for, terrorist financing. Funds used to support terrorism may originate from legitimate sources, criminal activities, or both. Nonetheless, disguising the source of terrorist financing, regardless of whether the source is of legitimate or illicit origin, is important. If the source can be concealed, it remains available for future terrorist financing activities. Similarly, terrorists need

to conceal the use of the funds so that the financing activity is held undercover and goes undetected until carried out (Schott, 2006).

Salami considers the terrorism financing risk associated with the growth of Financial Technology innovations. The ease with which cross-border payments by virtual currencies are facilitated, the anonymity surrounding their usage, and their potential to be converted into the fiat financial system make them ideal for terrorism financing. He considers the extent of the risk of terrorism financing through virtual currencies in "high-risk" States by focusing on countries that have been recently associated with terrorism activities. It assesses the robustness of their financial regulatory and law enforcement regimes in combating terrorism financing and considers the extent to which regulatory technology and its global standardization can mitigate this risk (Salami, 2017).

In countering terrorist financing, informal money transfer systems become a challenge to counter-terrorism investigators. As Brisard pointed out, Hawala is an informal system to transfer money. It is based on a short-term, discountable, negotiable, promissory note (or bill of exchange). While not limited to Muslims, it has come to be identified with "Islamic Banking". The system is mostly in use in Pakistan, India, the Gulf countries, and Southern Asia. In Hawala activities, brokers advance funds to depositors on a nod or a handshake, leaving no paper or electronic trails. Those involved often operate from the back of a store or, in remote areas, may not even have an "office" from which to conduct transactions. Brokers are known to use telephones to communicate. Furthermore, Hawala's generations of existence throughout South Asia and the Middle East make it difficult for foreign authorities to eradicate the arcane system (Brisard, 2002).

According to Jayasekara, terrorist financing activities become a huge challenge to regulators. Especially, extremist groups such

as Islamic State in Iraq and the Levant (ISIL) have been a global concern. The ISIL is growing rapidly despite sustained international efforts to control the movement of funds. The quality of systems and controls adopted by financial institutions depends on the associated cost, complexity, and ability to afford them. Therefore, regulators cannot expect the same quality of AML/CFT effectiveness measures from each member of the financial institutions. Therefore, continuous improvement and upgrading of systems and controls are key to combat ML and TF issues. Effective national and international cooperation is also a challenge traced by the regulators. Though Sri Lanka had signed 27 memorandums of understanding, the challenge is, how to cooperate with other countries that are not parties to international conventions (Jayasekara, 2018).

As Ariyasinghe stated, the dynamic nature of ML/TF threats arising within the financial system would no doubt challenge a financial institution as well as a financial system as a whole. Financial institutions individually, as well as in the club form, should have the best-suited balance of strength and flexibility fitting their risks.

A bank's money transactions and assets-related ML/TF risk management capability is key to the overall safety and soundness of the bank as a firm, the bank cartel, as well as the financial system. An inadequate or inefficient system that fails to cater to the dynamic environment where ML/TF risks expose the bank/bank cartel to reputation risks, operational risks, investment risks, compliance risks, and concentration risks is untenable in the present day.

As the risk-based strategy is adopted, an institution should avoid "one-size-fits-all" solutions, which are typically in the form of widely available advisory or consultant agency products that "map" the overall risk profile of a bank that meets the traditional institutional description (Ariyasinghe, 2018).

In summary, though there are differences, both money launderers and terrorist financiers have been using similar methods in transferring funds. These methods have now transformed into a more complicated nature due to emerging technological innovations.

Sri Lanka has been a victim of painful terrorist attacks over the years and the country remains extremely vulnerable to various forms of terrorism threats and associated terrorist financing risk. Even though Sri Lanka has signed international conventions including the International Convention for the Suppression of the Financing of Terrorism and is also a founding member of the Asia Pacific Group of Money Laundering (APG), notable deficiencies have been identified in respect to the effective implantation of the Financial Action Task Force (FATF) recommendations on countering the financing of terrorism. As a result, Sri Lanka has many issues including challenges associated with its international relations. Thus, the purpose of this study is to explore the following research questions. What is the nature of awareness of the FATF recommendations on countering the financing of terrorism amongst the key stakeholders on the AML/CFT regime in Sri Lanka? What are the main weaknesses in the effective implementation of the FATF Recommendations on countering the terrorist financing in Sri Lanka? What are the associated risks that arise as a consequence of the ineffective implementation of the FATF recommendations on countering the financing of terrorism? What strategic action steps will assure Sri Lanka to enhance its international relations' acceptance through the effective implementation of the FATF recommendations on countering the financing of terrorism? The following objectives were designed in line with the research questions above: to identify the nature of awareness of the FATF recommendations on countering the financing of terrorism amongst the key stakeholders on the AML/CFT regime in Sri Lanka, to examine the weaknesses in Sri

Lanka in the effective implementation of the FATF recommendations on countering the financing of terrorism, to identify the associated risks that arise as a consequence of the ineffective implementation of the FATF recommendations on countering the financing of Terrorism, and how should these weaknesses be addressed, and, to make recommendations for effective implementation of the FATF recommendations on countering the financing of terrorism as a value enhancer in the international relations of Sri Lanka.

## **2. Materials and Methods**

Colombo district has been identified as the main research area for the study. Colombo is the main administrative and commercial center in Sri Lanka, and also it provides the largest share of the national revenue. The total study population consists of five hundred (500) employees of financial, regulatory, supervisory, law enforcement, and academic institutions and a Google questionnaire was used for data collection. Accordingly, one hundred ninety-eight (198) participants responded to the questionnaire within the period of April to August 2022 and all of them were considered as the study sample by using the convenience sampling technique. Primary and secondary sources were used for data collection. It was intended to collect primary data using Google questionnaires. The secondary data was collected through books, reports, magazines, decided court cases, official websites, media reports, parliamentary records, legal enactments, and publications of international organizations. Data collection was carried out in different steps. Primarily, a list of government and private institutions was selected that directly linked and related to the implementation of the FATF Recommendations and Countering Financing of Terrorism. Second, five hundred participants from the selected institutions were chosen under the purposive sampling method. The questionnaire, which was developed as a Google form, was distributed

among the participants through emails. Basic demographic data and the rest of the data were analysed using MS Excel software. Analyzed data has been presented using tables and graphs while indicating the frequency and percentages. Though the FATF introduced 40 recommendations in protecting the global financial system against money laundering, terrorist financing, and financing of proliferation of weapons of mass destruction, this study focused only on the recommendations related to countering the financing of terrorism, especially covering recommendations 5, 6, 7 and 8 under the category of “C”, due to its complex nature.

The literature review is also limited to the FATF recommendations on countering the financing of terrorism and Sri Lanka’s engagement on terrorist financing-related activities. The sample population is limited to the employees of supervisory, regulatory, law enforcement, financial institutions and academic institutions mainly located in Colombo.

### 3. Results and Discussion

The section presents the results of the data analysis in accordance with the research objectives of the study.

#### 3.1 Basic demographic data

As per the responses received, participants are recognized based on their gender. Accordingly, 80.8% are males, and 19.2% females. According to the data, 20% of participants have postgraduate degrees, 16% are graduates, 3% have diplomas, and 1% are undergraduates. Further, 60% of participants possess the GCE Advanced Level qualification. The participants were recognized based on their field of employment. Accordingly, 71% of the participants represent the country's law enforcement agencies, and 15% of people work for banks and financial institutions. Additionally, 3% represent civil society, 3% academics, 2% tax auditors, 3% of legal community, and 3% other disciplines.

**Table 01.** Awareness of Key institutions, legal enactments, and FATF recommendations on Countering the Financing of Terrorism

Institution/Acts/FATF recommendations	Yes (%)	No (%)	Total (%)
Financial Action Task Force (FATF)	49.2	50.8	100
Asia Pacific Group on Money Laundering (APG)	47.7	52.3	100
Financial Intelligence Unit of Sri Lanka	60.1	39.9	100
Egmont Group	24.5	75.5	100
Convention on the Suppression of Terrorist Financing Act, No. 25 of 2005 (CSTFA)	58.7	41.3	100
Prevention of Money Laundering Act, No. 05 of 2006 (PMLA)	62.9	37.1	100
Financial Transactions Reporting Act, No. 06 of 2006 (FTRA)	54.6	45.4	100
FATF Recommendation 5: Terrorist financing (TF) offence	46.9	53.1	100
FATF Recommendation 6: Targeted financial sanctions related to terrorism and terrorist financing	47.2	52.8	100
FATF Recommendation 7: Targeted financial sanctions related to proliferation	40	60	100
FATF Recommendation 8: Non-profit organizations	40.8	59.2	100

According to table 1 above, 49.2% of participants are aware of the Financial Action Task Force (FATF) and 47.7% is aware of Asia Pacific Group on Money Laundering (APG), respectively. In comparison to other sectors of the chart, the Financial Intelligence Unit of Sri Lanka (FIU Sri Lanka) is known to 60.1% of the participants, which is the largest percentage. Among the participants, only 24.5% are familiar with Egmont Group. AML/CFT laws including the Financial Transactions Reporting Act, No. 06 of 2006 (FTRA), Prevention of Money Laundering Act, No. 05 of 2006 (PMLA), and Convention on the Suppression of Terrorist Financing Act, No. 25 of 2005 (CSTFA) are known to 58.7%, 62.9%, and 54.6% of respondents, respectively. Furthermore, FATF Recommendation 5: Terrorist financing (TF) offense, Recommendation 6: Targeted financial sanctions related to terrorism and terrorist financing, Recommendation 7: Targeted financial sanctions related to proliferation, and Recommendation 8: Non-profit organizations, which especially designed in relation to countering the financing of terrorism, are known to 46.9 %, 47.2 %, 40 %, and 40.8 % respectively.

### **3.2 FATF recommendations on Countering the Financing of Terrorism in Sri Lanka - Status of implementation**

Through the questionnaire, which allowed them to choose more than one option, the participants' opinions on how the FATF recommendations in connection to countering the financing of the terrorism regime in Sri Lanka were implemented were solicited.

About 42% of the participants, as shown in Table 2 above, stated that Sri Lanka has enough laws in place to prevent the financing of terrorism. However, a considerable 22 % disagree with the assertion and 35.9% have mixed feelings about it. According to the data, 44% of participants believed that Sri Lankan authorities have reasonably detected the

potential threats of terrorist financing, 18.6% disagreed, and 37.4% had mixed feelings. Participants' responses to the statement that Sri Lanka's institutional framework is effective in addressing the risks of terrorist financing in the country were as follows: 38.8% agreed, 20.8% disagreed, and 40.4% expressed mixed feelings.

Further, 48% of participants agreed that Sri Lanka's Financial Intelligence Unit (FIU) is effective in addressing the country's risks of terrorist financing; 40.9% agreed that Sri Lankan law enforcement agencies are capable of effectively combating those risks; and 33.3% consented that the country's prosecution agencies are capable of doing so effectively. According to the data in the chart, 32.8% of respondents thought Sri Lanka's cross-border transaction reporting and control framework is successful in reducing the risks of terrorist financing; however, 26.3% disagreed and 40.9% were undecided.

Meanwhile, 49.5% of respondents think that cross-border transactions in virtual currencies enhance the risk of terrorist financing, 38.9% agree that Sri Lanka's current technology increases the risk of terrorist financing, and 41.5% think that Block Chain and similar innovations do the same. Furthermore, 55.1% of the participants concurred that the risk of terrorist financing is reduced by the effective management of illicit financial flows, especially those connected to drug trafficking and cross-border money transfers.

Table 2 shows that 34.3% of participants agreed that Sri Lanka's existing laws, processes, and practices decrease the likelihood of the occurrence of terrorism financing, 20.2% disagreed, and 45.5% had mixed feelings on the issue.

Only 26.8% of participants stated that Sri Lanka's political commitment to reducing the risk of terrorist financing is sufficient, and only 19.2% think resources are being allocated to this end effectively.



Notably, 51% of the respondents expressed that improving inter-agency coordination in Sri Lanka will assist in reducing the likelihood of terrorism financing. However, barely 33.8% of respondents think Sri Lankan authorities have shown enough commitment and professionalism to win support from other countries in the fight against the risk of

terrorism financing. Moreover, 48% of respondents think that improving Sri Lanka's international relations will result from the effective implementation of FATF recommendations linked to countering terrorist financing by all local stakeholder institutions.

**Table 02.** The Countering of the Financing of Terrorism in Sri Lanka – Status Quo

Category	Subcategories	Nature of Participants' Responses			Total (%)
		Agree (%)	Disagree (%)	Mix Feeling (%)	
<b>Legal and Institutional Framework</b>	Sri Lanka has Sufficient laws to combat the financing of terrorism.	42	22.1	35.9	100
	Sri Lankan authorities have reasonably identified the terrorist financing risk.	44	18.6	37.4	100
	Sri Lankan institutional framework on Combating the Financing of Terrorism is effective in responding to the country's terrorist financing risks.	38.8	20.8	40.4	100
	The Financial Intelligence Unit (FIU) of Sri Lanka is effective in responding to the country's terrorist financing risks.	48	16.1	35.9	100
	Sri Lankan law enforcement agencies are capable of effectively combating terrorist financing risks.	40.9	23.7	35.4	100
	Sri Lankan Prosecution Agencies are capable of effectively combating terrorist financing risks.	33.8	20.2	46	100
	Further enhancement of inter-agency coordination in Sri Lanka will assist in combating the financing of terrorism risk.	51	8.1	40.9	100
	Sri Lanka's cross-border transaction reporting and control regime is effective in combating terrorist financing risks.	32.8	26.3	40.9	100

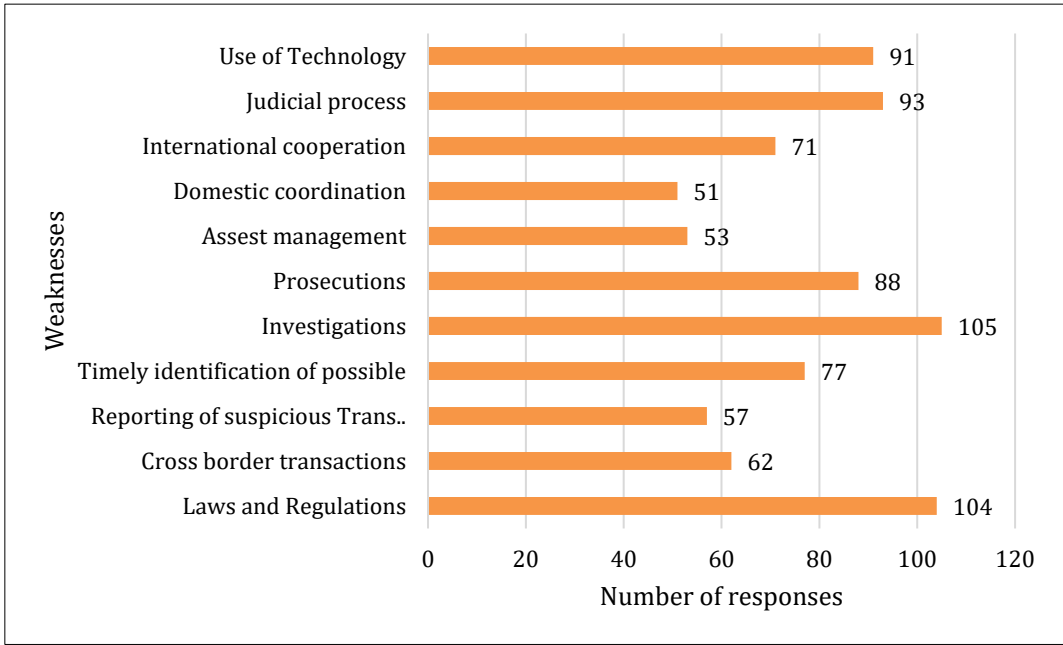
<b>Risks Associated with Cross-Border Transactions and Technology</b>	Cross-border payments in virtual currencies increase terrorist financing risks.	49.5	13.6	36.9	100
	The existing technology available in Sri Lanka increases the terrorism financing risk.	38.9	21.7	39.4	100
	Block Chain and similar developments increase the terrorist financing risks.	41.5	1.6	48	91.1
<b>Effectiveness of institutional approaches</b>	Effective control of illicit financial flows, including those associated with narcotics trading and cross-border currency movements, mitigates the risk of terrorist financing.	55.1	10.1	34.8	100
	Current Policies, Procedures, and Practices in Sri Lanka reduce the risks of the occurrence of Terrorism Financing.	34.3	20.2	45.5	100
<b>State Commitment</b>	The political commitment is adequate in combating the risk of terrorist financing in Sri Lanka	26.8	34.8	38.4	100
	Resource allocation in respect of combating the financing of terrorism in Sri Lanka is adequate.	19.2	36.4	44.4	100
	Sri Lankan authorities have demonstrated a sufficient level of commitment and professionalism in securing international cooperation in combating the financing of terrorism risk.	33.8	21.8	44.4	100

Participants were invited to describe the shortcomings in Sri Lanka's implementation of the FATF's recommendations for countering the financing of terrorism, and they were allowed to list down the options as much as they deemed appropriate. The said options were identified from the previous studies and reports. Issues with investigations have been identified as the fundamental weakness in Sri Lanka's AML/CFT regime, as seen in Figure 1. Additionally, laws and regulations, issues with the judicial process, issues with technology, issues with prosecutions, timely

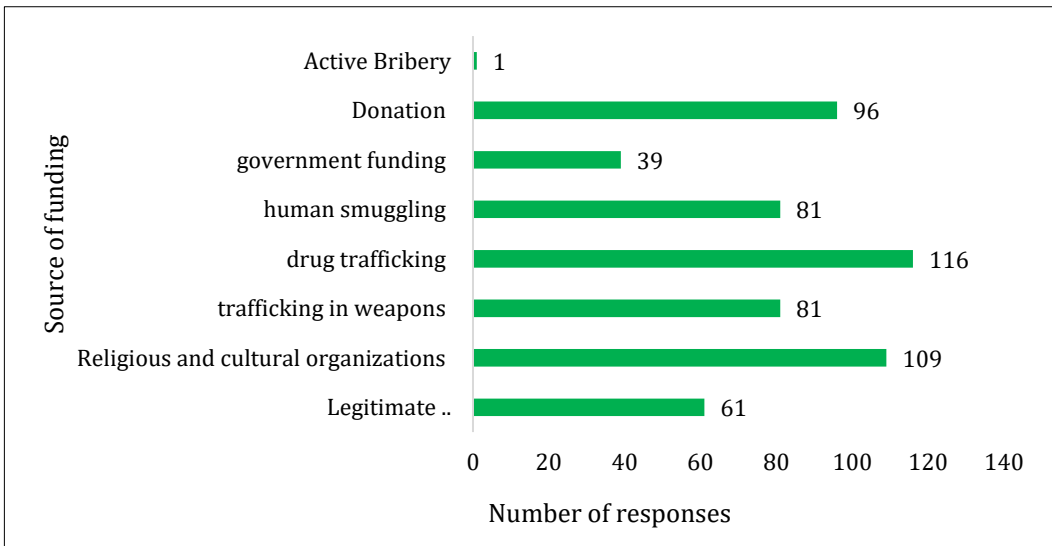
detection of potential terrorist financing activities, cross-border transactions, reporting of suspicious transactions, asset management, and domestic cooperation have all been identified as Sri Lanka's major weaknesses.

### 3.3 Nature of Risk Associated with Financing of Terrorism

As per the responses given by the participants, the risk associated with the financing of terrorism in Sri Lanka was assessed.



**Figure 01.** Effective implementation of FATF recommendations on Countering the Financing of Terrorism in Sri Lanka: Main weaknesses



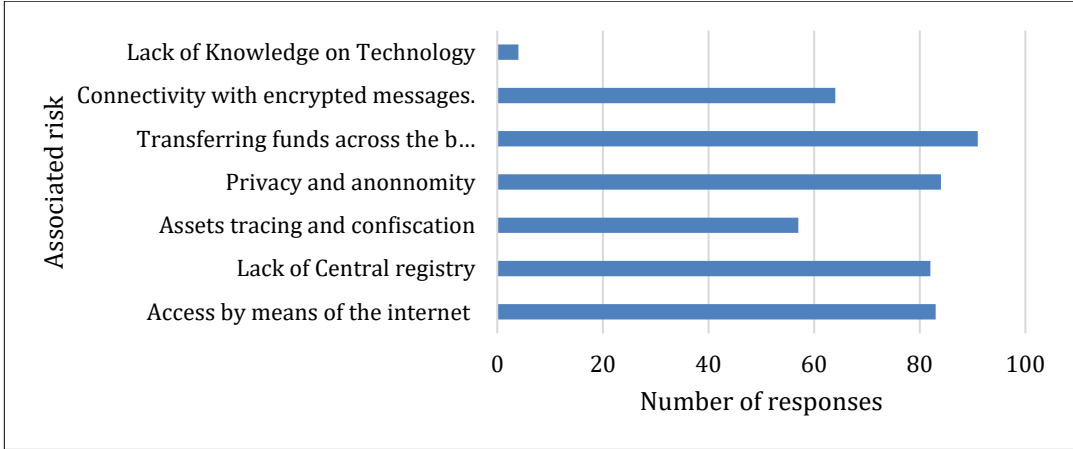
**Figure 02.** Sources of funding for financing of terrorism in Sri Lanka

Participants were asked to select the main sources of funding options for the financing of terrorism in Sri Lanka. In particular, the participants were offered the option to choose from multiple options. The said

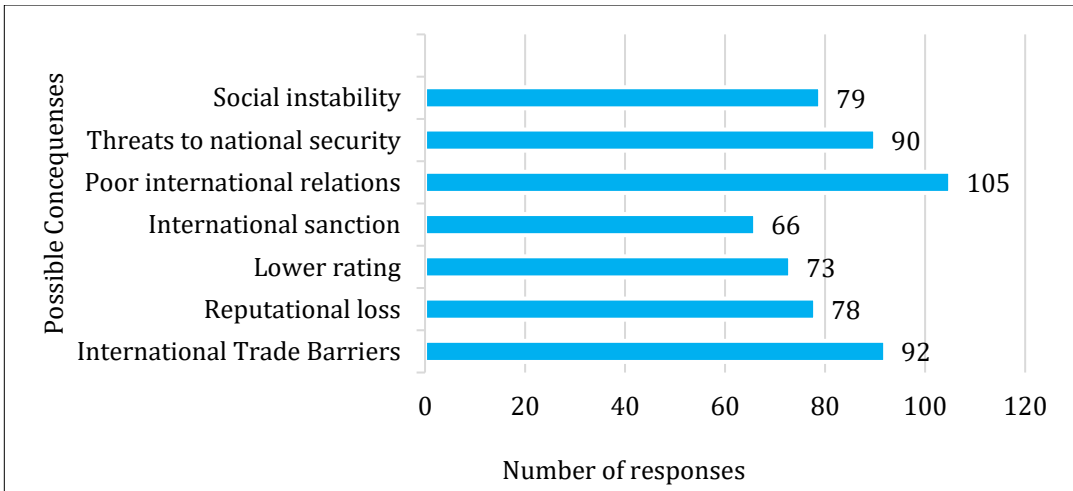
options were identified from the previous studies and reports. According to Figure 2, the highest number of participants (116) identified drug trafficking as the predominant source of funding for the

financing of terrorism. Religious and cultural organizations (107), donations (96), trafficking in weapons (81), human smuggling (80), legitimate businesses (60)

and government funding (39) have been nominated as the major sources of funding for terrorism respectively.



**Figure 03.** Risks associated with terrorism financing driven by virtual currencies – Sri Lanka



**Figure 04.** Ineffective implementation of FATF recommendations on Countering the Financing Terrorism in Sri Lanka – Possible Consequences

Risks associated with virtual currencies have been assessed through the questionnaire and participants were given the opportunity to select options. The said options were identified from the previous studies and reports. Accordingly, participants identified the capacity to transfer funds across borders

as the biggest threat associated with virtual currencies, as seen in Figure 3.

The main risks linked with virtual currencies are also cited as having a high level of privacy and anonymity, internet access, no central registration, connectivity with encrypted chat

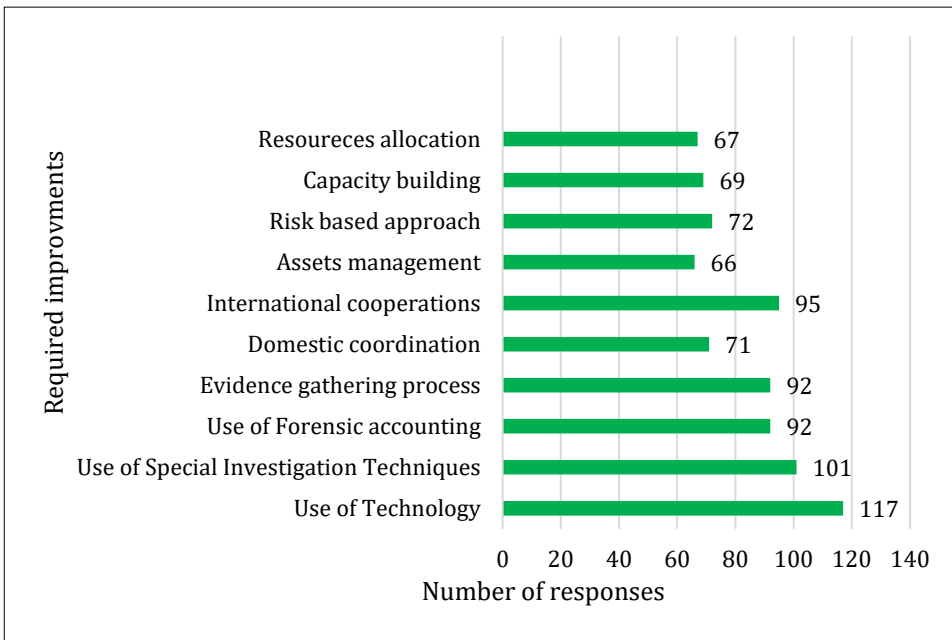
platforms, and challenges in tracking down and seizing assets.

Figure 4 depicted the participants' opinions on the consequences that could result from ineffective implementation of FATF recommendations with respect to countering the financing of terrorism. Accordingly, poor international relations have been cited by 105 participants as the main impact. Additionally, it has been stated that the main consequences associated with the ineffective implementation of FATF recommendations include international trade barriers, threats to national security, loss of reputation as a member of the international community, social instability, a lower rating by international rating agencies, and international sanctions.

### 3.4 Effective implantation of FATF Recommendation in Sri Lanka - Addressing the weaknesses

Participants were asked for their opinions on how to address the weaknesses in the implementation of FATF recommendations by giving them the option of choosing from multiple options.

The responses are compiled by grouping them into three major categories: those required by Sri Lanka's law enforcement agencies, those required for the country's prosecution of terrorist financing offenses, and those needed overall from all stakeholders to counter the financing of terrorism in Sri Lanka.



**Figure 05.** Improvements required by the law enforcement agencies in Sri Lanka

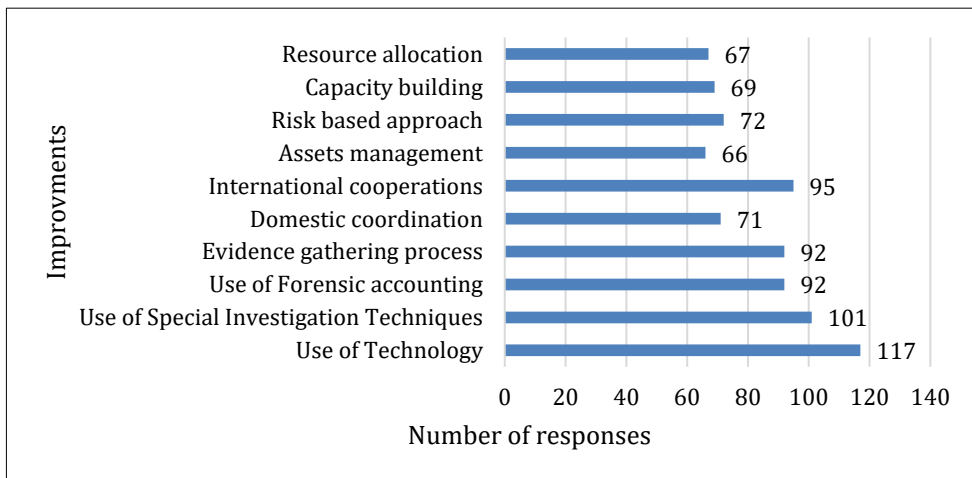
Participants were asked to comment on the area of identification, detection, investigation, and disruption of terrorist financing activities by law enforcement agencies in Sri Lanka. According to Figure 5, the majority of participants highlighted the use of technology

as a crucial area for improvement. Additionally, they have identified a number of key initiatives that must be carried out to improve the identification, detection, investigation, and disruption of terrorist financing activities, including the use of

special investigation techniques, accounting, a risk-based approach, domestic international cooperation, evidence-gathering methods, the use of forensic coordination, capacity building, asset management, and resource allocation.

**Table 03.** Improvements required for prosecuting terrorist financing offences in Sri Lanka

Areas of improvements	No. of Responses
Use of technology	112
Legal reforms	100
International cooperation	92
Designated courts for prosecutions	80
Inter- agency coordination	78
Capacity building of Prosecutor	76
Resource allocation	63
Risk-based approach	56
Assets management	52
Other	3



**Figure 06.** Overall improvements required from all stakeholders in Sri Lanka

As shown in Table 3, participants' responses regarding overall improvements that are needed for prosecuting offenses involving the financing of terrorism were recorded. Accordingly, the majority of participants (112) have chosen the use of technology as the key improvement required. Subsequently, areas such as legal reforms in capturing international standards and best practices, formal and informal aspects of international cooperation, designated courts for prosecutions, inter-agency coordination, capacity building of prosecutors, resource

allocation, a risk-based approach, and assets management.

Figure 6 summarized the overall improvements required in all stakeholders including law enforcement agencies, prosecuting agencies, and the Financial Intelligence Unit of Sri Lanka in respect of countering the financing of terrorism. As displayed in Figure 6, the highest number of participants (119) voted for using of technology as the key improvement required. Subsequently, inter-agency coordination, international cooperation, capacity building,

effective supervision and monitoring, resources allocation and risk-based approach

were determined to be the top priorities for improvement.

**Table 04.** Strategic opportunities and advantages for Sri Lanka to gain through effectively combating the financing of terrorism

Strategic opportunities and Advantages	Number of Responses
High-Level international acceptance	99
Encourage foreign direct investments; Facilitate smooth functioning of international fund transfers; Growth in the tourism sector; Socio-economic development	96
Facilitate smooth functioning of international fund transfers	90
Growth in the tourism sector	82
Development assistance	73
International assistance for capacity building	74
Socio-economic development	76
Support for economic growth	3

As demonstrated in Table 4. Sri Lanka will be able to achieve a high level of international acceptance through an enhanced image by effectively countering the financing of terrorism as participants have responded (99). Furthermore, it encourages foreign direct investments; facilitates the smooth functioning of international fund transfer; and growth in the tourism sector development assistance, international assistance for capacity building, and finally socio-economic development.

**4. Conclusion and Recommendations**

The present study on “Combating the Financing of Terrorism and the Financial Action Task Force Recommendations (FATF), a Sri Lankan Perspective” leads to the following conclusions and key findings which include the current status of technical and effectiveness aspects of the FATF recommendations on countering the financing of terrorism in Sri Lanka and key findings from survey results that connect to the research objectives and questions.

Sri Lanka had its first Mutual Evaluation (ME) of its Anti-Money Laundering (AML) and Countering the Financing of Terrorism (CFT)

regime in 2006 by the Asia Pacific Group of Money Laundering (APG). As per the Mutual Evaluation Report (MER), the country’s CFT regime was rated either partially compliant or non-compliant where fundamental improvements were required. Sri Lanka was subjected to the second Mutual Evaluation in 2015 by the APG. This evaluation was intended to assess the level of technical compliance and effectiveness. Compared to her first MER, Sri Lanka's level of technical compliance with the FATF Recommendations on countering the financing of terrorism has shown notable progress. However, the effectiveness aspects were weak and required significant improvements.

Having noted the issues highlighted in the MERs, Sri Lanka has made reasonable progress in addressing the technical compliance deficiencies identified in its MERs. This includes the formation of the Financial Intelligence Unit (FIU), which is the central institution within her AML/CFT regime, and the criminalization of both money laundering and terrorist financing offenses in compliance with FATF recommendations. According to the follow-up reports to the APG, ratings related to

technical compliance with FATF recommendations on countering the financing of terrorism have improved to a certain extent. However, progress made to improve its effectiveness has not been assessed. As discussed above, Sri Lanka still has to make significant progress toward meeting the technical compliance requirements. More importantly, Sri Lanka needs to focus more on the effectiveness aspects of the AML/CFT matters in relation to countering the financing of terrorism.

The study focuses on the nature of awareness of AML/CFT matters in Sri Lanka. Accordingly, awareness of key institutions, legal enactments, and FATF recommendations on countering the financing of terrorism remains within the 50 % range which is not in line with risk and context. According to the findings, the status quo of the implementation of FATF recommendations in connection with countering the financing of terrorism in Sri Lanka is not at a satisfactory level. Especially, the effectiveness of the institutional framework in combating the financing of terrorism including the Financial Intelligence Unit (FIU) of Sri Lanka, law enforcement agencies, Prosecution Agencies, and Sri Lanka's cross-border transaction reporting and control regime required significant improvements in their effectiveness. Moreover, resource allocation and political commitment are not adequate in combating the risk of terrorist financing in Sri Lanka. Further enhancement of inter-agency coordination and a sufficient level of commitment and professionalism in securing international cooperation are equally important aspects in countering the financing of terrorism risk in Sri Lanka.

Issues associated with investigations have been identified as the fundamental weakness in the AML/CFT regime with respect to countering the financing in Sri Lanka. In addition, inadequate laws and regulations, problems with the judicial and prosecutorial processes, lack of asset management

mechanisms, cross-border transactions, reporting of suspicious transactions, and domestic collaboration have all been noted as major weaknesses in the system. The study identified the high-risk funding options due to ineffective implementation of FATF recommendations on countering the financing of terrorism. Accordingly, drug trafficking has been identified as the main risk area for funding for the financing of terrorism in Sri Lanka. In addition, religious and cultural organizations, donations, trafficking in weapons, human smuggling, legitimate businesses, government funding, and active bribery have been recognized as the major risk areas for funding for terrorism respectively.

The use of virtual currency has grown to be a serious issue in the fight against terrorism financing. Especially, the cross-border payments in virtual currencies supported with new technology have increased the terrorist financing risks. The study found that the main risk posed by virtual currencies is the flexibility to transfer funds across international boundaries. The main risks associated with virtual currencies have been recognized as having a high level of privacy and anonymity, internet access, no central registration or database, connectivity with encrypted chat platforms, and difficulties in locating and seizing assets. Illicit financial flows; including those associated with narcotics trading and cross-border currency movements, have also contributed to increasing the risk of terrorist financing. Poor international relations have been identified as the main consequence of the ineffective implementation of FATF recommendations in respect of countering the financing of terrorism.

Moreover, other consequences include international trade barriers, threats to national security, loss of reputation as a member of the international community, social instability, a lower rating by international rating agencies, and international sanctions.



The study identifies that effective implementation of FATF recommendations on countering the financing of terrorism increases international acceptance, encourages foreign direct investments, facilitates smooth functioning of international fund transfers, growth in the tourism sector, socio-economic development, and increases development assistance and international assistance for capacity building, and socio-economic development. Overall, the above findings emphasize how important the effective implementation of FATF recommendations on countering the financing of terrorism with respect to the country's national security, image, ratings, and international relations. However, Sri Lanka, as a country that has experienced various forms of terrorism, appears yet to be a low-commitment jurisdiction in effectively implementing the FATF recommendations on countering the financing of terrorism as an embedded practice. This situation has negatively impacted the international relations of Sri Lanka.

The following measures are recommended to overcome the weakness in the effective implementation of FATF recommendations on countering the financing of terrorism by the Sri Lankan authorities.

Accordingly, it is necessary to develop carefully planned awareness campaigns with the support of subject matter experts in covering the knowledge gaps among the stakeholders and the general public. Sri Lanka is required to conduct a national risk assessment to identify its terrorist financing risk.

More importantly, the assessment should be done by international standards and the authorities should ensure that the results of risk assessment are communicated to relevant parties. National-level and institutional-level measures are to be taken to prevent or mitigate the risk appropriately. Institutions should be compelled to apply a

risk-based approach, and it should be converted to embed practice.

Sri Lanka needs to address the effectiveness aspects of her AML/CFT regime. Particularly, improvements are required within the institutional framework on countering the financing of terrorism with a special focus on the Financial Intelligence Unit, law enforcement agencies, the Attorney General's Department, and Supervisory and Regulatory agencies. It is recommended to revisit the existing systems and processes with a view to identifying the issues associated with them and steps to be taken in addressing those issues with a time-bound action plan supported by sufficient financial allocations.

Sri Lanka should focus on capacity-building issues in line with the terrorist financing risk. Especially, investigators, prosecutors, and judges should process a sufficient level of expertise and professionalism in handling cases involving new technology-associated products such as virtual currencies and block chain technology. Investigators should have the ability in timely detecting potential terrorist financing activities. They should be able to use a wide range of investigative techniques including special investigative techniques such as undercover operations, intercepting communications, accessing computer systems, and controlled deliveries, forensic accounting, and more advanced tools in evidence gathering.

Sri Lanka should improve its effectiveness in investigating and prosecuting terrorist financing offenses. The authorities should ensure proper functioning of effective counter terrorism regime covering investigation, prosecution, conviction and sanctions. Sri Lanka should address the issues associated with the asset recovery and confiscation of terrorist assets in covering virtual assets. It has become necessary to make appropriate amendments to the existing laws for capturing new terrorist financing typologies. Especially, civil forfeiture regime is to be introduced covering

the asset forfeiture issues associated with a conviction-based confiscation regime. The establishment of proper asset management mechanism is also identified as a critical requirement.

Effective formal and informal international cooperation mechanisms are to be established in partnership with international organizations. The authorities should introduce new laws covering the abuse of None Profit Organizations (NPOs) by terrorists, terrorist organizations, and terrorist financiers. This has to be done without disrupting legitimate NPO activities. Sri Lanka needs to establish an effective mechanism for addressing risks associated with the proliferation of weapons of mass destruction. The authorities should ensure that persons and entities are barred from raising, moving, and using funds, consistent with international requirements. Sri Lanka should revisit the National Anti-Money Laundering and Countering the Financing of Terrorism (AML/CFT) Policy in capturing the current developments and the same to be effectively implemented as an embedded practice supported by a high level of political commitment.

#### 4.1 Future Research

The authors are of the view that, there are gaps in the existing literature regarding modern technology associated products such as use of virtual currencies, block chain technology and tracing and confiscating of virtual assets used to facilitate terrorist financing activities. Therefore, it is suggested that, these areas be explored as new study fields.

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