



Asia/Pacific Group
on Money Laundering

NEPAL ME 2

Mutual Evaluation Report

Anti-Money Laundering and
Combating the Financing of Terrorism

Nepal

July 2011

Nepal is a member of the Asia/Pacific Group on Money Laundering. This 2nd evaluation was conducted by that body and adopted by its Plenary on 21 July 2011.

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TABLE OF CONTENTS

PREFACE.....	5
EXECUTIVE SUMMARY.....	6
1. GENERAL.....	11
1.1 General Information on Nepal.....	11
1.2 General Situation of Money Laundering and Financing of Terrorism.....	17
1.3 Overview of the Financial Sector and DNFBPs.....	21
1.4 Overview of Commercial Laws and Mechanisms Governing Legal Persons and Arrangements.....	27
1.5 Overview of Strategy to Prevent Money Laundering and Terrorist Financing.....	28
2. LEGAL SYSTEM AND RELATED INSTITUTIONAL MEASURES.....	34
2.1 Criminalisation of Money Laundering (R 1 & R 2).....	34
2.2 Criminalisation of Terrorist Financing (SR II).....	44
2.3 Confiscation, Freezing and Seizing of Proceeds of Crime (R 3).....	47
2.4 Freezing of Funds Used for Terrorist Financing (SR III).....	56
2.5 The Financial Intelligence Unit and its functions (R.26, 30 & 32).....	61
2.6 Law Enforcement, Prosecution, Other Competent Authorities (R 27, 28, 30 & 32).....	72
2.7 Cross Border Declaration or Disclosure (SR IX).....	82
3. PREVENTIVE MEASURES - FINANCIAL INSTITUTIONS.....	90
3.1 Risk of money laundering or terrorist financing.....	94
3.2 Customer Due Diligence, Including Enhanced or Reduced Measures (R 5 to 8).....	95
3.3 Third Parties and Introdurers (R 9).....	111
3.4 Financial Institution Secrecy or Confidentiality (R 4).....	115
3.5 Recordkeeping Requirements and Wire Transfer Rules (R 10 and SR VII).....	118
3.6 Monitoring of Transactions and Relationships (R 11 & 21).....	120
3.7 Suspicious Transaction Reports and Other Reporting (R 13-14, 19, 25 & SR IV).....	123
3.8 Internal Controls, Compliance, Audit and Foreign Branches (R 15 & 22).....	131
3.9 Shell Banks (R 18).....	134
3.10 Supervisory and Oversight System - Competent Authorities and SROs (R 23, 29, 17 & 25).....	135
3.11 Money/Value Transfer Systems (SR VI).....	168
4. PREVENTIVE MEASURES – DESIGNATED NON-FINANCIAL BUSINESSES AND PROFESSIONS.....	171
4.1 Customer due diligence and record-keeping (R 12) (applying R.5, 6, and 8 to 11).....	172
4.2 Suspicious transaction reporting (R.16) (applying R.13 to 15 & 21).....	175
4.3 Regulation, Supervision and Monitoring (R.24-25).....	178
4.4 Other non-financial businesses and professions.....	182
5. LEGAL PERSONS AND ARRANGEMENTS & NON-PROFIT ORGANISATIONS.....	184
5.1 Legal Persons – Access to Beneficial Ownership and Control Information (R 33).....	184
5.2 Legal Arrangements – Access to beneficial ownership and control information (R34).....	188
5.3 Non-Profit Organisations (SR VIII).....	191
6. NATIONAL AND INTERNATIONAL COOPERATION.....	198

6.1	National Co-Operation and Coordination (R 31 and R 32)	198
6.2	The Conventions and UN Special Resolutions (R 35 & SR I).....	199
6.3	Mutual Legal Assistance (R 36-38, Special Recommendation V)	203
6.4	Extradition (R.37, 39, SR.V)	208
6.5	Other Forms of International Co-Operation (R 40 & SR V)	211
7	OTHER ISSUES.....	214
7.1	Resources and Statistics.....	214
7.2	Other Relevant AML/CFT Measures or Issues	215
TABLES		212
ANNEXES		235

PREFACE

INFORMATION AND METHODOLOGY USED FOR THE EVALUATION OF FEDERAL DEMOCRATIC REPUBLIC OF NEPAL

1. The evaluation of the anti-money laundering (AML) and combating the financing of terrorism (CFT) regime of the Federal Democratic Republic of Nepal (Nepal) was based on the Forty Recommendations 2003 and the Nine Special Recommendations on Terrorist Financing 2001 of the Financial Action Task Force (FATF), and was prepared using the AML/CFT Methodology 2004 (updated February 2009). The evaluation was based on the laws, regulations and other materials supplied by Nepal, and information obtained by the evaluation team during its on-site visit to Kathmandu, Nepal from 6 to 17 September 2010 and subsequently. During the on-site visit the evaluation team met with officials and representatives of relevant Nepal government agencies and the private sector. A list of the organisations met is set out in **Annex 2** to this mutual evaluation report.

2. The evaluation was conducted by a team of experts in criminal law, law enforcement and financial/regulatory issues as follows:

- Gregor Allan, Crown Counsel, Crown Law Office, Wellington, New Zealand (legal expert);
- Mohammad Abdur Rab, Deputy Director, Anti-Money Laundering Department, Bangladesh Bank, Dhaka, Bangladesh (law enforcement expert);
- Scott Rembrandt, Policy Advisor, Office of Terrorist Financing and Financial Crimes, Department of Treasury, Washington DC, United States (financial expert);
- Santosh Shukla, Joint Legal Advisor, Securities and Exchange Board of India, Mumbai, India (financial expert); and
- Gordon Hook, Executive Secretary, APG Secretariat, Sydney, Australia.

3. The experts reviewed the institutional framework, the relevant AML/CFT laws, regulations, guidelines and other requirements, and the regulatory and other systems in place to deter money laundering (ML) and the financing of terrorism (FT) through financial institutions and Designated Non-Financial Businesses and Professions (DNFBPs), as well as examining the capacity, the implementation and the effectiveness of all these systems.

4. This report provides a summary of the AML/CFT measures in place in Nepal as at the date of the on-site visit or immediately thereafter. It describes and analyses those measures, sets out Nepal's levels of compliance with the FATF 40+9 Recommendations (**Table 1**), and provides recommendations on how certain aspects of the system could be strengthened (**Table 2**).

MUTUAL EVALUATION OF NEPAL

EXECUTIVE SUMMARY

1. This report summarises the anti-money laundering and combating the financing of terrorism (AML/CFT) measures in place in Nepal as of the time of the on-site mutual evaluation visit (September 2010) and shortly thereafter. The report describes and analyses those measures and provides recommendations on how the system could be strengthened. It also sets out Nepal's levels of compliance with the Financial Action Task Force (FATF) 40+9 Recommendations (see the attached table on the Ratings of Compliance with the FATF Recommendations).

Key Findings

2. The key findings of this report are as follows:

- Nepal faces a number of money laundering (ML) and terrorist financing (TF) risks and threats. Primary predicate crimes in Nepal are drug trafficking, human trafficking, arms trafficking, corruption, counterfeit currency, tax evasion and gold smuggling. Significant vulnerabilities relate to the porous Indo-Nepal border including terrorist activity and TF.
- Nepal has criminalised ML in the *Asset (Money) Laundering Prevention Act 2008* (ALPA) but there are significant deficiencies in this offence and the range of predicate offences is not wide enough to comply with the FATF standards. In addition, ancillary offences do not extend to conspiracy and counselling and possibly do not extend to aiding the commission of a predicate offence. Criminal liability for legal persons, as well, is not clearly enacted nor is it pursued by law enforcement and prosecution authorities.
- TF is not criminalised. Despite including TF within the definition of ML in the ALPA, the structure of the ML offence does not encompass TF.
- The mechanism for freezing the assets of terrorists listed under UNSCR 1267, and for freezing other terrorist assets, is provided within the framework of subordinate instruments (FIU Directives) which is not legally binding and is therefore unenforceable.
- The Nepal FIU is a departmental unit within the Nepal Rastra Bank (NRB), Nepal's central bank. However, notwithstanding that the ALPA provides that the FIU shall be located within the NRB, the FIU lacks a sufficient administrative basis for its continuing operations. In addition, the FIU lacks proper skills and resources to properly undertake analysis of STRs and TTRs (threshold transaction reports). The FIU also requires operational independence within NRB.
- Financial institutions, as well as some non-financial institutions (including casinos), are required to file STRs and TTRs but significant deficiencies in the ML offence and the lack of a TF offence narrows the scope of reporting. In addition, the implementation of the reporting obligation is ineffective.
- Nepal has attempted to require financial and non-financial institutions to adopt AML/CFT preventive measures since 2008, however the instruments imposing those requirements are not enforceable and there are gaps in the scope of institutions included – postal saving banks, commodities brokers, lawyers, accountants, person acting as real estate agents and precious metal/gem dealers are not included. Access to beneficial ownership of natural

and legal persons is not ensured and effective measures to protect NPOs from abuse for terrorism financing purposes are not yet in place.

- Customer identification and verification is a weakness in Nepal's preventive measures. The measures which purport to impose identification requirements for non-banks are not binding; and
- Nepal does not have a mutual legal assistance (MLA) law. Although Nepal has provided very limited MLA it has only done so on an *ad hoc*, unstructured, basis and not in compliance with the requirements of the FATF recommendations. In relation to extradition, Nepal has not used the Extradition Act (either to extradite a foreign national or to prosecute Nepal citizens) since its enactment in 1988. The extradition process enables considerable executive intervention and is not likely to enable the swift surrender of requested persons.

Background

3. Nepal became a federal republic in 2008 and is currently going through a period of constitutional reform with the goal of achieving multi-party consensus on a new constitution. In 2008 Nepal enacted the ALPA and established an FIU within Nepal's central bank, the Nepal Rastra Bank. In the three years since its establishment the FIU has received 186 STRs and has achieved one conviction for ML. In 2009 AML Rules were issued by the Government of Nepal. The FIU has also issued a number of sector-specific AML/CFT related Directives covering a range of issues from STR forms, CDD and other preventive measures.

4. Nepal faces a number of ML and TF risks associated with its large cash-based economy and informal sector associated with hundi (underground banking). There are also challenges for Nepal related to its open border with India. Nepal's formal financial sector consists of commercial banks, development banks, finance companies, micro-finance companies, money value transfer systems, securities companies, insurance companies, cooperatives and postal savings banks. Access to financial services remains limited for most people in Nepal but has increased in recent years. Only an estimated 26% of Nepalese households have a bank account. The bulk of remittances that enter Nepal come from Nepalese workers working abroad. Despite being illegal, alternative remittance service providers have a significant market share in Nepal.

5. Nepal's DNFBP sector includes casinos, lawyers, accountants, precious metal and gem dealers and real estate agents. Casinos are regulated by the Ministry of Tourism and are the subject of an FIU AML/CFT Directive.

6. There are 27,790 NPOs registered/affiliated with the Social Welfare Council, 223 of which are international NPOs. Domestic NPOs are registered with the District Administrative Offices and are not mandatorily required to affiliate with the SWC notwithstanding that many have. Nepal companies and foreign companies (both public and private) must register with the Company Registrar's Office. Trusts (both domestic and foreign) are taxed in Nepal but there are no statistics on the number of trusts (domestic and foreign) operating.

Legal System and Related Institutional Measures

7. Nepal has criminalised ML under the ALPA. Nepal's ML offence uses a list approach to predicate crimes but the list is deficient in a number of the required FATF designated categories. TF is not a predicate offence to ML in Nepal but certain TF activities qualify as predicate conduct. Foreign predicate offences are not included as predicate offences under the Nepal ML offence. In other major respects the ML offence does not comply with the

requirements of the Vienna and Palermo Conventions. Ancillary offences are not fully covered within this criminal and criminal liability of legal persons is at best ambiguous but appears not to be covered as required by the FATF. There has been one prosecution and conviction for ML in Nepal since enactment of the offence in 2008.

8. TF is not criminalised in Nepal. Despite an attempt to criminalise it within the structure of the ML offence, the construction of the ML offence is deficient on TF. There has been one investigation for TF in Nepal but no prosecutions. The legal regime to freeze, seize and confiscate criminal proceeds is limited.

9. Nepal's FIU is located with the NRB as an administrative unit. The FIU requires operational independence within the NRB and needs to adopt effective measures in STR and TTR analysis. Since 2008 the FIU has received 186 STRs and disseminated all of them to law enforcement for investigation.

10. At the time of the on-site visit the government of Nepal had only provisionally appointed the Department of Revenue Investigation as the AML Department under the ALPA. Nepal needs to complete a formal appointment of a responsible agency for AML issues under the Act.

11. Despite the significant risks arising from its porous borders, Nepal has not yet implemented effective controls for the cross border movement of cash and bearer negotiable instruments.

Preventive Measures – Financial Institutions

12. Nepal has implemented AML/CFT preventative measures through the application of the ALPA, *Asset (Money) Laundering Prevention Rules 2009* (AML Rules) and a number of sector-specific AML-related FIU Directives. The FIU Directives do not fall within the FATF definition of "other enforceable means" as they do not contain provisions that permit the imposition of penalties for their breach. These measures and requirements apply to the financial sector, however, it is not possible to establish whether the preventative measures contained in these documents are being implemented effectively since there is no systematic monitoring of compliance through the supervisory system.

13. Overall, Nepal's compliance with the FATF standards relating to customer due diligence (CDD) shows a number of critical gaps. Important elements are not addressed in either law, regulation, or other enforceable means. CDD requirements for non-banks are unenforceable.

14. There is no legal requirement for financial institutions to have measures in place to: identify the beneficial owner; understand the ownership and control structure of the customer; identify and verify that natural persons acting on behalf of legal persons and purporting to act on behalf of the customer are authorised to do so; verify the status of a legal person or arrangement, including the provisions regarding the power to bind the legal person or arrangement; conduct ongoing due diligence on the business relationship to ensure that transactions being conducted are consistent with the institution's knowledge of the customer, their business and risk profile, and source of funds; or perform enhanced due diligence for higher risk categories of customers, business relationships or transactions.

15. There is no requirement for financial institutions to put appropriate risk management systems in place to determine whether a potential customer or beneficial owner is a politically exposed person and if so, to apply enhanced customer due diligence measures as outlined in Recommendation 6. Moreover, there are no specific enforceable requirements for financial institutions to perform enhanced CDD measures in relation to cross-border correspondent

banking and other similar relationships. There is no obligation on financial institutions to have policies in place to prevent the misuse of technology for ML and TF and to address specific risk associated with non-face-to-face business relationships or transactions.

16. Nepal does not explicitly require banks or non-bank financial institutions to maintain records of business correspondence or after termination of business relationships. In addition, Nepal lacks statutes, regulations, and/or Directives on wire transfers.

17. Nepal lacks enforceable requirements to pay attention to complex, unusual large transactions or unusual patterns of transactions that have no apparent or visible economic or lawful purpose or to examine as far as possible the background and purpose of those transactions and to record those findings in writing.

18. Nepal lacks sufficient provisions for financial institutions to give special attention to business relationships and transactions with persons (including legal and other financial institutions) from, or in, countries/jurisdictions that do not, or insufficiently apply FATF recommendations. Nepal also lacks a regularized communication mechanism for the FIU to inform financial institutions of countries/jurisdictions with significant weaknesses in their AML/CFT systems or that do not sufficiently comply with the FATF recommendations.

19. Not all financial institutions are required to report STRs to the FIU. Those that do are in the nascent stage of developing AML/CFT policies and regimes that include STR filing reporting. Financial institutions appear to have minimal understanding of how to identify suspicious transactions. Less than a handful of STRs have ever been filed by institutions that are not commercial banks.

20. The FIU AML Directives do not address tipping off in attempted suspicious transactions and contain no penalty provisions for breach of other tipping off provisions. Immunity for those who tip off only occurs in the case where “loss occurs” and applies in the case against civil action (not in criminal cases).

21. There are no prohibitions on financial institutions establishing correspondent relationships with shell banks nor are there obligations for financial institutions to ensure that their accounts cannot be used by shell banks.

Preventive Measures – Designated Non-Financial Businesses and Professions

22. A full range of DNFBPs conduct business in Nepal including 10 casinos, lawyers, real estate agents (although there is no professional agency for real estate agents), accountants, gold dealers, and dealers in precious metals and stones. There is no independent profession of trust and company service providers. But these services are provided by lawyers and accountants.

23. With the exception of casinos (of which there are 10 only, operating in 5-star hotels), DNFBPs are not subject to the ALPA provisions. Nepal has adopted a phased approach to implementation of AML/CFT to the other DNFBPs. It is not clear when those other entities will be brought within the provision of the ALPA.

24. As for casinos, only non-Nepalis may enter and use the services offered by casinos but the AML laws are deficient in many respects. In particular, only the basic requirements of the ALPA and the AML Rules apply to casinos and these do not address much of the issues required under the FATF recommendations. Protection for STR reporting and prohibitions of tipping-off are not fully incorporated. No casinos have filed STRs.

Legal Persons and Arrangements & Non-Profit Organisations

25. Nepal's corporate registry and information collection system does not focus on obtaining information relating to the beneficial owner and control of companies or partnerships. The information maintained (including changes in information) relates almost solely to persons and other corporations that are the immediate owners or controllers of a company. In addition, there is the possibility that nominee directors act on behalf, and at the direction, of an undisclosed principal in the operation of a company. Bearer shares are not permitted under Nepal's legislation but the Companies Act does permit ownership of public companies through bearer share warrants. Safeguards to mitigate the ML and TF risks posed by bearer share warrants do not exist.

26. Nepal authorities deny that trusts operate in Nepal but the law of Nepal clearly permits their formation and operation (and income tax legislation requires their taxation) and, indeed, lawyers and accountants advertise these services and assist their clients in the formation and administration of trusts. There are no measures in place to mitigate the ML risk posed by trusts.

27. The NPO sector plays a vital social role in Nepal society. But there are an unknown total number of domestic and foreign NPOs operating in the country. Domestic NPOs must incorporate under the Association Registration Act 1977. Local NPOs are not required to but may affiliate with the Social Welfare Council (SWC) to obtain foreign assistance. Foreign NPOs must register/affiliate with the SWC which provides a degree of oversight of those NPOs while operating in Nepal. There are 27,790 NPOs registered with the SWC, 223 of which are international NPOs.

28. There has been no effective outreach to the NPO sector by the Government of Nepal in relation to risks and vulnerabilities of the sector to terrorist financing abuse. The NPO sector is subject to limited or no monitoring and supervision, but the NPOs registered under these Acts only account for a small number of entities within the sector. While Nepal officials indicated that they believe the TF risk in the NPO sector is small, it is difficult to understand how they can maintain this confidence, in light of the fact that they were unable to state the size, wealth and activities of the majority of NPOs in Nepal.

National and International Co-operation

29. Nepal established a National Coordination Committee on AML/CFT in 2008 to "coordinate inter-related entities with regard to asset laundering" and consists of key government ministries and agencies. The NCC's work programme, including agenda setting, needs to be formalized and include additional relevant agencies.

30. Nepal has not ratified/acceded to the Palermo and TF Conventions and does not have an MLA Act. And while there is an Extradition Act in Nepal, deportation is used primarily to effect delivery of fugitive offenders rather than the mechanism in the Act.

1. GENERAL

1.1 General Information on Nepal

31. The Federal Democratic Republic of Nepal (Nepal) occupies 147,181 square kilometres in the Himalayan mountain range bordering the People's Republic of China to the north and Republic of India to the south (as well as to the east and west). This location, between two of the largest and fastest growing economies in the world, makes Nepal a strategically important country. Kathmandu, the national capital, is located in the east-central part of the country in the Kathmandu Valley (UNESCO World Heritage Site, 1979).

32. Nepal has diverse geography with mountains in the north, and a hilly region in the mid- and low- plain fertile area in the south, ranging from east to west. The mountains to the north have eight of the world's 10 highest peaks, including the world's highest, Mount Everest at 8,848 meters.

33. Nepal has a population of 29.33 million (2009), 3 million of whom reside in the Kathmandu Valley. The primary language is Nepali but more than 100 regional and indigenous languages exist. English is spoken to some degree within the public service and in the business sector. Nepal has a literacy rate of 58% (15 years and above) and an average life expectancy rate of 67 years. About 27% of Nepal's population lives below the international poverty line of US\$1.25 a day. There is a diversity of religions in Nepal: 81% of the population is Hindu; 11% Buddhist; 4% Muslim; and 4% other faiths. Buddhism is linked historically with Nepal as the birthplace of the Buddha.

Evolution of Democratic Government

34. The political and constitutional history of Nepal in the mid- to late 20th century and early 21st century was turbulent, marked by civil unrest, corruption, tax evasion insurgency, and political crisis.

35. A monarchy throughout most of its history, Nepal was ruled by the Shah dynasty of Kings from 1768 to 2006. In the 1990's a movement for democratic change emerged opposed to rule by the King. Prince Gyanendra was crowned King (and final monarch) on 4 June 2001, the second time he had held this office - the first while he was a child of three years between 1950 and 1951.

36. The three-year rule of King Gyanendra has been characterised as "brief and traumatic"¹ and included his dismissal of three prime ministers. On 1 February 2005, the King declared a state of emergency (based on a decade-long Maoist insurgency in which 13,000 people had been killed), dismissed the government and suspended many basic civil rights. In his announcement on the assumption of direct rule, King Gyanendra said he was dismissing the government "because it has failed to make necessary arrangements to hold elections by April and protect democracy, the sovereignty of the people and life and property".² A joint peace pact between Parliamentary political parties of Nepal and Nepal Communist Party Maoist pressured

¹ 11 June 2008, "Nepal's Ex King Gyanendra" http://news.bbc.co.uk/2/hi/south_asia/4225171.stm.

² 1 February 2005, "King Declares Emergency" http://news.bbc.co.uk/2/hi/south_asia/4224855.stm

the King to reinstate the dissolved Parliament and form a new government. Once re-established the government later formed a Constitutional Assembly which, among other things, abolished the monarchy on 29 May 2008 and elected the first President of Nepal as a Republic.

System of Government

37. On 15 January 2007 the Interim Government of Nepal promulgated the *Interim Constitution of Nepal 2007*. This instrument abolished the monarchy and established a new state structure transferring executive power from the monarch to a Council of Ministers chaired by the Prime Minister.

38. The Interim Constitution also established a “Constituent Assembly” the main purpose of which is to create a new and permanent constitution for the country in close consultation with the Nepali people. Under s 83 of the Interim Constitution, the Constituent Assembly shall also act as Legislature-Parliament and conduct legislative functions.

39. Elections for the Constituent Assembly were held in 2008 following which the first Prime Minister was elected. He later resigned and the assembly then elected the second prime minister, who was sworn into office on 25 May 2009. The first President of Nepal (largely a ceremonial office), Ram Baran Yadav, was sworn into office a year earlier on 23 July 2008.

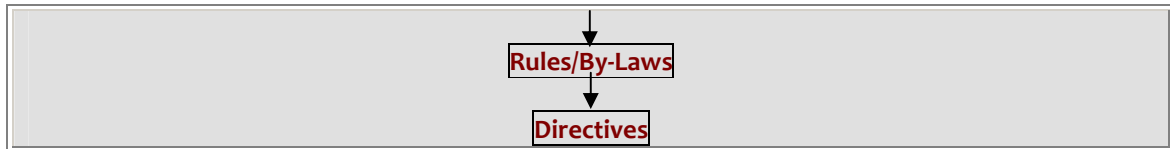
40. The Constituent Assembly is a unicameral parliament, consisting of 601 members. 240 members are elected through a direct electoral process representing single-member constituencies across the country; 335 members are nominated from party lists through a mixed party proportional representation system; and 26 are nominated by the cabinet (executive) as representatives of ethnic and indigenous communities. The judicial branch consists of district courts, a special court and tribunals, appellate courts and the Supreme Court of Nepal.

41. As of late 2010, Nepal was still in transition with no permanent constitution. The current constitutional and political environment (referred to as a “constitutional crisis” by many both within and outside Nepal) has unfortunately stifled legal, political, social and economic progress. Political deadlock in Nepal meant that the election of a Prime Minister had not yet occurred as of September 2010, and that Parliament was unable to consider and pass legislation in a timely manner. Even though the Nepal authorities had drafted a number of important amendments to existing legislation and some new bills, these had not been approved by the Interim Government. In the absence of a Prime Minister, the Parliament, though it has power to enact laws, focused primarily on the election of a Prime Minister rather than the enactment of legislation.

Legal System

42. The Nepal legal system is generally similar to the British common law system with elements of Hindu traditional law. Under the Interim Constitution 2007 the hierarchy of laws is represented as follows:





43. **Nepal’s Interim Constitution 2007** is supreme law in Nepal (until a more permanent constitution is issued). Laws enacted by the Parliament must be consistent with the Constitution. The Supreme Court has authority to strike down legislation not consistent with the Interim Constitution, and has done so.

44. **International Conventions and Treaties** that are ratified by Nepal establish a second order of supreme law in Nepal. Section 9 of the Nepal Treaty Act 1991 provides that any treaty to which Nepal is a State party is enforceable as national law. In the event of a conflict with other laws (including statutes), the convention/treaty prevails. While the Treaty Act 1991 is simply another statute and on its face would not override other statutes, the Supreme Court has upheld the principle contained in the Treaty Act against other statutes – see for instance the case of *Reena Bajracharya v HMG*.³

45. **Statutes** are enacted by the Parliament by virtue of s 83 of the Interim Constitution. They have precedence over other laws subordinate thereto including administrative measures. Statutes may delegate rule making- or directive-making powers to subordinate organs of government (such as ministries or departments) but those rules and directives must be compliant with the terms of the enabling statute under which they are issued otherwise a court may strike them down as *ultra vires*.

46. **Rules and By-Laws** may be issued pursuant to statutory delegation. The “Government of Nepal” is defined in the Interpretation of Laws Act 1954 as the Council of Ministers (i.e. the Executive). Rules and By-Laws are similar to regulations in that in general the government, and not a Ministry or Department, issues them. However, certain statutes have granted authority to specific agencies to issue Rules, e.g. the Commission for the Investigation of the Abuse of Authority (CIAA) Act grants this power to the CIAA.

47. **Directives** are departmental or ministerial orders issued under the authority of statutes or rules. The Nepal Rastra Bank (NRB) and FIU are among some of the agencies which have delegated authority under statute law to issues Directives.

Judicial System

48. The judiciary has a three-tier structure comprised of the Supreme Court of Nepal, the Court of Appeal and the District Court. There are 75 district courts and 16 appellate courts in various districts throughout the country.

49. The Supreme Court is composed of the Chief Justice of Nepal, 14 justices and additional *ad hoc* judges. The Chief Justice is appointed by the President on the recommendation of the Constitutional Council. He/she is appointed from amongst the justices having minimum of three years experience on the Supreme Court bench. Justices of the Supreme Court are appointed by Chief Justice on the recommendation of the Judicial Council. The Chief Justice appoints *ad hoc* judges on the recommendation of the Judicial Council. The Registrar and other officers of the court are appointed by the government on recommendation of the Judicial Service Commission.

³ *Reena Bajracharya v His Majesty’s Government (HMG)* No. 2812 of 1999, Supreme Court of Nepal.

50. The “Special Court” was also designated with exclusive jurisdiction over money laundering was established in 2009. That court also has jurisdiction over corruption, foreign exchange offences, and other designated offences. Similarly, there are tribunals such as the debt recovery tribunal (in lower and appellate levels) and the revenue tribunal. Some administrative agencies also exercise quasi-judicial powers. Decisions of the Supreme Court are final and binding on all lower courts including the Special Court.

51. The Supreme Court has constitutional power to interpret and test the constitutionality of legislation. Rights enshrined in ratified international treaties supersede Nepalese legislation if they conflict. This arises via specific legislative provision within the Nepal Treaty Act 1990.

Economy

52. Annual per capita GDP is US\$449 (2009 estimate).⁴ Nepal operates a small free market economy, key facts of which are as follows:

NEPAL - KEY ECONOMIC FACTS	1998	2007	2008
GDP (US\$ billions)	3.5	10.3	12.6
Exports – goods and services (US\$ billions)	11.4	13.0	12.1
Gross domestic savings/GDP (US\$ billions)	11.4	9.9	11.2
Gross national savings/GDP (US\$ billions)	15.2	28.7	29.5
STRUCTURE OF NEPAL’S ECONOMY (% OF GDP)	1998	2007	2008
Agriculture	39.9	33.5	33.7
Industry	22.5	17.1	16.7
- Manufacturing	9.6	7.7	7.4
Services	37.6	49.4	49.6
Household final consumption expenditure	76.9	80.9	78.8
General government final consumption expenditure	9.3	9.2	10.0
Imports of goods and services	33.9	31.3	32.7

Source: World Bank, “Nepal at a Glance” 9 December 2009

53. Political deadlock, coupled with other factors like corruption and tax evasion have meant that Nepal remains one of the poorest countries in the world despite vast hydroelectric power potential, potential for considerable tourism and agricultural resources.

54. Salient features of the economy are: low economic growth, high rate of unemployment, under-utilization of capacity, poor development of infrastructures, high population growth rate, high poverty, very large informal financial sector, low technological advancement, labour intensive methods of production, agro-dominated economy, widening trade deficit, foreign assistance dependency, high rate of inflation, regional disparity and high rates of corruption in the government sector and a massive rate of tax evasion in the private sector.

⁴ Nepal Government, *Economic Survey 2009*.

Major Exports/Imports and Trading Partners

55. Nepal's major export destinations include India (the largest partner), followed by the US, Bangladesh, Germany and China. In terms of export performance, readymade garments, pulses, woollen carpet, textiles, zinc sheet, thread, and other such goods are the major exportable commodities which contribute more than a half share in total exports from Nepal.

56. Principal import trading partners are India (largest), China, Saudi Arabia, Indonesia, Singapore, Thailand and UK.

Current Macroeconomic Situation

57. The preliminary estimate of Central Bureau of Statistics is that the real GDP in F/Y 2009/10 is projected to increase by 3.5% at basic price, and 4.6% at producers' price. In F/Y 2008/09, such growth rates were 3.9% at basic price and 4.9% at producers' prices. The manufacturing production index in the third quarter increased by 3.65% in F/Y 2009/10. This index had increased by 8.49% in the corresponding period of the previous year.

58. Nepal has large hydro-electricity, tourism and agriculture potential. It arguably has the second largest capacity to produce hydro-electricity in the world and its tourism sector (particularly eco-tourism) is built primarily around the attraction of the Himalaya Mountains. Largely unexploited, Nepal is making efforts to tap these resources and, in an effort to boost tourism, has declared 2011 "Nepal Tourism Year".

Transparency, Ethics, and Anti-Corruption Efforts

59. A disturbing recent news article citing Nepal's Judgment Enforcement Directorate, indicates that the judicial system is virtually powerless to enforce its own verdicts after conviction. According to the article⁵ "there are over 100,000 court verdicts unimplemented, leading to impunity for an average of three lawbreakers in each case. The exact number of convicts enjoying impunity could be more than 300,000 as most of the verdicts have more than three convicts," according to the Judgment Enforcement Directorate. This has an impact on the effectiveness of the judicial system in general and the criminal justice system in particular.

60. The Good Governance Act 2007 enacted in the wake of the fall of the monarchy has the following objective (from Preamble):

Good governance by ... adopting the basic values of good governance like rule of law, corruption-free and smart (lean or smooth) administration, financial discipline, and efficient management of public work and resources to create situation for providing public services in speedy and cost-effective manner; by bringing into execution (enforcement) of the right of the citizens upon having good governance by translating it to practical reality; and transform the administrative mechanism into service delivery mechanism and facilitator.[sic]

61. The Act provides for the establishment of a Unit for Governance Improvement at every Ministry (s 29). The Act requires transparency in decision-making with reasons (s 16), avoidance of conflict of interest (s 17), public hearing and participation in public issue (s 20, 28, 30), compliance with codes of conduct (s 23), maintaining a citizen's charter (s 25), and grievance management (s. 31), among other measures.

⁵ Kathmandu Post, *Over 300,000 Cons on the Loose*, 16 November 2010 (by Kamal Raj Sigdel) – see <http://www.ekantipur.com/the-kathmandu-post/2010/11/16/top-story/300000-cons-on-the-loose/214890/>. "Despite the horrific picture of impunity, the official response is miserably slow. ... with only half a dozen staff and no separate security back up, the JED has been able to nab only 297 out of over 36,000 absconding convicts in Kathmandu. It is yet to start its work in other districts."

62. The Corruption Prevention Act 2002, the Commission for the Investigation of Abuse of Authority Act 1991, the Good Governance Act 2007, Civil Service Act 1993, and codes of conduct related to other services, are all designed to prohibit corruption, misuse and abuse of government funds and misappropriation of power, resources and authority. These instruments apply to police officers, prosecutors and the wider civil service (including the Nepal Rastra Bank and FIU).

63. Nepal has not had a good record of transparency and accountability in government and consistently ranks in the lower half of the Transparency International (TI) Corruption Perception Index. In 2008 Nepal ranked 121 (equal) out of 180 and in 2009, despite enactment of the Good Governance Act a year and a half earlier, dropped ranking to 143 (equal) out of 180. According to TI, a score of less than 3.0 out of 10.0 indicates that there is “rampant” corruption. Nepal has a score of 2.3.

64. The 2009 *Global Integrity Report* on Nepal stated that Nepal's network of anti-corruption agencies "lacks consistency in approach and clear areas of jurisdiction, resulting in frequently overlapping functions. While many corruption-related legal reforms were adopted in 2007, their implementation has been stalled as the government's focus shifted to peace building, conflict resolution, social inclusion and elections."⁶

65. The Interim Constitution provides for the independence of the judiciary but the judiciary is not free from corruption. Nepal has a history of judicial corruption as reflected in 2007 TI report, *Global Corruption Reports 2007 – Corruption in the Judicial System*. While this report is three years old, judicial corruption has not abated. During the on-site visit in September 2010 the evaluation team noted many local media reports on corruption in the judiciary.

AML/CFT Compliance Culture

66. Nepal is in the initial phases of AML/CFT implementation. The ALPA was enacted in 2008 and since then a number of important institutional AML/CFT measures have taken place including:

- Establishment of a National Coordination Committee with policy oversight for AML/CFT;
- Establishment of the Financial Information Unit (FIU) in the Nepal Rastra Bank;
- Designation of the Department of Revenue Investigation as the provisional AML Investigation Department;
- Designation of the Special Court as the adjudication authority of ML/FT offences;
- Issuance of AML Prevention Rules; and
- Issuance of industry-specific FIU AML Directives.

67. The government has recognised the need to do more in order to build commitment and compliance with AML/CFT. The AML/CFT National Coordination Committee (NCC), established in 2008, underlines the importance of good coordination, cooperation and communication among government agencies involved in AML/CFT. This committee meets regularly but lacks an overarching coordination framework and strategic approach to policy issues. Furthermore, its membership lacks key government agency representation and it does not engage private sector stakeholders in issues.

⁶ <http://report.globalintegrity.org/Nepal/2009> (accessed 12 September 2010).

68. These deficiencies have hampered the government in developing, or facilitating, a proper culture of compliance among government agencies, private sector stakeholders and generally amongst individual businesses and professions. The FIU has tried to fill the breach in this regard, but it has limited resources and capacity to reach out to the private sector for this purpose.

1.2 General Situation of Money Laundering and Financing of Terrorism

69. Nepal joined the APG in 2002 and was first evaluated in 2005. Since 2005 Nepal has taken some important steps (some outlined above) to achieve closer compliance with the FATF standards. But Nepal has not undertaken a comprehensive evaluation of ML and TF risks in the country. Plans are underway to promulgate a national strategy on AML/CFT. Meetings with officials during the on-site visit suggested some confusion between a national strategy and a national risk assessment, with many officials believing they were the same. However, Nepal has initiated an ML/TF risk assessment process.

Nepal/Indian Border

70. Nepal and India share a porous border of more than 1,800 km (1,100 miles) with few check points and a large volume of people moving between Nepal and India on a daily basis. Given the few resources allocated to enforce immigration, customs and other controls, the border area is a particular concern in relation to ML and terrorist activities, including TF. Both the Nepal and Indian governments have raised concerns over the open border as an important issue that could pose security threats to both countries.⁷

71. Crimes associated with the open border include narcotics trafficking, trafficking of women and girls, arms smuggling, smuggling of goods, archaeological art, artefacts and manuscripts, kidnapping for ransom, robbery, theft, murder and gold smuggling. For instance, recent restrictions on the volume of gold which can be imported into Nepal from abroad have led to increased gold smuggling to Nepal from overseas, including from the United Arab Emirates. Smugglers have exploited the open border with India to move gold into Nepal from India.⁸ This vulnerability arising from the relative simplicity of legally shipping gold to India then move it across the largely unpatrolled Indo-Nepal border into Nepali markets for on-sale.

72. Since the 1980s, there is a concern that the border has developed into a passage for the cross-border movement of terrorists as well. In view of the growing terrorism threat in the South-Asia region, the open border between Nepal and India needs closer management and enforcement to mitigate this threat on both sides of the border.

73. The current political situation in Nepal (noted earlier) together with the open border with India presents significant challenges for Nepal in managing border crime and terrorist activities. Furthermore media reports have stated that security shortfalls at Tribhuvan Airport (Nepal's only international airport) are a concern. In June 2010, Lashkar-e Tayyiba (LeT)

⁷ Comments by Indian Foreign Secretary Nirupama Rao - *Nepal political instability concerns India*, 21 November 2010 at: <http://www.ekantipur.com/2010/11/21/headlines/Nepal-political-instability-concerns-India/325386/>. See also comments of Indian Minister of State for Foreign Affairs Praneet Kaur at: <http://bordernepal.wordpress.com/2011/01/11/nexus-of-open-border-with-india-2/> where he stated that: "it is the danger of anti-India elements exploiting the open border using Nepali soil to create security problems in India."

⁸ Media reports were many during the mutual evaluation on-site visit: see for instance, "Yellow metal tops list of imported items" in *The Himalayan*, Vol IX, No. 319, 8 September 2010, (front page). *Nepal seizes gold smuggled from India* *Indo-Asian News Service*, September 2, 2010 at: <http://www.ndtv.com/article/world/nepal-seizes-gold-smuggled-from-india-49089?cp>; also see: *Gold Crunch Hits Industry* in, *The Kathmandu Post*, 14 Sept 2010, p.B where it was reported that local markets are procuring gold for re-sale from smuggled sources operating along the border.

member, Muhammad Omar Madni, travelled through Nepal via this airport en route to New Delhi without detection.⁹

Money Laundering

74. Up-to-date crime statistics provided by Police authorities during the on-site visit are as follows:

NUMBER OF CASES INVESTIGATED BY NEPAL POLICE (to June 2010)					
Offences	Cases				
	2006	2007	2008	2009	2010
Murder	394	512	495	622	154
Attempt murder	145	210	232	412	97
Murder with armed robbery	13	14	14	5	2
Robbery	121	187	101	115	33
Theft	303	360	328	436	111
Archaeological theft	3	3	1	2	0
Kidnap & abduction	0	7	103	130	28
Extortion	6	13	11	10	6
Human trafficking	63	70	61	102	24
Rape	182	234	219	321	82
Attempt rape	8	28	33	40	11
Fraud	57	56	48	68	12
Bank fraud	2	0	0	5	1
Forgery of government stamps & signature	50	46	37	78	27
Forgery about citizenship	22	26	18	23	3
Copyright infringement	0	0	0	0	2
Counterfeit currency	15	20	23	26	6
Drugs	291	281	275	444	151
Black marketing	3	7	6	4	0
Gambling	3	1	1	8	2
Possession of illegal weapons	69	206	306	304	89
Explosives	10	9	8	31	2
Bomb blast	0	1	2	1	0
Public offence	821	1331	1251	2407	664
Vehicle accident	619	611	656	1085	322
Accidental death	554	551	492	998	281

75. The Department of Revenue Investigation provided the following statistics in relation to offences, including ML and TF within their exclusive jurisdiction:

⁹ http://www.nepalmonitor.com/2010/08/nepals_border_concer-print.html

OFFENCES INVESTIGATED BY DEPARTMENT OF REVENUE INVESTIGATION (to June 2010)								
OFFENCES	FILED IN COURT				CONVICTIONS			
	2007	2008	2009	2010	2007	2008	2009	2010
Revenue leakage			4	16				1
Foreign exchange abuse	16	26	20	23	10	18	11	11
Money laundering			1	22				1
Terrorist financing				1				

76. Nepalese officials recognise that there is a range of sources of proceeds of crime; and that these sources present significant ML risks. Contributing to those ML risks are: Nepal’s large cash-based economy and informal remittance system (hundi); a lack of central recording system; political instability in the current constitutional crisis; continuing internal dissatisfaction and conflict; a porous border with India; and significant liquidity issues.

Prevalent Predicate Crimes in Nepal

77. Nepal has yet to conduct a study to specifically identify and evaluate major predicate crimes that generate illegal proceeds. In discussion with government authorities, it was agreed nonetheless that the major challenges are the following crimes:

- Drug trafficking;
- Human trafficking;
- Arms trafficking;
- Corruption;
- Counterfeit currency;
- Tax evasion; and
- Gold smuggling.

78. Drug trafficking: Police and prosecution authorities confirmed that drugs and drug trafficking are major law enforcement concerns in Nepal. This concern has also been reflected in international reports. According to the UN International Narcotic Control Board, Nepal is the largest producer of cannabis resin in South Asia. The government seized over 9,623 kilograms of cannabis in 2008 over twice the amount since 2003. In addition to local consumption, the drug is smuggled to other parts of South Asia and the Asia-Pacific. The main destination is India where 40-50% of the total cannabis seizure in that country was found to have been smuggled from Nepal.

79. The United Nations has reported concerns over the trafficking through Nepal of heroin (“brown sugar”), crystalline methamphetamine and amphetamine-type stimulants to other parts of South Asia. In a comment to a UN Working Group in 2000, the Nepal delegate stated that: “...Nepal’s... close proximity to the Golden Crescent and the Golden Triangle -- the source of a considerable portion of the world’s heroin supply -- meant that it was not immune from drug-related problems.”¹⁰ During the APG on-site visit prosecutors confirmed that there is still a

¹⁰ “Links between Terrorism, Drug Trafficking, Illegal Arms Trade Stressed in Continuing Third Committee Debate on Crime” UNIS/GA/SHC/302, (comments by Dil Bahadur Gharti, <http://www.unis.unvienna.org/unis/pressrels/2000/shc302.html>. (accessed 14 September 2010).

prevalence of “brown sugar” and other drugs in Nepal trafficked by Nepali organised crime groups from neighbouring countries.

80. Human trafficking: Trafficking in women and children from Nepal to India and other parts of the region is a continuing problem, acknowledged both by officials within the country and by external agencies. The porous Indo-Nepal border contributes to movement of persons for illicit purposes. Recently, an NGO in Nepal which supports trafficked victims reported (July 2010) that the crucial problem in Nepal is weak implementation of Nepal’s anti-trafficking laws.¹¹ In addition, according to the recent US State Department Trafficking in Person’s Report 2010, Nepal is a source country for men, women, and children for commercial sexual exploitation and forced labour within the country and abroad. Trafficking-related complicity by government officials remained a serious problem in Nepal, with traffickers using ties to politicians, business persons, state officials, police, customs officials, and border police to facilitate trafficking¹². Recently it was reported that 11 Nepalese women were arrested while using a land route to India on the pretext of providing employment to work in Goa’s ‘O’ casino (in India).¹³

81. Arms trafficking: Nepal officials expressed continuing concern over illegal trafficking in small arms in the country. This has its origins in the decade-long civil conflict commencing in the 1990s. Reports have cited the porous Indo-Nepal border as a source on concern for arms shipments from India into Nepal. In many cases Nepal is used as a transit point for arms to other countries in the region. In a recent media report (4 October 2010) 10 people were arrested in Nepal for their alleged involvement in separate cases of human trafficking and illegal arms trade rackets.¹⁴

82. Corruption: Nepal’s ranking on Transparency International’s Corruption Perception Index was noted earlier in this section. According to the *2009 Global Integrity Report*, private sector corruption in the form of kickbacks and facilitation payments is widespread in Nepal. As noted in that report: “Bribery and corruption have been thriving for years in key offices responsible for Nepal’s public service. And that culture is showing no signs of changing for the better, despite the ground-breaking “revolution” and political changes that have swept Nepal in recent years.”¹⁵ In addition, the Commissioner of Nepal’s anti-corruption agency, the CIAA, has stated on the CIAA’s website that corruption “is a big problem in Nepal ...and...has trickled into both private and public sectors, and into almost all walks of life.”¹⁶ High rates of petty corruption exist in Nepal as well as cases of grand corruption.

83. Counterfeit currency: Counterfeit Indian notes in 100, 500 and 1,000 Indian Rupee denominations are found each year in Nepal. The Nepal government, as per the decision of the Government of Indian, has banned the use of 1,000-rupee and 500-rupee notes for more than a decade to prevent organised criminal networks from flourishing. The revenue generated from these counterfeit notes has been used to fund other criminal activity including drugs and arms trafficking. Trader networks in the south of Nepal are reported to deal in these notes at the rate of 2-1 in the underground market.

¹¹ <http://www.irinnews.org/Report.aspx?ReportId=89750>

¹² US State Department Trafficking in Person’s Report 2010

¹³ “Five Indians are among 10 people arrested in Nepal for their alleged involvement in separate cases of human trafficking and illegal arms trade rackets” at <http://www.deccanchronicle.com/national/5-indians-arrested-nepal-trafficking-arms-smuggling-722>.

¹⁴ <http://www.deccanchronicle.com/national/5-indians-arrested-nepal-trafficking-arms-smuggling-722>.

¹⁵ “Global Integrity Scorecard” p 1. See <http://report.globalintegrity.org/reportPDFS/2009/Nepal.pdf>

¹⁶ Mr. Beda P. Shiwakoti, Commissioner CIAA, Nepal, at: <http://www.icac.org.hk/news/issue33eng/button1.htm> accessed 15 January 2011.

84. Tax evasion: Nepali government authorities admit that tax evasion is an endemic problem largely due to unsophisticated tax collection methods (paper-based), lack of resources, poor reporting by business and persons and lack of training for tax revenue authorities, including customs. There is concern by the Government over general tax compliance levels in Nepal. The Department of Revenue Investigation's primary function is the investigation and prosecution of tax evasion and other tax cases.

85. Gold smuggling: Smuggled gold moving across the porous border with India constitutes more than 35% of the precious metal supply in the local market, at the time of the evaluation, due to gold import restrictions imposed by the central bank. During the on-site evaluation visit there were reports in the local media of large shipments of illegally smuggled gold crossing the border.¹⁷ Concerns over links with criminal networks have been expressed both within and outside Nepal.

Terrorist Financing

86. Independent studies and media sources have reported that the UN 1267-designated terrorist group Lashkar-e Taiba (LeT) maintains a significant presence in Nepal, focused on supporting operations in neighbouring India. In addition, extremist elements in southern Nepal (primarily minority separatist groups, such as the Madhesi) in 2009 have continued to conduct sporadic bombings against civilians.¹⁸ Officials acknowledged that these groups and their activities require on-going funding and that funds are likely generated from illegal activities including arms and drug trafficking along the Indo-Nepali border.

87. Independent sources, including the International Peace Research Institute, have identified hundi traders as the conduit for funds to support LeT activities in Nepal and in India. Nepal does not have anti-terrorist legislation. However, there is a special Terrorist Control Directorate with the Nepal Police to pursue domestic and international terrorists and terrorism.

88. Nepal has not conducted a national risk assessment to determine the level of ML and TF risk across relevant sectors. Agencies spoken to during this visit seemed unaware of the importance and mechanics of such an exercise. Environmental factors that exacerbate the ML/TF vulnerabilities include Nepal's predominantly cash-based economy, porous borders, under-developed AML/CFT measures and a newly formed central government that is in the process of re-establishing its rule following a decade-long civil war.¹⁹

1.3 Overview of the Financial Sector and DNFBCs

89. The financial institutions operating in Nepal can be categorized as follows:

- Commercial Banks, Development Banks, other Finance Companies and Micro-Finance Companies (Classes A to D described in more detail below);
- Money value transfer systems (MVTs);
- Securities companies;

¹⁷ See footnote 6 for media references.

¹⁸ International Peace Research Institute (Oslo), *Illicit Trading in Nepal: Fueling South Asian Terrorism* South Asia briefing Paper #3, (Jason Miklian) 2009; Jamestown Foundation: "Lashkar-e-Taiba's Financial Network Targets India from the Gulf States," July 2, 2009. S Asia Terrorism Portal: <http://www.satp.org/satporgtp/countries/nepal/terroristoutfits/jtmnj.html>; "Arrested cleric ran Lashkar's Nepal hub," The Hindu (major Indian periodical), 6 June 2009; Agence France-Presse: "Five injured in Nepal bomb attack" January 30, 2009.

¹⁹ US State Department: *2009 International Narcotics Control Strategy Report (INCSR) Country Report, Nepal*.

- Insurance companies;
- Cooperatives; and
- Postal Savings Banks.

90. Access to financial services remains limited for most people in Nepal. Only an estimated 26% of Nepalese households have a bank account. Six commercial banks offer credit cards, but the number of actual Nepali credit card holders is small. Family and friends are by far the largest informal providers of credit to households.

91. Estimates of the percentage of foreign remittances coming through informal channels vary from 10% to 15%, according to Nepal government officials, and up to 60% according to an industry participant. Banks' procedures for remittance are perceived as being the most cumbersome among financial institutions.

92. The following table outlines the class of institution and its supervisor/regulator in relation to the FATF definition of financial activity:

Financial Activity by Type of Financial Institution			
Type of financial institution activity (see the Glossary of the FATF 40 Recommendations)	Type of Financial Institution that performs this activity	Subject to AML/CFT requirements Y/N	AML/CFT Supervisor/ Regulator
Acceptance of deposits and other repayable funds from the public	A, B, C, savings and lending cooperatives, and postal savings banks (for government officials only).	Yes. No for postal savings banks.	NRB, None for postal savings banks.
Lending	A, B, C and savings and lending cooperatives to members. NGOs licensed by NRB for limited banking also lend a limited amount of micro finance. Postal savings banks (for government officials).	Yes, No requirement for NGOs or postal savings banks.	NRB, For NGOs banking licensed-by NRB. None for postal savings banks.
Financial leasing	A, B, C	Yes	NRB,
Transfer of money or value	A, B, C, and licensed money remitters via banks.	Yes	NRB.
Issuing and managing means of payment (e.g. credit and debit cards, cheques, traveller's cheques, money orders and bankers' drafts, electronic money)	A, B, C Note: C class are not allowed to manage payment through traveller's cheques Postal bank do for money order to a limited extent.	Yes, but not for postal bank.	NRB, None for postal bank except postal office for postal issues.
Financial guarantees and commitments	A, B	Yes	NRB,
Trading in Money market instruments (cheques, bills, CDs, derivatives etc.)	A, B, C	Yes	NRB,

Trading in Foreign exchange	A, B	Yes	NRB,
Trading in Exchange, interest rate and index instruments	A class banks	Yes	NRB,
Trading in Transferable securities	Nepal Stock Exchange Market Limited	Yes	Securities Board of Nepal (SEBON)
Trading in Commodities	Commodities & Metal Exchange Nepal Ltd.	No	Proposed Regulator: SEBON
Participation in securities issues and the provision of financial services related to such issues	A, B, C and Securities business persons, Note: A class needs to do business through its subsidiary company Merchant Banks	Yes	NRB, SEBON
Individual and collective portfolio management	Merchant Banks	Yes	SEBON
Safekeeping and administration of cash or liquid securities on behalf of other persons	No liquid securities. The companies themselves or Merchant banker can do as agent.	Yes for merchant bankers and banks and FIs but not for others.	SEBON
Otherwise investing, administering or managing funds or money on behalf of other persons	Citizen Investment Trust (Authorised statutory body to manage mutual fund)	No	Proposed Regulator: NRB
Underwriting and placement of life insurance and other investment related insurance	Insurance Companies Merchant banks	Yes	Insurance Board SEBON
Money and currency changing	A, B class FIs and Money Remitters	Yes	NRB, Supervision and Forex Department

Banks and Financial Institutions

93. Nepal is not a major financial centre. Eight banks have foreign equity participation. There are four basic categories of banks and financial institutions in Nepal, all of which are regulated by the Nepal Rastra Bank (NRB):

- Class A: Commercial Banks
- Class B: Development Banks
- Class C: Finance Companies
- Class D: Micro-Finance Companies

94. Postal saving banks (small deposit institutions) are established for government staff in rural areas and are permitted under the Postal Services Act. They offer accounts to 46,981 government officials across 117 branches. Deposits total NRps 1.085 billion (US\$14.68 million). Maximum deposits are set at NRps 1,500,000 (US\$20,270). Outstanding loans stood at NRps 335.4 million (US\$4.5 million), as of September 2010.

BANKS: PAID-IN CAPITAL AND TOTAL VALUE OF ASSETS			
INSTITUTION TYPE	TOTAL INSTITUTIONS	PAID-UP CAPITAL (OCTOBER 2010)	TOTAL ASSETS (OCTOBER 2010)
Commercial Banks	27	US\$10.38 billion	US\$92.43 billion
Development Banks	78	US\$0.16 billion	US\$84.24 billion
Finance Companies	79	US\$.095 billion	US\$90.06 billion
Micro-finance Companies	18	US\$0.0126 billion	US\$18.00 billion
TOTAL	202	US\$10.65 billion	US\$284.73 billion

95. NRB is empowered to regulate and supervise any licensed banks and financial institutions under the Nepal Rastra Bank (NRB) Act 2002 and the Banks and Financial Institution Act 2006 (BAFIA). Banks and financial institutions are required to comply with conditions prescribed in registration, licensing and any other times. Such conditions include fit and proper test, minimum capital requirements, structural management, good governance, transparency, reports and statistics, working for the interest of depositors and financial system and compliance of legal and prudential measures.

96. The NRB Act confers powers on NRB to recommend the registration of banks and financial institutions to the Company Registrar and license them by itself after registration under the BAFIA. Only NRB licensed banks and financial institutions are able to take deposits and conduct other aspects of banking business. Postal savings banks are regulated by the Nepal Post Office.

97. Neither the NRB Act nor the Banking Offence and Penalty Act 2008 (BOPA) reference AML/CFT obligations although BAFIA contains a few provisions of relevance to AML/CFT.

Non-Bank Financial Institutions

98. Non-bank deposit takers (consisting primarily of cooperatives and micro-finance companies) provide a range of financial services, some more extensive than others, which are similar to many of the financial services provided by registered banks.

99. Non-bank deposit taking financial institutions in Nepal consist of:

- Money value transfer services, including money changers and remitters/transfersors;
- Insurance companies;
- Cooperatives;
- Non-governmental organisations offering limited banking; and
- Postal saving banks.

100. Statistics on paid-in capital and total value of assets for non-bank financial institutions in Nepal is:

NON-BANK FINANCIAL INSTITUTIONS: PAID-IN CAPITAL AND TOTAL VALUE OF ASSETS			
INSTITUTION TYPE	TOTAL INSTITUTIONS	PAID-UP CAPITAL (OCTOBER 2010)	TOTAL ASSETS (OCTOBER 2010)
Money Remitters	50	US\$18,055,555	NA
Money Exchanges	437	US\$6,069,444.	NA
Securities Firms		US\$19,027,777	Not available
Insurance companies	9	US\$481,312,500	Not available
Co-operatives licensed for limited banking by NRB	15	US\$5,798,013	US\$783,895,277
NGOs licensed for limited banking	45	N/A	N/A

101. NRB licenses money remitters/transferors and currency exchange operators under the NRB Act, 2002 and the Foreign Exchange Regulation Act, 1962. No remitter is permitted to remit funds out of Nepal. Foreign and domestic money remittances must use banking channels. Transmissions of remittances outside of Nepal is strictly limited and only permitted through banking channels. The bulk of remittances that enter Nepal come from Nepalese workers working abroad, particularly from India, Malaysia, Qatar, and the United Arab Emirates. Despite being illegal, alternative remittance service providers have a significant market share in Nepal of remittances, although estimates vary from 10% to 15%, according to government officials, and upwards to 60%, according industry. Officials are aware of the large number of Hundi operators but acknowledge they lack resources to enforce the law.

102. The Securities Board of Nepal (SEBON), established under the Securities Act 2007, regulates merchant bankers, portfolio managers, stockbrokers, and securities traders. 180 listed companies on the Nepal Stock Exchange with value in September 2010 of nearly NRps 86 billion (US\$1.16 billion). As of 2010 23 stockbrokers were licensed with SEBON.

103. Fifteen (15) merchant banks were licensed by SEBON in 2010. Pursuant to the Securities Act 2007, SEBON required that banks and financial institutions were only allowed to perform roles of issue managers, securities businesspersons, share registrar, investment management and underwriter through a separate subsidiary company with the approval from SEBON. All banks and financial institutions conducting merchant banking business must do so through one of the 15 SEBON-licensed merchant banks.

104. Nepal is taking steps to establish a Central Securities Depository as an independent company.

105. Insurance companies, agents, surveyors and brokers are licensed by the Insurance Board Nepal under the Insurance Act 1992. These entities offer life and general insurance throughout the country. 1.19 million life and non-life policies are active in Nepal and many were issued years before ALPA. Nepal is a member of the International Association of Insurance Supervisors. 70 to 80% of life insurance policies are estimated to have NRps 100,000 (US\$1,388) payout value. Insurance companies have also begun to offer single premium life insurance policies that may be purchased and surrendered after two years. The evaluation team was not provided with any details on the number of outstanding single premium life insurance policies nor the rationale for permitting them in the Nepalese market, given their higher risk of ML.

106. Cooperatives are registered under the Cooperatives Act 1992. Only “members” may use the services of cooperatives. Nepal has 5,612 savings and lending cooperatives authorised

by the Department of Cooperatives 15 of which are licensed by NRB to provide limited banking services.

107. Other financial institutions include provident funds such as the Employee Provident Fund and Citizen Investment Fund, both government entities.

Designated Non-Financial Businesses and Professions

108. The table below summarises the types of and estimated number of DNFBPs operating in Nepal:

DNFBPs in Nepal	
Type	Number
Casinos	10
Real estate agents	Unknown (no legal framework to licence/regulate)
Dealers in precious metals and stones	Unknown
Lawyers	
- Senior advocates	103
- Advocates	13,141
- Pleaders	9,732
Notaries (attestation license holders)	2,094
Accountants:	
- Chartered Accountants	488
- Registered auditors	7,285

109. The 10 casinos are operated solely in 5-star hotels. Casinos are licensed under the Tourism Act, 1978. Only non-Nepal citizens may enter and gamble in these operations. There are no plans to expand the number of casino licences.

Casinos in Nepal (up to June, 2010)		
Name of Casino operator	Place of Operation	License Issued
Casino Nepal, Soaltee Hotel Ltd	Kathmandu	1966
Casino Anna, Hotel de La Annapurna Ltd	Kathmandu	1992
Casino Royal, Hotel Yak & Yeti Ltd	Kathmandu	1992
Casino Everest, Hotel Everest Int'l Ltd	Kathmandu	1992
Casino Pokhara, The Fulbari Ltd	Pokhara	2001
Casino Tara, Tara Gaun Regency Hotel Ltd	Kathmandu	2003
Casino Rad, Hotel Radisson	Kathmandu	2003
Casino Sangrila, Sangrila Hotel	Kathmandu	2006
Casino Pokhara, Hotel Pokhara Grand	Pokhara	2008
Casino Venus, Hotel Malla	Kathmandu	2008

110. At least one online casino operates from Nepal, although the basis of their license could not be established by the assessors.

111. The following list constitutes the main features of casinos in Nepal:

- Table games, slot machines and electronic games, subject to low limits;
- Nepali citizens are not allowed to gamble in casinos. Indians are the major customers.

- All games are played in chips. The chips are available in Indian rupee denomination of 100, 1000, 10,000. Chips can be purchased with foreign currencies such as US dollars, UK pound and Euro or with Indian rupees
- Few customers undertake transactions of US\$1,000 or more.
- Deals/ exchange of chips with other casinos are permissible. The customers can take the chips outside the casino and can game in other casinos with those chips. For chip control, chips have been assigned casino unique visible mark and casinos undertake inventory of chips regularly.
- Account-based relationships are permitted, but the casinos currently do not offer account-based or credit based gaming/gambling.
- There are no VIP rooms for gambling and no ATM facility is provided in casinos.
- All payouts are in cash and no cheque or any other instrument is issued.

112. Casinos are included under the ALPA's AML/CFT controls.

113. Real estate agents are not regulated or supervised nor is there a self-regulating professional association of real estate agents. Anyone in Nepal may act in the capacity of an agent or broker of real estate, commercial or residential.

114. Dealers in precious metals and stones may be registered as limited liability companies, partnerships or sole traders. Gold and silver dealers may join the Nepal Gold and Silver Dealers Association which currently has approximately 2,500 members with 7 sub-branches in Nepal. The Association is a voluntary self-regulating body established 23 years ago. Precious stone dealers or dealers in other precious metals are not represented by a professional association.

115. The Nepal Bar Council licenses and regulates lawyers under the Nepal Bar Council Act 1994. There are 21,000 lawyers in Nepal licensed to practice law including those licensed to appear in courts. The Bar Council issues professional rules of conduct and has a discipline committee to enforce those rules. Notaries are licensed under the Notaries Public Act 2007 and are regulated by the Notary Council. Only lawyers can act as notaries.

116. The Nepal Institute of Chartered Accountants licenses and regulates chartered accountants and registered auditors. Licenses must be renewed yearly. The Institute issues professional rules of conduct and has a discipline committee to enforce those rules.

1.4 Overview of Commercial Laws and Mechanisms Governing Legal Persons and Arrangements

Legal Persons

117. There are a variety of legal persons and arrangements permitted in Nepal including: public limited liability companies, private limited liability companies, partnerships, sole proprietors (called private firms) and trusts.

118. Company incorporation and registration (both public and private) is required through the Company Registrar's Office in Kathmandu (there are no branch offices) after filing the required statutory documents. There are currently:

- 615 non-government public limited liability companies and private limited liability companies;
- 38 joint ventures (involving Nepali and foreign companies) registered in Nepal; and
- Over 80,000 private companies including foreign companies.

Trusts

119. Nepal has a system of private trust law similar in many respects to Indian trust law - based on British common law. Trusts (both domestic and foreign) are taxed in Nepal but there are no statistics on the number of trusts that have paid tax nor is there a registration law, central registry or other mechanism to determine the number of trusts, including foreign trusts, operating in Nepal.

Non-profit organisations

120. There is an unknown total number of domestic and foreign NPOs operating in Nepal. Domestic NPOs must incorporate under the Association Registration Act 1977. Local NGOs are not required to, but may, affiliate with Social Welfare Council (SWC) to obtain foreign assistance. Foreign NPOs must register with the SWC, which provides a degree of oversight of those NPOs while operating in the country.

121. There are 27,790 NPOs registered with the SWC, 223 of which are international NPOs.

1.5 Overview of Strategy to Prevent Money Laundering and Terrorist Financing

122. Despite becoming a member of the APG in 2002 Nepal is still in a nascent stage of developing a comprehensive AML/CFT framework. As noted earlier, Nepal has taken some steps to implement many of the recommendations made in the 2005 mutual evaluation report but these efforts, while important, are minimal in terms of the overall requirements of the FATF standards.

123. Banks and other financial institutions as well as some DNFBPs are included as reporting entities under the Asset (Money) Laundering Prevention Act 2008 (ALPA) and therefore have a statutory duty to comply AML/CFT measures. A provision defining “Non-financial institution” extends AML/CFT measures to any business and institution. Some professional businesses, including lawyers and accountants, are yet to be included in broader AML/CFT measures beyond the Act. .

124. The Nepal FIU has issued Directives to banks and financial institutions, remitters/transfers, moneychangers, cooperatives, related government agencies, casinos, insurance companies, and the securities sector. It is currently considering Directives for other businesses including precious metal and precious stone dealers. Regulation and supervision for AML/CFT is maintained under the AML Rules, which require any regulator to regulate and supervise AML/CFT. The central bank has also issued an administrative order to its supervision Departments in this regard.

125. The key financial regulators are: NRB, Insurance Board, SEBON and others. The regulator for corporate affairs is the Company Registrar.

a. AML/CFT Strategies and Priorities

126. Nepal’s formal financial sector is underdeveloped with low levels of automation and computerization. Authorities are clearly aware of the ML and TF risks associated with Nepal’s predominantly cash-based economy. The percentage of financial transactions moving through informal - and illegal – channels is considered high, but there are no credible estimates. Nepal authorities stated that up to 90% of all Nepali expatriate worker remittances are sent through informal financial channels. A substantial number of Nepali citizens work overseas, primarily in India, Malaysia, Qatar, and the UAE. Incoming remittances, from these overseas workers, through remittance agents made up approximately 23% of GDP in 2010

according to official statements.²⁰ Other estimates from independent sources outside Nepal put the figure higher. Nepali government officials acknowledge that while most of these remittances are legitimate funds there is a high risk that many are the proceeds of crime.

127. Currency smuggling and gold smuggling, also vulnerabilities for ML in Nepal, reflect high risks from Nepal's extensive porous border with India. There is a high risk of cash /gold smuggling between the two countries, but supervision and implementation levels are by law enforcement agencies who are assigned to detect cash couriers/gold dealers at the border are low.

128. During on-site visit, the Gold and Silver Dealers Association informed the evaluation team that a ML risk in the sector is the shortage of supply of precious metals through formal channels. They advised that due to the acute short supply of gold acquired through commercial banks, the use of gold to facilitate smuggling and black marketing poses high ML risks. Though there is no implementation of the ALPA and AML Rules on the dealers in precious metals, the NRB took a preventive step and notified on 17 September, 2010 (after the meeting of the evaluation team with the association) that it shall sell 100 kg gold and 1000 kg silver every week by auction between gold traders. Only the traders with a Permanent Account Number (PAN) registration will be able to buy gold and they will have to provide details of their sales to the NRB, when demanded.²¹ This step may reduce the risk of ML due to factor of short supply.

129. The National Coordination Committee (NCC), established under s 8 of ALPA, has indicated that it will review the threats, vulnerabilities and risks in different parts of the financial sector. However, authorities have yet to undertake a comprehensive risk assessment despite an acknowledgement of its priority and a planned completion date in 2010.

130. At the time of the on-site visit (September 2010), Nepal authorities were actively engaged in preparing a number of measures (with donor assistance) to improve the existing framework including the recent filing in Parliament of a draft amendment Bill to change the current ALPA and a draft Bill to introduce a law on mutual legal assistance. At the time of the on-site visit the authorities were unsure of the date when these Bills would be enacted but indicated that they were a matter of priority for passage by the Parliament.

131. Nepal authorities insist that they are committed to implementing compliant AML/CFT measures in the short term to address a recent review by the FATF's International Cooperation Review Group and to implement an action plan associated with that review. Nepal does not yet have a national AML/CFT strategy but is in the process with the IMF to produce such a strategy. Work in that area would usefully complement recent efforts to improve their regulatory framework and to focus on the long term.

132. Nepal is strengthening relations with other FIUs through a number of MoUs. In 2009, MoUs were signed with Bangladesh and Sri-Lanka. In 2010 Nepal signed MoUs with Thailand, Malaysia and Mongolia. Nepal has reached an understanding with India for the signing of a MoU in due course. Nepal is in negotiation with the FIU of Japan and contacted Hong Kong, China which does not require any MOU to exchange data.

²⁰ Nepal Government, *Economic Survey 2009*.

²¹ The Kathmandu Post – September, 18, 2010.

b. Institutional Framework for Combating Money Laundering and Terrorist Financing

133. Nepal's institutional framework for combating ML and TF includes policy and operational agencies as follows:

- National Coordination Committee;
- Ministry of Law and Justice;
- Ministry of Finance;
- Ministry of Foreign Affairs;
- Ministry of Home;
- Ministry of Trade and Commerce;
- Financial Information Unit (FIU);
- Nepal Rastra Bank
- Securities and Exchange Board of Nepal
- Insurance Board of Nepal (Beema Samiti)
- Department of Revenue Investigation
- Nepal Police
- Narcotics Control Administration
- Commission for Investigation of Abuse of Authority
- Office of Attorney General
- Ministry of Tourism
- Department of Customs
- Social Welfare Council

134. National Coordination Committee: Section 8 of ALPA establishes a Coordination Committee to coordinate inter-related AML entities and to provide essential suggestions to the Government of Nepal in regard to the prevention of assets laundering. It consists of:

- Secretary, Ministry of Finance – Coordinator
- Secretary, Ministry of Law, Justice and Parliamentary System
- Secretary, Ministry of Home
- Secretary, Ministry of Foreign Affairs
- Deputy Governor, Nepal Rastra Bank

135. The Head of the FIU is Secretary to this committee and the FIU acts as the secretariat. NCC procedures are determined by the committee itself. The committee has not yet promulgated any rules of procedure, and meets in an unstructured way on an *ad hoc* basis.

Ministries

136. Ministry of Law and Justice: The Ministry of Law and Justice is the lead legal policy agency for the government of Nepal. Its approval is mandatory for any draft legislation and rules, including those related to AML/CFT.

137. Ministry of Finance: The Ministry of Finance is responsible for Nepal's financial policies and issues. It is the contact Ministry for financial regulators. The Ministry of Finance is responsible for AML/CFT policies. This Ministry chairs the National Coordination Committee. The Customs and Revenue agencies are responsible to the Ministry of Finance.

138. Ministry of Foreign Affairs: The Ministry of Foreign Affairs is the Government's lead adviser and negotiator on foreign policy and diplomatic and consular issues. It is responsible for implementation of international treaties, MoUs and other instruments, including UN Security Council Resolutions.

139. Ministry of Home: The Ministry of Home is responsible for peace and order. The Department of Immigration and Police as well as local and district administrations fall within the scope of this Ministry.

140. Ministry of Trade and Commerce: The Ministry of Trade and Commerce is responsible trade and commerce issues. The Department of Commerce has oversight responsibility for the corporate registry. It also issues and monitor licensed businesses and trades.

Financial Sector Policy Agencies

141. Financial Information Unit: The FIU is a focal national agency for AML/CFT. It is located at the NRB. Its basic statutory functions include issuing AML/CFT Directives and guidance to reporting institutions, receiving STRs, analysing and disseminating STRs, and working cooperatively with the AML Investigation Department. It is also responsible for inspecting reporting institutions and has the power to fine entities for non-compliance with reporting obligations under the ALPA.

142. Nepal Rastra Bank (NRB): NRB is Nepal's autonomous central bank. Its objectives under the Nepal Rastra Bank Act 2002 include the formulation and management of monetary and foreign exchange policies for the sustainable development of Nepal's economy. For this purpose the NRB regulates and supervises the banking and financial system of Nepal. The NRB's supervisory powers include licensing, onsite and offsite inspections and the imposition of sanctions. The NRB is responsible for AML/CFT supervision under AML/CFT Rules.

143. Securities and Exchange Board of Nepal: SEBON is an autonomous statutory entity constituted under the Securities Act 2007. It is responsible for the overall policy, enforcement, supervision of the securities, stock exchange, its business, businesspersons and related activities. It is responsible for the AML/CFT supervision of issuers of securities, trustee companies, futures dealers, collective investment schemes, brokers, merchant banks and financial advisers. It is responsible for AML/CFT supervision under AML Rules.

144. Insurance Board of Nepal: The Insurance Board is an autonomous statutory entity established under the Insurance Act 1992 and is responsible for the overall policy, enforcement, and supervision of the insurance sector. The Insurance Board is also responsible for AML/CFT supervision of insurance companies and activities.

Criminal Justice and Operational Agencies

145. Department of Revenue Investigation (DRI): DRI is a department of the Ministry of Finance, with statutory powers and authority to investigate revenue leakage (tax evasion), foreign exchange abuse, ML and TF.

146. Nepal Police: Nepal Police is responsible for investigating ML predicate offences and terrorism. Nepal Police have a dedicated financial crimes unit that investigates bank fraud and other financial motivated criminal activity. The Criminal Investigation Bureau within the Nepal Police supports investigations by other law enforcement agencies.

147. Narcotics Control Administration: This agency is established within the Ministry of Home. The Narcotics Control Administration serves to supervise, control, direct and coordinate activities against narcotics under the Narcotics (Control) Act, 1976. The Narcotics Drug Control Law Enforcement Unit (NDCLEU) of the Nepal Police is the frontline agency for narcotics investigations.

148. Commission for Investigation of Abuse of Authority (CIAA): CIAA is the prime constitutional agency to investigate and prosecute issues of corruption and abuse of power. CIAA

149. Office of Attorney General: The Attorney-General is a constitutional position and is the principal legal adviser to government. The Attorney-General represents the Government of Nepal in all criminal cases as the prosecutor, except where an agency has additional prosecuting authority (such as the CIAA). The Attorney General's office provides pre-prosecution advice to assist investigating authorities, including the DRI, in collecting and marshalling evidence in support of prosecutions. The investigation authority is required to obey the direction given by the Government Attorney in the course of the investigation.

150. Ministry of Tourism: The Division of Tourism Industry under the Ministry of Tourism is the authority to permit casinos under the Tourism Act 1978. The responsibility extends to monitoring the compliance of minimum operating standards, but not AML/CFT compliance.

151. Department of Customs: Customs oversees the movement of goods across Nepal's borders, including Nepal's large and porous border with India. Customs contributes a large share of Nepal's total revenue receipts. Customs is responsible for administering and enforcing the cross border declarations of funds at the international airport in Kathmandu and has powers of search, seizure, confiscation, arrest, detention and forfeiture. Customs does not investigate narcotic drugs or foreign currency cases, but refers such matters to the Nepal Police and the DRI for action.

152. Social Welfare Council: The SWC co-ordinates and, to a limited extent, supervises the NPO sector. No international NGO can operate in Nepal without first registering with SWC. As part of its supervision function, the SWC consults with other government agencies regarding funding sources of all international NGOs. NGOs are obliged to report annually on their operations and budget to the SWC. International NGOs are obliged to operate their funding resources through bank accounts and must be subject of independent audits.

c. Approach Concerning Risk

153. Nepal is slowly implementing an inclusive approach to the scope of the AML/CFT obligations and has not sought to exclude any of the activities on a risk-based approach. Implementation of AML/CFT obligations has been by a "phased" approach.

154. In late 2009, 10 FIU AML Directives to reporting entities were issued. A phased approach has meant that some reporting entities have not yet been included in the scope of the reporting obligations. Although no formal risk assessment has been undertaken to determine the sequence of this phasing, nevertheless some key financial activities have been captured (and with them STR reporting obligations) as a matter of priority.

155. Although the ALPA has been in force since 2008, the detailed AML/CFT provisions preventive measures for financial institutions have been introduced through Directives issued by the FIU. Since the beginning of 2010 a succession of Directives has been issued, some being applicable to several sectors, other being tailored to individual types of institution. While the process of phased implementation is intended to allow institutions time to adjust their systems and controls to the new environment there remain serious issues with the pace of implementation.

d. Progress Since 2005 APG Mutual Evaluation

156. Nepal has made some important progress towards reforming its AML/CFT regime since its first APG evaluation in 2005, including:

- Enactment of the Asset (Money) Laundering Prevention Act 2008;
- Establishment of the FIU within the NRB in 2008;

- Issuance by the Government of Nepal of AML Rules in 2009;
- Issuance by the FIU of sector-specific AML/CFT Directives in 2009 and 2010;
- Establishment of STR and threshold transaction reporting (TTR) regimes for a limited number of reporting institutions;
- Designation of the DRI as the Asset Laundering Investigation Department under the ALPA;
- Establishment of an AML/CFT national coordination committee and an AML/CFT technical committee to coordinate ALPA policy and operational matters; and
- Designation of the Special Court with exclusive jurisdiction over ML and TF cases.

157. While these developments are critical to the implementation of the international standards, other policy developments and operational implementation have been slow due primarily to lack of strategic planning, capacity and expertise and lack of AML/CFT awareness across the government. There is also a general focus on constitutional and political issues which is creating difficulty for the enactment of legislation in a timely fashion. The progress achieved to date has occurred on an *ad hoc* basis.²²

²² The only implementation plan for AML/CFT is one agreed by Nepali officials following ICRG pressure in 2010 through a regional review group jointly chaired by the FATF and the APG. But this plan is not, nor is it intended to be, a comprehensive national strategy.

2. LEGAL SYSTEM AND RELATED INSTITUTIONAL MEASURES

2.1 Criminalisation of Money Laundering (R 1 & R 2)

2.1.1 Description and Analysis

158. Money laundering is criminalised under ss 3 and 4 of the Asset (Money) Laundering Prevention Act 2008 (ALPA). ALPA adopts a list approach to predicate offences. Sections 3 and 4 of ALPA provide as follows:

3. **Asset not to be laundered:** (1) No person shall launder or cause to launder assets. (2) Any person committing acts pursuant to subsection (1) shall be deemed to have committed offence as per this Act.

4. **Offence of Asset Laundering:** It shall be the offence of asset laundering if any person owns, possesses or uses, utilizes or consumes or displays or does any transaction of the asset that person has earned directly or indirectly acquired or received from tax evasion or terrorist activities or TF or any or all of the following offences and from the investment of such property in any manner, as a legally earned asset or assists the person who has acquired such property to conceal the source of such property or to disguise, hide or transfer such property so as to avoid legal action against such person...

159. The material components of this offence are as follows: assets are laundered if a person:

- owns, possesses, uses, utilizes, consumes, displays or does any transaction with
- an asset
- earned directly or indirectly
- acquired or received
- from a listed predicate offence (including tax evasion, TF and terrorist activities)
- and from the investment of such property in any manner
- as a legally earned asset.

160. The need for an asset to be “legally earned” greatly restricts the scope of the ML offence. An ML offence is committed only when proceeds are held out not as criminal proceeds but as legitimately earned. This point has implications for compliance with Recommendation 1 and is discussed later in this section. Assisting a person who has acquired property in the same manner to conceal the source of the property or to disguise, hide, transfer that property in order to avoid legal action is also an offence.

161. Ancillary offences to ML are contained in s 5 and in s 30(2) of ALPA. The punishment for ML and its ancillaries is:

- Principal ML offence: fine equal to the “claimant value of the offence” or one to four years imprisonment. If the person is a public servant they are liable to 10% more of the punishment (s 30(1));
- Ancillary ML offence: up to half of the sentence for ML (s 30(2)).

162. “Claimant value” is not defined in the ALPA but Nepal officials stated that it is equivalent to the amount laundered or the value of property laundered.

163. The offence seems to use both “asset” and “property” interchangeably. The term “property” is also not defined in ALPA. “Asset” is defined in s 2 of ALPA as any movable, immovable, tangible or intangible property. Section 2 of the Interpretation of Laws Act 1954 provides that:

- “immovable property” means land, benefits of land and things attached to land; and
- “movable property” means property of every description except immovable property.

164. The terms “tangible” and “intangible property” are (also) not defined in ALPA or the Interpretation of Laws Act 1954. “Intangible property” likely extends to choses in action, such as contractual or equitable rights (although Nepal authorities provided no case law or other material to support this). It is not clear whether “tangible property” is intended to cover assets or property other than movable and immovable assets or property.

Recommendation 1

Consistency with Vienna and Palermo Conventions

165. Article 3(1)(b)(i) of the United Nations Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances 1988 (Vienna Convention) requires each Party to establish as a criminal offence the “conversion or transfer of property, knowing that such property is derived from any offence or offences established in accordance with subparagraph a) of this paragraph, or from an act of participation in such offence or offences, for the purpose of concealing or disguising the illicit origin of the property or of assisting any person who is involved in the commission of such an offence or offences to evade the legal consequences of his actions.”

166. Similarly, Article 6(1)(a)(ii) of the United Nations Convention Against Transnational Organised Crime 2000 (Palermo Convention) requires each Party to criminalise the “concealment or disguise of the true nature, source, location, disposition, movement or ownership of or rights with respect to property, knowing that such property is the proceeds of crime.”

Conversion or transfer

167. Section 4 of ALPA does not use the terms “conversion” or “transfer”. “Use” and the doing of “any transaction” could be considered acts of conversion or transfer as contemplated by the Convention, but no Nepal case law as yet supports this view.

168. A difficulty is that the physical element (whether it be use, utilisation, consumption, display or the “doing” of “any transaction”) must entail the asset being used as a “legally earned asset”. On this basis, the transfer of funds to a 3rd party launderer is not criminalised as ML (in such a situation, there is no pretence of legality as required under s 3).

Concealment or disguise

169. ALPA does not specifically criminalise the simple act of conversion or transfer of property for the purpose of concealing or disguising the illicit origin of the property in accordance with the Vienna and Palermo Conventions. Concealment or disguise is criminalised only where a person “assists the person who has acquired such property” to conceal etc “so as

to avoid legal action against such person". In other words, the "disguise"/"hide" element of the offence does not extend to self-laundering.

170. A further difficulty with the ML offence is that it is only concealment of "source" that is provided in the offence. Section 4 of ALPA does not extend to concealment of the true nature, source, location, disposition, movement or ownership of or rights with respect to property, knowing that such property is the proceeds of crime, as required by Art 6 of the Palermo Convention.

Acquisition, possession, use

171. Section 4 of ALPA does not cover "acquisition" as required by the Vienna and Palermo Conventions. The generic phrase "does any transaction..." in s 4 does not, and could not reasonably be argued to, include what is contemplated by the term "acquisition" in the Vienna and Palermo Conventions, given the definition of "transaction" in s 2(c) of ALPA cited earlier²³. However, ALPA extends to mere "possession" and to that extent covers acquisition.

Mental element

172. Under Nepalese law, circumstantial evidence is admissible to prove a variety of facts in issue in any case, including the mental elements of an offence. Certain provisions of the Evidence Act 1974 (which apply in the special courts) support this. For example, s 7(c) enables a court to draw inferences and "presume facts" from documents or actions.

173. With respect to the mental element of ML in particular, s 4 of the ALPA does not specify the degree of knowledge required. While there are no cases as yet in which a court has examined this issue, it is clear that as a key material element of the ML offence, knowledge that an asset is an asset "earned directly or indirectly" from a predicate offence requires proof that an accused knows that the asset is derived from criminal activity.

Proving property is the proceeds of crime

174. Section 29 of ALPA provides that "the commission of acts or offences mentioned in s 4 shall not need to be established to punish one for the offence mentioned in section 3". Further, "the mere fact that acts or offences mentioned in section 4 were not prosecuted or such prosecutions were unsuccessful shall not bar the punishment of offence mentioned in s 3".

175. The reference to the fact that offences or "acts" need not be proved is incongruous. In the absence of at least conduct that would, if prosecuted, amount to predicate offending there is no basis for an assertion that the assets in question are proceeds of crime capable of being laundered. The absence of a comprehensive definition of "proceeds of crime" is problematic. Given the difficulty in proving that an asset has been "earned" from the specified activities or conduct without evidence of acts that at least fall within the ambit of those offences or activities, a court would likely interpret s 29 as requiring simply the absence of proven offending and subsequent conviction.

Predicate offences

176. Nepal uses a list approach to predicate offences. 47 statutes contain predicate offences to ML and are referred by general description rather than by direct reference to operative

²³ ALPA s 2(c): "Transaction" means any act or agreement made in order to carry out any economic or business activities and the term also means the purchase, sale, distribution, transfer or investment and possession of any assets.

statutory or other legal provisions which establish the underlying offence. The following offences are listed predicate crimes under the ALPA:

MONEY LAUNDERING PREDICATE OFFENCES	
Listed in ALPA Offences in relation to, or under:	Gazetted as additional predicates between 30 March 2009 and 5 April 2010 Offences in relation to, or under:
<ul style="list-style-type: none"> • tax evasion; • terrorist activities; • terrorist financing; • arms and ammunitions laws; • foreign exchange regulation laws; • murder, theft, cheating, forgery of documents; counterfeiting, abduction or hostage taking laws • drug control laws; • national park and wildlife conservation laws; • human trafficking and transportation control laws; • cooperatives laws; • forest laws; • corruption control laws; • bank and financial institution laws; • banking offence and punishment laws; • ancient monuments conversation laws; and • <u>other offences prescribed by notice in the Nepal Gazette.</u> 	<ul style="list-style-type: none"> • consumer protection, black market control and competition laws; • company, commerce, supply, transport business laws; • education, health, medicine, environment laws; • foreign employment laws; • lottery, gambling, donation laws; • securities, insurance laws; • negotiable instruments laws; • election laws; • intellectual and industrial property laws; • communication, transmission, advertisement laws; • real estate, property laws; • custom, revenue, tax laws; • immigration, citizenship, passport laws; • organisations, associations laws; • coercive collection/provision of assets laws; • sexual exploitation or abuse of children, women and destitute laws; • robbery or looting of goods laws; and • illegitimate profession, business or trade laws.

177. **Terrorist financing as a predicate crime:** As noted in the SR II analysis (section 2.2 of this report), TF is not criminalised in Nepal. It is referred in a clarification clause to s 4 of ALPA but it is not separately criminalised. At most, TF is defined for the purposes of establishing predicate conduct. Even on that basis, as set out in section 2.2 of this report, the scope of predicate conduct is deficient in that it does not cover:

- financing of terrorist organisations or individuals;
- indirect financing;
- provision of assets of every kind;
- financing of all acts under the terrorism conventions; and
- counselling or conspiracy or, possibly, aiding.

178. The following table sets out the sufficiency of Nepal’s coverage of predicate offences within each of the designated categories of offences:

DESIGNATED CATEGORY	OFFENCES FALLING WITHIN DESIGNATED CATEGORY (IF ANY)	DEFICITS IN COVERAGE AS A PREDICATE OFFENCE (IF ANY)
Participation in an organised criminal group and		These acts are neither criminalised nor described in any of the descriptions in ALPA

racketeering		
Terrorism, including terrorist financing	<p>“Terrorist activities” is specified as predicate conduct in the body of s 4. However, this term is entirely undefined and incapable of definition by reference to any other legislation.</p> <p>ALPA, s 4 (Clarification) defines as a predicate offence the collection or provision “by any means” of “any amount” with the intention that “such amount should be used or in knowledge that it is to be used in order to carry out any act which constitutes an offence within the scope of [listed] conventions or any other act intended to cause death or serious bodily injuries to an individual”</p>	<p>“Terrorism”, as opposed to TF, is not covered.</p> <p>TF is deficiently covered (as detailed later in this report)</p>
Trafficking in human beings and migrant smuggling	<p>The Mulukai Ain (Country Code) 1963</p> <p>Luring and taking abroad a person with intention to sell</p> <p>Luring a minor from legal guardian</p> <p>Making a person a slave or bonded labourer</p> <p>Foreign Employment Act 2007</p> <p>Sending a person aged under 18 “for foreign employment”</p> <p>Carrying on a “foreign employment business” without a licence</p> <p>Immigration Act 1992</p> <p>Use of fake passport or visa</p> <p>Human Trafficking & Transportation (Control) Act 2007</p> <p>Sale/Purchase of a person</p> <p>To “use someone into prostitution”</p> <p>To “go for in prostitution”</p> <p>Extraction of human organs</p> <p>Taking a person out of Nepal “for the purpose of buying and selling”</p> <p>To take any person by means of force, trickery etc and to keep in custody or to handover to another “for the purpose of prostitution and exploitation”</p> <p>Child Labour (Prohibition and Regulation) Act 2000</p> <p>Engaging a child in work as a labourer</p> <p>Bonded Labour (Prohibition) Act 2002</p> <p>Employing a person as a “bonded labourer”</p>	<p>Migrant smuggling is not covered (and only very generally described under ALPA as a potential “immigration” offence, which is inapt to cover smuggling out of Nepal)</p>
Sexual exploitation, including sexual exploitation of children	<p>Human Trafficking & Transportation (Control) Act 2007</p> <p>To “use someone into prostitution”</p> <p>To “go for in prostitution”</p> <p>Taking a person out of Nepal “for the purpose of buying and selling”</p> <p>To take any person by means of force, trickery etc and to keep in custody or to handover to another “for the purpose of prostitution and exploitation”</p> <p>Children’s Act 1992</p> <p>Subjecting a child to torture or cruel treatment</p> <p>Use of a child in an “immoral profession”</p> <p>Taking or distributing photographs “for the purpose of engaging a child in an immoral profession”</p> <p>Publication of photographs or descriptions “tarnishing the character” or a child</p>	<p>The description under ALPA limits the scope of predicate offending to sexual exploitation of “children, women and destitute” whereas the offences are actually broader in scope</p>
Illicit trafficking in narcotic drugs and psychotropic substances	<p>Narcotics Drugs (Control) Act 1976</p> <p>Exportation/Importation of narcotic drugs (defined to extend to psychotropic substances and their salts)</p> <p>Trafficking</p> <p>Distribution/Purchase/Sale/Possession/Storage</p>	
Illicit arms trafficking	<p>Arms and Ammunition Act 1962</p> <p>Importation/Exportation without a licence</p> <p>Possession without a licence</p>	

	Explosives Act 1961 Production, storage, use, sale, transportation of and importation of explosives without a licence	
Illicit trafficking in stolen and other goods	Chapter 4, s 24 of Muluki Ain 1963 (the General/Country Code) provides an offence of accepting, keeping or purchasing stolen property. Illicit trafficking in certain forms of contraband is covered by other Acts such as the Customs Act 2007, the National Parks & Wildlife Conservation Act 1973 and the Arms and Ammunition Act 1962.	There is no offence of “trafficking” in stolen goods. Persons engaged in the enterprise of trafficking who do not personally take possession of stolen goods would need to be either fixed with constructive possession or held liable as accessories.
Corruption and bribery	Prevention of Corruption Act 2002 (applicable to public servants) Giving and taking “graft” Accepting goods free/at lower price Taking commission Leaking revenue Getting illegal benefit/Causing illegal loss Preparing false documents Falsely translating documents Tampering with public documents Breaching secrecy Claiming false designation Exerting illegal pressure Commission for the Investigation of Abuse of Authority Act 1991 “Improper conduct” by a person holding a public post such as: failure to comply with mandatory procedures; exercising powers for improper purpose; failure to discharge a duty; abuse of immunity or privileges.	Private sector corruption and bribery is not covered
Fraud	The Mulukai Ain (Country Code) 1963 Cheating (various forms of obtaining by deception) Bank Offence and Punishment Act 2008 Opening an account in false name or with false documents Misuse of cheques Fraudulent transfers etc Fraudulent obtaining of loans/credit Fraudulent book keeping Companies Act 2006 Provision of false financial statements Fraud by an auditor Misleading prospectuses and offer documents Consumer Protection Act 1998 Imitation of a consumer good in a misleading manner Sale of product as a “separate” product Securities Act 2007 Publishing misleading statements to “entice others to purchase or sell securities”	
Counterfeiting currency	The Mulukai Ain (Country Code) 1963 Counterfeiting coins, notes, stamps	
Counterfeiting and piracy of products	Copyright Act 2002 Infringement of a protected right (being copyright or rights via licences and other agreements) Importation of an “unauthorised copy” (being a copy that would, if produced in Nepal, have been illegal) Patent, Design and Trade Mark Act 1965 Manufacture of an article using or imitating another’s registered	It is debatable whether all these offences are offences “relating to intellectual and industrial property”, as described under ALPA. In a trade mark context, for

	design—fine: 800Rs Illegal use of trade mark—fine: 1000Rs	example, the mere manufacture of a product carrying an unauthorised mark does not violate intellectual property rights. The mark must be used in connection with trade.
Environmental crime	National Parks & Wildlife Conservation Act 1973 Farming, building upon, clearing, mining, damaging, hunting upon etc a “national park or reserve” Forest Act 1993 Deforesting, cultivating, building upon, extracting from, hunting within, altering boundary markers of etc a “national forest” Removing, trafficking, selling, distributing, exporting “forest products” from a “forest area” Environment Protection Act 1997 “Implementing a proposal” (development) without requisite resource consent.	Pollution of environments outside national parks/forests and of air environments or maritime environments is not a predicate offence.
Murder, grievous bodily injury	The Mulukai Ain (Country Code) 1963 Murder (multiple forms) Causing “hurt” Battery	
Kidnapping, illegal restraint and hostage-taking	The Mulukai Ain (Country Code) 1963 Illegal detention Kidnapping Abduction Hostage taking	
Robbery or theft	The Mulukai Ain (Country Code) 1963 Theft/Stealing “Forcible theft” (involving use of force) Robbery (involving multiple persons or weapons)	
Smuggling	Customs Act 2007 Export/Import smuggling Provision of false or forged information to customs officer	
Extortion	Prevention of Corruption Act 2002 (applicable to public servants) Exerting illegal pressure	Nepal has no generally applicable offence of extortion.
Forgery	The Mulukai Ain (Country Code) 1963 Forgery, tampering, altering documents Protection of Records Act 1989 Alteration of records by an employee of the National Archives	
Piracy		Piracy does not fall within any of the descriptions of predicate offences under ALPA
Insider trading and market manipulation	Securities Act 2007 Insider trading Causing “stability, increase, decrease or frequent change” in the price of securities by “fake or artificial or false trading” Increasing, decreasing or stabilising the price of listed securities with intent to affect market participation	

Foreign predicate offences

179. Predicate offences in another country do not qualify as predicate offences under ALPA for the purpose of ML. Section 1(2) states that ALPA “shall apply” within Nepal and to any

person “irrespective of where they are residing or located” who “remits, transfers or sends assets generated from the offences under this Act from Nepal to abroad or abroad to Nepal”. The assets in question must be generated from “offences under this Act”. Nothing in ALPA states explicitly nor can it be inferred that offences committed under foreign enactments constitute predicate offences to ML in Nepal.

Self- laundering

180. Criminalisation of self–laundering is not precluded by fundamental principles of domestic Nepali law and is effected by s 4 of ALPA. By contrast concealing, disguising, hiding or transferring assets can amount to money laundering only where done for the purpose of assisting another person “who has acquired” proceeds of crime to “avoid legal action against such person”. Acts of concealment etc by the person who actually committed the predicate offence is not covered.

Ancillary offences

181. The Palermo and Vienna Conventions require the criminalisation of ancillary offences relating to conspiracy to commit, attempts to commit, and aiding, abetting, facilitating and counselling the commission of money laundering.

182. Under s 5 of AMLPA only attempts, abetment and incitement are prohibited, even though “aiding”, “conspiring” and “counselling” are also recognised heads of ancillary or inchoate liability in Nepal.

183. Furthermore, it is not clear whether abetment (which does fall within s 5) is subject to penalty. Section 30 of AMLPA provides the penalties for offences under the Act. Section 30(2) provides that anyone attempting, inciting or “assisting” the commission of an offence shall be liable to half of the applicable sentence. It is possible that a court would interpret “assistance” as a reference back to “abetment” under s 5. It is also possible that a court would construe “assistance” (and, so, abetment) as broadly covering acts of “aiding” and “facilitating”. This is not clear. Regardless, conspiracy and counselling would remain uncriminalised because they are clearly beyond the scope of both s 5 and s 30.

Additional elements

184. As noted above, the qualifying assets under s 4 are limited to assets generated from the commission of those Nepalese offences described in s 4 of ALPA.

Recommendation 2

185. Under s 3(2) of ALPA, “any person” who launders or causes to launder assets is deemed to have committed an offence. “Person” includes natural and legal persons (s 2(s) of the Interpretation of Laws Act 1954) including “any joint or non-joint company, institution or group of people”.

186. Despite this, the position with respect to liability of legal persons is ambiguous. Section 1(2) of ALPA provides that the Act applies to “any person *or* corporate body”, implying that a corporate body is not necessarily a “person”. Reinforcing this point is the fact that s 30 (which prescribes penalties) provides that “in the case of a bank, financial institution or non-financial institution” a sentence of imprisonment can be imposed upon “the person or staff of a bank etc who has committed the offence”. Again, this suggests that only natural persons can commit the offence of ML.

187. More broadly it is not clear that Nepalese law permits corporate criminal liability. Nepalese officials conceded that no prosecutions to date have been mounted against corporate entities for any offence.

188. Section 25 of ALPA provides that any act constituting an offence under ALPA remains punishable under any other existing law. To the extent that corporate entities can be criminally liable under ALPA, prosecution would not preclude other sanctions.

Sanctions

189. Under s 30, any person committing the offence of money laundering is liable to a fine equivalent to the “the claimant value of the offence or a term of imprisonment of between one and four years”. Where the offender is a “public servant or official, chief or staff of a bank, financial institution or non-financial institution”, the maximum sentence increases by 10%. As noted earlier, anyone “attempting” or “assisting or inciting offending” is liable to half of the available sentence.

190. A maximum term of imprisonment of four years is not especially high relative to other serious offences. Fraud carries a maximum term of five years. Forgery carries 10 years. Theft can carry over six years. Accordingly, within the penalty framework of Nepal’s criminal law, ML does not appear to be as serious as some, indeed many, of the predicate crimes. And, since there has been only one prosecution for ML, Nepal has not been able to demonstrate that the levels of penalties imposed are effective, proportionate and dissuasive. The one case that has been prosecuted (*Government of Nepal v Min Bahadur Ghale*) resulted in a fine of NRps 300,000 rupees (approx. US\$4,000) - the “claimant value of the offence” as assessed by reference to the amount of currency confiscated from the defendant. Because a fine can operate only as an alternative to a sentence of imprisonment, imprisonment was not imposed.

Statistics

191. To date there has been one (1) prosecution and conviction for ML.

Effectiveness

192. The judgment of the Special Court which resulted in the one conviction was not predicated upon an application of the precise elements of the offence of the ML offence under ALPA.²⁴ Rather, the Court’s analysis conflates the notion of contraband or instrumentalities of crime with the notion of proceeds of crime. The conviction, currently under appeal, appears to be predicated simply upon recognition that a predicate offence was attempted. The decision reflects the need for greater training with respect to ML investigations, prosecutions and adjudication. Nepal officials recognise and acknowledge this need.

193. Additionally, the concept of corporate criminal liability is not well understood in Nepal. Continued reliance upon the prosecution of natural persons in cases of corporate

²⁴ The defendant was apprehended at Tribhuvan International Airport in the course of departing to Dubai while carrying NRps300,000 contrary to currency controls under the Foreign Exchange Regulation Act. The defendant stated that the money belonged to his employer, a bullion trading company, and was for the purpose of paying airport tax upon return from Dubai. The judgment neither suggests nor records any submissions that the currency was the (direct or indirect) proceeds of crime. Rather, the judgment records that “it is found that this act is an offence under the *Foreign Exchange Regulation Act* 2019, and this Act seems to be the definition of the offence as stated in section 4(B) of the *Money Laundering Prevention Act* 2064 and found to be an offence under the section 3 of that Act”. The judgment continues: “There is no doubt that the amount, which is restricted to send or carry in other countries except India, was recovered from the defendant, and this type of act is mentioned in the section 4(B) of the Act”. Accordingly, the Special Court found that “it is hereby proved that the defendant Min Bahadour Ghale committed the offence in accordance with section 3”.

liability (as expressly contemplated under ALPA) is less likely to improve corporate compliance.

194. Although ALPA permits prosecution for ML in the absence of a conviction for a predicate offence, as a matter of practice prosecutors within the Attorney-General's office indicated that they would not prosecute an ML offence unless and until a conviction on a predicate offence has been entered. Furthermore, it does not appear possible to join a prosecution for a predicate offence with a prosecution for ML as the Special Court has limited and exclusive jurisdiction over ML prosecutions. Further, due to divisions of responsibility within the Attorney-General's office, the prosecutors handling predicate offence prosecutions are not the same prosecutors who handle ML prosecutions. Additionally in relation to penalties (maximum sentence of imprisonment of four years) the ML regime does not ensure effective, proportionate and dissuasive sanctions. This is particularly so given that the maximum penalty for "assisting or inciting" ML is only half that which would otherwise prevail.

195. Beyond these issues, the structural deficiencies in the ML offence are significant and materially impair its effectiveness. Key in this respect is the failure of to cover conversion or transfer by a person other than the predicate offender, concealment or disguise by other than a third party, the need to show ultimate use "as a legally earned asset" and the failure to cover critical ancillary offences such as conspiracy.

196. The fact that, to date, there is merely a single instance of prosecution for ML is indicative of lack of effectiveness—particularly given the volume of predicate crime (as set out in Section 1 of this report) and the prevalence of corruption (Section 1).

2.1.2 Recommendations and Comments

197. Nepal's ML offence is poorly constructed and is limited in scope. While officials indicated that the courts would not view the offence as ambiguous and limited there has been only one conviction under the offence so far and that conviction is questionable as a money laundering offence. Moreover, while it appears, and was argued by Nepal officials, that the TF offence is valid within the structure of the ML offence (in the clarification clause) it is clear from the structure of the offence that there is no TF offence in Nepal. Additionally, corporate criminal liability is neither clearly spelled out nor implemented. The weakness of sanctions for ML renders it less useful than simply pursuing predicate offences in many cases.

198. Nepal should comprehensively criminalise ML in keeping with international standards, and particularly should:

- Structure the ML offence to cover concealment or disguise by other than a third party.
- Extend concealment or disguise to concealment of the nature, location and movement of, and rights in relation to, proceeds of crime.
- Supply definitions for the predicate conduct of engaging in "terrorist activities".
- Extend predicate offences to conduct in another country that, if committed in Nepal, would constitute a predicate offence.
- Remove the reference to ultimate "investment... as a legally earned asset".
- Give consideration to the utility of a single definition of "proceeds of crime" as opposed to the inconsistent terminology employed in ALPA at present.
- Expand the coverage of predicate offences and clearly identify predicate offences rather than generally describing them in the current manner. This may be achieved by adopting a threshold.
- Amend the range of ancillary offences to remove inconsistencies between conduct ostensibly criminalised and that which is subject to sanction.

- Amend the range of ancillary offences so that conspiracy, counselling and aiding are clearly criminalised.
- Ensure proportionate and effective sanctions are available for the ML offence.
- Provide greater training with respect to the nature of the offence of ML, including training of investigators, prosecutors and judicial officers within the Special Court.

2.1.3 Compliance with Recommendations 1 & 2

	RATING	SUMMARY OF FACTORS UNDERLYING RATINGS
R 1	PC	<ul style="list-style-type: none"> • Conversion or transfer covered only if it results in projection of laundered property “as a legally earned asset”. • Concealment or disguise is covered only when committed by third parties. • Does not extend to concealment or disguise of the nature, location and movement of, and rights in relation to, proceeds of crime. • Predicate offences do not cover a range of conduct within each designated category of predicate offence. • Predicate offences do not extend to conduct in another country that, if committed in Nepal, would constitute a predicate offence. • Not all conduct allegedly constituting predicate conduct is clearly identified. • Ancillary offences do not extend to conspiracy and counselling and possibly do not extend to aiding the commission of a predicate offence.
R 2	PC	<ul style="list-style-type: none"> • Liability of legal persons is neither clearly enacted in the context of ML nor pursued more generally. • Sanctions are not proportionate, effective or dissuasive. • Ineffective implementation.

2.2 Criminalisation of Terrorist Financing (SR II)

2.2.1 Description and analysis

199. Nepal does not have a stand-alone TF offence. As seen in the last section, the TF offence is structurally linked with the money laundering offence in s 3 and s 4 of ALPA. Nepal’s TF offence is found in a clarification clause to ML at s 4 of ALPA as follows:

Clarification: For the purpose of this Section it shall be the offence of financing of terrorist activities if any person by any means collects or provides to any person any amount with the intention that such amount should be used or in knowledge that it is to be used in order to carry out any act which constitutes an offence within the scope of the following conventions or any other act intended to cause death or serious bodily injuries to an individual.

- (a) Tokyo Convention on Offences and Certain Other Acts Committed on Board Aircraft, 1963,
- (b) Hague Convention for the Suppression of Unlawful Seizure of Aircraft, 1970,
- (c) Montreal Convention for the Suppression of Unlawful Acts Against the Safety of Civil Aviation, 1971,
- (d) Convention on the Prevention and Punishment of Crime Against Internationally Protected Persons Including Diplomatic Agents, 1973,
- (e) International convention Against the Taking of Hostages, 1979,
- (f) SAARC Regional Convention on Suppression of Terrorism, 1987,
- (g) Any Convention against Terrorist Activities which Nepal is a party to.

200. The structure of this offence can be broken down into its component parts as follows:

- Any person

- Who collects or provides
- By any means
- To any [other] person
- Any amount
- With the intention that the amount is used, or in the knowledge that it is to be used
- To carry out an act within the listed Conventions, or
- Any other act intended to cause death/serious injury to an individual.

201. The word “amount” is not defined in the ALPA, the AML Rules or the FIU AML Directives. Nor is it defined in the Interpretation of Laws Act 1954 or in any enactment that relates to criminal law or financial activities/institutions. A court would almost certainly interpret the word as referring to cash or money. Various sections of the ALPA use the term “amount of money”. Further, had other forms of “property” or “assets” (as defined in the ALPA and Interpretation of Laws Act) been intended, ALPA would have used those terms and not the word “amount”.

Why s 4 of ALPA does not establish a TF offence

202. As noted, during the onsite visit Nepal officials maintained that TF has been criminalised under s 4 of ALPA. The basis for this assertion is a “clarification” to s 4 that was inserted by way of amendment to ALPA following its enactment in 2008 (quoted above). However while this clarification clause is binding legislation it does not criminalise TF because:

- There is no penalty in ALPA attached to the conduct proscribed in s 4;
- The context of the purported offence does not suggest any legislative intent to independently criminalise TF; and
- The purported offence is vague and incomplete for the purpose of the requirements of the Terrorist Financing Convention and SR II.

203. First of all, ALPA does not stipulate a penalty for the conduct stated in the clarification clause of s 4. Section 30 stipulates the penalties only for conduct falling within s 3. As noted, s 3 provides that “no person shall launder or cause to launder assets”. Section 4 then defines conduct that amounts to asset laundering. Section 4, as noted, criminalises (in certain circumstances) (i) certain actions in relation to assets “earned” through predicate offending and (ii) assisting another to hide etc such assets. The “clarification” to s 4, by contrast, relates to acts of collection or provision (of “amounts”). Such acts cannot be sensibly regarded as acts of using etc or hiding etc proceeds of crime. They clearly lay outside the ambit of s 3 and, therefore s 30.

204. Secondly, a natural or plain reading of the “clarification” to s 4 would interpret its effect as one of clarifying, not criminalising. Specifically, it is most naturally read as stipulating what might amount to predicate conduct capable of giving rise to the s 3 offence of asset laundering (as defined in s 4). As noted, that offence can in certain circumstances be committed where a person uses etc or hides etc assets “earned” through “TF”. Given there is no counter-terrorism legislation currently on foot in Nepal, the asset laundering definition must be supported in this respect by clarification as to the type of conduct that might amount to “terrorist financing”. The “clarification” supplies that. Further, only a plain reading along these lines is consistent with the preamble to ALPA, which makes clear that the Act was enacted because “it is expedient to provide for the prevention of laundering of criminal proceeds”. Terrorist financing does not require any disposition of criminal proceeds.

205. Thirdly, the purported TF offence fails to meet the requirements of Article 2 of the Terrorist Financing Convention because:

- The clarification does not extend to “assets of every kind” as required in the definition of “funds” under the Terrorist Financing Convention. Instead, the clarification uses the word “amount” and, so, likely refers to only money/cash.
- It is not clear whether provision or collection “by any means” extends to indirect provision or collection.
- Four key conventions that prescribe offences related to TF are not listed as conventions for the purpose of the clarification.²⁵
- Although the alternative limb of the clarification to s 4 is extremely broad in that it covers “any other act intended to cause death or serious bodily injuries to an individual”, such that acts falling outside the ambit of the listed conventions/protocols that are committed with this intention would be caught by the clarification, there is still scope for conduct within the ambit of Art. 2 of the Terrorist Financing Convention to be excluded. For example, nuclear material may be transferred without any “intention” whatsoever to cause death or serious bodily injury to another person.

206. Furthermore, because the provisions relating to ancillary offences for TF would be the same as those for ML (the assertion being that TF is “deemed” ML), the problems in those provisions would apply equally in this context. Accordingly, counselling and conspiracy to commit the offence of TF would not be criminalised. Nor is it an offence to contribute to the commission of Convention offences by merely furthering the terrorist purposes of a group or otherwise contributing to a group knowing that the group’s intention is to commit a terrorist act.

207. In terms of compliance with SR II, the following deficits arise (in addition to those listed above):

- Provision or collection with the knowledge or intention that the funds will be used by a terrorist organisation or an individual terrorist is not covered. The clarification is limited to provision or collection associated with terrorist acts; and
- It is not clear whether the clarification requires that funds collected or provided actually be used to carry out or attempt a terrorist act or be linked to a specific terrorist act. The clarification specifies “knowledge that [the amount] is to be used in order to carry out any act which ...” To the extent that this posits a mental element of mere “belief”, the clarification would be consistent with SR II; however this is far from clear.

208. Despite these deficits, Nepalese officials argued that TF was criminalised via the operation of counter-terrorism conventions to which Nepal is a party. This argument was based on s 9 of the Nepal Treaty Act 1990, which provides that wherever the provisions of a ratified treaty are “inconsistent with the provisions of prevailing laws” then the inconsistent provision “shall be void” and the provisions of the treaty “shall be enforceable as good as Nepalese laws”. The evaluation team does not accept this argument. First, s 9 applies only in the face of an “inconsistency” between domestic legislation and international obligation. Secondly (and more fundamentally), s 9 of the Nepal Treaty Act was enacted to expedite Nepal’s compliance with international human rights instruments by enabling plaintiffs to obtain redress resulting from non-compliant Nepali legislation without resort to the writ process under the Constitution. Section 9 has not been used in any other context. There is no precedent upholding its application as a mechanism by which “offences” under international instruments are automatically rendered offences under domestic law. Indeed, s 9(2) of the *Nepal Treaty Act* shows that treaties are not regarded as self-executing. It provides that where treaties impose

²⁵ Those Conventions are: (1) The Convention on the Physical Protection of Nuclear Material; (2) Protocol for the Suppression of Unlawful Acts of Violence at Airports Serving International Civil Aviation; (3) Convention for the Suppression of Unlawful Acts Against the Safety of Maritime Navigation; and (4) Protocol for the Suppression of Unlawful Acts Against the Safety of Fixed Platforms Located on the Continental Shelf.

“any additional obligation or burden” the Government shall “initiate action as soon as possible to enact laws for its enforcement”.

Effectiveness

209. There has been one investigation for TF under s 4 but no prosecutions. Given the most natural interpretation of the purpose of the “clarification” (discussed above) and the absence of any applicable penalty it is highly unlikely that, under the legislation as it currently stands, there could ever be a successful conviction for TF in Nepal.

2.2.2 Recommendations and Comments

210. TF is not criminalised in Nepal Either through amending the ALPA or another statute Nepal should:

- Establish a clear and comprehensive stand-alone TF offence consistent with the TF Convention and with the elements of SR II;
- The new offence should extend to the financing of terrorist organisations and individual terrorists;
- Liability for TF should extend to legal persons;
- There should be clear ancillary offences to a new TF offence, including aiding, abetting, counselling, inciting, procuring, attempting and conspiring to commit TF; and
- Penalties for TF should be proportionate and dissuasive and apply to legal persons.

2.2.3 Compliance with Special Recommendation II

	RATING	SUMMARY OF FACTORS UNDERLYING RATING
SR II	NC	<ul style="list-style-type: none"> • TF is not criminalised

2.3 Confiscation, Freezing and Seizing of Proceeds of Crime (R 3)

2.3.1 Description and analysis

Proceeds of crime

211. Nepal has no overarching proceeds of crime legislation. Provisions relating to the recovery of proceeds are found in a variety of in Acts relating to specific crime types:

- ALPA;
- Muluki Ain (General/Country Code);
- Narcotic Drugs (Control) Act 1976;
- Human Trafficking and Transportation (Control) Act 2007;
- Commission for the Investigation of Abuse of Authority Act 1991; and
- Prevention of Corruption Act 2002.

Asset (Money) Laundering Prevention Act 2008 (ALPA)

212. Section 34 of ALPA provides that any assets obtained “from an offence under this Act”, as well as “further assets generated from such asset and assets used for commission of such offence” shall be confiscated. Nepalese officials confirmed during the on-site visit that the words “offence under this Act” connotes only the ML offence and not predicate offences.

213. As noted in section 2.1, the term “assets” likely includes choses in action such as contractual and equitable rights. The inclusion of “further assets generated from such assets” extends s 34 of ALPA to indirect proceeds of crime. Furthermore, s 28 of ALPA has the effect of deeming assets that a defendant cannot show have been legitimately derived to be “generated from commission of offences under this Act”.

214. Section 36 is also relevant. That section provides that any assets provisionally frozen under the Act must be released if it is “somehow” proven that they “have no criminal origin”. No guidance is provided as to whether indirect proceeds or assets purchased with intermingled funds have “criminal origin” within the meaning of s 36. Assets of corresponding value would certainly not qualify and, if frozen, would need to be released.

Muluki Ain (General/ Country Code)

215. The Muluki Ain is long-standing legislation that sets forth the basic crimes and criminal procedure of Nepal where no specific provision has been made. It has no provisions with respect to confiscation and forfeiture of proceeds of crime generally but does provide for the forfeiture of stolen property and property derived through other crimes of dishonesty, such as “cheating” (fraud).

Narcotic Drugs (Control) Act 1976

216. Section 18A of the Narcotic Drugs (Control) Act 1976 provides that all “moveable or immovable property” that has been “earned” as a result of offending under the Act (i.e. as a result of the cultivation, manufacture, sale, distribution, export, import, purchase or possession of narcotic drugs) shall be confiscated. The Act places a burden upon any person convicted under the Act of showing the legitimate origin of property in his possession, in default of which the property is liable to be confiscated even if held in the name of others.

Prevention of Corruption Act 2002

217. There are numerous provisions within the Prevention of Corruption Act that enable the confiscation of any “graft” or other illicit reward received in contravention of the Act. Beyond this, s 47 of the Act provides that any property proved to have derived from “corruption under this Act or other prevailing laws” is amenable to confiscation even if held in the name of another person. It further appears that property may be recovered from bona fide third parties by virtue of a provision vesting in the third party rights of a debtor against the offender.

Commission for the Investigation of Abuse of Authority Act 1991

218. Section 29b of the CIAA Act similarly enables the confiscation of “any property earned” and any “property increased from it” (presumably a reference to indirect proceeds) by a person holding a public post a result of corruption under that Act or any other “prevailing law”, regardless of whether the property is kept in that person’s name. Again, there is a provision enabling recovery from third parties via the creation of a statutory debt.

Human Trafficking and Transportation (Control) Act 2007

219. Section 18 of this Act enables the seizure of “any movable or immovable property acquired as a result of an offence” under the Act. “Seizure” is not defined. In context, it appears that this provision is intended to enable permanent confiscation rather than interim restraint.

Instrumentalities

220. As noted above, s 34 of ALPA enables the confiscation of “assets used for the offence” of ML. Various enactments provide for the seizure and confiscation of illicit goods/contraband

(e.g., the Customs Act, the Explosives Act, the Arms and Ammunition Act). Beyond this, the following enactments contain provisions relating to seizure of instrumentalities of crime:

ACT	RELEVANT PROPERTY
Black-marketing and Some Other Social Offences and Punishment Act 1975	“Goods, vehicles, documents and cash” related to the sale of goods in contravention of price fixing requirements; excessive “profiteering; “hoarding and artificial shortage”; sale and distribution by misrepresentation; sale of “adulterated medicine”.
Commission for the Investigation of Abuse of Authority Act 1991	Instrumentalities (and proceeds) of “improper conduct” by a person holding a public post (such as: failure to comply with mandatory procedures; exercising powers for improper purpose; failure to discharge a duty; abuse of immunity or privileges).
Copyright Act 2002	Devices used to reproduce materials in breach of copyright.
Explosives Act	Explosives produced, imported, possessed or sold without a licence.
Foreign Exchange (Regulation) Act 1962	Any foreign exchange “related” to the following offences: Engaging in foreign exchange transactions without a licence; importation or exportation of currency or bullion without a licence; receiving payment for exported goods via un-prescribed channels; exporting or transmitting securities without authority of Nepal Rastra Bank; entering into agreements in contravention of the objectives of the Act.
Forest Act 1993	Any “load carriers, tools, quadruped and any other equipment” seized in connection with offences relating to deforestation or defilement of National Forest.
Gambling Act 1963	All “cash and goods” used or intended to be used for the purposes of gambling.
Human Trafficking and Transportation (Control) Act 2007	Any “movable or immovable property” acquired as a result of an offence related to human trafficking and “any house, land or vehicle” used for the commission of such offences.
Narcotic Drugs (Control) Act 1976	Any building, land or vehicle used in the commission of narcotics related offences as well as any narcotics, materials or equipment used in the manufacture of narcotics. (As noted earlier any movable or immovable property earned from any narcotics related offending may also be confiscated.)
National Parks and Wildlife Conservation Act 1973	Any “trophies, weapons, means of transport and other materials” connected with illegal hunting or entry into national parks or reserves and associated trading in trophies without a licence.
Nepal Rastra Bank Act 2002	Any assets related to accepting deposits, issuing credit or debentures or other financial instruments in contravention of the Act or rules and by-laws framed there-under.
Postal Act 1963	Prohibited newspapers, magazines, books or other documents.
Patent Design and Trade Mark Act 1965	Goods or commodities “related to” offences committed in breach of patent or trade mark protection.
Prevention of Corruption Act 2002	Any “graft, gifts or commission” accepted by a public servant other than in accordance with prior approval and any property earned as a result of private trade or business carried on by the public service contrary to a prohibition. Additionally, under s 20 any property acquired by a public servant that “seems to be incompatible or unnatural may be confiscated.

221. Under the s 83 of the Banks and Financial Institutions Act 2006, any deposits in a licensed institution that have been “misappropriated” from a governmental body or “collected

through any activity relating to terrorism or organised crime” may be recovered “in accordance with the laws in force”. This provision appears to simply constitute recognition within Nepal’s banking laws that recovery orders made by the Courts under other “laws in force” are binding when made in relation to funds held on deposit.

222. The evaluation team was not referred to any provisions enabling the confiscation of property corresponding in value to benefits derived through the commission of offending.

Intended instrumentalities

223. As can be seen from the table above, the ambit of instrumentalities amenable to forfeiture is generally limited to those that are related to the commission of completed, rather than intended, crime. The Gambling Act 1963 is an exception in that it covers cash and goods used or “brought or kept with an intention of” being used for the purposes of gambling.

Whether held or owned by a defendant or third party

224. Section 34 of ALPA, which enables the confiscation of proceeds and instrumentalities of ML, is not limited to assets held by a defendant. However, the Act does not provide any process for determining how third party interests might be represented on any application for confiscation of property that is in the possession of third parties.

225. Also, as noted above, provisions in several other enactments similarly enable the confiscation of property even though it may be in the possession (or ownership) of third parties. Provisions under the Prevention of Corruption Act 2002 and Commission for Investigation of Abuse of Authority Act 1991 expressly contemplate confiscation of property held by or in the name of third parties.

Provisional measures to prevent dealing in property subject to confiscation

226. As with powers enabling the seizure and confiscation of proceeds and instrumentalities of crime, provisions relating to interim freezing are found across a range of enactments relating to specific crime types.

Proceeds

ALPA

227. Section 12(f) of ALPA enables the Department of Revenue Investigation to “cause to freeze assets relating to the offence under this Act and cause inquiry and investigation of the offence”. As with s 34 of ALPA (which relates to confiscation), the words “offence under this Act” relates to the offence of ML and does not extend to the listed predicate offences. It is probable that assets “relating to” the offence of ML include proceeds of crime. As noted earlier in s 2.1 of this report, the fact that ALPA does not have a consistent definition of proceeds of crime introduces considerable ambiguity.

228. Even if s 12(f) extends to proceeds from the commission of predicate offences described in s 4, such freezing is of minimal utility if those proceeds cannot be ultimately confiscated. As noted above, there is only limited capacity to confiscate proceeds. Additionally, there is no express power to freeze assets beyond investigation—i.e., once charges are laid but pending a court determination. It is probable that the Special Court would infer this power by virtue of s 36. That section presumes that the court might release frozen assets if they have “no criminal origin”, suggesting that some power to freeze assets until a trial has concluded. Again, however, this could be clearer.

229. The Department is empowered to impose a fine of up to NRps 50,000 (US\$697) upon “the Chief” of any “concerned entity” that does not comply with a freezing directive. The preconditions for a departmental freezing directive are set out in s 18 of the Act. Under that section a directive is available where “there exists reasonable ground” that anyone is “likely to transfer, sell or hide or disguise” property “generated from offence”. It is not clear whether the “reasonable grounds” are reasonable grounds to suspect or reasonable grounds to believe. The reference to property “generated from offence” would probably enable the freezing of indirect proceeds. Additionally, it is not sufficient that the property in question is suspected to be proceeds of crime. There must be likelihood that the property will be irrecoverable if not frozen.

230. The effect of a freezing directive is to restrain a “concerned entity” from engaging in a “transfer, mortgage, sale” of the property for a “fixed period of time”. There are no provisions ensuring against any breaches of such orders such as provisions enabling the Department to take property into custody or to register caveats.

231. The fact that property with “no criminal origin” must be released suggests that powers to freeze in the first place do not extend to indirect proceeds of crime or assets purchased with intermingled funds. Assets of corresponding value certainly could not be frozen. It is unclear whether “disproportionate assets” that might, under the Act, be “deemed” to have derived from ML could be frozen.

232. Section 19 of ALPA is also relevant. That section confers upon the Revenue Investigation Department the power to order a bank, financial institution or non-financial institution to freeze assets whenever the Department “receives information” that “anyone” has an account. This discretion is incongruous given the specific restrictions placed upon the Department in issuing Directives relating to other types of property. It is unclear whether any exercise of this power would survive a constitutional challenge in light of constitutional protections to “acquire, own, sell, dispose of, and otherwise deal with property”. Presumably, s 19 would prevail only where such interests are outweighed by legitimate and demonstrable law enforcement objectives. Section 19 also includes a proviso requiring that the Department “make a request through diplomatic channel” in order to freeze any such account that is “operated from abroad”. It is probable that the intention of s 19 was to mirror s 39 of the Narcotics (Drugs) Control Act, which enables the freezing of accounts that are *located* in a foreign jurisdiction.

233. Additionally, contrary to the position in relation to Directives issued under s 18, the Department is not empowered to impose fines for non-compliance with s 19 Directives.

234. Aside from the ALPA itself, Rule 6(b) of the AML Rules 2009 purports to confer upon the FIU the power to “write to [a] concerned organization to freeze the property for 30 days at maximum if the analysis of the transaction or the information, particulars received from the reporting institution presents reasonable ground to believe that the property involved in the suspicious transaction is likely to be transferred, sold or in any manner transformed or changed unless frozen at once.” As noted below, the FIU cannot confer upon itself via any rule-making power additional powers not contemplated by the governing legislation. Indeed, this Rule does not directly impose an obligation to comply. Quite apart from these points, Rule 6(b) applies only with respect to property “involved in” a suspicious transaction that is subject to analysis—not more broadly in the context of investigations of ML or predicate offending.

Narcotics (Drugs) Control Act 1976

235. “Narcotic drugs and other materials connected with the offence, and any other document which may serve as evidence” may be seized. The ambit of this power is clearly

limited to evidence preservation, rather than the preservation of, for example, “any building, land or vehicle” or “movable or immovable property earned from any narcotics related offending” that may ultimately be confiscated under powers of forfeiture.

Prevention of Corruption Act 2002 & CIAA Act 1991

236. Under s 39 of this Act, funds in accounts may be “frozen” via directive of an investigating authority if it “appears that there has been financial transaction or operation of an account... with any bank or financial institution within the country or in any foreign country”. A breach of any such directive carries a fine of NRps 50,000 (US\$697).

237. Additionally, under s 48, if “any foreigner” fails to appear before the investigating authority (having received notice to do so) “any property, entitlement, interest or concern” of that person within Nepal may be frozen via an order not to take the property outside Nepal. These powers are mirrored in s 23(a) and s 29(c) of the *Commission for the Investigation of Abuse of Authority Act 1991*.

Human Trafficking and Transportation (Control) Act 2007

238. As noted above, s 18 of this Act enables the “seizure” of movable or immovable property, including houses, land and vehicles. However, in context this appears to relate solely to post-conviction confiscation, rather than interim restraint. Powers to restrain property at the investigative stage are limited to property that might constitute evidence of offending (s 7(1)(d)).

Banks and Financial Institutions Act 2006

239. Section 80 of the Banks and Financial Institutions Act 2006 empowers the NRB to order licensed financial institutions to freeze accounts. This power is available “in the course of carrying out the investigation of any type of crime or maintaining the national interests by controlling national or international terrorist activities or organised crimes”. The freeze is effected via a directive to the institution to “freeze any account... in such a manner as to prevent the withdrawal or transfer of funds in any way from that account”.

240. In light of the constitutionally-protected property rights referred to above, s 80 would likely be available only where there is an attendant ability to confiscate frozen funds. This would be consistent with the observation (above) that, under s 83, any deposits in a licensed institution that have been “misappropriated” from a governmental body or “collected through any activity relating to terrorism or organised crime” may be recovered only “in accordance with the laws in force”.

241. On this basis, the scope of this provision is greatly reduced. The NRB’s power to direct freezing would be limited to situations where the accounts in question hold funds that are allegedly either instrumentalities of a type recited in the table above or proceeds of money laundering, theft or other dishonesty-related offending, drug offending, corruption or human trafficking. Regardless, the potential utility of the provision is greatly reduced given that confiscation can occur only in relation to such funds.

Instrumentalities and intended instrumentalities

242. As noted, ALPA enables the provisional freezing of assets “relating to” ML. It is likely—but not clear—that this includes instrumentalities of ML. Beyond this, the enactments referred to earlier contain provisions that enable seizure at the investigation stage of instrumentalities or illicit goods/substances. Usually, these provisions require “reasonable

belief” or an “appearance” that the property in question is an instrumentality of offending or an illicit good.

243. It appears what these provisions envision is seizure at the investigative stage followed by an application for forfeiture in the event that a prosecution is successful. The Evaluation Team was advised that this is what occurs in practice. However, the team was not referred to any provisions enabling interim freezing other than via physical seizure (or Directives from the Rastra Bank). For example, there are no provisions that contemplate interim restraint of real estate via the lodging of a caveat over title deeds.

244. Also as noted above, the only enactment that appears to contemplate the forfeiture of intended instrumentalities is the Gambling Act 1963, s 5 of which enables “confiscation” of “goods” used/intended to be used for gambling. In context, this section probably enables both seizure and confiscation.

245. Powers to effect provisional freezing do not require a Court order. Powers to direct freezing action under the Prevention of Corruption Act 2002 and the CIAA Act 1991 arise via departmental directive. Other powers are incidental to powers to seize property pursuant to investigation.

246. To the extent that investigative agencies which receive account information are precluded from divulging that information to other such agencies (as discussed in relation to R 4), bank secrecy is an impediment to asset-tracing investigations.

247. As noted in Section 2.6 of this report, the DRI has power “in course of investigation and inquiry of the offences under this Act” to order the production of documents from “any concern government entity, bank, financial institution or non-financial institution” (s 12(a) ALPA), to conduct searches of such entities (s 12(b)) and to summons persons to give statements (s 12(c)). Although it is unclear whether “concern[ed] entities” include entities other than reporting entities, “investigation officers” appointed under the Act by the DRI can “conduct or cause to conduct search of any office, residence, building, warehouse, vehicles or any place in course of investigation and inquiry”. These powers are relevant in the context of tracing proceeds of crime for the simple reason that ML relates to the disposition of proceeds of crime. However, it is arguable that the “course of investigation and inquiry of the offences under this Act” does not extend beyond the detection of ML and into investigation as to the location of proceeds for the purpose of restraint.

248. Although other agencies with powers to actually restrain and confiscate proceeds of predicate offences have such mandates, they do not have the DRI’s mandate to investigate instances of ML in the first place. As noted in s 2.6, this bifurcation of investigative mandate creates scope for inefficiencies—particularly given that the Nepal Police, which cannot investigate ML, has a dedicated Financial Crimes Unit comprising 35 officers with training in financial investigations and forensic accounting.

249. The Evaluation Team was advised that challenges could occur via the writ process contained in the Constitution which requires a plaintiff to establish a breach of his/her constitutional rights.

250. There are no powers to void any actions that have frustrated recovery action.

Additional Elements

251. Section 28 of ALPA is unclearly worded but appears to require a person “charged” with (not convicted of) an “offence under this Act” to prove legitimate source of earnings, in default of which those earnings are “deemed to have been generated by the commission of offences under this Act”. The offence that is thereby deemed to have generated the assets in question appears to be that of money laundering: the section is headed “Assets Deemed to be Gained from Asset Laundering”. The consequence of such a “deeming” would be to trigger s 34, which provides that “assets obtained from an offence under this Act... shall be confiscated”.

252. Although the specified threshold for s 28 is merely the charging of a person, the procedure appears to be conviction-based: no procedure is specified for hearing evidence as to provenance of earnings. Officials advised that the section was intended to mirror anti-corruption legislation, pursuant to which the Court undertakes due enquiry if a conviction is entered. On this analysis, ALPA enables reverse-onus conviction-based forfeiture in cases of alleged ML. Similarly, under the Prevention of Corruption Act 2002 public officials are obliged to attest to their asset-holdings. Under s 20, where any “property statement” discloses assets disproportionate to the official’s earnings and the official is unable to show lawful provenance, the assets are deemed to have been obtained in an “illegal manner”. On that account, the official is liable to conviction and the assets are amenable to confiscation. Such deeming will also occur where an official maintains an improbable lifestyle or makes gifts or other asset dispositions that are incommensurate with his/her earnings.

Statistics

253. Nepal was unable to furnish any statistics relating to freezing, seizing or confiscation of assets or property, including instrumentalities. In the one ML case prosecuted to date, NRps 300,000 (US\$4,182) was confiscated, apparently on the basis that it was simply currency sought to be exported without a licence.

Effectiveness

254. Nepal has not furnished statistics on freezing and/or confiscation action. Nepal Police has a dedicated proceeds recovery unit. That no statistics were provided from that unit or from CIAA, which also similarly has power to recover proceeds (including by way of a reverse burden of proof), is surprising. In the assessment of the Evaluation Team - and as noted in more detail under Recommendation 27 - there does not appear to be a culture across the investigative agencies of “following the money”. Indeed, despite clear explication by the Evaluation Team of what was sought by way of additional information, many of the statutory provisions urged upon the Evaluation Team as provisions enabling the recovery of proceeds enable the retention of merely property for evidential purposes or illicit goods or contraband.

255. Furthermore, investigative agencies were unaware that they possessed powers to themselves direct the freezing of accounts. The Evaluation Team was consistently advised that accounts were frozen only via direction of the NRB, presumably under s 80 of BAFIA which, as discussed above, is of limited utility where there is no ultimate power of confiscation.

2.3.2 Recommendations and Comments

256. Nepal should enact legislation enabling comprehensive restraint and confiscation of instrumentalities of crime and proceeds of crime. Even if the ALPA is wide enough to enable provisional restraint of proceeds of any predicate conduct listed under ALPA s 4 (not clear), this is ineffectual given that confiscation under that Act is limited to proceeds of ML only.

Coverage provided by other legislation is *ad hoc*, both in relation to proceeds and instrumentalities. In considering the nature of a comprehensive regime along these lines, Nepal should consider the merits of (i) civil recovery procedures, and (ii) reverse burdens of proof.

257. New legislation should include a definition of proceeds of crime that contemplates both direct and indirect proceeds, whether or not those proceeds are held in a defendant's name. Such legislation should include appropriate mechanisms for:

- Ensuring compliance with freezing orders (whether judicial or executive), such as caveats; and
- Enabling third party interests to be determined other than via the writ process under the Constitution.

258. Nepal should also:

- Support such legislation with training to LEAs as to the efficacy of proceeds recovery from a deterrence perspective and training in asset-tracing and ML typologies;
- Maintain comprehensive statistics on provisional measures and confiscation of instrumentalities and proceeds of crime; and
- Enhance the capacity of law enforcement agencies to take actions to freeze, seize and confiscate proceeds of crime.

2.3.3 Compliance with Recommendation 3

	RATING	SUMMARY OF FACTORS UNDERLYING THE RATINGS
R 3	NC	<ul style="list-style-type: none"> • Capacity to confiscate proceeds is limited to proceeds of ML, corruption, drugs offending and human trafficking. • No capacity to comprehensively confiscate instrumentalities of predicate offending. • No capacity to confiscate intended instrumentalities of any offences required to be predicate offences. • No capacity to confiscate property of corresponding value. • No capacity to comprehensively seize or freeze proceeds of predicate offences. • No capacity to seize or freeze instrumentalities or intended instrumentalities of any offences required to be predicate offences. • Capacity to seize or freeze instrumentalities of ML is not clear. • No capacity to seize or freeze intended instrumentalities of ML • No capacity to seize or freeze property of corresponding value • Mechanisms for the protection of bona fide third parties are onerous, requiring the filing of a writ under the Constitution and proof of infringement of a constitutional right. • No statistics are maintained. • The effectiveness of the restraint and forfeiture regime is significantly compromised by deficient understanding and implementation of legislated powers.
R 32	PC	<ul style="list-style-type: none"> • Nepal does not maintain comprehensive statistics on provisional measures taken and confiscation of instrumentalities and proceeds of crime.

2.4 Freezing of Funds Used for Terrorist Financing (SR III)

2.4.1 Description and Analysis

259. In 2010 the FIU issued several Directives to reporting entities, including financial and non-financial institutions as well as government departments²⁶ prohibiting these institutions and agencies from conducting transactions with terrorist organisations. The Directives lay out a basic framework for dealing with:

- Terrorists listed under UNSCR 1267;
- Terrorist listed by South Asian Association for Regional Cooperation (“SAARC”), the European Union (EU) and other regional or international inter-governmental organisations”; and
- Terrorists listed by “different foreign jurisdictions”.

260. Section 80 of BAFIA is potentially relevant. As noted in section 2.3 of this report, s 80 empowers the NRB to order licensed financial institutions to freeze accounts. This power is available in the course of investigation or for the purpose of “maintaining the national interests by controlling national or international terrorist activities or organised crimes”. Arguably, this section enables the NRB to issue Directives concerning UNSCR 1267 compliance. However, none have been issued.

Legal Status of FIU AML Directives

261. An important issue is the legal status of the FIU AML Directives. The Directives require reporting entities to do certain things in relation to the UN Security Council Resolutions, including obtaining information necessary for the identification of terrorist by accessing the UN website. These Directives are stated to be issued “in exercise of the power under s 10(3) of ALPA and AML Rule 7(1)”:

- Section 10(3) of ALPA empowers the FIU to issue directions “regarding reporting” and specifically, “reporting of details, statistics, notices and information” pursuant to s 10(1)(a) (which relates to details of threshold or suspicious transactions).
- AML Rule 7(1) provides that the FIU may “for the purpose of controlling the offence” (and in a way that does not “contradict” the Act) issue Directives in relation to customer identification, suspicious transactions, record keeping, internal controls and “other necessary matters”.

262. Officials stated that “other necessary matters” in relation to AML Rule 7(1) extends to matters relating to compliance with UNSCR 1267. On a plain reading, however, it is likely that a court would read “other necessary matters” as relating to the sorts of matters previously listed, namely preventive AML measures. Further, the power under AML Rule 7 is expressly limited to issuing directives “for the purpose of controlling the offence” (being a reference to the offence of ML)—not the separate purpose of securing compliance with UNSCR 1267.

263. More fundamentally, the FIU cannot confer upon itself via the rule-making power additional powers not contemplated by the governing legislation. Indeed, under ALPA s 46 the power to formulate rules extends only to “the Government of Nepal” (not the FIU) and only for “implementation of the objectives of this Act”. The objectives of the Act are self-evident from both a reading of the Act, generally, and from its preamble, which indicates that the purpose of

²⁶ Banks, Securities, Casinos, Cooperatives, Money Changers, Money Remitters; and Government entities (Company Registrar; Land Revenue; Customs; Inland Revenue; Transport; Department of Cooperatives; Commerce; Industry; Education; Immigration; Postal Service; Office of Metropolitan City, Sub- Metropolitan City and Municipalities).

the Act is “to provide for the prevention of laundering of criminal proceeds”— and therefore not the freezing of terrorist assets.

Implementation of S/Res/1267 List

264. Nepal has no statutory or regulatory mechanism to recognize the consolidated list of entities named by the UNSCR 1267 Committee. There is no act or requirement otherwise that specifically indicates that the list of 1267 entities shall be given effect to under Nepalese law. In and of itself this may not necessarily defeat the effectiveness of a domestic 1267 mechanism, but Nepal also lacks an effective mechanism to freeze terrorist assets. When asked why Nepal did not have such a mechanism officials from the Ministry of Foreign Affairs indicated only that no 1267 entities operated in Nepal.

Freezing assets under S/Res/1267

265. For the most part, the various FIU AML Directives use the same wording in relation to situations where the institutions become aware of transactions with 1267 terrorists. The Directives vary slightly between them (for instance, some use the word “freeze” while others use “suspend” transactions) but for the most part they require reporting entities to establish the following structure:

- Reporting entities shall not conduct or cause to conduct any transactions with 1267 listed entities.
- Reporting institutions/agencies shall immediately put in place necessary mechanisms for “identification and control of the related transaction”.
- If any transaction is found or is evident, the reporting institution shall immediately freeze/suspend such transactions and report it to the FIU as a suspicious transaction.
- Reporting institutions/agencies are required to download information from the UN website in relation to UN listed terrorists.

266. The Directives are unclear on a number of points:

- Reporting entities are not directly required to freeze terrorist assets—the requirement is merely to freeze or suspend “transactions” with 1267 entities;
- It is not clear what institutions must do to implement the requirement to “put in place mechanisms” to identify and control transactions. As noted later in the analysis, the FIU has not issued any guidance note to assist reporting entities to give effect to this requirement.

267. The Directives prohibit “transactions”, or require reporting entities to freeze or suspend “transactions”. They do not explicitly direct reporting entities to freeze “terrorist assets”—indeed, there is no definition of “terrorist asset” in the Directives or in ALPA. “Transaction” is defined in ALPA s 2 to mean: “any act or agreement made in order to carry out any economic or business activities and the term also means the purchase, sale, distribution, transfer or investment and possession of any assets.”

268. When asked whether the Directive meant that assets in their possession are to be frozen, banks and other reporting entities were not clear. They indicated that they would not enter into any transactions with listed terrorists, i.e., open any accounts. But for those accounts already open they were very unclear what they would do. Some of them indicated that they would seek advice from the FIU or Police. Others stated that they would seek legal advice. None indicated that they would immediately freeze the account in its possession as they did not view a bank account with deposited funds as a “transaction” for the purposes of the Directives.

269. Further, transactions involving assets that may be jointly owned or controlled, or controlled only indirectly by designated entities, would not fall under the Directives if one of the transacting parties was not itself a designated entity.

Implementation of S/Res/1373

270. In addition to (purporting to) require the freezing of assets of UNSCR 1267 listed entities, the Directives prohibit more generally “transactions with the terrorist groups, organisation or individuals or any groups, organisations or individuals related to them which are listed as terrorist by SAARC, European Union and other inter-governmental international or regional organisations”. The Directives extend also to “transactions with” entities that are listed as terrorist by another country.

Communication of Listings

271. FIU AML Directives oblige reporting entities to check the UN 1267 list themselves. No government department or Ministry distributes, publishes or otherwise disseminates the 1267 list or its updates to reporting entities. While most banks indicated that they were aware that they should check the UN website to determine who is on the 1267 list, many said that had not done this, and those that had check the site only intermittently—“perhaps once a month”.

272. With respect to terrorists listed by foreign governments or organisations (SAARC, EU and “other intergovernmental, international or regional organisations”) no list is provided to reporting entities. Indeed, organisations qualifying as “other intergovernmental, international or regional organisations” are not identified. Nor do the Directives provide any information on how the identity of a foreign-listed terrorist could be determined.

Guidance to Financial Institutions

273. As noted, the only guidance provided is that contained within the Directives by way of providing the URL address of the 1267 list. Otherwise, the Directives do not assist reporting institutions to identify who the terrorist entities are - no information is provided which directs reporting entities to a list or other information to help them identify individual names. Nor has any guidance been provided concerning matters such as potential identification mismatches, means of addressing unforeseen consequences resulting from freezing action, authorising access to funds, the scope of permitted transactions or the administration of frozen funds generally.

Procedures for delisting or unfreezing

274. Nepal has not developed any processes for considering evidence that may negate the basis for freezing funds or other assets or for reviewing the propriety of freezing action. It has no domestic listing process, so has no delisting process.

Authorising access to funds

275. Nepal has not developed procedures relating to, or designated any competent authorities with respect to, providing access to frozen funds or other assets to mitigate the consequences of freezing action.

Review of freezing decisions

276. As noted earlier in this report, the *Interim Constitution* enables a person whose constitutional rights have been infringed to petition the Supreme Court for redress. Article 19 of the constitution affords the “right to acquire, own, sell, dispose of, and otherwise deal with, property.” However, this right is expressly subject to “the public interest”.

Freezing, seizing and confiscation in other contexts

277. None of the powers of confiscation available under Nepal's laws would enable the confiscation of assets purely on the basis that they would be assets otherwise under the control of a terrorist entity. Even if (i) provisional restraint under s 12(f) of ALPA - which enables the freezing of "assets relating to" ML - enables the freezing of proceeds of predicate conduct (which is far from clear) and (ii) TF, although not criminalised, is nonetheless regarded as constituting predicate conduct (also unclear), reliance upon ALPA to freeze terrorist assets would still require actual proof of the initial financing that funded those assets. Proceeds of crime legislation cannot substitute for a clear and simple freezing mechanism, particularly where, as here, the underlying TF offence is seriously deficient. Furthermore, as discussed in section 2.3 of this report, powers under ALPA to ultimately confiscate frozen assets are clearly limited to proceeds of ML, not proceeds of predicate offending. Capacity to use this power for the purpose of confiscating terrorist assets is negligible. The utility of other restraint and confiscation provisions in other legislation is similarly limited for the simple reason that those provisions relate to proceeds of only specific predicate offences.

278. As noted in section 2.6 of this report, the DRI (responsible for the detection of TF and tracing of proceeds of TF) does not have powers critical to these tasks, most notably the power to engage in communication interceptions. Further, expertise in funds tracing appears to lie within Nepal Police, not the DRI.

279. There are no provisions in any legislation that would enable a court to void actions intended to ensure that proceeds of TF or terrorist assets more generally are unable to be confiscated.

Protection of rights of bona fide third parties

280. As noted above, the only available mechanism is that provided by the writ process enabling a petitioning of the Supreme Court.

Enforcing obligations under SR III

281. Under s 10(1)(e) of ALPA, the FIU has powers to inspect records of a reporting entity. However, the purpose of this right of inspection is to obtain "information or clarification" about transactions. In light of this, and given that ALPA is not concerned with freezing action under the Security Council resolutions, in context this power of inspection is intended merely to facilitate the FIU's function of STR analysis.

Additional Elements

282. Nepal has not implemented the measures set out in the best practices paper for SR III. Nor has Nepal developed procedures to authorise access to frozen funds or other assets.

Effectiveness

283. Despite the lack of a clear legal foundation for the FIU AML Directives, reporting entities are aware of the Directives and regard them as binding. However, compliance levels are unsatisfactory. None of the Banks and other reporting entities subject to these Directives have actually issued any internal policies to implement the Directives. One bank said it had plans to enable 1267 screening of its account holders but had not done so at the time of the on-site visit. Another had initiated (a few months prior to the on-site visit) only a manual practice of checking names of foreign account holders against the 1267 and OFAC lists and had plans to purchase World Check, which would then be integrated into its server. Another bank had no capacity to screen any accounts held outside Kathmandu and had no policy in place concerning

screening where this was possible. A fourth (global) bank adhered to a rigorous global policy requiring screening via an IT solution that was administered at a group level from outside Nepal. Entities screened include those on the 1267 list, the OFAC list and a specifically generated PEP list. No funds or assets have been frozen pursuant to UNSCRs 1267 or 1373.

284. Outside the commercial banking sector, awareness is low and institutionalised compliance is non-existent. Securities broking firms, insurance companies and Cooperatives lack policies concerning the freezing of terrorist assets or the capacity to automatically screen client accounts or lists. A merchant banking company suggested to the evaluation team during the on-site visit that the FIU had advised it the Directives did not apply to merchant banking operations. Although disputed by the FIU, this exemplifies uncertainty as to the scope of the regime.

285. Awareness within the money remittance sector appeared higher but, again, compliance is poor. One money remittance agency functioned as an agent for a global bank and so relied upon screening undertaken by that bank. This agency confirmed that, should a name-hit happen to be identified, it would not process the transaction (as opposed to accepting the funds then freezing them). This mirrored advice from certain of the banks that, in the event of a name-hit, an account would not be opened.

286. Further, because the Directives (purport to) prohibit “transactions with [designated entities]” rather than simply effecting a freeze on assets, they prevent licensed institutions from, for example, accepting deposits into entity-related accounts and then freezing those deposits, thereby making them unavailable to the entity or its donor. Enquiries with the private sector established that this is what happens in practice.

287. The NRB has not undertaken any supervisory action with respect to UNSCR 1267 or UNSCR 1373 compliance.

2.4.2 Recommendations and Comments

288. The following is a list of recommendations for Nepal:

- Provide comprehensive statutory provisions and related mechanisms and procedures to implement SRIII, including UNSCR 1267, 1373 and measures to freeze and confiscate terrorist property in other contexts.
- The NRB has apparent authority to issue Directives requiring compliance with UNSCRs 1267 and 1373. At least pending any amendment that might confer similar power upon the FIU, Nepal Rastra Bank Directives should be issued. Rather than precluding “transactions”, Directives should be expressed in terms that require freezing of assets.
- Nepal should expedite its current plans to roll-out an “e-Network” enabling the FIU to provide up-to-date information as to those entities caught by the Directives and guidance relating to implementation.
- Those entities should, as far as possible, be expressly identified in the Directives, rather than being merely described. At the very least, the Directives should identify those “other” organisations that are also said to list terrorists and terrorist entities.
- Nepal should consider establishing a domestic listing mechanism and attendant processes to consider de-listing requests and requests for unfreezing.

289. Any proposals for reform of Nepal’s laws governing confiscation should include proposals that enable (i) confiscation of assets frozen pursuant to the UNSCRs, (ii) deployment of powers appropriate to the task of identifying and tracing terrorist assets and (iii) powers to void actions intended to ensure that terrorist assets are unable to be confiscated.

2.4.3 Compliance with Special Recommendation III

	RATING	SUMMARY OF FACTORS UNDERLYING RATING
SR III	NC	<ul style="list-style-type: none"> • Directives aimed at ensuring compliance with the UNSCRs are not binding. • The directives preclude transactions rather than requiring that assets be frozen. • Only some of the terrorist entities to which the Directives relate are readily identifiable. • No guidance to reporting entities with respect to compliance. • No procedures enabling delisting or unfreezing. • No procedures enabling access to frozen funds. • The only mechanism for reviewing freezing decisions or protecting third party interests requires the petitioning of the Supreme Court. • There are no powers enabling enforcement of Directives. • No capacity to confiscate frozen assets or to void actions intended to ensure that proceeds of TF or terrorist assets are unable to be confiscated. • Inadequate powers to identify and trace terrorist assets. Levels of compliance with the Directives are low.

2.5 The Financial Intelligence Unit and its functions (R.26, 30 & 32)

2.5.1 Description and Analysis

Recommendation 26

Establishment of FIU as National Centre

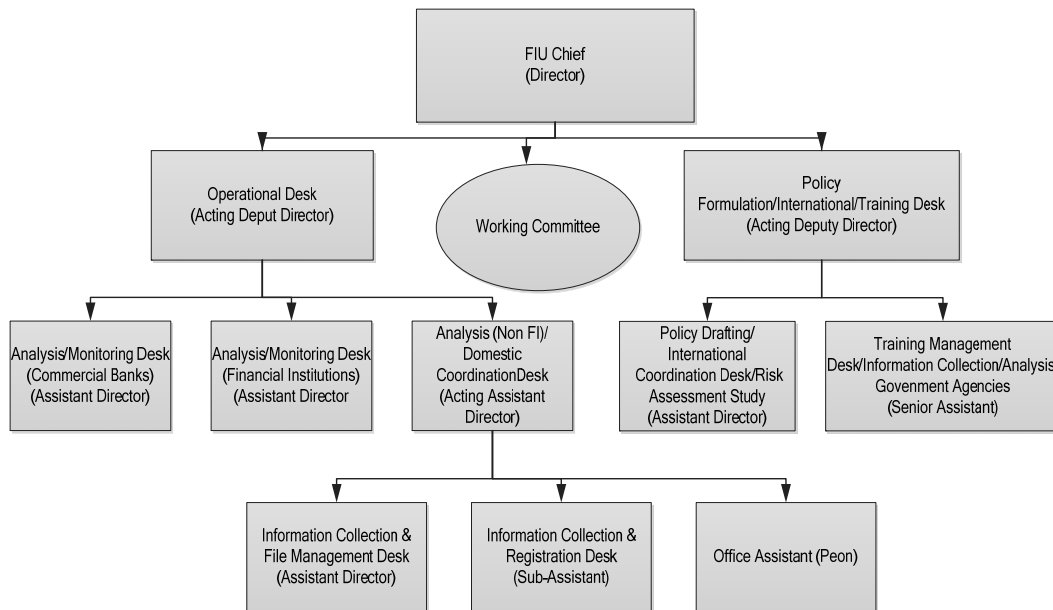
290. The Asset (Money) Laundering Prevention Act 2008 (ALPA) establishes the Financial Information Unit (FIU) as a departmental unit within the Nepal Rastra Bank (NRB) for “the collection and analysis of information relating to asset laundering.” The NRB Governor is empowered to appoint the Chief of this unit not lower in rank than a First Class Officer (a relatively senior officer in the Nepal public service).

291. The FIU is a predominantly administrative FIU with limited powers of evidence collection for preliminary investigation. The ALPA and AML Rules 2009 give the FIU a variety of powers and functions including:

- Receiving, analysing and disseminating STRs and TTRs (threshold transaction reports);
- Obtaining further information or clarification about transactions and records and to obtain their copies where necessary;
- Conducting preliminary inquiries into information received where necessary;
- Ordering institutions to freeze suspect property where necessary;
- Issuing AML/CFT Directives to reporting entities;
- Liaising with the AML Department (Department of Revenue Investigation – “DRI”);
- Sharing information with other FIUs and international organisations;
- Managing AML/CFT-related training programs for government entities;
- Carrying out other prescribed functions.

292. The FIU is established for 11 staff members, including the Director (Chief). Four of the officers are information analysts. The remaining are managers and policy experts. The organisational structure of the FIU is as follows:

Financial Information Unit Organizational Structure



293. The Nepal FIU started receiving STRs and threshold transaction reports (TTR) in 2008 shortly after its formation. Prior to November 2009, only one STR had been filed. Since then, 185 STRs have been received, bringing the total received to 186. Of the STRs, 183 came from Class A institutions, two from Class B, and one from a Class C institution. The breakdown by month and year is as follows:

TOTAL STRS RECEIVED SINCE 2008 – BY MONTH					
2008		2009		2010	
August	1	November	10	January	3
		December	3	February	17
				June	144
				July	1
				August	7
Total	1	Total	13	Total	172

294. The FIU advised that the spike in STRs for the month of June 2010 (144 STRs) relates to a business involved in a fraudulent investment scheme (or “ponzi”). The financial institutions reporting the STRs did so within a short period of time.

295. The number of TTRs received by the FIU since 2008 are as follows:

TOTAL TTRs RECEIVED SINCE 2008 – BY CLASS OF INSTITUTION		
Class of Institution	Number of TTRs	Volume of Money Involved
Class A - Commercial Banks	1,685,232	US\$72million
Class B - Development Banks	514,080	US\$14million

Class C - Finance Companies	140,572	US\$3.6million
Class D – Microfinance Institutions	N/A	N/A
Cooperatives	697	US\$11.8million
Insurance Firms	226	US\$1.9million
Securities Firms	247	US\$9.8million
Money Remitters	1	US\$14,500
Money Changers	N/A	N/A

296. TTRs (as per FIU AML Directives) are payment/remittance transactions and credit/debit transactions of NRps 1 million or more (US\$13,000) or forex transactions of NRps 500,000 (US \$6,500).

297. There are no TTRs from Class D financial institutions because the size of transactions through those institutions is very small. Class D financial institutions provide financial services to low socio-economic individuals who make deposits of NRps50 to NRps200 (approx. US \$1-\$3) per month.

Receipt, Analysis and Dissemination of STRs and TTRs

298. Under ss 10(1)(a) and 10(b) of ALPA the FIU has two principal functions, namely: (a) analysis of STRs and TTRs; and (2) inquiry and investigation into STRs and TTRs. The investigatory function of the FIU relates to evidence collection. These functions are discussed separately.

299. **Receipt:** Reporting institutions may send STRs and TTRs through mail, fax or email. There is no secure online reporting system available in Nepal. STRs and TTRs are filed in paper format and then converted manually to electronic disk format.

300. **Analysis:** Section 9 of ALPA provides the FIU shall collect and analyse information relating to ML. Section 10(1)(a) of ALPA directs the FIU “to regularly obtain details of transactions under s 7 from government entities, bank, financial institution and non-financial institution and maintain records thereof upon conducting an analysis.” Section 40 of the AML Rules further provides that the FIU may develop and implement an internal manual to perform the tasks it is required to perform. However, no such manual has been issued.

301. The FIU does not have a structured and formal analytical process for dealing with information obtained through STRs and TTRs. When asked during the on-site visit how analysts handle that information, officials advised that they use an informal 6-step process as follows:

- (a) Determine the elements of suspicion;
- (b) Look at all details of the transaction reported, including KYC documents;
- (c) Study the transaction pattern of the customer;
- (d) Try to link the customer to other transactions within the reporting entity;
- (e) Find out if the customer has other bank accounts or other accounts with other reporting entities; and
- (f) Talk with the tax authorities and secure any relevant information.

302. The FIU does not have software to cross-check information contained in STRs with information contained in large number of TTRs. It is difficult for the analysis function to match names between STRs and the 2.3 million TTRs received to date.

303. As noted above, four officers in the FIU are dedicated information analysts. No targeted analytical training has occurred for Nepal's FIU analysts as yet. Only general training and awareness raising workshops have been attended by FIU staff.

304. **Inquiry and Investigation:** The second FIU function is outlined in s 10(1)(b) of the as follows:

s10(1)(b): In case the notice, details and documents reported to it require an inquiry and investigation on asset laundering, [the FIU shall] conduct [a] preliminary inquiry and send details thereof to the concerned Department, government entity, bank, financial institution and non-financial institution.

305. Additionally, s 10(1)(c) of ALPA obliges the FIU to disseminate details of STRs to the AML Department (Department of Revenue Investigation – DRI) if transactions are suspicious or if there are reasonable grounds to believe that a transaction is suspicious. Officials from the FIU indicated that s 10(1)(b) empowers the FIU to:

- Investigate ML and TF suspicions;
- Collect evidence to support ML and TF allegations; and
- Refer those allegations and the evidence collected to the AML Department under s 10(1)(c) of ALPA.

306. The relationship between the FIU, as an AML/CFT investigation agency, and the AML Department (DRI), also charged with powers to investigate allegations of ML and collect evidence in the course of such investigations, is not clear. One FIU official said that the FIU could of its own accord investigate and collect evidence which it would then refer to the DRI while another seemed to indicate that it only meant the FIU could collect evidence of suspicion and then refer that evidence to the DRI to more fully investigate. No formal structure exists for these overlapping responsibilities. FIU officials have yet to clarify the meaning and functions relating to this statutory function.

Guidelines to Financial Institutions on Reporting STRs and Outreach

307. **Directives and Guidelines:** Section 10(3) of ALPA empowers the FIU to issue Directives to banks, financial institutions and non-financial institutions about the method, form, time and other procedures regarding reporting of details, statistics, notices and information. Rule 7 of AML Rules widens this power to permit the FIU to issue directives in relation to:

- (a) Customer Identification, introduction and acceptance procedure;
- (b) Identification of suspicious transactions;
- (c) Modes of reporting suspicious transactions;
- (d) Record of the transaction and business relation, particulars to be mentioned in such records and management and security of the record;
- (e) Diligence on and control of the transaction and internal inspection; and
- (f) Other necessary matters.

308. Pursuant to this power the FIU has issued 12 Directives to banks (two), money remitters (two), money changers (two), casinos (two), cooperatives, insurance, securities and government reporting entities²⁷ which cover, among other issues, reporting forms and procedures.

²⁷ Company Registrar, Land Revenue, Customs, Inland Revenue, Transport, Department of Cooperatives, Commerce, Industry, Education, Immigration, Postal Service, Office of Metropolitan City and Municipalities.

309. Reporting procedures are not adequately focused in these Directives and the FIU has not undertaken any initiatives to issue comprehensive guidelines for the reporting institutions to assist them with implementing these obligations. Under AML Rule 9 regulatory bodies are also required to issue necessary Directives for the institutions they regulate but no regulator has issued such Directives as yet.

310. **Feedback on STRs:** The FIU has not provided any feedback to reporting institutions on STRs. Consequently, many of the institutions that are required to file STRs do not have clear understanding of their filing obligations nor what it means to detect a suspicious transaction.

311. All of the reporting entities spoken to by the evaluation team expressed a strong desire to receive feedback to increase their understanding of the specifics of reporting and whether they are providing the quality and quantity of information expected by the FIU. This lack of understanding as a result of an absence of feedback on STRs is reflected in part by the relatively low number of filings.

312. **Outreach to private sector** While the FIU has provided information sessions and other limited outreach to government agencies pursuant to AML Rule 6(h), there has been no effective and targeted outreach to the private sector²⁸, nor is any planned due in large measure to lack of resources in the FIU to commit to this. Many of the private sector institutions required to file STRs which the evaluation team spoke to during the on-site visit indicated that they would benefit from outreach and have been puzzled why the FIU has not as yet contacted them for this purpose, particularly since the FIU has issued Directives to them. FIU staff are, however, in the initial stages of setting policy, issuing Directives and working out systems for STR and TTR analysis and admit that while outreach is important it cannot as yet occur.

Access to Additional Government Information

313. Access to financial, administrative and law enforcement information is undertaken on an *ad hoc* basis in Nepal. No statutory authority exists in the ALPA or AML Rules to permit this. Section 10(2) of ALPA mandates the FIU and regulatory bodies to exchange available information and AML Rule 9 requires regulatory bodies to send their inspection reports to the FIU.

314. There is no provision in the ALPA and AML Rules that permits the FIU to gain access to law enforcement information. Neither is there a formal MoU with Government agencies to exchange this information with the FIU. During the onsite visit FIU officials advised the evaluation team that they can make the request to any LEA to provide required information and there is no barrier to provide such information. The FIU can informally request any agency as and when required. Again, however, without a legal right to ask and a corresponding obligation to provide the requested information it is difficult to see that this regime complies with the requirements of the standards.

Additional Information from Reporting Institutions

315. The authority and power of the FIU to seek additional information from reporting entities once an STR has been filed is laid out in the ALPA and to a limited extent in the AML Rules. Under ALPA s 10 the FIU has access to “details of transactions under s 7” (s 10(1)(a)). Pursuant to s 10(1)(e) of ALPA the FIU is empowered to inspect transactions and records of banks, financial institutions and non financial institutions, to obtain any information or clarification about any transactions and records and collect copies thereof where necessary.

²⁸ Some private sector involvement has occurred within the context of government targeted training, but participation has been limited.

While the FIU views this provision widely to the extent it permits the FIU to call for any financial information a reporting entity may hold in relation to a person who is the subject of an STR, the wording of the provision clearly reflects that the power and authority is restricted to information about particular “transactions.” The word “transaction is defined in ALPA at s 2 and supports this interpretation: Under s 2, "Transaction" means any act or agreement made in order to carry out any economic or business activities and the term also means the purchase, sale, distribution, transfer or investment and possession of any assets” (attempted transactions are not covered under this).

316. Further, the bank secrecy requirements in BAFIA (s 79(1)) that enable disclosures to “authorised prosecutors or officers carrying out an inquiry, investigation or prosecution” are not likely to extend to officers of the FIU for the purpose of analysing STRs. The scope of the exemption enabling “disclosure of customer information to the NRB” is not clear. In any event, the legislature has expressly contemplated the FIU’s need for further information and limited its power to seeking information about “transactions”—in other words, the FIU powers appear to preclude “fishing expeditions” where the net is cast wider than a transaction in order to catch additional transactional information. Accordingly, regardless of the position with respect to bank secrecy, the FIU’s capacity to ask for customer information or additional information beyond particular transactions is questionable.

317. AML Rules do not explicitly describe the direct access of FIU to obtain additional information from reporting institutions. Section 7(2) of ALPA requires reporting institutions to furnish any additional information regarding submitted STR/TTR; and AML Rule 9 requires regulatory bodies to send their inspection reports to the FIU.

Dissemination of Information

318. Sections 10(1)(b) and 10(2) of ALPA authorise the FIU to disseminate information to the concerned department (DRI), government entity, bank, financial institution and non-financial institution. Section 10(1)(c) makes the FIU responsible for providing extensive details of analysed reports to the Department of Revenue Investigation. To date the FIU has referred all of its STRs (186 as of the date of the on-site visit) to the DRI. There is no formal process or procedure for the dissemination of STRs to other agencies. Decisions are taken by analyst to disseminate these reports. This issue relates to effectiveness discussed later in this report.

319. Section 10(1)(d) also authorises the FIU to share with foreign FIUs, international organisations and institutions notice, details and documents regarding asset laundering on the basis of reciprocity and receive such notice from concerned country and international organisation and institution. AML Rule 6(f) limits sharing to only those foreign FIUs with which Nepal has an MOU. There is no provision for spontaneous exchange of information with other countries.

STRs, INCLUDING KYC DOCUMENTS AND BANK STATEMENTS, DISSEMINATED		
Year	Within Nepal	Outside Nepal
2008	1 (to AML Department)	
2009	13 (to AML Department)	1 (to US Justice Department) 4 (to Indian FIU)
2010	172 (to AML Department)	

TOTAL	186	5
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Operational Independence and autonomy

320. ALPA s 9 states that “there shall be a Financial Information Unit in the Rastra Bank for collection and analysis of information relating to asset laundering” and that the Governor of the Bank shall appoint the Chief and provide staff required for it. However, no internal administrative order, direction or memorandum has been issued by the NRB to date in order to give effect to this statutory provision. The lack of an administrative order and formal framework for the FIU’s staff, training and operation is a concern. The status of the FIU at present is arguably *ad hoc* only. Although its existence in the NRB reflects the statutory framework in the ALPA, nevertheless the lack of underpinning within the formal administrative structure of the NRB opens a strong argument that the FIU lacks proper legal status within the NRB.

321. The Chief of the FIU does not hold security of tenure in his position or other guarantees against executive interference in his position (as might be contained in an internal administrative instrument to establish the office). Recruitment, posting, transfer and promotion of the Chief and his staff are the sole responsibility of the Governor. The Governor retains ultimate discretion to remove NRB staff including the Chief of the FIU and his subordinates. The Governor also retains residual discretion over the FIU’s staffing, budget and operations. There is no separate development budget allocation for the FIU. Budget “bottom-line” requirements are determined primarily within the NRB’s corporate planning development department.

322. Because FIU staff members are also, and primarily, NRB staff, the movement in and out of the FIU is seen as a professional development opportunity for many officials not necessarily associated with the operational needs of the FIU. Indeed, the current Chief of the FIU is a senior officer in the NRB’s Legal Department and has not (from what the evaluation team could determine) relinquished his duties in that department. It was apparent to the evaluation team that the role of the FIU Chief is seen within the Bank as an additional responsibility to his primary legal functions. The lack of tenure and the nature of staffing movements raises an issue in relation to the confidentiality of FIU information. Without a formal framework or mechanism in place to protect this confidentiality (of which there is none) the evaluation team has a significant concern.

323. This perception, coupled with the lack of structure within the NRB for the FIU and the inability of the FIU to control staff and budget raises serious concerns about the status and independence of the FIU.

Protection of information held by FIU

324. The FIU is located in a single space within the NRB’s central office building in Kathmandu. Entry and exit to this building is controlled by perimeter security guards who check identification and reasons for entry. Access to the FIU’s offices can be gained from internal and external doorways once access to the general NRB premises. While security for entrance into the NRB grounds is sufficient, there could be better arrangements in place for the FIU itself notwithstanding its location in the NRB complex.

325. The storage, handling and security of information in the FIU is rudimentary. STRs and TTRs are filed in paper format and then converted manually to electronic disk format. The FIU does not have soft ware or programmes to cross-check information contained in STRs with information contained in large number of TTRs. On a more fundamental point, it is difficult to

see how the FIU could match names in STRs (which are only in the hundreds) against those contained in TTRs (which number in excess of 2.3 million reports to date).

326. STRs and TTRs are stored in stand-up filing cabinets within the FIU office. The filing cabinets are not, however, stored in a safe room or other secure area, but are left in the open office area. But the cabinets are each secured and FIU staff are aware of the need for vigilance with the filing system and have taken safeguards with locking systems to prevent unauthorized entry into the information-security cabinets. Nevertheless additional measures and resources for the FIU to ensure greater security seem to be required.

327. Reporting institutions may send STRs and TTRs through mail, fax or email. There is no designated desk officer to receive, manage and handle these reports. Once received they are left in office view for any person in the FIU area to sight.

Publication of information

328. Under AML Rule 6, the FIU must report to the Coordination Committee and Nepal Rastra Bank with an annual report of performance within three months from the completion of the fiscal year. On the other hand, those Rules do not stipulate what information must be contained in the Annual Reports. The first annual report 2009/10 (16 pages) published in June 2010 includes the following chapters:

- Policy Decision and Recommendations;
- Issuance of Directives to Reporting Institutions;
- Receiving, Analysing and Disseminating Data;
- Awareness Programs;
- International Relations;
- Capacity Building Programs; and
- Miscellaneous Activities.

329. The report does not provide any detail on these headings, nor does it outline crucial statistics, typologies or trends in ML and TF in Nepal. While the FIU has developed a “News Letter”, first published in May 2010, it does not contain detail either.

Egmont Group Membership

330. The Nepal FIU applied for Egmont Group membership in January 2010.

Information Exchange with other FIUs

331. FIU is empowered under s10(1)(d) of ALPA and Rule 6 of the AML Rules to exchange financial intelligence/information with other FIUs:

- s10(1)(d): FIU [shall] share with the Financial Information Units of other country and international organisations and institutions notice, details and documents regarding asset laundering on the basis of reciprocity and receive such notice from concerned country and international organisation and institution.
- AML Rule 6(f): FIU [shall] sign Memorandum of Understanding with the Financial Information Unit of other country for the purpose of s 10 (1) (d) of the Act.

332. The requirement under AML Rule 6 for an MOU may hinder the ability to provide spontaneous exchanges on the basis of reciprocity.

333. Nepal's FIU has already signed MoUs with Bangladesh, Sri-Lanka, Malaysia, Mongolia and Thailand and is discussing MoUs with other countries. In terms of information exchanges to date there have been only two as follows:

FIU-TO-FIU INFORMATION EXCHANGES (TO JUNE, 2010)				
Date	Request to	Request from	Date of Answer	Information
November 2009	FIU-Nepal	FIU-India	December 2009	2 requests/responses made on the same date
January 2010	FIU-Nepal	FIU-India	January 2010	2 requests/responses made on the same date

Recommendation 30 (FIU)

Adequacy of FIU resources

334. The FIU is relatively new (2008) and its officials are aware that there is much it needs to do. The FIU lacks sufficient human and technical resources to perform the functions assigned to it.

335. **Human Resources:** While the FIU is established for 11 staff, only 4 are dedicated analysts and some positions within that 11-person establishment are not yet filled.

336. The 4 dedicated information analysts receive, examine, consider and evaluate STRs and TTRs. With only 186 STRs in the last 2 years there would likely be more if the FIU could undertake outreach and information sessions with reporting institutions. As noted in this section, many reporting institutions are confused by the new regime and lack the necessary information to assist them to comply with their obligations. The FIU needs additional human resources to enable it to undertake an effective outreach function in order to effectively capture information necessary for suspicious transactions. No doubt with outreach, and with it an increased understanding of the obligations on reporting institutions, the number of STRs would increase. In that event, there would be an increased need for analysts.

337. There is also a need for additional policy analysts and draft-persons. Currently only one officer in the FIU is responsible for drafting FIU AML Directives and other policy documents. That officer also undertakes the policy analysis and background investigations necessary for the drafting.

338. **Technical Resources:** The FIU lacks a number of tools necessary for it to effectively meet its obligations, including:

- hardware and analytical software appropriate to the functions of an FIU;
- an electronic information and filing system; and
- a secure system of information storage to manage that system.

Integrity of FIU authorities

339. There are no statutory provisions in the ALPA, or other statutes, which relates directly to recruitment, retention and integrity standards for FIU personnel. However, the NRB's Code of Conduct applies to FIU staff. Recruitment in the NRB, and hence in the FIU, includes background and academic record checks. Once recruited, individual staff members are bound by professional standards relating to honesty and integrity; loyalty and good faith; and confidentiality. Violation of these standards may result in departmental action including

warnings, demotion and dismissal. The Anti-Corruption Act also applies to FIU staff. Workplace corruption is a criminal offence and attracts criminal punishment.

340. AML Rule 39 provides that information, particulars and documents received by the FIU in accordance with AML Rules and/or Directives are confidential under s 3 of the Right to Information Act 2008. However, it is doubtful that the Right to Information Act 2008 applies in this context given that the definition of “information” at s 2 of that Act is restricted to “information related to the functions, proceedings or decisions of public importance made by a Public Body” not to information received from reporting entities. Nevertheless, even if that Act does apply, there are no penalty provisions in that Act or in the AML Rules should an individual breach the confidentiality of FIU-held information.

Training for FIU staff

341. Training for FIU staff is limited. While FIU officials indicated that training is a key interest, little is done to demonstrate this. For instance, the FIU budget has no training budget line for its staff. Basic information exchange programs have been attended by FIU staff and the FIU can, when sponsored by external agencies or organisations, attend international meetings and workshops (many of which are offered by the APG) but these events tend to be information exchange programs or mutual evaluation training on the interpretation of FATF standards.

342. The FIU did not point the evaluation team to any specific FIU-related work training such as:

- Financial information analysis;
- Data and intelligence information handling;
- Tactical and strategic intelligence analysis;
- AML/ CFT policy analysis;
- Legal instrument/regulatory drafting (relevant to its function in issuing Directives);
- AML/CFT risk analysis;
- Sector-related policy and operational issues relevant to AML/CFT; and
- Report writing.

343. When asked what entry-level training FIU analysts receive when posted into the FIU for the first time, the evaluation team was told that no training is provided.

Recommendation 32

Statistics

344. As noted above, the total number of STRs filed with the FIU to date is 186. Only Class A, B, and C institutions have filed STRs to date. Of the 186 STRs received, 183 were filed by commercial banks, two by development banks, and one by a finance company. The FIU has not provided statistics in relation to those disseminations that have resulted in investigation or prosecution of ML or underlying predicate offences by law enforcement.

345. In absence of a well structured FIU and sufficient resources for the FIU, the overall activities for preventing and combating ML and TF is not adequate and effective in Nepal. Considering the risk and vulnerabilities of ML and TF in Nepal, the FIU should be better supported more effectively by the government in order to mitigate those risks.

Effectiveness

346. The effective conduct of core FIU functions is undermined by the variety of other functions and responsibilities, such as issuing Directives, acting as Secretariat to the National Coordination Committee and acting as policy advisers on legislative initiatives. The evaluation team was impressed with the dedication and hard work of the FIU staff during the on-site visit in this respect. These functions, while critical to Nepal, have the effect of diverting limited staff resources away from the critical FIU functions – receipt, analysis and dissemination of STRs and TTRs. The current staffing levels of the FIU cannot support all of these functions without impact on overall effectiveness.

347. Effective analysis of reports received by the FIU is not clear. The dissemination of all STRs to law enforcement (DRI), the lack of analytical training for FIU staff, the paper-based system of information storage which severely restrict cross-checking analysis between STRs and TTRs, and the lack of FIU autonomy where staff may be posted in and out for primary NRB staffing needs, all point to significant effectiveness issues for the FIU. It appeared to the evaluation team that due to lack of resources and analytical training the FIU was simply disseminating every STR to the DRI, thereby diluting the product received by DRI. In addition, the lack of effective feedback exchanges with the private sector on STRs filings and their use by the FIU and law enforcement also has impact on the effectiveness of the FIU.

348. The lack of FIU software to cross-check information contained in STRs with information contained in large number of TTRs undermines effective analysis.

349. As noted above, four officers in the FIU are dedicated information analysts. No targeted analytical training has occurred for Nepal's FIU analysts as yet. Only general training and awareness raising workshops have been attended by FIU staff.

2.5.2 Recommendations and Comments

350. It is recommended that Nepal should:

- Ensure sufficient dedicated staff resources are available to meet the FIU's core functions of receipt, analysis and dissemination of information.
- Enhance the analytical capacity of the FIU, including effective software tools, dedicated staff and staff training.
- Enhance the FIU's operational independence incorporating the separate recruitment, transfer, posting and promotion policy, and allocating a detailed operational and development budget.
- The FIU should be relocated to a protected area and security measures should be taken for ensuring the physical security of the information.
- Establish an independent IT platform in the FIU for effective online reporting system.
- The numbers of staff in the FIU should be increased to handle the regulatory responsibilities smoothly and more specialized training on financial analysis related to ML and TF should be provided to the FIU officials and analysts.
- Prepare an operational FIU manual for effective working of the FIU, including all aspects of receipt, analysis and dissemination and other core functions of the FIU.
- Maintain a comprehensive database on STRs and TTRs.
- Ensure the spontaneous information exchange with other FIUs.
- Ensure the periodic publication including the statistics, trends and typologies of ML/TF.

2.5.3 Compliance with Recommendations 26, 30 and 32

	RATING	SUMMARY OF FACTORS UNDERLYING RATINGS
R 26	PC	<ul style="list-style-type: none"> • FIU does not properly undertake analysis of STRs and TTRs. • FIU does not have access directly or indirectly to additional law enforcement or administrative information in order to properly undertake its functions. • FIU cannot gain access to additional information from reporting entities – only information in relation to a particular “transaction”. • FIU lacks operational independence. • Information held by FIU is needs further security protected. • FIU does not publish statistics, typologies or trends in ML and TF. • Absence of comprehensive data management systems for the FIU • 100% dissemination of STRs to law enforcement is ineffective.
R 30	PC	<ul style="list-style-type: none"> • FIU is not adequately structured, funded, staffed, and lacks sufficient technical and other resources to fully and effectively perform its functions. • FIU staff require specialized training on financial analysis techniques.
R 32	PC	<ul style="list-style-type: none"> • Nepal does not maintain comprehensive statistics. • Inconsistencies between the data provided by the FIU and law enforcement agencies indicate that statistics are not well kept, hindering effective implementation of AML/CFT systems.

2.6 Law Enforcement, Prosecution, Other Competent Authorities (R 27, 28, 30 & 32)

2.6.1 Description and Analysis

Recommendation 27

Authority to Investigate Money Laundering and Terrorist Financing

FIU

351. The FIU has a limited function of ‘inquiry and investigation’ of ML as outlined in ALPA s 10(1)(b):

In case the notice, details and documents reported to it require an inquiry and investigation on asset laundering, [the FIU shall] conduct [a] preliminary inquiry and send details thereof to the concerned Department, government entity, bank, financial institution and non-financial institution.

352. Additionally, s 10(1)(c) of ALPA obliges the FIU to disseminate details of STRs to the AML Department (DRI) if transactions are suspicious or if there are reasonable grounds to believe that a transaction is suspicious. The ALPA goes into extensive details of the role of the DRI as the AML Department responsible for investigations. The ALPA provides no further details of the scope or powers of any investigation role by the FIU.

353. In practice, it is not clear that the FIU is conducting any evidence collection or other elements of investigations for ML. One FIU official said that the FIU could of its own accord investigate and collect evidence which it would then refer to the DRI while another seemed to indicate that it only meant the FIU could collect evidence of suspicion and then refer that evidence to the DRI to more fully investigate. No formal structure exists for these overlapping responsibilities.

354. In Nepal ML and TF offences are investigated exclusively by the Department of Revenue Investigation (DRI), while predicate offences to ML are investigated by a number of other agencies. Predicate offences are investigated by Customs Office, Commission for Investigation for the Abuse of Authority and Nepal Police. The Police have authority over the majority of predicate offence investigations. Each of these agencies and departments plays a fundamental role in the fight against ML and TF because of their role in predicate offending.

Department of Revenue Investigation (DRI)

355. Section 11 of ALPA provides that the Government shall establish an Asset Laundering Investigation Department “to investigate against and inquire into the offences under this Act.” By Gazette notice dated 4 August 2008 the Government provisionally designated the DRI as the competent authority. The DRI is competent for AML only given the fact that the ALPA only covers ML and not predicate offences, which are dealt with in numerous and various pieces of legislation, as spelled out in detail in section 2.1 of this report.

356. The DRI operates under the authority of Ministry of Finance. Its core objectives are:

- Customs related revenue leakage (income and excise tax collection and enforcement) under the Customs Act 2007;
- Foreign exchange enforcement, including illegal carriage of money and currency across the border under the Foreign Exchange (Regulation) Act 1962; and
- ML and TF (as TF is provided in ALPA) investigations.

357. The DRI has significant capacity constraints overall with only two out of 32 dedicated staff allocated to ML/TF investigations. Of the two staff allocated for ML and TF investigations one is a senior under-secretary and the other an investigation officer. This creates a serious effectiveness issue taking into account that 72 new investigations were opened in 2010 (see discussion at R 30 Resources, below).

358. DRI does not have forensic specialists in financial crimes. Nor do DRI’s investigators receive any special ML or TF training or other relevant training, such as training in financial investigation techniques and basic accounting methods.

359. In terms of TF investigations, although DRI is provided with a mandate to investigate TF, as was seen in Section 2 of this report, the ALPA offence of TF is deficient to the extent that it does not comply with the requirements of the FATF. Effectively Nepal does not have a TF offence and therefore the remit of the DRI to investigate this offence is problematic.

Other Agencies – predicate offences

Commission for Investigation of Abuse of Authority (CIAA)

360. The CIAA is an independent body established under Article 120 of the Interim Constitution and under the Commission for the Investigation of Abuse of Authority Act 1991. The CIAA has power to investigate corruption cases under the Prevention of Corruption Act 2002, the offences of which are contained in Chapter 2 and under the CIAA Act. The CIAA also acts an ombudsman, investigator and prosecutor. There are 100 investigators in the CIAA. Statistics from CIAA on complaints received and resolved or prosecuted are as follows:

CIAA Statistics		
Description	2008/2009	2009/2010
Total complaints	4,149	4,295
Total complaints decided	3,303	3,067
Investigations initiated	637	465
Prosecutions undertaken	50	27
Confiscation with Amount (NRps)	199,573,415.02	17,348,918.23
Corruption	36	19
Convictions	Unavailable*	110

*Nepal was able to provide total conviction figures for 2002 - 2008 as 478. Authorities did not isolate 2008/09 statistics

Nepal Police

361. The Nepal Police is the national law enforcement agency of Nepal. Most ML predicate offences under ALPA fall within the jurisdiction of the Nepal Police. There are 60,000 Nepal Police officers (the majority of which are located in the Kathmandu Valley) 2,376 of which are trained criminal/forensic investigators.

362. Nepal Police has a Financial Crimes Unit consisting of 35 specially trained officers. Training for these officers includes financial investigation techniques including forensic accounting. Recently, the Nepal Police unit investigated a significant case involving financial fraud through an assurance company. The Nepal Police has a Counter Terrorism Unit whose responsibility includes the investigation of terrorism cases. Despite not having anti-terror legislation, Nepal Police indicated that they investigate terrorism offences using criminal offences under “normal common-law” rules (e.g. explosive crimes, murder, theft etc...).

363. A second police force called the Armed Police Force (APF) consists of approximately 31,000 police personnel. The APF is a paramilitary force responsible for maintaining law and order, including border security, and dealing with national emergencies, including insurgency. The APF is also responsible for security of VIPs, vital installations and facilities as well as responses to riots and public unrest. APF may cooperate with Nepal Police on counter-terrorist operations but it does not conduct TF investigations.

Customs

364. The Customs Office is established under the Customs Act 2007 and is headed by the Director-General of Customs. Smuggling goods (an offence under the Customs Act) is an ML predicate offence under ALPA. Customs officers have authority under Chapter 8 of the Customs Act 2007 to search, seize, detain and arrest in the performance of their investigation powers – ss 34-42 of the Act. Officers also have forfeiture powers under the Act.

Securities Board of Nepal

365. The Securities Board of Nepal (SEBON) is the capital market regulator in Nepal. SEBON’s functions, duties and powers extend to the investigation of market-related crime, such as insider trading. Its department responsible for supervision and surveillance is staffed by two persons. SEBON’s has focused on regulatory compliance inspections, rather than criminal investigations. SEBON has never brought a prosecution for securities-related offences.

Ability to postpone or waive arrest

Department of Revenue Investigation (DRI)

366. DRI's powers, as the sole investigation agency responsible for ML and TF, are stated in the ALPA. However, the ALPA does not explicitly grant the power to postpone or waive the arrest of suspected persons and/or the seizure of the money for the purpose of identifying persons involved in such activities or for evidence gathering in investigating ML cases. Indeed, s 16 of ALPA states that the functions, powers and duties of an appointed or designated investigation officer shall include the obligation "to take necessary action by arresting the suspect promptly".

Customs, CIAA, SEBON and Police

367. Customs, Police, SEBON and the CIAA do not have the explicit authority to waive or postpone arrest, or waive seizure of funds during a predicate offence investigation pending further evidence gathering. Sections 25 and 30 of the CIAA Act actually makes the point clear about postponement of arrest, namely, once a complaint under the Act is received by the CIAA the investigating officer(s) must immediately arrest and seize documents. There is no discretion to wait for the result of the investigation.

368. Nepal Police authorities took the view that, even though the law does not specifically provide for the use of these techniques, it does not state that those techniques cannot be used and that they are therefore permitted under Nepal law. However, no statutory or constitutional provision was stated which supports this legal principle or position.

369. When questioned on this point, Police officials indicated that postponement and waiver of arrest are used notwithstanding their absence in a legal instrument. Customs was not clear on this point but none of the agencies were able to provide any statistics on the use of these investigative powers. In the absence of specific authority or precedent, it cannot be said that Nepal authorities have the legal power to postpone/waive arrest in the course of investigations. This is particularly so with respect to the CIAA.

Additional Elements - Special Investigative Techniques

Department of Revenue Investigation (DRI)

370. ALPA does not grant to the DRI any special investigative techniques such as authority to wire tap or undertake controlled deliveries with substituted evidence for investigative purposes. DRI officers did not argue (unlike the other agencies noted above) that the absence in law of these powers is irrelevant where there is no legal prohibition on their use. DRI also confirmed that they have not in fact engaged in wire-tapping or controlled deliveries in any investigation to date.

Customs

371. The Customs Act 2007 does not grant powers of wiretap or controlled deliveries to customs officers. No other forms of investigative techniques are provided for in the Customs Act.

CIAA

372. The CIAA Act 1991 provides that the Authority's functions, duties and powers shall be as provided by law. The Act provides many such powers, including powers to compel attendance of persons to answer questions (s 19(b)), to "demand clarification" from a suspect (s

15), to detain a person in order to preserve evidence (s 16), and to issue production orders (s 19(a)).

373. Under s 37 the Commission may frame Rules in order to implement the Act, and, pursuant to that power, has issued the CIAA Rules 2002. Rule 41 provides that employees or persons involved in the investigation of abuse of authority “shall have the power to possess and use scientific and communication equipment and devices as may be necessary according to order of the Commission.” When asked what this power encompasses, CIAA authorities indicated that it meant the Commission could issue orders for the use of wire taps on communication systems and devices in order to collect evidence. However, such powers are clearly beyond those expressly contemplated by the Act, which the Rules are required to implement. The Commission cannot grant itself special investigative powers beyond those conferred by the Act. And therefore the CIAA in law does not have the authority to issue wiretaps for the purpose of collecting evidence in relation to alleged offences under their Act.

Police

374. Powers conferred upon Police derive from the Government Cases Act 1992 (which confers upon police officials conventional powers of search and seizure), the Mulukai Ain (Country Code) 1963 (which regulates specific matters, such as authority to enter dwellings at night time) and crime-specific legislation, such as the Narcotic Drugs (Control) Act 1976 and the Human Trafficking Act 2007. The Evaluation Team was advised that there are 22 such specialist acts but that the Government Cases Act 1992 was the key repository of police powers of search and seizure. Indeed, powers conferred under the Human Trafficking Act 2007 are expressly limited to powers of search and seizure of buildings, land or vehicles, attendant powers to enter forcefully (if required), and powers of arrest.

375. Only the Narcotic Drugs (Control) Act 1976 appears to confer more expansive powers:

- Section 10A: If there is an order from Investigating Authority or Judicial Authority a Narcotic Drugs Control Officer, in the course of investigation of narcotic drugs, may use electronic taping devices on telephones, telexes, faxes or may take photographs and may “censor” (i.e., intercept) documents via mail delivery.
- Section 2(j1): defines “controlled delivery” or “controlled payment technique” as the technique of allowing narcotic drugs to remain in their original condition under the direct supervision of the Narcotic Investigation authority, with a view to identifying the final destination and recipient involved in the illicit traffic of those drugs from or through Nepal to other countries.

376. However, while that Act defines “controlled delivery” or “controlled payment technique” (second bullet point) the statute does not actually have an operative provision which permits its use in Police investigations. And, while Police said that they can, and do, use controlled deliveries despite its lack of legal basis, no statistics relating to the use of this technique were provided (despite the request).

Specialized Investigation Groups

377. Section 15 of ALPA empowers the DRI to appoint or designate any officer of the Government of Nepal or that of any public institution as an investigation officer under the ALPA to conduct investigation and inquiry of ML or TF offences under Act. DRI viewed this section as meaning it could accept the secondment of employees from other departments and has, for this purpose CIAA officials working in the AML unit in DRI.

378. Section 15, however, appears to be wide enough to permit the DRI to form special investigative inter-agency teams. Section 15 could be used to establish a cooperative inter-agency team with the Police, the latter of which might draw resources from its financial crimes unit. Whether used for this purpose rather than simple secondments into the DRI is a matter for the government of Nepal but it is a statutory mechanism for more effective use of inter-agency resources.

379. It is important to note at this point that there exists no formal mechanism for sharing information and/or evidence between the DRI and Nepal Police despite the important overlap between predicate offending and ML offending. Nepal authorities (both DRI and Police) were asked in this regard how they manage evidence issues associated with self-laundering. For instance, in the course of collecting evidence of predicate offending, the Police will inevitably secure evidence related to ML. However, since Police have no authority over ML investigation they must refer the ML issues and evidence to DRI. Neither Police nor DRI understood the risk associated with this point: i.e. the risk that in passing evidence back and forth there was a real risk that evidence could be lost, altered, or corrupted.

Recommendation 28

Production, search and seizure of financial and other records

Department of Revenue Investigation

380. Section 12 of ALPA provides a list of powers the DRI may use (as the responsible AML department) in the course of its investigation functions under the Act. Those powers include:

- Power to order reporting entities including government agencies defined as reporting entities under the Act, to submit to the DRI any relevant document, evidence or other required matters in their possession (s 12(a)); and
- Power to conduct a search of a reporting entity including another government department or agency in order to seize, take into their possession any relevant document, deed, material evidence or other evidence (s 12(b)).

381. Under ALPA s 14 the DRI can conduct any necessary investigations and inquiries if it receives information from any person, or the FIU, including under s10(1)(c) a dissemination of an STR, that any offence under this act is being committed, has been committed or is going to be committed. Section 14(2) states that the DRI, if it receives information that any offence under this act has, is, or is going to be committed, and there are reasonable grounds to suspect the person involved may abscond, destroy, hide or alter documents the DRI may seize documents or assets or arrest the person involved in the offence by conducting a search at the place where the offence was committed, being committed, or going to be committed.

Police and Customs

382. Police authorities also have search and seizure powers under s 10 of the Government Cases Act 1992. If Police have reasonable grounds to suspect that a person or place has any evidence in relation to a crime, they may search that person or place. According to Clause 8 of the Nepal National Code, the search may be authorised by a senior Police officer of, or above, the rank of Sub-Inspector. Searches do not require independent judicial approval (for instance a warrant by a justice of the peace or by a magistrate).

CIAA

383. The CIAA has legal authority under Chapter V of the Commission for the Investigation for the Abuse of Authority Act 1991 to engage in investigations and inquiries (s 13), or

preliminary probes in secret (s 14), into corruption under that Act and for this purpose its powers include:

- Order production of relevant files and documents of evidence (s 19(1) (a)); and
- Authority to search any place or to seize any object, document or file (ss 10 and 19(8)).

SEBON

384. Under the Securities Act 2007, SEBON has power to inspect documents (s 85), compel the production of documents (ss 86 and 103(3)), take depositions (s 103(3)) and detain persons in order to preserve evidence (s 104(2)).

Power to Take Witnesses Statements

385. DRI, Customs, CIAA, SEBON and Nepal Police each have legal authority to take witness statements as a part of their investigations. The Evidence Act provides the rules for their admissibility in evidence before a court.

Recommendation 30 (Law enforcement and prosecution authorities only)

386. The DRI has two departmental sections: (1) Investigation and (2) Administration. The DRI Investigation section has 52 staff with 32 investigators broken down as follows:

Allocation of Staff in DRI Investigation Section	
Department	Number of dedicated DRI staff
Revenue leakage/tax evasion	25
Foreign exchange	5
Money laundering /terrorist financing	2
Total	32

387. Of the two staff allocated for ML and TF investigations one is a senior under-secretary and the other an investigation officer. This creates a serious effectiveness issue taking into account that 72 new investigations were opened in 2010 (see table below).

388. DRI does not have forensic specialists in financial crimes. Nor do DRI’s investigators receive any special ML or TF training or other relevant training, such as training in financial investigation techniques and basic accounting methods. In July 2009, some officers had undertaken training in Australia, but this was of a generic nature and insufficient to meet the needs of financial investigators. DRI officials commented during the on-site visit that they are “severely suffering” and in “real need of training and resources” for this area of their enforcement work. Under the ALPA, DRI has authority to designate any government staff as an ML investigator. But to date it has not done so although it does have temporary staff seconded to it from the CIAA.

389. The Attorney-General is the country’s chief legal advisor and has the constitutional mandate to conduct criminal prosecutions on behalf of the State. The AG’s appointment is by the President on the recommendation of the Prime Minister. The Attorney-General holds office at the pleasure of the Prime Minister but can only be dismissed by the President.

390. The Attorney-General’s Office (AGO) has 244 counsel, 92 of whom are prosecutors. Prosecutors are appointed on the recommendation of the Attorney-General, Prime Minister or President. Persons are eligible for appointment if they hold a law degree and have completed

the “class three” public service examinations. These are examinations of an administrative nature that apply across the civil service. The levels rise to “class one”, after which there are “special classes”.

391. The AGO is responsible for prosecuting all criminal offences including ML and TF offences except where an agency has exclusive prosecuting authority (such as the CIAA). The AGO has a function to provide pre-prosecution advice to assist investigating authorities, including the DRI, in collecting and marshalling evidence in support of prosecutions. After the information report is lodged at the DRI, the investigation officer is required to forward the preliminary report to a government attorney and request necessary direction. The “investigation authority is required to obey the direction given by the Government Attorney in the course of the investigation.” (*Office of the Attorney General, Nepal*, pp.3-4, government publication)

392. The Office comprises a head office in Kathmandu and district offices outside the capital. Within the head office are four divisions, each headed by a special class officer at Deputy Attorney-General level. Responsibility for ML cases falls to the division that also has responsibility for corruption-related offences. This division is overseen by a Deputy Attorney-General and comprises eight prosecutors: three “class one” officers (“Joint Attorney”), two “class two” officers (“Deputy Attorneys”) and three “class three” officers.

393. None of the prosecutors has had training in ML or TF related prosecutions. The need for training was frankly acknowledged by Nepalese officials.

394. Nepal Police is sufficiently structured, funded and staffed compared to other agencies and is supported with adequate technical and other resources.

Integrity of Authorities

395. Under s 26 of ALPA, investigators and “any staff or person involved in the investigation and inquiry” should maintain the confidentiality of the information. As per rule 39 of the AML Rules 2009, the FIU is also responsible for maintaining confidentiality of information and documents. These provisions are mandatory for all officials of the FIU and the DRI and violation of these provisions may result in criminal penalties.

396. Similarly to FIU officials, DRI officials and most other law enforcement officials are public servants and under the Civil Service Act 1993. They are bound to maintain discipline, honesty, readiness, decent manner, impartiality, fairness and efficiency. The officials of investigative authorities also maintain professional standards and integrity.

397. At the time of the evaluation only very limited special training on ML or TF had been conducted for the judiciary which consisted of 4 hours of ML and TF awareness training in 2010 to the judges of the Special Court.

Statistics

398. Statistics on predicate offence investigations by the police and DRI were provided for the period 2007-2010 (see Section 1.2). Limited statistics were provided on the number of prosecutions and convictions for 2007-2010 on all or some ML predicate offences. Prosecutions for ML and TF cases are conducted by the Office of Attorney-General. The Attorney-General’s office also provides advice to the DRI during investigations. In the two years since its appointment, DRI has filed cases and secured convictions as follows:

ML and TF cases since 2008			
Classification	Cases Investigated by DRI	Cases filed in Court	Cases suspended
ML	73	1	2
TF	1		
Total	74	1	2

399. None of the ML cases investigated by DRI involved foreign predicate offences and by year these cases were assumed by the DRI for investigation as follows:

- 2008: 1
- 2009: 1
- 2010: 72

400. In terms of the one TF case under investigation, Nepal authorities did not provide information on the nature of the case except to say that three individuals are involved as persons under investigation. In terms of ages of the investigations Nepal provided the following statistics:

Age of cases	Number of cases
Older than one year	3
6-12 months old	19
3-6 months old	11
0-3 months old	41
Total	74

401. As can be seen, more than half the cases were considered by DRI in the 3 months prior to the evaluation on-site visit (September 2010). DRI informed the evaluation team that an additional 80 cases are currently being considered for investigation in relation to STRs filed with the FIU. These have not, as yet, gone to formal investigation. Of the cases that are under formal investigation, 30 are in an advanced phase – i.e., DRI is receiving the Attorney-General’s advice on how to proceed.

Effectiveness

402. Splitting the investigation of predicate offences across multiple agencies (Police, Customs, CIAA, SEBON, DRI) creates challenges to the investigation of ML including in relation to information-sharing and mechanisms to actually monitor and ensure the efficient exchange of information. No such obligations, powers and mechanisms exist in Nepal. For example, although the DRI has sole authority for investigating ML and TF, Nepal Police has sole authority for investigating the majority of predicate crimes to ML, yet there is no formal or informal inter-agency arrangement (such as a MoU) that would enable the efficient identification and sharing of information of mutual interest.

403. Given the close, and in most cases inextricable, link between predicate crimes and ML (e.g., self-laundering) problems will inevitably arise, and clearly have arisen.

404. The risk that most obviously arises in this setting is the failure to investigate clear cases of ML (or, once criminalised, TF). For example, the evaluation team was advised by CIAA that where it identifies evidence of ML it would refer that evidence to DRI but that, as at the time of the on-site visit, it had not referred any ML cases to DRI. However, the CIAA also

advised that, in its experience, proceeds of corruption are expended in a variety of ways—commonly in real estate. Such investments are obvious instances of ML that warrant referral for investigation.

405. Other problems are as follows.

- Real risk of delays in many cases, particularly given indications from prosecutors that ML should be prosecuted only once a conviction for ML has been secured. Police advised that they would handover evidence to DRI only once the investigation of the predicate had been concluded.
- Considerable risk, particularly given the (acknowledged) low level of technology used in investigations, that evidence may be lost when passed back and forth between investigating agencies.

406. The legislation governing key law enforcement agencies offers some avenues to redress these problems. For example, under the CIAA Act, the Authority may appoint “any employee of [the government of Nepal] or any institution, as investigation officer”. Similarly, as noted, under s 15 of ALPA the Asset Laundering Investigation Department (DRI) may “appoint or designate any officer of the Department or other officer of the Government of Nepal or that of any public institution as an investigation officer to conduct investigation”. Clear cases of corruption and associated ML might, therefore, be jointly investigated by investigators with dual mandates.

407. A further impediment to the efficient investigation of ML and predicate offending is the requirement under ALPA for Police to “obtain opinion of government attorney while conducting investigation and inquiry”: s 14(3). This provision is considered by prosecutors to invite excessive engagement by prosecutors with the investigative function. The requirement for AG sanction in terms of initiating investigations more broadly is not unusual (and serves to ensure appropriate allocation of limited investigative resources) but is usually expressed in terms that merely require the AG to “direct” investigation, rather than to proffer opinions on its conduct. The wording of s 14(3) was considered to impose considerable inefficiencies.

408. The requirement for AG sanction in this respect creates inefficiencies in any case unless there are mechanisms for ensuring there is no double-up in terms of sanctioning investigations into predicate offending and directly linked ML investigations. Again, administrative processes minimising this possibility should be effected.

409. Also relevant to effectiveness is the apparent understanding amongst law enforcement agencies that, despite their own powers in this regard, in order to get access to bank documentation, intervention by the NRB/FIU was required.

2.6.2 Recommendations and Comments

410. For effective investigation on ML and TF cases Nepal should:

- Establish a permanent AML Department (either within DRI or elsewhere).
- The AML department should establish a dedicated ML/TF Investigation Unit with posting sufficiently skilled officials.
- AML Department should develop and implement internal procedural manual as per Rule 40 of AML Rules to perform the task as assigned in the ALPA and AML rules.
- Specialized trained officials should be posted in the AML Unit. Staff posted in the AML Unit should have specialised training and adequate experience in ML/TF.

- DRI should be adequately resourced and all Law Enforcement Agencies should maintain comprehensive data to analyse the effective investigations, trends and typologies.
- Technical Committee may ensure the coordination among the investigation agencies and the FIU regarding the effective investigation mechanism.
- Specialized investigation techniques should be applied for ML and TF investigation procedure and laws and regulations should be amended to legalize the systems.
- Training programs on Financial Investigative Techniques and other specialized training programs should be organised for the Investigators regularly.
- All Law Enforcement Agencies should maintain comprehensive data on investigation, seizure of assets, confiscation and convictions. This may also be the remit of the prosecutors.

2.6.3 Compliance with Recommendations 27 and 28

	RATING	SUMMARY OF FACTORS UNDERLYING RATINGS
R 27	PC	<ul style="list-style-type: none"> • In the absence of TF offences, no clear designation of an investigation authority. • No proper investigation of ML & TF cases, more focus on revenue leakage cases. • Lack of specialized investigative techniques for proper investigation. • DRI does not have any legal authority to postpone or waive the arrest of persons or seizure of money for the purpose of identifying persons involved in ML. • DRI's lack of sufficient resources to properly undertake its ML and TF investigation function undermines effectiveness.
R 28	LC	<ul style="list-style-type: none"> • The power of seizing and searching of the financial records are not applicable for all the predicate offences.
R 30	PC	<ul style="list-style-type: none"> • No specialized training on ML investigation techniques and no training on TF investigation procedures. • The DRI is not adequately structured or sufficiently resourced. • Insufficient human resource in the AML Unit to conduct effective investigations.
R 32	PC	<ul style="list-style-type: none"> • Nepal does not maintain comprehensive statistics • No comprehensive data management by the LEAs. • No statistics from law enforcement agencies on any aspects of ML and TF.

2.7 Cross Border Declaration or Disclosure (SR IX)

2.7.1 Description and Analysis

411. Nepal has one international airport (Tribhuvan International Airport, in Kathmandu) and 30 land border crossings (29 with India and one with China). As Nepal is landlocked, there are no maritime entry points into the country.

412. The Nepal Tourism Board reported on 4 January 2011 that the number of visitors to Nepal in 2010 arriving via the international airport was 448,769²⁹ and that it expects that number to double in 2011 which is designated “Nepal Tourism Year.” This designation is a

²⁹ <http://www.news.com.au/travel/news/nepal-attracts-record-number-of-tourists-in-2010/story-e6frfq80-1225981457587>

push by the Government of Nepal to expand its tourism trade and industry and attract more visitors. There are no available figures on the number of persons crossing land borders in 2010 or in previous years.

Cross-border declaration system and bearer negotiable instruments

413. The Ministry of Finance and Customs Department have jointly issued a “Currency Declaration Form” applicable to foreign passengers entering the Tribhuvan International Airport in which those passengers are required to declare if they are carrying in excess of US\$5,000 or its equivalent in foreign currency. The term “currency” is defined in the Foreign Exchange (Regulation) Act 1962 (FERA) s 2(a) as:

...any kind of currency notes, postal orders, postal notes, money orders, cheques, drafts, travellers cheques, letters of credit, bills of exchange, promissory notes and credit cards, and this term also includes similar other monetary instruments as may be prescribed by the [NRB] by publishing and broadcasting a public notice.

414. “Foreign currency” is also defined to mean “currency other than Nepalese currency” (s 2(b)). Bearer negotiable instruments are not included in either of these definitions and the NRB has not prescribed bearer negotiable instruments as “currency” in accordance with the power provided in the definition.

415. Nepal authorities have indicated that the declaration form is issued under the authority of s 5 of the FERA. That section provides that:

5. Restriction on export or import of certain currency and bullion: (1) The Government of Nepal may issue an order by a Notification in the Nepal Gazette, thereby restricting the importing of or sending any certain type of Nepalese currency or foreign currency by any person, firm, company or body into or to the whole or any certain area of Nepal, without obtaining the license from the Bank. In issuing such an order, the Government of Nepal may specify in the order that such a restriction is not application to any person, firm, company or body or to any certain type of Nepalese currency or foreign currency.

(2) No person, firm, company or body shall, without obtaining the license from the Bank, carry or send any foreign exchange, except the Nepalese currency or any foreign exchange obtained from the licensee, outside any area of Nepal. Provided that, the Government of Nepal may, by a Notification in the Nepal Gazette, issue an order exempting any foreign exchange from such a restriction.

416. This section, however, is focused on the importation of foreign currency for the purpose of the business of foreign exchange transactions in Nepal. It is not focused on the detection of proceeds of crime or terrorist funds crossing the border into Nepal. This The FERA section stipulates that a license from the NRB must be obtained in order to import foreign currency for this purpose. Furthermore, the preamble to the Act clearly articulates the purpose of the Act, namely:

...to further regulate the foreign exchange related transaction [sic] in order to maintain the economic interests of the general public.

417. The primary purpose of the declaration form, therefore, is to regulate foreign exchange transactions within the framework of the Act and not generally to detect currency movements across the border or specifically to detect the movement of criminal proceeds. Consequently, ML and TF detection methods (more below) are lacking in this respect.

418. There are four important things to note in relation to the currency declaration form:

- Only non-Nepalis are required to complete it;
- It requires only foreign currency to be disclosed;

- It requires only incoming passengers to complete the form, there is no outgoing form;
- The border currency declaration form is only applicable at the International Airport.

419. Nepal does not have a currency declaration form applicable for land border crossings; any person crossing a land border into Nepal is not requested to disclose or declare if they are carrying any currency in any amount into the country.

420. Therefore, Nepali citizens carrying foreign currency into Nepal at the airport in excess of US\$5,000 are not required to complete the form. Moreover, the form does not require foreign passengers to declare if they are carrying Nepali currency into Nepal in excess of the equivalent \$5,000. Although the FERA prohibits the movement of Nepali currency outside the country, government officials in a number of departments acknowledged that because of the porous Indo-Nepal border there is undetected cross-border movement of Nepali currency in an unknown amount every year. It is easy for the currency to be transported on foot out of Nepal, laundered through a number of transactions, and then flown back in undetected by a foreign air passenger who has purchased the currency outside Nepal.

Detection methods

421. The Nepal Government has designated the Customs Department to monitor foreign passenger currency declarations at the international airport. All arriving passengers are requested to make a currency declaration, however, the declaration is deficient in number of ways:

- It does not require that passengers state whether or not they are carrying cash or currency above the threshold amount of US\$5,000. It simply requests that if the passenger is carrying that amount he or she must declare so.
- There is no statement on the form itself that legally requires passengers to complete the declaration form. Passengers are simply handed the form which on the reverse side states that “Travellers are required to declare foreign currency at red channel if the sum exceeds \$US5,000.”
- There appears to be no legal consequences for failure to truthfully complete the form. While the form is purportedly issued under FERA, that statute does not provide that it is an offence to falsely complete the form or not complete it at all.

422. On this last point Nepali officials have pointed to s 17 of the FERA as the offence provision for falsely completed declarations or for declarations not completed. But s 17 states that:

s. 17 (1): If any person does any act in contravention of this Act or Rules framed there-under or order or direction or circulation or Notification or any procedure as prescribed by the Bank, the foreign exchange related with the offence shall be forfeited and such a person shall be fined additionally from the amount in question to three fold of such amount in question.

423. This section does not prescribe an offence in relation to the cross border declaration form for two reasons:

- Section 17 provides that a person must contravene the FERA or its Rules (the declaration form is not contained in any section of the FERA or the Rules); or
- If not done in contravention of the FERA or the Rules, the person must contravene an order, direction, circulation or Notification issued by the Bank (NRB). The declaration was not issued by the NRB; it was jointly issued by the Ministry of Finance and Customs Department.

424. Accordingly, failure to complete, or truthfully complete, the border declaration form is not something that attracts any penalty. And, Customs officials and DRI officials have confirmed that they have never taken any action to secure punishment for such action.

False declarations

425. Under FERA s 11A, the Nepal government has designated DRI to inquire and investigate into offences under the Act and for this purpose to request and obtain further information from any entity, person or offender. A DRI investigation officer may conduct searches, issue warrants, arrest, detain and control or seize any object, keep in custody etc. However the primary purpose of the FERA is to enforce foreign exchange offences (as noted above) and not to enforce border currency reports. As mentioned earlier there are no specific offences in the FERA relating to falsely completed border reports or undeclared cash. Moreover, the Government of Nepal has confirmed that to date it not encountered any falsely declared forms.

Stop/restrain powers

426. Section 11B of FERA provides that “If there is adequate reason and ground to doubt that any person has any foreign exchange in contravention of this Act, the body of such a person may be searched by an employee of at least Gazetted second class by the order of the investigating officer.” But this section applies only in contravention of the Act, that is, when the foreign currency is imported without a proper licence issued by the NRB.

427. This point is strengthened by the fact that Nepali citizens arriving at the airport do not have to complete the declaration form, even if they are carrying foreign currency. Only foreigners must complete it and even then there is no penalty associated with falsely completing it (as noted above).

Record keeping

428. Customs officers confirmed during the on-site visit that they have very rudimentary or no record keeping of declaration forms.

429. When passengers arrive at the airport with the form it is handed to a customs officer. If the form is not completed the officer assumes that the passenger is not carrying any foreign currency above the threshold and the passenger is free to proceed over the border into Nepal. In some cases, the form is simply handed back to the passenger and the passenger leaves with the form in hand.

430. If the form handed to a customs officer does indicate that the passenger is carrying in excess of the threshold of US\$5,000 the customs officer may ask the passenger a series of questions to determine why. If satisfied that the currency is not the proceeds of crime, customs officials indicated to the evaluation team that the form is sent to the Customs central office in the airport where it is filed in a filing cabinet. There is no entry of the form data into an electronic data base.

Access to Information

431. Section 10 of ALPA permits the FIU to obtain data from governmental agencies which are prescribed as reporting entities by Gazette (s 2 ALPA). Customs is gazetted as reporting entity. The FIU issued an FIU AML Directive on 14 April 2010 containing a list of requirements for Customs and other government agencies in respect of ML and TF matters. The directive, however, requires Customs to report suspicious ML and TF activities only. Access by the FIU to Customs’ currency declaration information is not provided for in the directive. For this reason, there is no obligation on Customs to send information to the FIU if requested in

relation to border currency reports. Separately, the FIU and Customs have not entered into an MOU or other such instrument for the sharing of this information.

432. Not only is there is no legal obligation for Customs to send border currency declaration information, there is also no practice of forwarding it to the FIU. Both Customs and FIU officials have confirmed that no such information (albeit limited) has ever been forwarded to the FIU by Customs. Nor, for that matter, has the FIU ever requested such information.

National and international information sharing and cooperation

433. There is no arrangement for coordinated exchange of SR IX related information between domestic agencies in Nepal. And no cases involving information arising from a border cash report have been referred by the Customs to DRI. Moreover, there are no formal cooperation mechanisms with other countries and no statistics on providing any cooperation in this regard. No other country has requested customs held information in relation to border currency reports and Nepal has never made a request for the same to other countries or jurisdictions.

Confiscation

434. The declaration system is in place only for incoming passengers but not (as noted earlier for the purposes of ML and TF enforcement). Nepal Police have seized illegal and counterfeit Indian currencies on a number of occasions. Counterfeit currency is a predicate offence to ML. There is no mechanism in place to confiscate currency related to TF. Customs (and Immigration) authorities in Nepal are not familiar with the list of designated terrorists under UNSCR 1267 or any other foreign terrorist list. Immigration officials advised that they check Interpol lists only.

Movement of precious metals and stones

435. Cross border movement of gold, other precious metals and/or precious stones are not included in Nepal’s limited declaration system. Section 57 of the Customs Act 2008 provides taking the appropriate action against illegal importation and unusual cross-border movement of any thing including gold, precious metals and stones.

436. The Customs Act requires passengers to declare items carrying at the customs point. Import or export of restricted items and items without payment of duty should be seized and confiscated by the customs authority. The following are recent statistics relating to seizures:

Recent Seizure Cases of Gold & Silver (Custom)		
Date	Description of Seized Goods	Value of Seized Goods (NRps)
Apr 2010	Silver 40.855Kg	1,037,358.00
Aug 2010	Silver 4.8Kg	107,160.00
Aug 2010	Gold 700gms/plus US \$9,868.00	1,650,000.00 750,000.00

Additional elements

437. Nepal uses a declaration system only for the incoming passengers and it is not practiced in all of the customs ports. There is no procedure to inform passengers regarding the declaration system. Not all declaration forms are retained by Customs and those that are not shared with other government authorities. Nepal has not taken any specific measures to detect false declarations or specific measures to detect ML and TF.

Recommendation 30

438. The Customs Department is not adequately staffed, trained and funded. While the focus of activity for Nepal customs officials is at Tri00bhuvan International Airport, customs control and detection activities at land borders is almost entirely lacking. Moreover, technical and other resources, including AML/CFT training, are not provided to Customs authorities to fully and effectively perform their functions in relation to ML and TF.

439. Customs officials are public servants. Under ss 42(1) and 54B(1) & (2) of the Civil Service Act 1993 they are bound to maintain discipline, honesty, readiness, decent manner, impartiality, fairness and efficiency. Under s 65(c) of the Customs Act and 11G of FERA disclosing the secrecy of information is an offence. They are also bound by service code of conduct to ensure professional standards, integrity and confidentiality.

440. The Customs Department is responsible to control the revenue issues under Customs Act and some other duties designated by the Government under FERA, and they are not much aware about the ML/TF issues. The total number of customs officials is 1273 but no one has participated in any training programs on AML/CFT issues except a few participated in orientation program organised by FIU. As the Customs officials did not participate in any specialized training programs on AML/CFT, they are not following the required declaration procedures under this recommendation.

Recommendation 32 - statistics

441. The Customs department does not maintain comprehensive statistics and does not share information with other agencies. Despite the fact that not all cash declarations are kept by Customs, officials did provide the following information:

Recorded Foreign Currency Declarations at Tribhuvan Int'l Airport 2009/2010 - Customs Office					
2009			2010 (to Aug)		
Currency	No of Declarations	Total Amount	Currency	No of Declarations	Total Amount
USD	84	1,069,777	USD	60	799,239
Euro	33	359,540	Euro	33	2,82,185
GBP	4	29,915	GBP	2	640
CHF	3	50,800	CHF	2	7,510
JPY	4	5,269,000	JPY	6	44,12,000
SGD	1	12,000	NOK	1	37,000
AUS	4	20,100	RUB	1	1,200
BHAT	4	17,130	BHAT	2	16100
DHS	2	55,000	Dhiran	2	60,500
PAK	3	55,700	PAK	1	50,000
AED	1	12,000	PESO	1	10,000
KW	1	20,000	SF	1	6,400
HKG	1	4,700	Riyal	1	25,000
RMB	1	4,000	-	-	-

2.7.2 Recommendations and Comments

442. Considering the risk and vulnerabilities of cross border currency transportation to and from Nepal for ML and TF, Nepal should establish a comprehensive system to implement SR IX, including undertaking the following:

- identify false declarations or non declarations.
- Include all instruments defined as currency and bearer negotiable instruments in the declaration form and passenger, cargo and postal streams.
- Gold and other precious metals should be included in the declaration forms.
- Nepali Citizen should be included in the declaration system.
- Implement and enforce the existing declaration requirements for all the incoming and outgoing passengers.
- ensure effective monitoring mechanism for preventing illegal bulk cash smuggling with the exported or imported goods by covered van or lorry at the time of crossing the border.
- Customs should forward all the declared information to the FIU.
- Domestic and international cooperation should be ensured regarding information sharing.
- Customs authority should ensure electronic database for the currency movement and other precious metals movement information.
- The Customs Department should be adequately structured and supported by technical and other resources to perform its functions effectively to meet the requirements FATF standards.
- Nepal should fully implement the FATF Best Practices Paper for SR IX.

2.7.3 Compliance with Special Recommendation IX

	RATING	SUMMARY OF FACTORS UNDERLYING RATING
SR IX	NC	<ul style="list-style-type: none"> • Declaration system lacks legal basis. • Applicable for the incoming passengers only at the (one) international airport. • Not all entry points to Nepal are covered by the declaration systems. • Bearer negotiable instruments are not covered in the declaration system and not included in the declaration form. • Does not cover Nepali currency. • Does not cover Nepali citizens, only foreigners. • Gold, precious metals are not covered in the declaration form. • Customs Department does not share the information with FIU. • No effective coordination between Customs Department and FIU. • Lack of effective implementation of declaration system. • No effective monitoring system is in place for controlling bulk cash smuggling and cross border illegal movement of gold, precious metals and stones. • No system is in place for confiscating currencies pursuant to UNSCRs sanction lists.
R 30	PC	<ul style="list-style-type: none"> • Customs is not adequately structured with sufficient human and technical resources • No training programmes arranged for customs officials. • No training programs have been conducted to implement the requirements under SR IX. • No comprehensive data management in Customs.

R 32	PC	<ul style="list-style-type: none">• Nepal does not maintain comprehensive statistics.• Effectiveness:<ul style="list-style-type: none">○ statistics on cross border currency movement only available from the Tribhuvan International Airport

3. PREVENTIVE MEASURES - FINANCIAL INSTITUTIONS

Scope Issues

443. In Nepal financial institutions are required to comply with a host of obligations contained in the ALPA and AML Rules and sector-specific Directives issued by the FIU. Under s 2 of ALPA the following financial institutions have AML/CFT-related obligations:

- Class A, B, C and D licensed institutions (commercial banks, development banks, finance companies, and micro-finance institutions);
- Cooperatives;
- Licensed foreign exchange dealers;
- Licensed money remitters;
- Insurance companies; and
- Securities companies/dealers (excluding commodities brokers).

444. The exclusion of commodities brokers and postal savings banks from ALPA is not based on a formal risk assessment of the sector.

Law, Regulation and Other Enforceable Means

General

445. The AML/CFT obligations under Recommendations 5, 10 and 13 must be set out in law or regulation. Law or regulation refers to primary and secondary legislation, such as laws, decrees, implementing regulations or other similar instruments, issued or authorised by a legislative body, and which impose mandatory requirements with sanctions for non-compliance. Further AML/CFT obligations must be detailed in “other enforceable means” (OEM). OEM refers to guidelines, instructions or other documents or mechanisms that set out enforceable requirements with sanctions for non-compliance and which are issued by a competent authority (e.g., a financial supervisory authority) or an SRO.

446. In Nepal the relevant instruments with respect to Recommendations 5, 10 and 13 are:

- ALPA: this is primary legislation issued by the Nepal Parliament.
- AML Rules: these rules are issued by the Nepal government under the authority of ALPA s 46 which permits the Government of Nepal to frame Rules for implementation of the objectives of ALPA.
- FIU AML Directives: these Directives are issued by the FIU under the authority of s 10(3) of ALPA and AML Rule 7. Those provisions empower the FIU to issue necessary Directives to the concerned banks, financial institutions and non-financial institutions “about the method, form, time, and other procedures regarding reporting of details, statistics, notices and information” related only to suspicious transaction reports and threshold transaction reports.

Analysis

Asset (Money) Laundering Prevention Act 2008

447. Chapter 3 of ALPA requires banks, financial institutions and non-bank financial institutions to maintain clear records of the identity of persons who establish any kind of business relationship with banks, financial institutions or non-financial institutions. This information must include full names, citizenship or passport information and addresses. Other identifying information is required under s 6(2). Customer information must be kept in separate files (s 6(3)). While the language of ALPA, chapter 3 is mandatory, the Act contains no penalty provisions for non-compliance.

Asset (Money) Laundering Prevention Rules 2009

448. The Asset (Money) Laundering Prevention Rules 2009 (AML Rules) were published in the Nepal Gazette on 12 October 2009 under the authority of s 46 of the ALPA. The rules are effectively regulations as they are issued by the Government of Nepal under statutory authority. Chapter 4 of the Rules provides that in addition to the obligations prescribed in ALPA, reporting institutions shall maintain records or transactions as prescribed by the FIU, update customer profiles of existing customers as prescribed by the FIU and submit those records to the FIU within 5 years, and maintain separate confidential records of STRs. However, the AML Rules suffer from the same deficiency as the ALPA: the rules contain no penalty provisions for non-compliance by reporting institutions.

FIU AML Directives

449. The FIU is empowered under s 7 of the AML Rules to issue Directives “for the purpose of controlling the offence” and “in a way that does not contradict with the Act and these Rules”. Under s 7 of the AML Rules, the FIU may issue Directives in relation to CDD, identification of suspicious transactions, modes of STR reporting, records of transactions and business relationships, “diligence on and control of the transaction and internal inspection” and other necessary matters.

450. Since 2009, the FIU has issued 12 Directives to reporting institutions (collectively referred to in this report as “FIU AML Directives”) as follows:

- AML Directives to Banks and Financial Institutions, 2009 (17 Aug 2009) (FIU AML Bank Directive 1)
- AML Directives (2) to Banks and Financial Institutions, 2010 (14 April 2010) (FIU AML Bank Directive 2)
- AML Directives to Money Remitters/Transferors, 2009 (1 Dec 2009) (FIU AML Money Remitter Directive 1)
- AML Directives (2) to Money Remitters/Transferors, 2010 (14 April 2010) (FIU AML Money Remitter Directive 2)
- AML Directives to Money Changers, 2009 (1 Dec 2009.) (FIU AML Money Changers Directive 1)
- AML Directives (2) to Money Changers, 2010 (14 April 2010) (FIU AML Money Changers Directive 2)
- AML Directives to Casinos, 2009 (1 Dec 2009.) (FIU AML Casinos Directive 1)
- AML Directives (2) to Casinos, 2010 (14 April 2010) (FIU AML Casinos Directive 2)
- AML Directives to Cooperatives, 2010 (14 April 2010) (FIU AML Cooperatives Directive)

- AML Directives to Government Agencies, 2010 (14 April 2010) (FIU AML Government Agencies Directive)
- AML Directives to Insurance Sector, 2010 (1 July 2010) (FIU AML Insurance Directive)
- AML Directives to Securities Sector, 2010 (1 July 2010) (FIU AML Securities Directive).

451. These Directives are all effectively worded the same and cover the following matters:

- CDD and KYC;
- Reporting forms and reporting procedures;
- Risk based approach and risk categorization;
- Ongoing monitoring;
- Management responsibility of reporting institutions;
- Internal control mechanism and internal guidelines and its application;
- Responsibilities of compliance officers;
- Confidentiality of information;
- Internal training programmes; and
- Record keeping requirements.

452. Each of the Directives contain common clauses which state the following:

Financial Information Unit may impose a penalty [on] reporting institutions as provided in ALPA for failing to provide within stipulated time the information which [is] required to be submitted to the FIU as per the Act, Rules, By-laws, Directives or orders.

Action shall be initiated pursuant to the Asset (Money) Laundering Prevention Act against those breaching the provisions of the Asset (Money) Laundering Prevention Act and the rules, By-laws, Directives or order issued under the Act.

453. The first penalty clause relates to failure to comply with threshold transaction report (TTR) and STR filing requirements of ALPA s 31. It does not relate to CDD, KYC, record keeping or any other preventative measure. The second clause is vague. Nothing in the ALPA or in the AML Rules provides the FIU with additional punitive powers and so whatever “action” is contemplated is unclear but cannot include punitive or fining powers. It must relate solely to administrative action such as training, etc, on the basis that the FIU cannot issue Directives that “contradict the Act or the Rules” (AML Rules s 7). If the Act or Rules do not contain specific penalty provisions for non-compliance, then neither can FIU AML Directives – the FIU cannot grant itself a sanction power not provided for by the Parliament or Government.

Requirements in Other Directives

454. In 2006, the Nepal Rastra Bank (NRB) issued Directive 19/067 on customer record keeping requirements for banks. It was issued first under NRB Act s 110(3), which empowers the NRB Governor to issue any order, direction, procedures, and guidelines under the NRB Act. According to Nepal government authorities, it was later re-issued under s 79 of the NRB Act, whereby the NRB is granted the authority to regulate the function and activities of banks and to issue rules, by-laws, Directives, and circulars. Under s 79(5) of the same Act, the NRB is granted the power to enforce those instruments; to revoke licenses of banks; take over bank operations; to inspect and supervise banks; and to issue orders to bank officials to provide any necessary information. The Nepal government provided the evaluation team a copy of the Directive issued under s 110(3), but not the re-issued Directive under s 79 of the NRB Act. The NRB is also granted the authority under the NRB Act s 82 to furnish transactional information

as required by the NRB. Violations of Directives issued by the NRB are punishable by confiscation of assets related to the offence, fines up to three times the assets' value, and imprisonment of up to three years.

455. Insurance regulations and the Insurance Board Inspection Manual also do not include CDD requirements, inspections for AML/CFT requirements, or penalty provisions for failure to perform CDD. Collectively, this suggests that industry participants are performing CDD as a best practice in order to reduce risk, not due to a legally enforceable mandate. The Nepal government has not yet conducted KYC inspections of any insurer and Insurance industry representatives claimed not to have received any training by the Nepal government on ALPA requirements yet. Absent an amendment to ALPA or issuance of a specific directive by the Insurance Board under its authority under the Insurance Act, insurers will not likely face legally enforceable CDD requirements. While s 8(d)(1) of the Insurance Act 1992 permits the Insurance Board to issue Directives to insurers, and the Insurance Board could use this provision to issue enforceable specific Directives on CDD, it has not yet done so.

Summary of status of regulatory instruments

456. ALPA, the AML Rules, and FIU AML Directives do not include penalties for violations of any of their requirements. Due to the absence of such provisions in ALPA, under which both the rules and Directives were issued, the CDD requirements are not legally enforceable and accordingly, are not subject to sanction for non-compliance.

457. Further, since the FIU AML Directives were issued under s 10(3) of ALPA, the Directives' scope may not go beyond providing prescriptions related to STRs and TTRs. The requirements in those Directives related to customer due diligence are therefore not legally enforceable because they are not authorised under the underlying statute (ALPA). Even if the FIU were to enact new rules or Directives, CDD would not be enforceable under the ALPA unless it is amended. These Directives therefore cannot be considered as OEM.

458. If issued under the NRB Act, the provisions of Directive 19/067 are likely enforceable and potentially subject to sanction for non-compliance under the NRB Act. Without more information, however, the evaluation team could not determine whether Directive 19/067 is regulation or OEM. It is unclear how, in practice, these provisions would be enforced and Nepal officials provided no information in this regard. Regardless, however, this directive does not apply to non-bank financial institutions. The following table provides a snapshot of each legal instrument:

Summary of Instruments setting out AML/CFT Preventative Measures			
Instrument	Description	Enforceability	Law / OEM / Other
ALPA	This is primary legislation issued by the Nepal Parliament.	The language of ALPA Chapter 3 is mandatory, but the Act contains no penalty provisions for non-compliance	Law (but unenforceable for CDD)
AML Rules	Issued by the Nepal government under the authority of ALPA s 46 to frame Rules for implementation of the objectives of ALPA	AML Rules contain no penalty provisions for non-compliance by reporting institutions	Law (unenforceable regulation)
FIU AML Directives	Issued by the FIU under the authority of s 10(3) of ALPA and AML Rule 7 which empower the	Nothing in the ALPA or in the AML Rules provides the FIU with	Other

	FIU to issue necessary Directives to banks, financial institutions and NBFIs related only to STRs and threshold transaction reports.	additional penalty imposing powers. FIU cannot issue Directives that “contradict the Act or the Rules” (AML Rules s 7).	
NRB Directive 19/067 on recordkeeping	Issued under NRB Act which gives NRB the power to regulate and enforce compliance with its Directives.	Enforceable	OEM

Scope of Coverage

459. Gaps in implementation of preventative measures exist as Postal banks are excluded from the definitions of banks (Class A) and other financial institutions (Class B, C, and D) (collectively “banks” hereinafter) covered by ALPA. According to government officials, postal savings bank offer account services to government officials in rural areas only. There are 117 postal savings bank branches in Nepal providing banking services to 46,981 government officials with total deposits of NRps 1.1 billion (US\$14.7 million).

460. Because ALPA’s definition does not include postal banks within its definition of financial institutions, postal banks do not have any CDD obligations under the statute. Nepal has not conducted any analysis of TF and ML risks posed by postal savings banks. In a country with high rates of corruption, an average GDP per capita of US\$446, and a history of insurgency, postal savings banks with maximum deposits of US\$20,000 and no CDD could face significant risks. This gap is consistent across the range of preventive measures set out in the ALPA and will not be repeated throughout the analysis.

3.1 Risk of money laundering or terrorist financing

461. As noted in Section 1 of this report, Nepal’s formal financial sector is underdeveloped with low levels of automation and computerization. Authorities are aware of the ML and TF related risks associated with this sector and with the informal financial sector. Under current legislation there is no requirement for institutions to adopt a risk-based approach to AML/CFT. FIU issued Directives appear to require banks and other reporting institutions to adopt a risk based approach to ML and TF but as noted these Directives are not binding.

462. The FIU AML Directives are neither law nor OEM and do not include enforceable CDD requirements. A summary of each of the directives and the NRB Directive 19/067 and their enforceability is provided below:

Directive	CDD Requirements Enforceable?	Law or OEM?
FIU AML Bank Directives	No	No
FIU AML Cooperatives Directive	No	No
FIU AML Securities Directive	No	No
FIU AML Insurer Directive	No	No
FIU AML Money Remitter Directives	No	No
FIU AML Money Changes Directives	No	No

463. Commercial banks, development banks, and finance companies are permitted to offer the most banking services, including deposit-taking, loans, financial leases, transferring funds, credit cards, derivatives trading, and securities issues. In addition, commercial and development banks can issue financial guarantees and foreign exchange/trading. Given the number of services they are permitted to offer, the unenforceability of CDD requirements under the FIU AML Bank Directives, and a lack of an AML/CFT compliance culture, commercial and development banks and finance companies all face a high risk of exploitation by money launderers. Commercial banks, at present, are likely to be in a better position to identify individuals engaged in ML because their AML standards, to the extent they exist, are likely more developed due to higher number of connections with foreign banks for correspondent accounts. No banks of any category appear well-poised to confront exploitation by terrorist financiers.

464. The number of active life and non-life insurance policies active in Nepal is 1.19 million - and many were issued before ALPA. 70 to 80% of life insurance policies are estimated to be NRps 100,000 (US\$1,388). Insurance companies have also begun to offer single premium life insurance policies that may be purchased and surrendered after two years. Nepal authorities did not provide information on the aggregate size of the overall insurance market, a breakdown of the number of life and non-life policies, or on limits of high-value insurance policies. The evaluation team was provided no details on the number of outstanding single premium life insurance policies or the rationale for permitting them in the Nepal market, given their higher risk of ML.

3.2 Customer Due Diligence, Including Enhanced or Reduced Measures (R 5 to 8)

3.2.1 Description and Analysis

Recommendation 5

Anonymous Accounts

465. Anonymous and fictitious accounts are not permitted under Nepal law and violations of these provisions are subject to sanction under the NRB Act, despite the FIU AML Directive customer identification requirements being unenforceable.

Banks (comprising Class A, B, C, and D institutions)

466. Banks are required under s 6 of ALPA to maintain a clear record of the identity of persons and obtain records verifying customer identities while establishing any kind of business relationship or transacting above certain thresholds. As defined in s 3 of the Anti-Money Laundering Directives to Banks and Financial Institutions dated August 17, 2009 (FIU AML Bank Directive 1), the thresholds are:

- Credit and Debit Transactions: Nepali Rupees (NRps) 1 million (US\$13,514);
- Payment and remittances: NRps 1 million (US\$13,514);
- Foreign Exchange Transactions: NRps 500,000 (US\$6,757).

467. Individuals and entities are also explicitly barred under s 3 of the *Banking Offence and Punishment Act* (BOPA) from opening an account by submitting false documents or in the name of a fictitious or other person, “except as otherwise permitted by the laws.” Similarly,

banks are forbidden from knowingly allowing the opening of an account through false documents or in a fictitious or false name. FIU AML Bank Directive 1, s 1 requires that banks clearly identify customers and obtain customer identification documents when opening accounts and conducting transactions, regardless of the threshold. Banks are obligated to determine whether documentation is currently available and if not, to obtain it.

468. Directive 19/067 requires banks to obtain customer identification information including a clear name and surname of account holders.

469. Violations of the customer identification programs (CIP) required by ALPA and the FIU AML Bank Directive 1 are unenforceable because ALPA's penalty sections do not spell out any penalties or even reference the CIP section of ALPA. As a result, no penalties for ALPA CIP violations currently exist under Nepal law. At the same time, the BOPA prohibition on fictitious and false accounts, whose violation is potentially subject to a 10,000 NRps (US\$135) fine, would still permit the existence of anonymous accounts because anonymous accounts are not technically fictitious or false. Moreover, Nepali officials could not explain BOPA's allowance of fictitious accounts when "otherwise permitted by the laws." However, since Directive 19/067 was issued under the NRB Act and is enforceable, anonymous and fictitious accounts are illegal in Nepal and violations of this prohibition would be subject to sanction.

Securities

470. Securities firms claim that they regularly request customer identification. Securities firms may not open accounts for or transact with anonymous or fictitious account-holders, but such mandates are currently unenforceable under Nepal law. Securities industry participants uniformly said that numbered accounts are not allowed nor found in practice.

471. Securities firms are covered by ALPA and have the same obligations to identify and verify the identities of customers as banks when opening accounts and conducting transactions above certain thresholds. Pursuant to the FIU AML Securities Directive 1 securities-related businesses are required to verify existing customer identities and obtain documentation by June 30, 2012. These requirements, however, are unenforceable.

472. Rule 29 of the Securities Person (Broker, Dealer and Market Maker) Regulations of 2008 require stockbrokers to obtain natural person and corporate customer identification information before conducting transactions. The Securities Board of Nepal has prescribed a Client Identification Form and Client Identity Card through a circular to be prepared by the stockbroker, a copy of which the customer receives.

473. Stockbrokers that knowingly or with mala fide intent fail to obtain such information can be fined from NRps 50,000 (US\$697) to NRps 200,000 (US\$2788). Securities Acts s 97 on misleading statements and s 98 on fraudulent transactions, permit fines between NRps100,000 (US\$1,351) and NRps300,000 (US\$4,054) and/or imprisonment up to two years for individuals that entice others to buy or sell securities by intentionally hiding any fact or information with malign intent, making any misleading statement with mala fide intent subject to fines. These latter provisions could permit the Nepal Securities Board to take punitive action against customers, if not firms, that intentionally provide false information on their identities. As of September 2010 no such action had been taken.

Insurance

474. The FIU AML Insurance Directive requires that insurers obtain and verify specific customer identification information, making anonymous and fictitious accounts illegal. Insurers are given two years to obtain documentation for existing clients. As in the cases of banks and

securities firms, these provisions, however, are presently unenforceable. In addition, the Insurance Act 1993, the Insurance Regulation 1993, and the Insurance Board's 2008 On-Site Inspection Manual are all silent on customer identification and CDD requirements.

475. Representatives of the insurance industry that the assessors met stated that they, in all cases, collect customer identification information and claimed that anonymous and fictitious accounts do not exist because insurers required detailed information before underwriting and paying out policies. They also noted that their policy applications (1) all require customer identity information and verification, (2) must be approved by the Insurance Board, and (3) are modelled on the best practices laid out by the International Association of Insurance Supervisors.

476. Insurers interviewed during the on-site visit stated that, as representatives of a risk-adverse business, they as a matter of course require customer identification information. Numbered accounts, according to industry representatives, are not permitted. Based upon interviews, the extent of verification of customer identification documents, however, is unknown. Industry players acknowledged that two years may be insufficient to collect customer identification documents of all existing clients, suggesting the strong possibility that customer verification was not routinely practiced in the past. Further, without revision to ALPA applying penalties on CDD (and/or promulgation of regulations directly by the Insurance Board under its powers granted by the Insurance Act) on CDD and related penalty provisions, prohibition on anonymous and fictitious insurance policies will remain unenforceable.

When CDD is Required

477. ALPA s 6 requires that all banks, financial institutions and non-bank financial institutions obtain and maintain clear records of the identity of a person when establishing (1) any kind of business relationship; or (2) while transacting with a person above a certain threshold, either in a single transaction or a series of transactions as prescribed by Nepal Rastra Bank (NRB). CDD is not dependent upon doubts about identification or suspicions of ML or TF.

478. FIU AML Bank Directive 1, s 1, requires customer identification and verification when a financial institution establishes any type of business relationship or transactions with the customer. FIU AML Directives set out when and how to obtain customer identification information. FIU AML Bank Directive 1, s 1, requires customer identification and verification when a financial institution establishes any type of business relationship or transactions with the customer. The FIU AML Directives also provide thresholds at or above which, customer information must be submitted to the FIU. Thresholds in all cases fall below the FATF maximum of €15,000.

Banks (including Class A, B, C, and D Institutions)

479. FIU AML Bank Directive 1 requires banks to obtain documents on the identity of customers for establishing any type of business relationship with a person. This includes account openings; loans; foreign currency transfers; remittances; wire transfers and payments; and currency transactions. FIU AML Bank Directive 1, s 1(3), requires banks to verify the customer's documents and to update records for existing clients, while s 1(4) obliges these institutions to assign staff in every office and branch to certify such documents.

480. Directive 19/067 mandates that banks obtain customer information when opening accounts, making loans, preparing foreign currency drafts, wiring or receiving funds or doing any business involving money, such as letters of credit.

481. According to the government and bank officials, the collection and verification of customer identification information for all customers regardless of the amount transacted is required for all existing customers, all new account holders, and all individuals who transact through the bank. Officials from both the public and private sectors could not explain the discrepancy between ALPA, which requires identification and verification in the case of establishing a relationship and conducting transactions above threshold amounts, and FIU AML Bank Directive 1, which mandates identification and verification in all circumstances.

482. In contrast to the CDD requirements mandated by the ALPA and amplified by FIU AML Bank Directive 1, the CDD requirements of the 2005 Directive 19/067 of NRB appear enforceable because they were issued by NRB, not the FIU. While the evaluation team was not provided an explanation under what statute the 2005 Directive was issued, it was led to believe that it was issued under the authority granted to NRB under the NRB Act. The 2005 Directive 19/067 requires that all banks must obtain customer identification for opening accounts, loans, foreign currency drafts, wire transfers, and currency services. The 2005 Directive also requires that a separate procedural mechanism be created for accounts in which money is received above NRps 1 million (\$US13,513). No thresholds for customer identification, however, are imposed. The Directive also appears to cover walk-in customers for wire transfers.

483. **Assessment of CDD effectiveness for Banks (Class, A, B, C, D institutions):** Since ALPA, the AML Rules, and FIU AML Bank Directive 1 lack enforcement provisions, the CDD requirements for banks under ALPA are not enforceable. Even if the FIU were to enact new rules or Directives to banks, CDD would not be enforceable under ALPA unless it is amended because the AML Rules and FIU AML Bank Directive 1 derive their authority from the statute. As discussed above, the CDD requirements for banks, however, under NRB Directive 19/067 are enforceable because it was issued under the NRB Act.

484. The evaluation team only interviewed Class A commercial banks. These banks, both private and public, stated emphatically that even prior to the existence of ALPA, they required customer identification information to verify the identity of clients. Several banks also provided AML policies drafted before ALPA and FIU AML Bank Directive 1 whose CDD requirements are modelled on the 2005 Directive. In light of the 2005 directive and the AML policies presented to the evaluation team, it is judged likely that Class A financial institutions likely have been performing some form of CDD since the issuance of the 2005 Directive.

485. The extent of compliance by Class B, C, and D institutions with the 2005 Directive, ALPA, or FIU AML Bank Directive 1 is unknown, but is judged less likely—many officials and fellow bankers described the Class B, C, and D institutions as well behind commercial banks in their AML/CFT compliance. Only three STRs, in fact, had been filed by Class B, C, or D banks, as of September 2010, suggesting limited understanding or compliance with FIU AML Directives.

486. For customers opening accounts before at least 2005, adequate CDD may not have been performed and may not have yet been performed. It may take Nepal the full five years allocated under the ALPA, not merely the shortened timeframe of two years under the FIU AML Bank Directives, to conduct adequate customer verification because of the remoteness of many bank branches and illiteracy of many customers.

Cooperatives

487. Cooperatives licensed by NRB are obligated, pursuant to FIU AML Cooperatives Directive 1, s 1.1 to identify and verify the identity of members that are opening accounts, receiving loans, or engaging in any transaction.

488. The Department of Cooperatives informed assessors that it had also issued CDD requirements “two to three” years ago, but did not provide copies of the directive. According to the Department, all savings and loan cooperatives are obligated to perform CDD and failure to perform CDD is subject to penalty under the Cooperatives Act 1991.

489. **Assessment of CDD effectiveness for Cooperatives:** Implementation of the CDD requirements for cooperatives faces severe constraints for reasons that go beyond the unenforceability of the Cooperative Directives’ CDD obligations due to the lack of enforcement provisions for CDD in ALPA. While 15 cooperatives have been licensed by NRB to provide banking services, there are 5,612 savings and lending cooperatives authorised by the Department of Cooperatives. Such cooperatives, as of April 2010, had capital and savings equal to NRps 28.9 billion (US\$392 million). According to Nepal government officials, all savings and lending cooperatives are covered by the FIU AML Cooperatives Directive’s CDD requirements. Nepal authorities agree that there is a lack of resources to effectively monitor all of cooperatives. There are 11 staff at the FIU and 17 at the Department of Cooperatives (responsible for oversight of all savings and lending cooperatives). This number is insufficient to conduct effective monitoring.

490. The vast majority of cooperatives, as of the date of the evaluation, had received no training on AML and CDD issues. Further, while the Cooperatives Department shut down 153 cooperatives last year and fined cooperatives NRps 1,028,084 (US\$13,983) for (1) failure to submit reports, (2) not holding a General Assembly meeting, and (3) not performing an audit or submitting an audit report on time, no fines had been levied for failure to perform CDD. This suggests that enforcement of CDD under the past Department of Cooperatives Directive or the FIU AML Cooperatives Directive is not a priority. Even if it were, the maximum penalty for non-compliance is NRps 15,000 (\$203), which is not dissuasive.

491. Representatives of cooperatives interviewed by the evaluation staff indicated that they only required CDD when members joined the cooperative or when members cashed checks of over NRps 500,000 (US\$6,757). Otherwise, representatives did not check identification for transactions because they said they know all of the customers given the small size of many cooperatives. If the representatives interviewed are any indication, many cooperatives in Nepal do not require CDD after accounts are established or high-value checks are cashed.

Securities

492. FIU AML Securities Directive 1 issued under ALPA in July 2010 requires securities firms to obtain identification information from all customers when maintaining a business relationship or conducting any transaction with an individual or institution. Securities firms are required to verify identification information for all pre-existing customers and have two years to update records from the date of the directive. They are also obligated to appoint compliance staff in every branch and office and have the right to instantly decline to conduct any transaction or establish business relationship with anyone who fails to provide necessary information. Copying verbatim from previous Directives, the FIU AML Securities Directive 1 states in s 2 that “where the establishment of a business relationship may not be denied owing to prevalent of an otherwise circumstance, the transactions with such customer shall be treated as doubtful and submit the particulars submitted to the Financial Intelligence Unit as per Annex 3 [STR form].”

493. **Assessment of CDD effectiveness for Securities:** The CDD requirements of the FIU AML Securities Directive are unenforceable due to the deficiency of ALPA discussed above. Beyond this, the knowledge of the Directive’s requirements by securities firms appears to be low. While the Nepal Securities Board had received basic AML training, many securities-related firms had not. Moreover, one interviewed firm clearly covered under ALPA and the FIU

AML Securities Directive 1, according to the Nepal government, told assessors that it had appointed a compliance officer and was collecting CDD information, but believed that ALPA and the FIU AML Securities Directive did not apply to its business. Interviewed securities firms also lacked written AML procedures, though many have appointed compliance managers after enactment of the FIU AML Securities Directive.

494. The Securities Board has also never issued fines or penalties due to failure to perform CDD despite the fact that there are 180 listed companies on the Nepal Stock Exchange with value in September 2010 of nearly NRps 86 billion (US\$1.16 billion) and the Board's own Directives require CDD. With no written manual for inspections and a skeletal staff of 40 individuals, the Securities Board lacks the ability to effectively enforce any CDD provisions.

Insurance

495. FIU AML Insurance Directive, issued under ALPA, requires that insurers, agents, surveyors and brokers, while insuring life or goods, obtain and verify CDD information from all applicants. Insurance companies and representatives have two years to update their records for pre-existing members.

496. Insurance companies and representatives are given the right under s 2 of their directive to decline to conduct any transaction with or maintain a business relationship with anyone who fails to provide required information. When the business relationship cannot be denied "owing to the prevalence of an otherwise circumstance," a phrase the Nepal government could not explain for any industry, insurers must file a STR.

497. Insurers and their representatives must file transaction threshold reports with the FIU within seven days for life insurance policies of NRps 100,000 (US\$1,351) or more that must be paid in a year or for non-life insurance policies for which the premium of NRps 300,000 (US\$4,054) or more must be paid in a year. Insurers and their agents, brokers, and surveyors must also adopt a procedural mechanism to account for such policies.

498. STRs must be filed regardless of the amount or whether the transaction is believed to relate to ML or terrorism. None have been filed to date.

499. **Assessment of CDD effectiveness for Insurance:** Members of the Nepal government and the insurance industry stated that they generally followed CDD requirements prior to the existence of ALPA and assessors were provided with copies of forms approved by the Insurance Board for use by insurance industry players. These forms request detailed customer identification and verification information. These include questions on income, with some insurers requesting proof of income for policies above certain thresholds which vary by insurer (NRps 2.5 million - US\$34,722 - for life insurance in the case of one interviewed firm).

500. The CDD requirements under ALPA are unenforceable. Even if insurance agencies follow them as a matter of best practice, implementation of the CDD requirements under ALPA could take more than the required two years, according to insurance industry participants, as over 1.19 million life (718,000) and non-life (476,000) policies are active in Nepal and many were issued years before ALPA. Estimates varied considerably on how long comprehensive updating of records in compliance with the FIU AML Insurance Directive would take, ranging from anywhere from one year or less to several years, according to those interviewed by assessors. A lag time beyond the two year imposed in ALPA should be expected as most insurance companies and their representatives, as of the date of the evaluation, had not been trained in AML.

Money Transmitters/Money Exchanges

501. On 1 December 2009 the FIU issued FIU AML Money Exchanges Directive 1 and FIU AML Money Transmitter Directive 1. Both money transmitters and money exchangers must verify the identity of customers. In the case of transmitters, they must verify the identity of anyone who is receiving or transmitting funds, while for money exchanges, anyone exchanging currencies. Both may instantly decline to conduct any transactions or establish business relationships with customers who fail to provide required information. When establishment of the business relationship cannot be “denied owing to the prevalence of an otherwise circumstance,” both must file a STR.

502. **Assessment of CDD effectiveness for Money Transmitters/Exchanges:** Money remitters and money exchanges pursuant to their respective FIU AML Directives must collect information only for all natural persons that send or receive funds or exchange funds respectively. Despite the lack of enforceability of the FIU AML Directives, money remitters are judged more likely to verify the identities of their customers picking up funds to ensure the correct identities of recipients. Many money remitters also serve as agents of international money transmitters and in larger cities are more likely to comply with the CDD requirements for customers transmitting funds. For money exchangers, there is scant evidence of compliance with CDD obligations defined in the FIU AML Money Exchanges Directives.

Identification Measures and Verification Requirements

503. Under ALPA s 6, banks, cooperatives, insurance companies and their representatives, money transmitters, money exchanges, and securities-related business are all required to identify and verify the identities of (1) natural persons, (2) corporate entities, (3) agents acting on behalf of firms, (4) individuals “benefiting from business transactions; (5) the issuer and payee of negotiable instruments where applicable; and (6) any other documents that the FIU may prescribe. Institutions must also maintain a separate record of documents and transactions of each customer, including date and nature of transactions, type of account and code number.

504. While ALPA does not require customer identification and verification for existing customers that transact below the thresholds, the individual Directives, as discussed above, do require customer identification and verification for all transactions.

505. Banks and financial institutions under FIU AML Bank Directive 1 are required to obtain separate and distinct information and supporting documents requested for account opening and business transactions for (1) natural persons; (2) partnerships and proprietorships; (3) companies; (4) clubs and non-governmental organisations; (5) cooperatives; (6) public and private trusts; (7) schools, campuses and other educational entities; (8) international non-governmental organisations; (9) foreign individuals; (10) foreign companies; (11) diplomatic missions/embassies; and (12) non-resident Nepalis.

506. Cooperatives, in accordance with Cooperative Directive 1, must identify and verify supporting documentation for (1) natural persons; (2) partnership or proprietorship firm; (3) companies; (4) clubs and non-governmental organisations; (5) cooperatives; (6) public and private trusts; and (7) accounts of schools, campuses or other educational entities.

507. Securities-related businesses are obligated under FIU AML Securities Directive 1 to identify and confirm the identity of the following categories of customer: (1) natural persons; (2) partnership or proprietorship firm; (3) companies; (4) clubs and non-governmental organisations; (5) cooperatives; and (6) public and private trusts.

508. Insurers and their agents, brokers, and surveyors are obligated under FIU AML Insurance Directive to obtain and verify by collecting supporting documentation in the following categories: (1) natural persons; (2) partnership or proprietorship firm; (3) companies; (4) clubs and non-governmental organisations; (5) cooperatives or other insurance companies; (6) public and private trusts; and (7) schools or campuses.

509. Money transmitters pursuant to Money Transmitter Directive 1 and money exchanges per FIU AML Money Exchange Directive 1 must collect information only all natural persons that send or receive funds or exchange funds respectively.

510. **Assessment of Implementation and Effectiveness for Banks and NBFIs:** As discussed above, the FIU AML Directives' sections on CDD were issued under ALPA and are unenforceable. NRB Directive 19/067 imposes enforceable CDD obligations on banks. It does not impose a CDD obligation for money transmitters and money exchange, meaning they have no enforceable obligations.. Cooperatives, securities-related firms, and insurers appear not to be covered under Directive 19/067 and thus have no enforceable obligations.

511. **Assessment of Implementation and Effectiveness for Money Transmitters and Exchanges:** Most money exchanges and money transmitters, as of the date of the evaluation had received minimal to no AML or CDD training. No fines have been issued by the NRB for failure to perform CDD by money transmitters and money exchanges, although NRB's Foreign Exchange Supervision Department stated that it had prepared a section for its inspection manual of transmitters and exchanges on AML and would begin including AML inspections as part of its supervisory exams by the end of September 2010, but these had not occurred by the date of the evaluation.

512. Interviews with Nepal government officials and industry representatives suggest that at least large money transmitters are performing CDD, according to FIU AML Money Remitter Directive 1's requirements. Some money exchanges appear to conduct some form of CDD, but a judgment on its regularity and comprehensiveness could not be made by the evaluation team.

513. Since all money transmission must occur through banks, which appear to be the most compliant of all financial institutions with FIU AML Directives, money transmitters appear to regularly conduct some form of CDD. Industry representatives provided evaluation team members with forms used by senders and recipients of funds and an AML policy. The representatives demonstrated a strong understanding of CDD requirements, but appeared to have minimal understanding of the company's purported AML policy. This suggests that the AML policy may not applied in practice or that it is rolled out to attract foreign counterparty relationships. The interviewed representatives admitted that they were not yet checking on the source of funds and said that they had provided AML training to their regional managers, but not local staff. They noted that management had received some training from multinational money transmitter companies for which they serve as Nepali agents.

514. According to industry participants, the average size of remittances received from abroad to residents in Nepal is approximately \$500, meaning that threshold transaction reporting requirements are rarely triggered.

Identification of Legal Persons or Other Arrangements

515. ALPA s 6 mandates that banks, financial institutions and NBFIs maintain a clear record of the identity of a person while establishing a relationship or facilitating a transaction above declared thresholds. Institutions are required to "cause the person establishing business relations or having transactions" to provide documents related to "the principal's identity, address including power of attorney clarifying the business of the principal."

516. Institutions are required to verify the legal status or legal arrangement, by obtaining proof of incorporation or establishment or existence, and obtaining information concerning the customer's name, name of trustees (where relevant), legal form, address, directors, and provisions regulating the powers to bind the legal person or arrangement.

517. Limited resources at the Office of Company Registrar and no enforcement against filers of false or misrepresentative materials with the Office suggest that sophisticated money launderers could provide documentation, properly registered and related to legal status or arrangement, to banks, financial institutions, and NBFIs that does not accurately reflect their ownership structure.

518. Due to the lack of penalty provisions, this provision and the Directives' CDD requirements applicable to legal persons and arrangements are unenforceable. Despite this, interviewed banks and non-bank financial institutions appear to be collecting the required information to identify particulars of formation and registration of a legal person or arrangement.

Banks and Financial Institutions

519. Pursuant to FIU AML Bank Directive 1, s 1 and annex 1, agents opening accounts at banks for partnerships, proprietorships, companies (both foreign and domestic), clubs, non-governmental organisations (both foreign and domestic), cooperatives, trusts, schools, and embassies and missions must obtain written authorisation permitting the natural person to open and conduct transactions through an account.

520. Also pursuant to FIU AML Bank Directive 1, s 1 and annex 1, agents of companies require Board of Directors approval and clubs and non-governmental organisations mandate executive committee authorisation; cooperatives require a board resolution, while trusts and schools must provide a resolution from the board or management committee.

521. A "person" under the Interpretation of Laws Act 1953 s 2(10) includes any company or association or body of individual whether incorporated or not. Companies or associations of corporate bodies are legal persons, while one individual or a body of individuals not incorporated is a natural person. For legal persons, the documentary submission requirements vary by corporate entity:

- Companies: certificate of incorporation and operating license, memorandum of understanding; articles of association; name, addresses and phone numbers of board directors, as well as their photos.
- Clubs/Non-governmental organisations: certificate of registration, constitution of the organisation or clubs; name and address of executive committee; telephone number; photos of directors/members of working committee of club and non-governmental organisation.
- Cooperatives: constitution; name and address of Board of Directors; contact information, and photos; and certificate of registration.
- Public and private trusts: constitution; agreement related to establishment of trust; name and address of management trustee; photos of trust members; certificate of registration; name and address of Board/Management Committee.
- School, Campus or other educational entity: name; address; constitution or memorandum of association and articles of association; certificate of approval; name, address, and photo of chief executive; name and address of member of board/management committee.
- International Non-Governmental Organisations: name; address, copy of agreement with social service national coordination council, if available; copy of agreement with Nepal

government; recommendation letter from concerned country or embassy; charter of the organisation; name, address, and contact details of representative or chief of Nepal office.

- Foreign companies: foreign incorporation documents (not specified); memorandum of association and articles of association; documents confirming address; contact details of two principal executives and written proof of address; address and agent in Nepal.

522. **Assessment of Implementation and Effectiveness for identifying legal persons and arrangements:** Due to lack of penalty provisions in ALPA for CDD, the requirements for customer identification and verification of legal persons and arrangements are not enforceable. In spite of this, interviewed banks informed the evaluation team and provided KYC application forms suggesting that at least commercial banks are attempting to comply with ALPA and FIU AML Bank Directive 1 in terms of CDD and legal arrangements. They likely comply with these requirements because the 2005 Directive 19/067 issued by NRB is enforceable under the NRB Act.

523. Banks and non-bank financial institutions and government officials appeared confused as to when a power of attorney can be used to establish a financial relationship on behalf of an individual and/or to engage in financial transactions on behalf of an individual. Representatives from both the private and public sectors stated that powers of attorney, while not legally prohibited by law, were neither used nor generally permitted except in the case of guardians acting on behalf of minor children. They did agree that official and written authorisation from a legal person was needed to open a bank account on behalf of a legal person. Officials, however, generally did not refer to this arrangement as a “power of attorney”. Representatives of the legal and accounting professions, despite Nepali authority statements to the contrary, uniformly agreed that powers of attorney for individuals, legal persons and arrangements to engage in a wide range of financial transactions, is legal and is common practice, in Nepal.

524. Once an account is opened by a legally authorised natural person on behalf of a legal person or legal arrangement, Nepali banks do not appear to be conducting additional due diligence as time passes and do not appear to collect or review amendments to articles of association, changes in trustees or beneficiaries, or information on changing board members. This significantly undercuts their ability to comply with the FATF standard on legal persons and arrangements.

525. **Securities-related Businesses and Assessment of Implementation and Effectiveness:** Securities-related businesses requirements mirror the legal person documentation requirements of banks for securities transactions for partnerships or proprietorships; companies; clubs and non-governmental organisations; cooperatives and trusts.

526. In contrast to commercial banks, the securities industry, some of whose members stated incorrectly that they are not covered by ALPA or FIU AML Securities Directive 1, did not lead assessors to believe that the industry is in fact complying with FIU AML Securities Directive 1’s requirements for legal persons and arrangements. Minimal oversight of the industry by the Nepal Securities Board, lack of enforcement provisions for CDD under the ALPA, the lack of Nepal Securities Board guidance on CDD, and the dearth of fines (total: zero) for CDD violations in the securities-industry account for this assessment.

527. **Insurers, Agents, Brokers, and Surveyors and Assessment of Effectiveness:** Insurers and their representatives must largely follow the same customer verification and identification of legal persons and arrangements seeking to obtain insurance policies as securities-related business for partnerships or proprietorships; companies; clubs and non-governmental organisations; cooperatives; trusts; and schools or campuses.

528. Insurance representatives stated during the on-site visit that they comply with CDD requirements under ALPA applicable to legal persons and legal arrangements. This may be accurate; however, insurers and their representatives have no incentive to comply with the law due to the unenforceability of ALPA's CDD provisions; the absence of Insurance Board Directives on CDD; the exclusion of an AML/CFT component from its inspections; and the non-existence of fines for CDD violations.

Cooperatives

529. Cooperatives face the same obligations for legal persons and arrangements as the insurance industry does. The industry faces the same challenges to enforcement that the securities industry does.

Money Transmitters and Money Exchanges

530. Only natural persons can send, receive, and exchange currency. Money transmitters and exchanges are only required to verify the identity of the individual conducting the transacting, not who is representing. While senders, recipients, and exchangers of currency could be acting on behalf of another legal person or arrangement, they are not required to submit necessary information. Further, the CDD requirements for transmitters and exchanges are not only unenforceable.

Beneficial Ownership

531. Banks and non-bank financial institutions are not required under existing Nepal law to identify the beneficial owner and take reasonable measures to verify the identity of the beneficial owner.

532. ALPA s 6(2)(d) states that banks, financial institutions, and non-bank financial institutions should cause a person establishing a business relationship or conducting a transaction above a certain transaction threshold to submit documents on the "name, surname, address of close relative, person or institution benefiting from business." Nepal government officials and private sector representatives alike interpret this provision to mean that institutions must verify the immediate beneficiary of an account opening or transaction. They interpret the beneficiary as being the recipient of funds or the principal who has an authorised agent to transact on his behalf. Officials and private sector representatives both confirmed that institutions are not obligated to seek information on the natural person that ultimately owns or controls accounts. When queried, bank officials indicated that they would access identifying information on further beneficial owners (such as through searching incorporation documents) but would not request identifying information on beneficial owners or holding companies controlling the parent of a corporate entity.

533. Government officials and business representatives also stated that the use of holding company structures are infrequent and the use of powers of attorney and personal trusts to control business and hide identities are not practiced in Nepal and therefore checking beneficial ownership information beyond what they do is unnecessary. However, this was not agreed by Nepal lawyers and accountants who, during on-site evaluation interviews, clearly stated that these practices do exist in Nepal and are not prohibited.

Information on Purpose and Nature of Business Relationship

534. Under FIU AML Bank Directive 1, banks are required to create a separate procedural mechanism to account for transactions above the stated thresholds, which includes information disclosed by the customer on source of funds. Beyond this Directive, the FIU has not provided

additional written or oral guidance to banks as to what type of mechanisms should be implemented.

535. There is no requirement applying to all financial institutions on the purpose and intended nature of business relationships. Neither the ALPA nor the FIU AML Directives to banks, cooperatives, securities-related businesses, insurers, and money exchangers stipulate requirements. Money transmitters, however, are obligated under FIU AML Money Transmitter Directive 1 to maintain records on the source of funds and the purpose of the money transfer. Private sector officials interviewed said, however, that they do not request such information at this point in time.

Ongoing Due Diligence and Risk

536. FIU AML Bank Directive 1 s 6 requires that banks and financial institutions classify transactions by risk and provides general guidance as to who should be included in the high-risk category. Neither the FIU AML Bank Directives nor other Directives adequately identify what steps institutions must take to perform ongoing due diligence. The language of Directives issued to other institutions offering financial services mirrors the categories in FIU AML Bank Directive 1, which include customers that:

- Conduct abnormal transactions;
- Currently or previously occupied a high rank in politics, business, administration, as well as in social and financial sectors;
- Conduit transactions (non-face-to-face transactions);
- Corporate entities having no particular regulatory or supervisory authority;
- Carrying out international transactions; and
- Come from countries not “adopting the necessary measures for the prevention of ML and financing of terrorism.”

537. In the FIU’s AML Bank Directive 2 what constitutes high-risk categories was expanded to include persons or transactions related to:

- Terrorism;
- Relatives of politically-exposed persons;
- Corporate entities that lack a regulator and supervisor;
- Transactions with individuals not residing in Nepal;
- Transactions with any country that the United Nations or any inter-governmental organisation has sanctioned or warned;
- Any customer that is a well-known launderer or involved in any financial crime; any person or their relative that has engaged in tax or revenue evasion;
- Any transaction with offshore bank or financial institutions;
- Transactions with countries that are categorized as non-cooperative by FATF;
- Transactions with citizens or institutions of countries that are not serious about customer identification;
- Any transaction with customers to whom the regulatory authority of respective country has warned; and
- Any other transaction which is considered high-risk on the basis of work, workplace or activities.

538. Certain exemptions for reporting are laid out in FIU AML Bank Directive 1, Banks need not submit transaction threshold reports for the following (the exemptions does not apply for any suspicious transaction):

- Transactions of the Nepal government, offices or entities, offices, or companies, organisations partially owned or substantially owned by the Nepal government;
- Transactions of entities promulgated under so-called special statutes;
- Internal transactions by banks and with other banks or government entities;
- Transactions of public limited companies with other public limited companies, government and semi-government offices, organisations, institutions, companies or entities, or entities established under special statutes;
- Transactions of insurance companies related to the reinsurance business;
- Transactions by banks related to loans or other customer services;
- Transactions by banks regarding service and facility provided to its staff; and
- Transactions with the United Nations and other international organisations.

539. Nepal has not conducted a risk-based analysis in preparation of these exemptions notwithstanding the risks and vulnerabilities in Nepal outlines in Section 1 of this report (government and private sector corruption).

540. The Directives do not explicitly require that private banking customers, legal persons or arrangements (such as trusts that are personal asset holding companies, companies that have nominee shareholders or have issued bearer share warrants) be considered as high-risk. While Nepal regulators stated that each of these categories was not legally permitted or practiced in Nepal, trusts, nominee shareholders and bearer share warrants are permissible and used in Nepal (see Section 5 of this report) and this was confirmed by the legal and accounting profession in interviews with the evaluation team.

541. Nepal does not permit simplified or enhanced CDD measures for customers residing outside of Nepal and instead, explicitly treat such customers as high-risk in its Directives.

542. Suspicious transaction reports in Nepal must be filed regardless of type of customer, the type of financial institution, the transaction, or the amount. Simplified CDD procedures are not permitted in Nepal whenever there is a suspicion of ML, TF, or other specific high risk scenarios apply.

543. FIU AML Bank Directive 1, s 6, also mandates that banks and financial institutions, on a quarterly basis, discuss setting up and improving mechanisms “to prevent customers’ suspicious and abnormal transactions or ML and to make necessary arrangement for this effect.” Banks and other financial institutions must submit to the FIU a report on the review of risks every six months from the first month of each fiscal year, which begins on October 1. FIU AML Bank Directive 1, s 11, further requires that banks prepare and implement necessary guidelines regarding prevention of ML documents and keep the FIU informed, in addition to providing the FIU with copies of such documents. Banks are obligated to put into place contain procedures relating to CDD, customer acceptance, customer identification, and the process for monitoring customers’ transactions. The Directives for securities firms, insurers, cooperatives, money transmitters, and money exchanges include similar language.

544. Nepal’s approach to ongoing due diligence appears to be providing categories of type of individuals or transactions that are high-risk, while providing little or non-existence guidance on how to perform the required due diligence. The FIU AML Directives to date provide no concrete guidance to institutions on how to design and implement ongoing due diligence procedures.

545. In relation to implementation of the FIU AML Directives this has lagged. To date, no bank, financial institution, or non-financial institution has provided reports on a bi-annual basis to the FIU, suggesting minimal implementation of FIU AML Directives. Several banks and

non-bank financial institutions said that they considered PEPs as high-risk, but failed to describe how they actually identify and monitor PEP accounts. No Nepal institution interviewed during the evaluation visit could identify the exact number of PEP accounts it has or provide details on how these were monitored. At present, for Nepal institutions, ongoing due diligence (to the extent it exists) appears to be a push by institutions to design AML/CFT policies, and to perform some transaction-based testing and flagging of transactions above certain threshold amounts for all customers, with source of funds being requested by some banks for transactions above threshold figures. Without specific guidance from the FIU on what ongoing due diligence, Nepal's legal framework, its implementation, and private sector compliance with it is unlikely to comply with FATF standards.

546. Banks, financial institutions, and non-bank financial institutions are required under Nepal law to ensure that information collected under the CDD process is kept up-to-date. However, the guidance in the Directives is vague and reporting institutions indicated that they were not sure how it should be implemented. Institutions appear as a matter of practice to retain records and to be in the early stages of updating records of existing customers but this practice is *ad hoc* and not formalized through implementation of the Directive (given its vagueness).

547. FIU AML Bank Directive 2 describes "normal risk" clients in s 4.3 as follows:

- Any customer or transaction who public their reports for the general public;
- Customers regulated and supervised by a regulator and supervisor;
- Exempt customers; and
- Any other transaction considered as normal risk transaction by reporting institutions.

548. Beyond providing categories, the Directives provide minimal-to-no guidance on what type of continuing due diligence should be performed for normal risk-customers.

549. Nepal does not permit simplified due diligence for customer identification or suspicious transacting reporting. It does not in any circumstance require that institutions identify beneficial owners. The FIU's Directives further exempt threshold transacting reporting for certain institutions. While the exempt institutions vary by directive, the Directives do not require reporting for transactions by Nepal government entities, public companies, and banks/financial institutions. These exemptions may have the practical effect of lowering ongoing due diligence for such classes of customers; and given the high risk of public sector corruption in Nepal it is surprising that government entities are exempt.

Timing of Verification and Failure to Satisfactorily Complete CDD

550. FIU AML Bank Directive 1 requires all banks to obtain documents on the identity of customers for establishing any type of business relationship with a person. This includes account openings; loans; foreign currency transfers; remittances; wire transfers and payments; and currency transactions. FIU AML Bank Directive 1, s 1(3) requires banks to verify the customer's documents and to update records for existing clients, while s 1(4) obliges these institutions to assign staff in every office and branch to certify such documents.

551. Under the FIU AML Directives, financial institutions may decline to conduct transactions or establish business relationships with any person who fails to provide the required documentation. This appears to be at the institution's discretion, and is not mandatory. The FIU AML Directives also state that "Where the establishment of business relationship may not be denied owing to prevalence of an otherwise circumstance, the transactions with such customer shall be treated as doubtful and submit the particulars submitted to the FIU in Annex 3 [STR form]." When asked to explain the meaning of "an otherwise circumstance" officials

from the public and private sectors were unable. They were in agreement nevertheless that identification and verification is always required.

552. Officials from banks, NBFIs and regulators advised the evaluation team that customer verification was required in all circumstances prior to the establishment of a business relationship. Nepal law appears less clear. ALPA s 6 mandates that institutions maintain a clear record of a person while establishing any kind of business relationship or transacting above certain thresholds. It also states that institutions when establishing a relationship or transacting above the threshold to present documents verifying identity. Thus, the ALPA does not require customer verification for pre-existing customers that are transacting below transaction threshold amounts. The Directives to different financial institutions attempt to close this gap by requiring institutions to collect verification documents from all customers opening accounts and engaging in transactions, not just those above the threshold amount.

553. Despite the intent of the Directives and statements by financial institutions and regulators, Nepal would appear to permit the collection of verification documents after the fact. FIU AML Bank Directive 1, s 1(3), permits banks and financial institutions to verify customer identity through documentation and “in the case of non-availability” such particulars should be obtained and updated.” Section 2 of this Directive states further that “Where the establishment of business relationship may not be denied owing to prevalent of an existing circumstance, the transactions with such customer shall be treated as doubtful and the particulars submitted to the FIU as per Annex 3 [on filing of STR reports].” Other sector Directives include similar language. That language permits institutions to open accounts and transact business with customers without necessary identification, provided they file a STR.

554. Nepal regulators and private sector representatives understand that FATF standards recommendations permit the verification of customer identity following, but not prior to, the establishment of business relations under certain circumstances. They acknowledged some ambiguity in Nepal law, but said that as a matter of course, customer verification always occurs prior to establishment of relationships and conducting of transacting. Insurance industry representatives commented that verification of a beneficiary and his relationship with the life insurance policyholder can be established following the creation of a policy and often occurs after a policy becomes due. In addition, interviewed cooperative representatives maintained that customer verification always occurred prior to a person becoming a member of a cooperative, but stated that for transactions below certain thresholds (NRps 500,000 or US\$7,812), customer verification was not required since cooperative tellers and managers knew the identity of all clients by face and by client history.

555. Nepal does not formally require the verification of beneficial owners prior to or following the establishment of a business relationship or when conducting transactions.

556. Where financial institutions in Nepal have already commenced a business relationship and the institution is unable to verify customer identification in accordance with the FATF standard, Directives explicitly give institutions the “right” to decline to conduct transactions or establish relations. The Directives do not “require” institutions to terminate those relationships. The Directives also require institutions to treat such transactions as “doubtful” and to file STRs.

Existing Customers

557. Nepal’s statutes and regulations do not require financial institutions, bank and non-bank, to apply CDD requirements on the basis of materiality and risk and to conduct due diligence on existing customers on such relationships at appropriate times. As discussed above, CDD on all customers for establishing accounts and conducting transactions is required, regardless of materiality and risk. Minimal guidance is provided in Nepal’s Directives, while different types

of financial institutions are given different deadlines, ranging between two and five years, to update customer records.

558. As noted above, guidance on what due diligence is required for customers beyond basic CDD expectations is minimal. With the exception of cooperatives and life insurers (in the case of beneficiaries), officials from financial institutions and regulators uniformly stated to the evaluation team that CDD for both existing and new clients is being performed on a regular basis. Representatives of the insurance industry expressed doubt that they could update all existing client accounts in the two years mandated by FIU AML Insurance Directive.

559. As in the case of Nepal's other CDD requirements provided in ALPA and industry-specific Directives, the CDD requirements on existing clients are likely unenforceable.

Recommendation 6 - Politically Exposed Persons

560. FIU AML Directives contain no specific provisions in relation to politically exposed persons. All sector-related Directives simply provide that "...people who are in high position of politics, business, society, financial, administration, etc., their available relatives and associated firm, company or organisation..." are to be classified by reporting entities as "high risk" (see for instance, FIU AML Directive No. 2 to Banks, s 4 (4.1)(2)). As seen earlier in the section the framework for dealing with high risk clients or customers is limited.

561. Aside from directing that financial institutions treat PEPs as high-risk, no guidance in the FIU AML Directives is provided specific to PEPs. Boards of Directors are generically required to discuss on at least a quarterly basis setting up and improving mechanisms to prevent suspicious and abnormal transactions and to make a report to the FIU every six months. Other reporting institutions are also directed to establish internal rules on ML. No guidance is provided by the Nepal government on PEP-account risk management.

562. The Directives do not distinguish between domestic and foreign PEPs. While Nepal authorities stated that the definition is inclusive of both, some reporting entities during the on-site visit stated that the Directives applied only to domestic PEPs; others said they thought it would cover both kinds of PEPs. Nepal's Directives on this point are not clear. Additionally the Directives do not require reporting entities to identify beneficial owners or treat beneficial owners that are PEPs as high-risk.

563. Senior management approval is not legally required for PEPs to establish a relationship, and no financial institution interviewed could provide the assessors with an exact, or approximate estimate of the number of their PEP clients.

564. Specific directives on the sources of wealth and of funds of customers and beneficial owners identified as PEPs do not exist. Further, where a financial institution is in a business relationship with a PEP, there is no requirement, beyond treating PEPs as high-risk, that enhanced ongoing monitoring should be performed.

565. No interviewed bank or non-bank financial institution had received from the Nepal government or provided to its staff training or guidance on PEPs. The FIU and banks appear to be awaiting the finalization of the "Know Your Customer Due Diligence and Anti-Money Laundering Policy for Banks and Financial Institutions" drafted by the AML Committee of the Nepal Bankers Association. This "model" policy was in draft form at the time of the assessor's visit. While it includes a detailed section on PEPs that goes well beyond the FIU AML Bank Directives' guidance and may be adopted as a best practice by Nepal banks and financial institutions, it is a voluntary policy that will not be enforceable. The banking sector appears well-ahead of other sectors in drafting a model policy and representatives of other sectors told

the assessors that they planned to wait for the Banker's Association manual to be finished to begin work on their own industries' best practices.

566. No private sector institution interviewed during the on-site visit had implemented a PEP policy, though several Class A banks had skeletal AML/CFT policies drafted after the promulgation of Regulation 19/067 in 2005 that included references to PEPs. The Nepal government stated that four or banks or financial institutions had prepared and sent in internal guidelines related to risk following passage of ALPA, though none had done so after issuance of FIU AML Bank Directives 1 and 2. Interviewed financial institutions said that they were waiting for circulation by the police or FIU of master lists on PEPs, so that they could better identify PEPs.

567. No STRs had been filed on PEPs by any financial institution.

Recommendation 7 - Correspondent Banking

568. Bank and non-bank financial institutions are not required under law to gather sufficient information about correspondent institutions 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 ML or TF investigations or regulatory action. Banks and non-bank financial institutions are also not required to assess a correspondent's AML/CFT controls; to obtain approval from senior management to establish new correspondent relationships; or to document the respective AML/CFT responsibilities of each institution. No statute or regulation presented relates to the maintenance of payable-through accounts.

569. As a best practice, representatives of Class A financial institutions and money transmitters spoken to during the on-site evaluation visit all stated that they have specific policies to examine whether correspondents are fit and proper. They all stated that senior management, typically the CEO, must approve the establishment of a correspondent relationship. In addition, one money transmitter presented a specific list of AML/CFT questions that it sends to foreign counterparts that may be suitable respondent /correspondents.

570. No STRs related to foreign correspondents have been filed by any reporting institution.

Recommendation 8 - New Technologies and Non-Face-to-Face Business

571. Nepal has no statutes or regulations pertaining to new technologies and non-face-to-face business. No laws have been passed or promulgated requiring financial institutions to have policies in place or take such measures as may be needed to prevent the misuse of technological developments in ML or TF.

572. Several banks offer account access via the Internet and most Class A banks offer ATM access for withdrawals to accountholders. "PayPal" also can be accessed in Nepal and is used as a means of payment.

573. Although there are no legal prohibitions on financial institutions establishing a relationship without meeting face-to-face, Nepal authorities and private sector representatives informed the evaluators that non-face-to-face banking business in Nepal is not permitted without approval by the NRB.

3.2.2 Recommendations and Comments

574. In relation to Recommendation 5 it is recommended that Nepal should take action to:

- Amend the ALPA to include penalty provisions for violations of CDD obligations so that CDD provisions of ALPA are enforceable.
- Amend ALPA, BOPA, the AML Rules, and Directives for banks, cooperatives, insurers, and securities-related businesses to expressly ban anonymous accounts and to include penalty provisions in underlying statutes, rules and Directives.
- Delete provision in BOPA s 3 that allows the opening of fictitious accounts “as otherwise permitted in law” to close a loophole allowing fictitious accounts.
- Extend AML/CFT obligations to postal banks throughout the amendment of ALPA and issuance of Directives.
- Revise NRB and industry-specific regulator supervision manuals for banks and all NBFIs covered by FIU AML Directives to include AML/CFT obligations following amendment of ALPA to allow penalties for failure to comply.
- Raise the fine of NRps 10,000 (US\$135) under BOPA for fictitious and false accounts so that it is effective and dissuasive.
- The FIU should offer sweeping and detailed AML/CFT training specific to CDD to all banks, savings and lending cooperatives, insurers, securities-related businesses, money transmitters and money exchanges.
- Close gaps between ALPA and Directives that allow ambiguity on whether CDD is required for pre-existing customers that transact below thresholds by amending ALPA.
- Amend Directives to make it clear that business relationships must not be established absent complete CDD. Filing of a STR should not be an out for a bank or NBFI.
- Once finalized, in accordance with FATF standards, incorporate the Nepal Banker’s Association model AML/CFT policies into Directives to be issued by FIU to give them the force of law.
- Introduce measures applicable to financial institutions and NBFIs which prohibit establishing a relationship or processing transactions with or for individuals whose identities cannot be verified.
- Offer specific training to Cooperatives Department on CDD obligations.
- Direct the Securities Board to revise its Directives to specifically include AML/CFT obligations.
- Explicitly clarify in FIU AML Directives when powers of attorney are permitted for representatives of legal persons and legal arrangements per criteria 5.4.
- Introduce enforceable obligations on banks and NBFIS requiring them to collect and review information related to changes of legal ownership of clients.
- Amend ALPA, AML Rules, and Directives to require obliged entities to obtain and record beneficial ownership information.
- In order to enhance CDD requirements, conduct a detailed study of the existing of holding company structures, legal trusts, and the use of power of attorney to further legal arrangements.
- Impose a requirement applying to all financial institutions that mandates the collection of information on the intended nature of the business relationship.
- Revise FIU AML Directives to ensure that they explicitly require that private banking customers, legal persons and arrangements, such as trusts and companies using nominee shareholders or bearer shares, are classified as high-risk. If, as stated by Nepali regulators, these practices are illegal, Nepal should revise its statutes to prohibit.
- Provide specific guidance to banks and NBFIs on risk management and ongoing due diligence policies and procedures, including on PEPs, after revising ALPA, AML Rules, and Directives to include enforcement mechanisms on risk management that are presently unenforceable. Supervisory inspection manuals should be revised for all industries to include AML/CFT inspections that include inspection and testing of risk management systems.

- Re-examine categories identified as “normal risk,” such as public companies and exempt customers, as part of national ML threat assessment in light of corruption and insider trading allegations.

575. In relation to Recommendation 6, it is recommended that Nepal:

- Revise ALPA, AML Rules, and Directives to impose penalties for failure to design and implement adequate PEP policies.
- Revise ALPA and Directives to ensure that, at a minimum, foreign PEPs are considered high-risk.
- Have the FIU provide specific and detailed guidance on PEP policies and procedures to financial institutions.
- Revise Directives to explicitly state that beneficial owners associated with PEPs are high-risk.
- Have the FIU offer training specifically on PEPs, procedures and transaction threshold and suspicious reporting obligations.
- Include analysis of PEPs policies and procedures in supervisory inspection manuals and make violations subject to penalty.
- Revise FIU AML Directives to mandate that sources of wealth and funds of PEPs, including beneficially owned institutions, are disclosed when establishing a relationship or conducting transactions.
- Require senior management approval for PEP account opening and management.

576. In relation to Recommendation 7, it is recommended that Nepal:

- Impose enforceable obligations under Nepal law on financial institutions to gather sufficient information about respondent institutions to understand fully the nature of the respondent’s business, including quality of supervision, whether the parties have been subject to any ML or TF investigations or regulatory action.
- Require financial institutions to assess respondent’s AML/CFT obligations and whether they are adequate.
- Require senior management approval before establishing new correspondent accounts.
- Require documentations of AML/CFT responsibilities of any potential correspondent.
- Offer training to institutions on establishment of correspondent banking relationships and AML/CFT obligations and red flags associated with foreign correspondents.

577. In relation to Recommendation 8, it is recommended that Nepal:

- Require financial institutions through statute, rules, and FIU AML Directives to put policies in place and take measures needed to prevent misuse of technological developments in ML or TF schemes. Ensure the enforceability of legal mandates.
- Mandate that financial institutions develop policies and procedures to address specific risks of non-face-to-face business relationships or transactions, including specific and effective CDD procedures.
- Offer training to financial institutions on laws, once implemented, on non-face-to-face transactions and legal strictures.
- Include in supervisory inspection manuals for financial sector a review of policies and procedures on non-face-to-face business relationships and transactions, subject to fine for failure to comply.

3.2.3 Compliance with Recommendations 5 to 8

	RATING	SUMMARY OF FACTORS UNDERLYING THE RATINGS
R 5	NC	<ul style="list-style-type: none"> • CDD requirements for most NBFIs are unenforceable • Risk management requirements of banks and NBFIs are unenforceable. • Postal Banks have no AML/CFT obligations. • Lack of enforcement of existing AML/CFT obligations by Nepal government or basic understanding among banks and NBFIs. • Near non-existent understanding of AML/CFT obligations demonstrated by securities industry. • Gaps in statutory and regulatory requirements on when CDD is required. • Absence of clear prohibition on establishing relationships or conducting transactions when incomplete documentation received by customers. • Lack of clear guidance on development of procedural mechanisms for accounting for above-threshold transactions. • Classes of institutions exempted from transaction threshold reports not demonstrated to have lower ML/TF risks, limiting effectiveness. • Non-existence of AML/CFT policies on CDD complying with ALPA at all financial institutions. • Non-inclusion of AML/CFT CDD safeguards into Directives issued by non-NRB regulators or into inspection manuals for financial institutions. • No demonstrable CDD of existing clients by cooperatives. • Absence of CDD requirements for Insurance Board inspection manual, regulations, or Directives. • No requirements to obtain information on the purpose and nature of relationship. • No provisions in Nepal law on obtaining beneficial ownership information of customers. • Deficient requirements on ongoing due diligence. • Lack of training in all industries on CDD requirements both by Nepal government and by corporate entities for staff.
R 6	NC	<ul style="list-style-type: none"> • The limited PEP provisions are unenforceable. • Foreign PEPs not considered high-risk. • No reference to beneficial owners. • No guidance to financial industry on development of PEPs policies and procedures. • No senior management approvals required on PEP accounts. • No specific mandates on sources of funds or wealth for PEPs. • Absence of effective PEP procedures at all financial institutions.
R 7	NC	<ul style="list-style-type: none"> • FIs are not required to gather sufficient information on correspondents. • No obligation on FIs to examine respondent's AML/CFT controls. • Absence of senior management approval mandate. • No requirement to document respective AML/CFT responsibilities of each institution.

R 8	NC	<ul style="list-style-type: none"> • No requirements on non-face-to-face transactions and technological developments to prevent the misuse of TF and ML • No mandates that FIs should be required to have policies and procedures in place on risks of non-face-to-face business.
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3.3 Third Parties and Introducers (R 9)

3.3.1 Description and Analysis

578. There are no provisions in the relevant legislative texts which allow financial institutions or non financial institutions to rely on intermediaries or other third parties to perform some elements of the CDD process. Nepal government officials and financial institutions representatives alike informed the assessors that financial institutions in Nepal do not rely upon any third parties or intermediaries representatives. Both stated that financial services groups or holding companies are largely absent in Nepal. Private and public sector representatives both stated that no law or regulation prohibits them from relying on third parties and intermediaries; however, the FATF standard is that if financial are permitted to rely on intermediaries or other third parties then there must be explicit criteria in place under which this is allowed.

579. Reporting institutions and regulators gave no indication that financial institutions have any safeguards in place to comply with FATF expectations related to third party and other intermediaries.

3.3.2 Recommendations

580. It is recommended that Nepal either:

- Explicitly prohibit reliance on intermediaries or other third parties for performing some of the elements of CDD; or
- Introduce measures setting out the criteria under which they are allowed to do so.

3.3.3 Compliance with Recommendation 9

	RATING	SUMMARY OF FACTORS UNDERLYING THE RATING
R 9	N/A	<ul style="list-style-type: none"> • Nepal law is silent on reliance on third parties in CDD process. • The authorities and the private sector agree that in practice no reliance is placed on intermediaries or other 3rd parties. • No reference in Nepal law on relationship with third parties that take into account information on countries' application of FATF recommendations.

3.4 Financial Institution Secrecy or Confidentiality (R 4)

3.4.1 Description and Analysis

Access to Financial Institution Information by NRB and FIU

581. Bank secrecy is provided in s 79(1) of the Banks and Financial Institutions Act 2006 (BAFIA). That section provides that notwithstanding anything contained in any other law, the relationship between a licensed institution and its customers and information pertaining to its accounts, records, books, ledgers and statements shall not be disclosed to any person other than

a concerned person. Subsection (2), however, provides a list of exceptions to this rule, including:

- disclosure of customer information to the NRB;
- disclosure to the court in connection with a lawsuit or other legal action;
- disclosure to legally authorised prosecutors or officers carrying out an inquiry, investigation or prosecution; and
- disclosure to another country pursuant to a bilateral or multilateral treaty.

582. BAFIA s 79(3) restricts the authorities that receive information from financial institutions from divulging that information to third parties.

583. The FIU is a department of the NRB and so the exception noted above in BAFIA s 79(2) permits financial institutions to share banking information with the FIU. Moreover, ALPA s 7 requires all reporting institutions to file TTRs and STRs with the FIU. According to the FIU AML Directives, TTRs and STRs must contain customer identification, account, and transactional information. ALPA s 10(1)(e) gives power to the FIU to seek additional information and documents from financial institutions where necessary. However, ALPA also does not provide for information disclosure obligations with respect to terrorist financing.

584. The FIU can share information with respect ML with concerned departments under ALPA s 10(1)(b) and with FIUs in other countries and international organizations (s10(1)(e)). However the ALPA does not explicitly declare its statutory supremacy over BAFIA; and the restriction under s 79 (3) of BAFIA also seems to apply to FIU. While ALPA s (10)(2) enables information exchange between the FIU and supervisory/regulatory authorities of banks, financial institutions and non-financial institutions in Nepal, there is no legal basis for sharing of information amongst regulators/supervisors and other law enforcement authorities.

585. The Foreign Exchange (Regulation) Act (FERA) s 11(G) permits an investigating officer investigating offences under FERA to divulge information of any matter known to him where disclosure is required by prevailing law.

586. There is no legal basis in Nepal for information disclosure/sharing mechanism between financial institutions in relation to correspondent banking accounts (R 7) and wire transfers (SR VII). Lack of control and regulation on correspondent banking and wire transfer also indicates unclear information disclosure obligations on financial institutions.

Securities and Exchange Board of Nepal (SEBON)

587. The Securities Act 2007 does not restrict licensed securities businesses from disclosing customer information to competent authorities. Under the Securities Act and regulations, the securities businesses are required to submit financial and transaction related statements to SEBON and non compliance attract sanction of revocation of license under s 89. Section 86 of the Act authorises inspecting and investigating authorities to demand any information, from an issuer, stock exchange and the securities business person and they are obliged to submit the required information.

588. The Securities Act s 21 enables the Board to share confidential information to any law enforcement authority or court, in accordance with the procedures as specified by the Board. Although there are no legal restrictions against making financial transaction information available to competent authorities, it is difficult to say that there is a proper compliance procedure in place.

Insurance Board

589. The Insurance Act, 1992 (Insurance Act) does not restrict insurance companies, insurance agents, surveyors or brokers from disclosing client information. The Insurance Act gives general powers to the Insurance Board to request any information on the insurer license application. Insurance Act, s 15 requires the insurers to furnish specific information to the Insurance Board. However, Insurance Act, s 39 creates general obligation on the insurer, insurance agent, surveyor or broker to provide accounts, records, registers or any other documents, information during inquiry and investigation, as may be required by the inspector or investigator.

Money Remittance and Exchange

590. There are no distinct secrecy obligations relevant to money exchanges and money remitters differing from those imposed on other financial institutions.

Income Tax Authorities

591. The *Income Tax Act* s 84 provides for official secrecy and restricts every officer of the Department from disclosing any document and information coming to his possession or knowledge in performance of his duty; however sub-section (2) provides exceptions to this secrecy provisions in case of disclosure of information, inter alia, to court, any person where the disclosure is required under any other fiscal law and to the law enforcement authority or the government of another country to the extent permitted under the bilateral agreement.

Implementation and Effectiveness

592. The reporting requirements imposed on financial institutions are extensive, however, the exceptions to the secrecy provisions under the laws governing those institutions are limited, to some extent. The powers granted to competent authorities to call for, or have access to, additional information as they may require, provides a framework to enable disclosure of information to regulators. However, though bilateral or multilateral treaties for information exchange with international bodies does not exist, Nepal authorities informed the evaluators that Nepal has at least, in one instance, shared information with another country under s 79 of BAFIA on an ad hoc reciprocity basis.

593. During the on-site visit, law enforcement authorities (CIAA, DRI, and Nepal Police) confirmed that they are fully competent to obtain information from the financial institutions and they have access to documents and records of those institutions. The regulators also asserted that they do not face any problems with accessing necessary information, documents and records from the financial institutions they regulate. There is no information available to show that secrecy provisions inhibited access by regulators.

594. Financial institutions stated that they consider that they have an obligation to submit whatever information may be requested by the competent authorities and that they are not inhibited from so doing by any statutory provisions.

595. There is no legal basis for sharing of information amongst regulators/supervisor and other law enforcement authorities, and Nepalese authorities asserted that they can informally share information about any crime including ML/TF with concerned authority in Nepal.

3.4.2 Recommendations and Comments

596. Although a wide range of exceptions exists to the secrecy provisions in financial laws, there are shortcomings with respect to information sharing between competent authorities. Therefore, it is recommended that:

- The law/regulation should provide basis for information disclosure/sharing between financial institutions with respect to correspondent banking accounts and wire transfers.
- Establish a clear legal basis for lifting bank secrecy for sharing information between competent authorities domestically and internationally.

3.4.3 Compliance with Recommendation 4

	RATING	SUMMARY OF FACTORS UNDERLYING RATING
R 4	LC	<ul style="list-style-type: none">• No explicit provisions enabling the financial institutions to share customer information with other financial institutions to meet the requirements of Recommendations 7 and Special Recommendation VII.• No legal basis for lifting bank secrecy for information sharing between competent authorities domestically or internationally.

3.5 Recordkeeping Requirements and Wire Transfer Rules (R 10 and SR VII)

3.5.1 Description and Analysis

Recommendation 10

597. ALPA s 6(3) (in Chapter 3 of the Act which was seen earlier to contain no sanctions for breach) purports to require banks and NBFIs to maintain a separate record of documents and transactions of each customer with which it establishes a relationship or conducts transactions. Records to be retained include customer's name, address, and identity documentation. Banks and NBFIs must maintain records that include the date and nature of transactions, types of accounts and code numbers.

598. ALPA s 7 requires (with the caveat on enforceability noted) banks and NBFIs maintain records related to transactions above established thresholds and suspicious transaction reports for at least five years from the date of transaction. Nepal government officials and financial institution representatives both informed evaluators that Nepal's tax law requires that all institutions retain records for at least five years and that, as a matter of practice, Nepal banks and NBFIs retained all customer and transaction records. Recordkeeping requirements on the customer, date, nature, type, and amount of transaction, according to Nepal regulators and financial industry participants, should be sufficient to permit reconstruction of individual transactions.

599. Nepal law does not explicitly require banks or NBFIs to maintain records whether the account is ongoing or terminated. Financial institutions are not specifically required to maintain records on business correspondence. Interviewed financial institutions claimed that they maintained all records, including business correspondence, indefinitely as a best practice.

600. Nepal tax law requires that institutions keep records for clients' transactions for five years, while most financial and non-bank financial institutions interviewed stated that they retained customer records indefinitely. ALPA s 3(4) requires that bank and non-bank financial

institutions maintain a record of transactions that are reported as suspicious or above transaction threshold requirements.

601. In accordance with ALPA s 7, banks and NBFIs must (with the caveat on enforceability noted) submit transaction threshold reports within seven days after the date of the transaction and suspicious transaction reports immediately. ALPA also allows the same institutions to obtain details of threshold and suspicious transactions and to maintain records of such reports. No deadline for submission of or exact parameters on information that the FIU can request are stated in statute or directive. Nepal regulators stated that they had the power to request information within any stated time frame, giving examples of 24-hour, 72-hour, and one week deadlines. They acknowledged, however, that no exact timetable by which reporting institutions must respond is spelled out in law or regulation.

Special Recommendation VII

602. Nepal has no statutes, regulations or administrative measures related to the retention of wire transfer information. No statutes or regulations require that financial institutions retain any information for wire transfers, including the name of the originator, the originator's account number; or the originator's address. As discussed above, Nepal does require the identification by financial institutions for all persons, subject to certain exemptions, that engage in financial transactions, including wire transfers, but this mandate is unenforceable.

603. For cross-border wire transfers, there are no obligations in Nepal law for the originator to include full originator information in the message or payment form accompanying the wire transfer. For domestic wire transfer, no statutes or regulations have been enacted or promulgated related to the inclusion of originator information on payment messages. Intermediary and beneficiary financial institutions in a payment chain are not required to ensure that originator information accompanies wire transfers.

604. Beneficiary financial institutions in Nepal are not required to adopt effective risk-based procedures for identifying and handling wire transfers that are not accompanied by complete originator information. Nepal has confirmed that it has no measures in place to effectively monitor the compliance of financial institutions with rules and regulations implementing SR VII.

3.5.2 Recommendations and Comments

605. In relation to R 10, Nepal should:

- Explicitly state in statute, rules, and/or Directives that financial institutions must maintain records for at least five years following termination of an account.
- Specify that financial institutions have a legally enforceable obligation to comply.
- Supervise financial institutions to ensure compliance with record keeping obligations.

606. In relation to SR VII, Nepal should:

- Enact laws that would introduce a mandatory requirement that financial institutions need to comply with the SR VII obligations.
- Make it a mandatory requirement that, for all wire transfers of €/US\$1,000 or more, ordering financial institutions collect originator information in conformance with SR VII.
- Oblige financial institutions for cross-border wire transfers of €/US\$1,000 to include full originator information in the message or payment forms accompanying wire transfers.

- Require financial institutions for domestic transactions to include full originator information in the message or payment forms accompanying wire transfers.
- Oblige all intermediary and beneficiary financial institutions in a payment chain to ensure that all originator information that accompanies a wire transfer is transmitted with the transfer.

3.5.3 Compliance with Recommendation 10 and Special Recommendation VII

	RATING	SUMMARY OF FACTORS UNDERLYING RATINGS
R 10	PC	<ul style="list-style-type: none"> • Nepal law does not explicitly require banks or NBFIs to maintain records after termination. • Financial institutions are not specifically required to maintain records on business correspondence. • Effective implementation has not been established by supervision
SR VII	NC	<ul style="list-style-type: none"> • No statutes, regulations, and/or Directives on wire transfers.

3.6 Monitoring of Transactions and Relationships (R 11 & 21)

3.6.1 Description and Analysis

Recommendation 11

607. ALPA s 7(b) requires financial institutions to investigate any transaction that appears to be suspicious or was transacted with the motive of ML, was laundered, or there are reasonable grounds to suspect ML. Under ALPA s 10(3) financial institutions are obliged to file STRs on these transactions immediately with the FIU. FIU AML Directive 1 defines what type of transaction merits the filing of STRs. These could include transactions that would constitute unusual transactions that have no apparent or visible economic or lawful purpose but there is no specific mention in the Directives of unusual or large transaction or patterns of such transactions.

608. Nepal law (whether the ALPA, AML Rules or Directives) makes no explicit reference to a requirement to pay attention to complex, unusual large transactions or unusual patterns of transactions that have no apparent or visible economic or lawful purpose or to examine as far as possible the background and purpose of those transactions and to record those finding in writing. Instead, the FIU AML Directives list activities that could arguably be considered complex, unusual transactions or unusual patterns of transactions without an apparent or visible economic or lawful purpose that should be grounds of suspicion for a possible STR filing. Bank AML Directive 2 at s 3.2, for instance, lists such possible grounds for suspicion. These include: a customer depositing a large amount not supported by his profession or without mentioning the source of funds; transmission of funds between unrelated customers; large fund transfers to foreign citizens, tourists, students, recent migrants from countries where terrorist organizations are active; large growth of personal transactions in comparison to company's transactions; "unnatural" deposits or withdrawals; and repayment of a large loan without sufficient reason or source. These requirements are related to filing STRs only which is not the purpose of R11.

609. Financial institutions are not required to examine as far as possible the background and purpose of complex, unusual large transactions, or unusual patterns of transactions, that have no apparent or visible economic or lawful purpose.

Recommendation 21

610. Financial institutions are required under ALPA s 7(4) to maintain records of transactions related to STR filings for five years from the date of the transaction. Financial institutions are not explicitly required to maintain such records if a STR is not filed.

611. Te ALPA, AML Rules and FIU AML Directives do not contain provisions for financial institutions to give special attention to business relationships and transactions with persons (including legal and other financial institutions) from or in countries that do not, or insufficiently apply FATF Recommendations. The FIU AML Directives only require financial institutions to treat such customers and transactions as “high-risk” and state further that:

...customers carrying out international transactions or with customers of the countries not adopting the necessary measures for the prevention of ML and financing of terrorism shall be classified as high risk. (FIU AML Directive No. 1 to Banks and FIs, s 6(3)).

612. The Directives also require financial institutions to treat the following transactions as high-risk:

- Any transaction with the resident of the country which is categorized as non-cooperative by the Financial Action Task Force and transactions with the citizen of the countries which have not adopted necessary standards for AML/CFT; and
- Any transaction with the citizens or institutions of the country which are “not serious on the matter of customer identification.”

613. Additionally, FIU AML Directives require reporting institutions to treat “multiple transactions without any reason in a country or with people from a country where an AML/CFT regime is poor” are grounds for suspicion for filing a STR.”

614. No guidance has been issued to financial institutions on how to implement risk management systems for “high risk” customers and transactions or to identify AML/CFT regimes that are poor, Nepal law lacks the measures necessary to ensure that financial institutions put into place effective measures to pay special attention to transactions with persons from or in countries which do not sufficiently apply the FATF recommendations. Nepal also does not have an FIU advisory system to adequately advise financial institutions of concerns about weaknesses in the AML/CFT systems of other countries. Commercial banks, however, stated that they are cognizant of the Financial Action Task Force and the ICRG process. But compliance officers from these institutions said that they treated all international customers as high-risk. None of the financial institutions interviewed had AML/CFT policies that required special attention to business relationships and transactions with persons from or in countries that do not sufficiently apply FATF standards.

615. In Nepal, there is no regularized communication mechanism that the FIU has used to inform financial institutions of countries that have significant weaknesses in their AML/CFT systems or that do not insufficiently comply with the FATF recommendation. The Nepal authorities have never issued an advisory on specific countries which are considered high-risk. Nepal also has no mechanism to take appropriate countermeasures against high-risk jurisdictions.

616. No requirement in Nepal law exists for financial institutions to describe in writing the background and purpose of transactions that have no apparent economic or visible lawful purpose.

3.6.2 Recommendations and Comments

617. In relation to Recommendation 11 Nepal should:

- Issue an enforceable requirement for all financial institutions to pay attention to all complex, unusual large transactions, or unusual patterns of transactions, that have no apparent or visible economic or lawful purpose.
- Require financial institutions to examine as far as possible the background and purpose of unusual transactions and to set for their findings in writing and maintain such findings for five years.
- Provide specific training and written guidance to financial institutions on unusual transactions.

618. In relation to Recommendation 21, Nepal should:

- Implement an effective system for transmission of information and advisories to financial institutions on AML/CFT deficiencies of high-risk jurisdictions.
- Require financial institutions to give special attention to business relationships and transactions with persons from countries that do not adequately apply FATF recommendations.
- Provide enforceable guidance to financial institutions on how to implement risk management systems, including those related to customers and transactions from high-risk jurisdictions.
- Mandate that financial institutions identify the background and purpose of transactions deemed suspicious because they have no apparent economic or visible purpose and to record their findings in writing.
- Provide for an effective system for Nepal to take counter-measures to countries that do not sufficiently apply the FATF Recommendations.

3.6.3 Compliance with Recommendations 11 and 21

	RATING	SUMMARY OF FACTORS UNDERLYING THE RATINGS
R 11	NC	<ul style="list-style-type: none"> • Financial institutions are not required in law or regulation or other instrument to pay special attention to complex, unusual large transaction or unusual patterns of transactions • Financial institutions are not required to ask customers about the background or purpose of unusual transactions and to set forth their findings in writing.
R 21	NC	<ul style="list-style-type: none"> • Financial institutions are not required to give special attention to business relationships and transactions with persons from countries that do not adequately apply FATF recommendations. • No existing system exists for Nepal authorities to ensure that financial institutions are aware of countries with weak AML/CFT regimes. • No mandate for financial institutions to identify background and purpose of transactions with no apparent economic or visible purpose • No system is in place in Nepal to employ countermeasures against countries that insufficiently apply FATF recommendations.

3.7 Suspicious Transaction Reports and Other Reporting (R 13-14, 19, 25 & SR IV)

3.7.1 Description and Analysis

Recommendations 13 and Special Recommendation IV

Obligation to report STRs related to Money Laundering

619. ALPA s 7(1) states that the specified financial and non-financial institutions, should investigate, enquire, and inform the FIU within seven days any transaction, which: (1) appears to be suspicious; (2) was transacted with the motive of asset laundering; (3) ML has occurred; or (4) there are reasonable grounds for suspicion.” Section 7(1) does not apply to postal savings banks.

620. ALPA s 2(l) defines “suspicious transaction” as a “transaction of such nature that it is impossible in general economic, commercial, and business practice.” No guidance in ALPA is provided as to what constitutes “impossible,” making the obligation very difficult for financial institutions to understand and therefore to comply with. In addition, the mandate related to reporting transactions “transacted with the motive of asset laundering” suffers from the same deficiencies described under Recommendation 1. Further, ALPA, s 2(c) defines "transaction" (contained in the above definition) to mean “any act or agreement made in order to carry out any economic or business activities and the term also means the purchase, sale, distribution, transfer or investment and possession of any assets.”

621. ALPA s 31 authorises fines of NRps 500,000 (US\$7,812) for banks and NRps 25,000 (US\$337) for NBFIs for failure to file STRs. Under the FIU AML Directives, financial institutions shall immediately provide information to the FIU on transactions, which, *inter alia*, are (1) not commensurate with the general financial condition of the customer; (2) not possible in the process of any particular trade or business or the transaction is of an abnormal nature; and (3) suggestive of an “abnormal increment to change in any customer’s financial or business transaction;”

622. Financial institutions are also required under the FIU AML Directives to provide “particulars” of doubtful transactions to the FIU regardless of the amount. Customer identity information must be provided on all suspect transactions, regardless of the amount or whether the suspicions related to ML or TF. Such suspicions could include doubts about identification documents provided, but this is not explicitly stated in Nepal law. In this regard, it is important to note that the STR reporting requirements of ALPA s 7 are enforceable (by virtue of s 31) notwithstanding that the CDD requirements in Chapter 3 are not.

623. Less than a dozen financial institutions account for the 186 STRs filed by September 2010, two years after the enactment of ALPA. Nearly 72% of these STRs related to a single case. No cooperative, insurer, securities-firm, money transmitters or money exchange has ever filed a STR.

624. Financial institutions have not received additional guidance from the Nepal government on how to implement STR reporting requirements. Those interviewed appear to be at the nascent stage of developing AML/CFT policies and regimes that include STR filing reporting. When queried on how to detect suspicious transactions, compliance officers said that the only way to do so is by implementing IT systems that flag large transactions above a certain threshold, but could not offer any additional ideas. Commercial Banks appear to have such transaction threshold systems in place, but appear to have minimal understanding of how to identify suspicious transactions. It is also unclear if the remainder of the financial sector does,

but is judged unlikely by the evaluation team given their lack of AML/CFT policies and failure to file STRs.

625. The model STR form that financial institutions are required to complete (annexed to Directives) offers a “check the box” format in 12 categories which includes a summary of suspicious activities. The STR form does not include a section to describe the background and purpose of the transactions.

626. ALPA s 7(4) directs financial institutions to maintain a secured record of suspicious transactions for five years from the date of the transaction. No detail is provided as to what records should be maintained in Nepal law.

SR IV - Obligation to report STRs related to Terrorist Financing

627. ALPA s 7(1)(c) provides that financial and non-financial institutions shall inform the FIU of any transactions related to “asset laundering” under s 4 of the ALPA. “Asset laundering” as seen in Section 2 of this report (SR II) is defined to include “terrorist financing”. The clarification clause to s 4 of the Act states that “it shall be the offence of financing of terrorist activities if any person by any means collects or provides to any person any amount with the intention that such amount should be used or in knowledge that it is to be used in order to carry out any act which constitutes an offence within the scope of [5 named] conventions or any other act.”

628. ALPA s 2(1) defines “suspicious transaction” as a “transaction of such nature that it is ‘impossible in general economic, commercial, and business practice.’” ALPA, s 2(c) defines “transaction” (contained in the above definition) to mean “any act or agreement made in order to carry out any economic or business activities and the term also means the purchase, sale, distribution, transfer or investment and possession of any assets.” As seen in the earlier section the obligation to file STRs (including those in relation to TF is binding.

629. However, as noted in the discussion under SRI in Section of the report, TF is not criminalised in the ALPA despite the references above to its criminalization as a form of asset laundering. Therefore it cannot be said that there is an obligation to file STRs in relation to an offence which does not exist.

630. Notwithstanding that point, the FIU AML Directives require the filing of STRs by reporting institutions where there are reasonable grounds to suspect that funds are for terrorist activities, terrorism or for TF. The Directives list offences that constitute predicate offences to asset laundering and transactions of individuals or organisations declared to be involved in terrorist or criminal activities by the Government of Nepal or individual or organisation listed as terrorists by the United Nations.

631. Various financial institutions who discussed this reporting obligation with the evaluation team during the on site visit expressed confusion over the meaning of the requirement to file TF related STRs. It was not clear to them that the obligations in the ALPA extended to TF STRs given the meaning of “asset laundering” and the meanings of the terms “transactions” and suspicious transactions”.

Reporting of Attempted Transactions

632. There is no requirement in law, regulation or other enforceable means that STRs be reported for attempted transactions. The ALPA s 7 stipulates that financial institutions are obliged to file STRs when they suspect ML or TF. The definitions of “suspicious transaction” and “transaction” in s 2 of the ALPA (noted above) do not expressly or impliedly include

attempted transactions. There is no requirement in law, regulation or other enforceable means that STRs be reported for attempted transactions.

633. The FIU AML Directives provide no guidance with respect to attempted transactions. While Nepal authorities advised the evaluation team that financial institutions should submit STRs for attempted transactions, in discussion with financial institutions during the on-site visit officials from those institutions indicated that it was not their understanding to do so and that in fact no institutions have filed STRs in relation to attempted transactions.

STR reporting regardless of the amount of transaction

634. ALPA s 7 provides that even if amount of the transaction is less than the reporting threshold, a reporting institution shall submit an STR if it has reasonable grounds to suspect that the funds involved are illegal assets or that the party involved in financial transaction is engaged in ML or TF. In practice, STRs are being reported regardless of the amount involved.

STR reporting regardless of whether tax matters involved

635. When financial institutions have reasonable grounds to suspect that assets received are illegal or that a party involved in a financial transaction is engaged in ML or TF, they are required to file an STR irrespective of whether they suspect the activity involves tax matters.

636. Under ALPA s 4, it is an offence of asset laundering if any person owns, possesses or uses, utilizes or consumes or displays or does any transaction of the asset that person has earned directly or indirectly from tax evasion. Thus, tax evasion is considered a predicate offence for the purpose of STR reporting under the ALPA and financial institutions are required to report STRs when they suspect the transaction relates to tax evasion.

Recommendation 14

Protection from liability for disclosure

637. ALPA s 37 provides protection for employees and institutions who disclose information to the FIU as follows:

In case any loss occurs to a person because of submission of information [to the FIU] by a government entity, bank, financial institution or non-financial institution or by a staff, official or agent of such bank, financial institution or non-financial institution as per the provision mentioned in Section 7 and Clause (a) of Section 10, no such entity, bank, financial institution or non-financial institution or staff, official or agent of such entity, bank, financial institution or non-financial institution shall be liable to any action.

638. The protection under this provision extends to the reporting institution and its “staff, officials or agents.” These terms (“staff”, “officials” and “agents”) are not defined in the ALPA nor are they defined in the Interpretation of Laws Act 1954. However, the Companies Act 2006 s 2(j) defines “officer” to include directors, chief executives, managers, company secretaries, and employees undertaking departmental responsibility of the company. The term “official of such bank...” can be interpreted to mean the same as “officer”(as defined in the Companies Act) of the bank and other related institutions (listed in s 37) and therefore the ALPA includes directors within the scope of protection delineated in the ALPA above (as required by the methodology).

639. Two problems arise, however, in relation to ALPA s 37:

- First, it appears that a pre-condition to protection from “action” is when “loss” occurs. If no loss occurs to a person from disclosure it is arguable that this protection does not extend.
- Second, the term “action” is not defined in the ALPA or in the Interpretation of Laws Act 1954. It is unclear whether this word includes criminal prosecution or is reserved only for civil action. In the absence of clear wording in the ALPA, it is arguable that protection from criminal liability is not provided in this statutory section.

640. In addition, the *Banking Offence and Punishment Act 2008* (BOPA) s 21 states that “notwithstanding anything contained in the prevailing laws, if the person, who provided information on happening of offence or possible happening of the same to initiate legal proceedings or to stop occurrence of offence under this Act, is an employee of a bank [Class A commercial banks] or financial institution [Class B, C, and D financial institutions], no action shall be taken on the ground of breach of secrecy in terms of his/her service rules, for the reason of his/her providing/doing such cooperation.”

641. Nepal officials stated during the on-site visit that this BOPA provision applied for protection against criminal liability. This is not clear, but what is clear is that even if protection from criminal prosecution is provided for in this section it only applies to banking staff (not other reporting institutions) and only when an offence or possible offence occurs.

Prohibition on “tipping off”

642. FIU AML Directives to financial institutions bar tipping off by employees, officials and representatives of financial institution as follows:

Bank and financial institutions or any staff, official or representative thereof shall not disclose any information provided to the Financial Information Unit nor divulge the facts/confidentiality of the document that has come into knowledge during investigation and enquiry or during the execution of own duties to any other persons including the customers through any means except under the circumstances as may be required under the prevailing laws (s 14 in FIU Directive No 1 to Banks and FIs).

643. Each of the Directives includes specific language directing that reporting institutions, staff, officials or representatives of those institutions shall not disclose any information provided to the FIU nor divulge the facts/confidentiality of the document that has come into knowledge during investigations and enquiries or during the execution of its duties to any other persons including customers through any means except under the circumstances as may be required under the prevailing laws (FIU AML Directive No. 1 to Banks and Financial Institutions, s 14).

644. There are three difficulties with this provision:

- First, the Directive refers to only to disclosure of information provided to the FIU or to documents that have come the attention of the FIU during an investigation or enquiry. It does not encompass the fact that an STR is being reported or has been reported without reference to any documents provided to or which have come to the attention of the FIU; and
- Second, the Directive does not encompass prohibiting disclosure in relation to attempted suspicious transactions; and
- Third, as was seen earlier, FIU AML Directives contain no penalty provisions for breach of their requirements. Section 14 cited above contains a prohibition on disclosure of certain (and limited) information in relation to STRs but no penalty can attach to its breach. Accordingly it is unenforceable.

Additional Elements

645. There are no laws or regulations, or any other measures, to ensure that the personal names and details of financial institution staff required to file STRs are kept confidential by the FIU.

Recommendation 19

646. In 2008 Nepal implemented a threshold transaction reporting (TTR) system under which reporting institutions are required to report to the FIU all amounts above a designated threshold (ALPA s 7). Reporting entities should report to the FIU when the amount transacted is a single or in a series of transactions by a person (ALPA s 7(a)).

647. For the purpose of this obligation, transaction means "...any act or agreement made in order to carry out any economic or business activities and the term also means the purchase, sale, distribution, transfer or investment and possession of any assets" (s 7(2(c))). Transactions therefore include cash payment or receipt means physical movement of cash between financial institutions and customers. Thus any transaction at the counter, cash deposits or withdrawals at ATMs, and cash deposits at night safes are subject to reporting. Thresholds are prescribed by the NRB (s 7) pursuant to FIU AML Directives (s 3) as follows:

- Credit and debit transaction of rupees one million or more [US\$13,513] in the account of any person or entity either by single or multiple transactions through any mode in a day.
- Payment or remittance of rupees one million or more [US\$ 13,513] by any person or entity to any person or entity through single or multiple transactions in a day.
- Exchange transactions of rupees Five Hundred Thousand [US\$6,756] or more provided to any person or entity through single or multiple transactions in a day.

648. In addition to financial institutions, casinos have TTR obligations with respect to client gambling activities stipulated in the FIU AML Directives to Casinos (issued 1 December 2009) s 3 as follows:

- If any person gambled of three hundred thousand rupees (US\$4,054) or more amount in a day, whether at a single or series of gambling,
- Exchanging three hundred thousand rupees (US\$4,054) or more amount in a day by a any person through Casino chip to Casino cheque, either at a transaction or series of transactions.

Explanation: "Amount" means cash amount in Indian Currency or convertible foreign currency acceptable in casino gaming/gambling transaction or card, chips, token, coin, coupon, electronic or monetary instrument that is loaded with monetary value of the said currency and the value of such instrument.

Additional elements

649. TTR reporting is paper-based. Nepal does not have an electronic filing system nor are TTRs once filed converted to electronic format. Additionally, the handling and storage of large currency transaction reports is not subject to strict safeguards to ensure their proper use (as discussed under R 26 earlier).

Recommendation 25 (guidance and feedback related to STRs)

650. ALPA s 10(3) authorises the FIU to issue Directives to banks, financial institutions and non-financial institutions about the method, form, time and other matters regarding TTRs and STRs. In 2010 the FIU issued Directives to banks and financial institutions, money remitters

and transferors, money changers, insurance sector, securities sector. No Directives have been issued to other financial institutions. These Directives do not provide any description of ML/TF techniques and any additional measures that financial institutions and DNFBPs should take to ensure compliance of AML/CFT requirements.

651. Under ALPA s 7 reporting institutions have to satisfy themselves that there are genuine grounds for suspicion before filing STRs. In the absence of guidance from the FIU or from sector-specific supervisors/regulator the level of analysis that reporting institutions are expected to perform is low.

652. During the on-site visit, it was clear to the evaluation team that private sector agencies (other than those that are subject to FIU AML Directives) were not aware of AML/CFT obligations and were waiting for Directives from the FIU. Financial institutions in the securities sector in particular were unaware of their obligations/responsibilities under ALPA and the AML Rules.

General Feedback

653. STR reporting to date has been from banks and financial institutions. No STRs have been filed by securities and insurance firms. The FIU has not interacted with reporting institutions about the manner and content of STR reporting. The FIU has not issued any general guidance or feedback based on statistics relating to number of STRs and results achieved from STR analysis or examination /inspection.

654. The authorities informed that reporting institutions are in initial stage of reporting STR. The FIU has conducted and planning to conduct workshops for reporting institutions, supervisory authorities, Government agencies and Parliamentarians on general AML/CFT requirements, including STR reporting . These workshops have addressed, to some extent, the AML/CFT obligations including STR reporting obligations. However, no outreach meetings/workshops have been held to guide reporting institutions on ML techniques, trends and patterns and sanitised examples of actual ML cases. The above workshops have been basic interaction/orientation programmes rather than a specific feedback-oriented outreach meeting. Moreover, no data is available on the content and quality of training/workshop.

655. Though the FIU AML Directives describe various situations of suspicious transaction, no feedback on the quality of a specific institution's STRs have been issued. The FIU has taken positive steps in familiarising the authorities, regulators and reporting institutions about AML/CFT requirements by conducting regular workshops. However, endeavour to provide appropriate guidance and feedback on AML/CFT requirements particularly on suspicious transaction identification and reporting system, quality of STRs, the types of information that should be included in STRs is yet to be made.

Focused Sector-Specific STR Review Meetings

656. While all STRs to date have been filed by banks and financial institutions regulated by NRB (of which the FIU is a part) the FIU has not conducted any STR-related review meetings for banks and other reporting institutions in order to provide feedback on the quality and content of reports and on ML and TF techniques and trends.

Specific Feedback

657. Not all the financial institutions have furnished the name of their compliance officer to the FIU although there is obligation in the AML Rules and the various FIU AML Directives in

this regard. The FIU does not hold periodic preview meetings with compliance officers of reporting entities particularly those who regularly files STRs, to review the performance.

658. STRs in relation to legitimate transaction are as follows:

Instances STRs in relation to a legitimate transactions				
RECEIVED	EXAMINED	COMMUNICATE TO FI	GUIDANCE TO FIS	INSTANCES
2009-12-08	2010-02-25	2010-02-26	2010-04-14	2
2010-04-07	2010-04-30	2010-05-01	2010-05-01	1

659. The above information does not describe the finding of the FIU and nature of feedback/guidance to FIs on the basis of those STRs. There are no instances when FIU returned any STR with instructions to correct any deficiencies.

660. The FIU Annual Report 2010 mentions that it is receiving TTRs/STRs from different financial institutions, analysing and disseminating them, it does not provide any statistics of feedback on STR reporting that includes breakdowns by reporting institution; the nature of suspicion ; and dissemination.

661. FIU has its own website containing national and international instruments including the FATF Recommendations. The website publishes the FIU Newsletter the first of which was posted to the website in May 2010. This Newsletter contains information the FIU, its future plans and the frequently asked questions (FAQs). The FAQs do not provide guidance or feedback on the results of STRs, current techniques and method or sanitised examples.

Recommendation 32 – Statistics

662. Financial institutions have filed 186 STRs related to ML. 183 of all 186 STRs filed as of September 2010 came from Class A banks. Four (4) STRs have been filed related to terrorism as of September 2010. Three of these reports were linked to a single transaction, but were for three different individuals. The source of information for the STRs came for a foreign government.

3.7.2 Recommendations and Comments

663. In relation to Recommendation 13 and SR IV Nepal should:

- Include an enforceable obligation in law or regulation that the STR obligation covers proceeds from all offences required to be included as predicate offences under Recommendation 1.
- Establish a clear mandatory obligation to report STRs in relation to TF.
- Extend the STR filing obligation to postal savings banks.
- Require STRs for attempted suspicious transactions.
- Support the enhanced scope, quality and quantity of STR reporting. This may include providing STR-specific training for all financial institutions and regulators. A specific component on how to check for terrorist-financing links (referencing software and websites) of individuals conducting transactions or establishing business relationships should be provided.
- Provide, through the FIU, specific guidance to financial institutions on how to develop AML/CFT policies including on terrorism and TF and sanction financial institutions that fail to develop and provide them to the FIU.

664. It is recommended in relation to Recommendation 14 that Nepal:

- Amend the ALPA to delete the requirement for loss to occur before immunity from action occurs.
- Amend the ALPA to make it clear that immunity from “action” for disclosure of information in relation to STRs (including the fact that a STR will be filed or has been filed) done in good faith includes immunity from criminal prosecution as well as civil or administrative action.
- Amend the ALPA to clarify that the prohibition on tipping off relates also to the fact that an STR or related information may or will be filed, or has been filed, with the FIU.
- Amend the ALPA to provide that the personal names and details of financial institution staff required to file STRs are kept confidential by the FIU.
- Amend the ALPA to further provide that tipping off prohibitions also apply to attempted suspicious transactions
- Amend the ALPA to provide sanctions for breaches of the tipping off prohibitions.

665. It is in relation to Recommendation 25 that:

- The FIU and regulatory authorities should establish appropriate guidance for reporting institutions to implement their AML/CFT obligations .
- The FIU should provide appropriate general and specific STR-related feedback to reporting institutions to assist them to file STRs and to improve the quality of their reporting.
- The FIU and/or relevant regulatory bodies should provide reporting institutions with information on current methods and techniques of ML and TF and examples of actual cases where possible.

3.7.3 Compliance with Recommendations 13, 14, 19, 25 and SR IV

	RATING	SUMMARY OF FACTORS UNDERLYING RATINGS
R 13	PC	<ul style="list-style-type: none"> • Not all financial institutions are required to report suspicious transactions to the FIU. • Deficiencies in the criminalisation of ML in the ALPA, including the scope of predicate offences, narrows the scope of STR reporting obligation in Nepal. • In the absence of a clear TF offence, reporting STRs when there are reasonable grounds to suspect TF is not clearly covered. • No requirement to report attempted suspicious transactions. • The narrow scope of reporting (Class A banks) and low rates of STR reports overall means that effective implementation of reporting obligation cannot be established. • Most financial institutions lack understanding of what constitutes suspicious transactions.
R 14	NC	<ul style="list-style-type: none"> • Immunity under ALPA only applicable in case where “loss” occurs. • Immunity only applies against civil action (not criminal liability). • Tipping off prohibitions do not apply to the fact that a STR is being reported or has been reported. • Tipping off prohibition not applicable to attempted suspicious transactions. • Tipping off prohibitions not enforceable - no penalty provisions for breach.
R 19	C	<ul style="list-style-type: none"> • Fully observed

R 25	NC	<ul style="list-style-type: none"> No guidelines have been issued by the FIU to assist reporting institutions on how to implement and comply with their AML/CFT obligations in the ALPA, AML Rules and FIU Directives. No general or specific feedback by the FIU or other relevant agencies has been provided to reporting institutions on STR reporting provided by FIU to assist reporting institutions. Directives issued by FIU to reporting institutions do not include ML/FT techniques and methods.
SR IV	NC	<ul style="list-style-type: none"> TF is not formally criminalised in Nepal and there is no clear legal obligation to report TF-related STRs by reporting institutions. Financial institutions lack understanding of what constitutes TF related suspicious transactions.

3.8 Internal Controls, Compliance, Audit and Foreign Branches (R 15 & 22)

3.8.1 Description and Analysis

Recommendation 15

Internal Policies, Procedures and Controls

666. As detailed in earlier sections of this report, the primary AML/CFT instruments are the ALPA, AML Rules and the FIU AML Directives. These instruments provide varying degrees of measures in relation to internal policies, procedures and controls.

Procedures

667. The ALPA does not require financial institutions and other reporting institutions to establish and maintain internal procedures, policies and controls to prevent ML and TF. However, AML Rule 40(3) provides that reporting institutions may develop and implement internal procedures to perform the tasks outlined in the ALPA, AML Rules and the FIU AML Directives. FIU AML Directives provide that reporting institutions “shall prepare and implement necessary guidelines in respect of prevention of ML activities and inform the [FIU] along with a copy of such documents.” The guidelines should include procedures relating to “CDD, customer acceptance, customer identification, and process for monitoring customer's transactions as well as risk management.” (see FIU AML Directive No 1 for Banks and Financial Institutions, s 11(1)).

668. As noted earlier in this report, the obligations under FIU AML Directives are not enforceable despite wording suggesting otherwise. In relation to the establishment of internal controls, the FIU or other supervisory agencies cannot enforce these Directives.

Compliance management arrangements

669. AML Rules 10 and 11 require that reporting institutions appoint a high ranking management level compliance officer for each reporting institution and to provide the FIU with his or her contact information. Those compliance officers are required to:

- function as a focal point to perform tasks in accordance with the Act, Rules and Directives;
- maintain secure transaction records;
- provide information on suspicious transactions or other transactions to the FIU; and
- provide information about branch offices to the FIU on a regular basis.

670. The FIU AML Directives add further functions and responsibilities by requiring compliance officers to:

- identify customers of reporting institutions;
- maintain up-to-date CDD information of customers
- maintain threshold and suspicious transactions records; and
- file TTRs/STRs with the FIU within the required times in the Rules and Directives.

671. These Directives also require the financial institutions to assign responsibility to branch/office staff to provide information to the designated compliance officer. The requirement on compliance officers to maintain records as noted means that they have timely access to customer identification data and other CDD information, transaction records and other relevant information as required in the methodology.

672. However (as noted above) there is no requirement in the ALPA, Rules or Directives to implement internal controls for which the compliance officer is responsible. Indeed the Rules do not require the implementation of these rules (“may develop”) whereas the Directives do (“shall prepare and implement”). The inconsistency is confusing and reporting institutions interviewed during the on-site evaluation indicated that they have appointed compliance officers, however, in many of those entities, the compliance officer is a junior level officer that does not meet the requirement of AML Rule 10 and the FIU Directives.

Adequately resourced and independent audit function

673. Neither the ALPA nor AML Rules require an adequately resourced independent audit function to test compliance with internal policies and controls.

674. FIU AML Directives to Banks and Financial Institutions and to the Insurance Sector and Securities Sector require the Chief Executive Officer of the reporting institution to review whether or not the applicable ALPA, rules, directives, order and policies are being complied with on a quarterly basis and to submit a report to the FIU within three months following the end of the institution’s financial year end.

675. But similar FIU AML Directives to other reporting institutions do not carry this obligation. In particular, the FIU AML Directives to casinos, money changers, money remitters and transferors, and government agencies do not contain an obligation on chief executive officers to review on a quarterly basis whether laws and rules are being complied with.

676. The requirements imposed on banks and financial institutions, and on insurance and securities companies, are not specific enough to comply with FATF requirements. There is nothing in the relevant FIU AML Directives to require proper levels of staff and resource for the functions mentioned. There is insufficient guidance or directive on how to implement such requirements, including sample testing. The requirement for the CEO of the named institution does not appear to satisfy the requirement for a “independent” audit function as contemplated in the FATF standard.

677. With respect to banks s 60 of the BAFIA obliges banks and financial institutions to appoint an auditor and his responsibility under s 63(2)(c)(d)(h) is wide enough to include audit functions to test compliance with AML/CFT policies and procedures. In practice,, this audit function has not been extended to test the system of compliance of AML/CFT requirements to date. In relation to insurance and securities companies, the Insurance Act s 25 and the Securities Act s 80 require audits of accounts and other financial statements. However, those provisions do not obligate insurance and securities companies to maintain an internal audit or

compliance function to ensure compliance with AML/CFT policies, procedures, and controls that includes sample testing.

678. As of the date of the on-site visit most of the reporting institutions spoke with by the evaluation team had no internal guidelines in relation to AML/CFT. The FIU confirmed that no reporting institution has provided copies of their guidelines.

Ongoing compliance training

679. The ALPA and AML Rules do not require ongoing employee training. The FIU AML Directives require reporting institutions to provide necessary training to their employees to put in place an internal management system for the prevention of ML/TF. However, none of the reporting institutions have established ongoing employee training in AML and CFT or on the underlying rationales behind AML/CFT obligations and requirements.

680. While the Securities Act s 76(i) obliges licensed financial institutions to provide necessary training to its employees for skill enhancement in relation to its business operations, it does not require on-going employee training for AML/CFT.. Similarly, other legislation governing banks does not establish an obligation for on-going AML/CFT employee training.

Screening procedures when hiring employees

681. ALPA, AML Rules and FIU AML Directives are all silent on screening procedures for hiring new employees. Nepal authorities have asserted that even in the absence of legal requirements the reporting institutions adopt rigorous screening process for hiring their employees.

Implementation and effectiveness

682. Some financial institutions have appointed compliance officers (below senior management level), but lack internal AML/CFT controls or procedures. While compliance officers may gain access to records, this process appears to be informal due to the lack of underlying policies and procedures. The reporting chains of command and whether compliance officers must report to chief executive orders were not uniform. Most of the institutions interviewed during the evaluation which have appointed compliance officers could not point to any internal policy in relation to those officers. No financial institution indicated that compliance officers had obligations to report findings to boards of directors.

683. Since the Directives have been recently issued and FIU has started conducting basic training, compliance with their mandates appears nascent. The ongoing AML/CFT employee training programmes, addressing the different requirements of frontline staff, compliance staff, and staff dealing with new customers could not be confirmed during on-site visit.

684. Though the governing legislations, ALPA, AML Rules and FIU AML Directives do not require the reporting institutions to put in place screening procedures, the financial institutions spoken to by the evaluators stated that they have suitable screening procedure in place to ensure that employees hired by them have suitable qualification, experience and are persons of integrity and good character.

Additional elements

685. Compliance officers of financial institutions who have been appointed are not able to act independently and do not report to higher management or the Board of Directors. Institutions spoke to during the on-site visit all conformed that compliance officers report through a chain of command as opposed directly to senior management or the board.

Recommendation 22

686. ALPA, AML Rules and FIU AML Directives issued to banks and financial institutions, co-operatives, securities sector and insurance sector apply to all branches of such reporting institutions.

687. Currently, banks in Nepal have no foreign branches and foreign subsidiaries. NRB approval must be sought prior to establishing a branch/subsidiary presence in another jurisdiction. The insurance companies and securities business persons in Nepal are not permitted to open foreign branches and subsidiaries.

Additional elements

688. NRB officials informed that financial institutions that are subject to the Core Principles are required to apply consistent CDD measures at the group level, taking into account the customer's activity with the various branches and majority owned subsidiaries.

3.8.2 Recommendations and Comments

689. It is recommended that Nepal should :

- Create mandatory obligations for reporting institutions to establish AML/CFT internal compliance programme.
- Provide that the internal audit function including sample testing in all sectors should be independent and adequately resourced.
- Extend the responsibilities of compliance officers to overall compliance.
- Provide guidance on compliance officer functions and responsibilities in relation to AML/CFT.
- Obligate reporting institutions to establish on-going employee training programmes on AML/CFT and employee screening procedure.

3.8.3 Compliance with Recommendation 15 and 22

	RATING	SUMMARY OF FACTORS UNDERLYING THE RATINGS
R 15	NC	<ul style="list-style-type: none">• No mandatory obligation to establish AML/CFT internal controls.• No requirement to maintain an adequately resourced and independent audit function to test compliance (including sample testing) with AML controls.• A lack of effectiveness as most financial institutions lack AML/CFT policies, procedures and controls to prevent ML and TF, defining compliance officers' responsibilities, access to information, and chains of command
R 22	N/A	<ul style="list-style-type: none">• Nepal financial institutions do not have foreign branches and subsidiaries.

3.9 Shell Banks (R 18)

3.9.1 Description and Analysis

690. No law expressly prohibits shell banks from operating in Nepal. Nor are there any prohibitions on financial institutions entering into, or continuing existing correspondent banking relationships with, shell banks. However, according to Nepal regulators and banking representatives, no shell banks operate in Nepal.

691. Nepal officials highlighted that the NRB Act requires banks to be specifically licensed to do business in Nepal and that any shell bank would not meet licensing requirements. Nepal officials advised that they must approve the establishment of all correspondent banking relationships with foreign banks. They did not however provide any regulatory support for this statement.

692. Nepal lacks provisions to require financial institutions to satisfy themselves that correspondent financial institutions in a foreign country do not permit their accounts to be used by shell banks.

3.9.2 Recommendations and Comments

693. It is recommended that Nepal:

- Amend the statutory framework to bar financial institutions from entering into or continue correspondent banking relationships with shell banks.
- Nepal should amend ALPA, the NRB Act, and promulgate related Directives to require financial institutions to conduct a review compliant with FATF Recommendations to satisfy themselves that correspondent financial institutions in a foreign country do not permit their accounts to be used by shell banks.

3.9.3 Compliance with Recommendation 18

	RATING	SUMMARY OF FACTORS UNDERLYING THE RATING
R 18	NC	<ul style="list-style-type: none"> • No prohibition on financial institutions establishing correspondent relationships with shell banks. • No obligations on financial institutions to ensure that their accounts cannot be used by shell banks.

3.10 Supervisory and Oversight System - Competent Authorities and SROs (R 23, 29, 17 & 25)

3.10.1 Description and Analysis

694. ALPA, AML Rules and FIU AML Directives subject banks, other financial institutions and non-financial institutions to AML/CFT requirements. There is a scope limitation in AML Rules and FIU AML Directives with respect to requirements relating to internal procedures, policies and control. There are also shortcomings relating to enforceability of certain AML requirements provided in ALPA and with respect to all the AML/CFT standards provided in AML Rules and FIU AML Directives.

Authorities/SROs roles and duties & structure and resources – R 23, 30

Designated supervisory authorities and application of AML/CFT measures – R 23

695. AML Rule 9 sets out obligations for regulatory bodies to prevent ML and to take steps to:

- (1) execute or cause to execute ALPA, the AML Rules, and the FIU AML Directives;
- (2) issue necessary directives to institutions that they regulate;
- (3) inspect and supervise institutions' compliance with numbers (1) and (2) ; and

- (4) provide the FIU with reports on inspection and supervision related to compliance on 1 and 2.

696. Nepal's three principal financial sector regulators are the Nepal Rastra Bank (NRB), the Securities Exchange Board of Nepal (SEBON) and the Insurance Board. These regulators have power under their governing statutes to license, supervise, and regulate their respective financial institutions, including issuing directives and licensing conditions. With the exception of NRB for money remitters and changers, no other regulator has issued AML/CFT directives in accordance with this power. NRB has issued AML/CFT Directives for banks and financial institutions since 2005, and has provided the Directives issued by NRB on 7 April 2006 to banks and financial institutions. However, the evaluators note that those instruments are unenforceable guidance to banks and financial institutions in the form of KYC requirements and do not meet all FATF standards.

697. FIU is part of NRB and is authorised under ALPA s 10(1)(e) to inspect transactions and records of banks, financial institutions and non-financial institutions, and to obtain any document, information or clarification relating to such transactions or records. However, its sanctioning power under ALPA s 31 is limited only to non-compliance with TTR and STR requirements under s 7 - and the FIU AML Directives are unenforceable for the reasons stated in earlier parts of this section.

698. There is only one licensed stock exchange in Nepal, the Nepal Stock Exchange (NEPSE) that accounts for all the transactions in equity shares and a few transactions in bonds. Under the Securities Act (s 45), the NEPSE is authorised to supervise and ensure that its members (stock brokers) adhere to the Securities Act, rules and by-laws made there under and to monitor and supervise the compliance by them. These by-laws are legally valid under s 45(g) of the Securities Act.

699. The Registrar of Cooperatives and NRB are the prudential supervisory authorities for Cooperatives that are engaged in financial activities. The Department of Postal Service has some supervisory authority over Postal Savings Banks (PSBs) but has no AML/CFT supervisory obligations. Non-governmental organisations (NGOs) also engage in micro-finance and are licensed by NRB for limited banking business. Commodity brokers are not subject to AML/CFT requirements. The inclusive definition of 'financial institution' in ALPA s 2(h) includes any company 'licensed for business operated as per prevailing laws'. Though there are commodities exchanges operating in Nepal, there is no 'prevailing law' to regulate their business and to establish a licensing and supervisory regime for them. Thus, commodities brokers are not included in the definition under ALPA.

700. AML Rule 8 authorises the Government of Nepal, in consultation with the AML Coordination Committee, to designate any regulatory body to regulate any institution. As stated above, the ALPA does not apply to the commodities exchanges and brokers sector. Nepal advised that SEBON is proposed to be assigned the responsibility of regulating commodities exchanges and brokers for AML/CFT compliance. For this purpose the Securities Act would require amendment, regardless of whether the Coordination Committee extended the responsibilities of SEBON under AML Rules 8 and 9. If designated under Rule 8, the designation could be limited for activities described under rule 9.

NRB

701. As per s 79 of the NRB Act, the NRB is the regulator having supervisory authority over a wide range of financial institutions. It has powers and responsibilities laid down in both its own governing legislation and the various sector-specific statutes. NRB is regulator for banks and financial institutions licensed under BAFIA ss 49 and 52 and NRB Act s 79. NRB is also the

regulator for money changers/ transferors and money remitters licensed under the Foreign Exchange (Regulation) Act (FERA) s 3. NRB also has supervisory powers over cooperatives that are licensed by it for 'limited banking business'³⁰. NRB has issued the Directives to the NRB licensed Cooperatives for Limited Banking Activities 2003 (NRB Directives to Cooperatives) under the NRB Act 2002 s 79 and the Cooperative Acts 1992 s 26(2).

702. There are five separate departments within NRB having regulatory authority responsibility over financial institutions as follows:

NRB Supervisory Departments	Class of FIs regulated/supervised
Regulation Department	Licensing power to class A, B, C and D of FIs
Bank Inspection and Supervision Department	Class A financial institutions
FIs Supervision Department/ Non bank Inspection and Supervision Department	Class B & C financial institutions
Micro Finance Promotion & Supervision Department	D Class FIs
FOREX Management Department	Money changers and money remitters

703. NRB has issued internal instruction to its supervisory departments to conduct AML/CFT supervision. All NRB supervisory officers are authorised to supervise and monitor AML/CFT compliance as per NRB's routine supervision programme and policy. Thematic inspections for AML/CFT have not yet commenced.

FIU

704. The FIU is authorised under ALPA s 10(1)(e) to inspect reporting institutions and issue sanctions in relation to TTR and STR requirements. At the time of the onsite visit the FIU had not commenced this supervision function and the NRB lacked supervisory capacity.

SEBON

705. SEBON is the regulator for the securities sector (ss 5 and 84) and has responsibility under the Securities Act for the licensing (ss 5, 36, 56)) and power to regulate, monitor (s 84) and supervise (ss 5, 85 to 86) stock exchanges, securities business persons including stock brokers and others. SEBON has licensed a stock exchange, stock brokers, issue managers, underwriters, portfolio managers and share registrars.

706. SEBON has not issued AML/CFT regulations for securities sector. Directives have been issued by the NRB/FIU, but SEBON has not begun to supervise implementation of those Directives. SEBON has not prepared AML/CFT supervision manuals or instructions for its staff.

707. SEBON recently issued prudential regulations for central depository and custodial services (Securities Central Depositories Services Regulations 2010) and for mutual funds/collective, investment schemes (Mutual Funds Regulations 2010). These regulations will commence in effect from the date prescribed by SEBON. SEBON has not yet prescribed information.

708. SEBON is primarily responsible to ensure the protection of interests of investors in securities, development of the capital market to mobilize capital for economic development and

³⁰ The "Limited Banking Activities" is defined in NRB Directives to Cooperatives as acceptance of deposits from members only or loans against collateral to agriculture, industry, service or productive sectors prescribed by NRB.

to counter market manipulation. Under the Securities Act, it has wide power to issue directives (s 87) to the financial institutions it regulates and to monitor their activities (ss 5(h),(m) and supervise compliance by them (ss 84-86).

NEPSE

709. NEPSE grants membership to its members and recommends to SEBON for their registration. Only a member of the stock exchange can be licensed as a stockbroker by SEBON. NEPSE can also supervise their members. However, to date NEPSE has not supervised its members for AML/CFT compliance.

710. NEPSE is required to report and give information to SEBON where it has appeared to it that any of its members has failed to fulfil or is not capable of performing its obligations under the law (s 46). Under s 51, the NEPSE is also required to render necessary assistance to the SEBON in regulation and supervision and to furnish information and advice to SEBON.

Insurance Board

711. Under the Insurance Act 1992 the Insurance Board is the regulator for insurers, insurance agents, surveyors and brokers. The Insurance Board has power to issue Directives to insurance companies regarding their business and impose a complete or partial ban on their business if they violate the Directives issued by the Board. It has the power to conduct inquiries and investigations into the supervised entities and can apply fines on directors, employees, surveyors, brokers or agents.

712. The Insurance Board has not issued AML/CFT regulations for insurance sector. Directives have been issued by the NRB/FIU, but the Insurance Board has not begun to supervise implementation of those Directives. The Insurance Board has not prepared AML/CFT supervision manuals or instructions for its staff.

Registrar of Cooperatives

713. Cooperatives are permitted to accept deposits from and lend to its members only, and are licensed by the NRB to conduct limited banking transactions. There are about 19,798 cooperatives in total, and 15 cooperatives have a license from the NRB for limited banking transactions. Over 5,000 cooperatives have been approved by the Registrar of Cooperatives to offer savings and lending to their members.

714. On 14 April 2010, the FIU issued Directives to cooperatives specifying certain AML/CFT requirements. The FIU AML Directives are yet to be implemented by cooperatives and Registrar of Cooperatives.

Department of Postal Service

715. The Department of Postal Services is responsible for regulating the postal savings bank. The postal savings bank offers account services to government officials in rural areas only. The postal savings bank has 117 branches, providing banking services to 46,981 government officials with total deposits of NRps 1.1 billion (US\$14.7 million).

716. Because ALPA does not include postal banks within its definition of “financial institutions” postal banks are not subject to AML obligations under the Act and no AML Directives have been issued. Nepal has not conducted any analysis of terrorist finance and ML risks posed by postal savings banks.

Structure and resources of supervisory authorities – R 30

717. Nepal suffers from a serious lack of proper technology, human resources, knowledge, skill enhancement and training of supervisory staffs. Despite these constraints and limitations, the AML/CFT culture is gradually growing in Nepal.

Nepal Rastra Bank

718. The NRB is established as an autonomous regulator under s 3 of the NRB Act. It is Nepal's central bank having full powers to formulate, implement and cause to implement the monetary policy of Nepal (s 44). Its Board consists of the Governor, Secretary of the Ministry of Finance, two Deputy Governors and three Directors. Although the Government has powers to appoint the Governor, Deputy Governors and Directors (ss 15, 16 and 17) and to remove them (s 22), the NRB has operational and functional independence from the Government.

719. The NRB Board has power to appoint employees for conducting its functions and the terms and conditions, remuneration and other benefits payable to the employees are to be governed by Rules made by the NRB (NRB Act s 36). Five separate departments within NRB have regulatory responsibility for various financial institutions. The number of supervisory staff in respective department is shown in the following table:

Supervisory Departments	Class of FIs regulated/supervised	No of supervisory staff
Regulation Department	Licensing power to A,B,C and D class of FIs	31
Bank Inspection and Supervision Department	A Class FIs	44
FIs Supervision Department/ Non bank Inspection and Supervision Department	B & C Class FIs	59
Micro Finance Promotion & Supervision Department	D Class FIs	27
FOREX Management Department	Money changers/transferors and money remitters	33

720. The supervisory staffs of NRB are permanent and are recruited through competitive examination.

721. Section 43 of the NRB Act requires NRB to approve its budget and programs prior to the beginning of each fiscal year. The NRB has also discretion to evaluate and amend the approved budget in each three months on the basis of actual position and the matters that can be estimated. The budget is decided internally by NRB and though it is sent to the Government of Nepal for information, it does not require approval of the Government. The budget is funded directly from the profit and income of NRB (s 41). Authorities in NRB informed the evaluators that there is no separate departmental budget arrangement; a centralized budgetary system is extant in the NRB.

722. The NRB as a whole seems to be adequately structured and has sufficiently technical and other resources to perform its duties. Allocation of funding within NRB on functions such as supervision, investigation and inspection is solely a matter for NRB and there is no government involvement in this regard.

723. The service conditions of employees are governed by Rules issued by the NRB under s 36 of the NRB Act. All staff members of the NRB are bound by the Code of Conduct which contains a set of standards relating to honesty, integrity, loyalty, good faith, professionalism, fairness, impartiality, confidentiality, etc. Violation of these standards may result in departmental action including warning, demotion and removal. NRB Act s 39 prescribes standards of confidentiality applicable to all officials and employees. The Anti-Corruption Act applies to all staff as well and violation may lead to criminal punishment.

724. Two officers of NRB have attended the India/IMF Workshop for Financial Supervisors on AML/CFT compliance held in November 2009. NRB imparts in-house training to its supervisors on inspection procedures laid down in the inspection manual. NRB is considering specific AML/CFT inspection procedures and expects to provide training to its inspectors on AML/CFT supervision.

FIU (Supervisory function)

725. FIU staff members are primarily NRB staff. While the FIU is established with 11 staff (including one “peon”), no dedicated supervisory staff is posted in the FIU. The current Chief of the FIU is a senior officer in the NRB’s supervision department. The FIU’s supervisory role is yet to be given focus. There is no separate budget allocation for the FIU.

SEBON

726. SEBON derives its structure, powers, functions, roles and responsibilities under the Securities Act. The structure and constitution of its Board is laid down in s 3(1) of this Act. The Governing Board of SEBON comprises seven members:

- One full-time Chairperson appointed by the Government of Nepal;
- Two Joint Secretaries, representing Ministry of Finance and Ministry of Law, Justice and Parliamentary Affairs;
- One Executive Director of NRB;
- Two representatives (one each) from Institute of Chartered Accountants of Nepal (ICAN) and Federation of Nepalese Chambers of Commerce and Industries (FNCCI); and
- One expert member appointed by the Government of Nepal.

727. While the Chairperson is a full-time appointment, the other members are part time: two joint secretaries of concerned Ministries of the Government are represented as ex-officio members, one expert member is appointed by the Government. The representative of NRB is nominated by NRB and is currently one of its Executive Directors. The representatives of ICAN and FNCCI are nominated by each of them respectively.

728. The international benchmarks³¹ require the regulators to be operationally independent from external political or commercial interference in the exercise of their functions and powers. Although SEBON is conceived as an autonomous regulator under s 4 of the Securities Act, its structure and composition may affect its independence and autonomy.

729. The specific authority of the Government to issue necessary directions from time to time (s 113) and to approve the Rules before they are laid down (s 116) and practice of government approval on all policy initiatives affect SEBON’s independence. In practice, SEBON does not appear to have sufficient autonomy and operational independence to fulfil its responsibilities.

³¹ IOSCO Principles (2003) and IMF Working Paper No WP/02/46 Regulatory and Supervisory Independence and Financial stability.

NEPSE is owned and controlled by the Government and governing board of the stock exchange and that of the SEBON may sometimes have similar composition. This may also undermine the efficiency of SEBON in supervision of NEPSE.

730. There are seven Departments and 16 sections in SEBON as shown in following Table :

Departmental Structure of Securities and Exchange Board of Nepal		
Department	Divisions	No of Staff
Management Department	• Human Resources Section	3 Headed by Deputy Director
	• Finance Section	
Planning and Development Department	• Research Section	4 Headed by Deputy Director
	• Training Section	
	• Information Technology Section	
	• International Affairs Section	
Corporate Finance Department	• Public Issue Section	2 Headed by Deputy Director
	• Collective Investment Scheme Section	
Regulation Department	• Stock Exchange Regulation Section	2 Headed by Director
	• Securities Businessperson Regulation Section	
Surveillance Department	• Stock Exchange Surveillance Section	2 Headed by Director
	• Market Intermediaries Surveillance Section	
	• Trading Surveillance Section	
	• Corporate Surveillance Section	
Financial Information Analysis Department	-----	2 Headed by Deputy Director
Legal Department	• Research and Investigation Section	4 Headed by Deputy Director
	• Enforcement Section	

731. Currently, the SEBON has 19 staff at officer level including Directors, Deputy Directors and officers out of which two are with the Regulation Department and two with the Surveillance Department. SEBON is currently facing an acute shortage of staff and it has yet to extend its regulatory and supervisory focus for AML/CFT purposes. The evaluators were informed that SEBON is not able to hire sufficient number of staffs because of non-receipt of approval from the Government.

732. Funding arrangements for SEBON is provided in s 22; that include the amounts received from the Government of Nepal, amounts received from grants and income sourced from license fees registration fees and transaction fees and amounts realized by imposing fines. However, there is substantial government involvement regarding allocation of funds for various functions of SEBON. SEBON also does not have sufficient technical resources to perform its functions effectively.

733. Although they did not inform about any relevant Rules, the authorities in SEBON asserted that the employees are hired through a screening process and are bound by code of conduct and integrity standards stipulated in appointment conditions / service contracts. Breach or inefficiency of an employee attracts penalties ranging from admonishment, warning, demotion or dismissal/removal from service. Secrecy provisions for the Chairperson, member, advisor, employee, auditor, agent or representative of the SEBON are stipulated in s 21 of the Securities Act. The Anti-Corruption Act applies to the staff and violation may lead to criminal punishment.

734. Except for a 4-hour awareness-raising workshop conducted by the FIU in 2010 employees of SEBON have not received any AML/CFT training. The workshop did not cover AML/CFT supervision procedure. There is a pressing need to train SEBON staff in AML/CFT requirements.

Insurance Board

735. Under s 3(1) of the Insurance Act the Insurance Board comprises five members:

- A full time Chairperson nominated or designated by the Government of Nepal;
- Two members representing one each from Ministry of Finance and Ministry of Law, Justice and Parliamentary Affairs;
- A member nominated by the Nepal Government from among the persons having the special knowledge in the Insurance Business;
- A member nominated by the Nepal Government from an insurance company.

736. The Insurance Board has operational independence from the Government with a total strength of 27 officials, including the Chairperson, one Executive Director and two Directors. It is organised into two departments headed by one Director each. Each Department has two Divisions and their strength is as stated in the following table:

Departmental Structure of Insurance Board of Nepal		
Department	Divisions	No. of Staff (including deputy director)
Research and Management Department Headed by Director	Development Administration Division Headed by Deputy Director	6
	Office Management Division Headed by Deputy Director	6
Supervision and Regulation Department Headed by Director	Supervision Division Headed by Deputy Director	6
	Legal & Regulation Division Headed by Deputy Director	5

737. The Insurance Act s 7 authorises the Board to appoint employees for the operation of its functions. While a team of only seven officials, including one Director, is involved in supervising and monitoring compliance with the requirements of the Insurance Act and its Rules/Directives these officials also conduct compliance checks. The Insurance Board recognises the need to increase its human resources for effective supervision and monitoring as well as training in supervision of AML/CFT requirements.

738. The Insurance Board's funding arrangement is stated in the Insurance Act s 34 which provides for the constitution of a separate Fund made up of (1) all amounts received from the government of Nepal or any foreign government or international organisation, (2) fees and service charges received by the Insurance Board under the Act, and (3) amounts received from other sources.

739. The Insurance Board has independence in its operations and expenditure of funds. However, it needs additional human and technical resources to perform its functions more effectively.

740. The conditions of service employees of the Insurance Board are to be governed by rules made by the Insurance Board with approval of the Government (s 7(2)). Although they did not provide the evaluation team with any relevant Rules, the officials interviewed stated that employees are hired through a screening process and are bound by integrity standards specified in the code of conduct or appointment conditions stipulated in service contracts. In case of breaches, an employee is liable for penalties ranging from admonishment, warning, and demotion to dismissal/removal. The Insurance Act does not contain any confidentiality standards for the employees of the Insurance Board. The Anti-Corruption Act applies to the staff and violations of this statute may lead to criminal prosecution and punishment.

741. Employees of the Insurance Board have not attended any training on AML/CFT except for a 4-hour workshop conducted by FIU in 2010 (as stated for SEBON above). Again, this workshop did not cover AML/CFT supervision procedure.

Registrar of Cooperatives

742. The Registrar of Cooperatives is appointed by the Government the Cooperatives Act 1992 s 21. The Registrar's head office is located at Kathmandu. It has total 40 offices across the country and a total of 594 employees 38 of which are responsible for monitoring and supervising cooperatives. Two officers of the NRB assist in the supervision of cooperatives licensed by NRB for undertaking limited banking activities. The Registrar can delegate any of its powers under the Co-operatives Act and Rules to any subordinate officer.

743. The service conditions of the Registrar have to be in terms of the rules prescribed by the Government and its staffs are bound by a set of standards relating to honesty, integrity, and good conduct.

744. Except for the 4-hour workshop noted above for other supervisors, no other training has been given to the employees of the Registrar of Co-operatives for AML/CFT supervision. The Registrar's office informed the evaluators that staff members involved in the supervision of cooperatives lack knowledge and experience in understanding new methods and techniques involved in financial transactions and AML/CFT requirements.

Authorities Powers and Sanctions – R 29, 17

Supervisory powers – R 29

745. AML Rules 9(b) and 9(d) provide that financial institutions can inspected and supervised by their relevant regulators for compliance with AML requirements and to submit reports to the FIU. However, as previously discussed, Rule 9 is not enforceable, authorisation of regulators is through administrative fiat rather than legislative mandate and the regulators have not issued individual AML/CFT directives or directives to ensure compliance to date.

NRB

746. **Power to monitor and ensure compliance and conduct inspections:** The NRB licences and supervises banks and financial institutions under BAFIA (s 4, 29, 30, 52, 78, 79 and 84) and FERA (s 3 and 14) it is also authorised to license and regulate the money changers/transfers and money remitters. NRB also has supervisory powers over cooperatives licensed for limited banking business. The NRB can issue Rules, By-laws Orders and Directives and impose terms and conditions for the issuance of licenses (s 33 of BAFIA and s 3 of the FERA).

747. BAFIA s 33 and FERA s 3, on granting a license, the NRB can impose terms and conditions on the licensed institution. One of the conditions subject to which the NRB grants licenses to money changers/transfers or money remitters is that licensees must comply with ALPA and AML Rules. However, money changers/transfers or money remitters claim that they face difficulty to ensure compliance due to lack of awareness and training and similar compliance obligations have not been imposed upon other financial institutions.

748. Nepal authorities claim that the NRB has issued AML/CFT Directives for banks and financial institutions since 2005; however, it seems they relate to KYC requirements and do not cover all AML/CFT requirements to meet FATF standards. NRB has yet not issued any Directives or circulars under BAFIA, NRB Act or FERA to apply AML/CFT compliance obligations on financial institutions including cooperatives that it has authority to regulate.

749. Under s 10(1)(e) of ALPA, the FIU is authorised to inspect transactions and records of banks, financial institutions and non-financial institutions and obtain any document, information or certification relating to those transactions or records. This is a limited supervisory power relating to “transactions” and “transaction filing”. Accordingly, there is no explicit authority with respect to monitoring and ensuring compliance of AML/CFT requirements. However, the power is not enforceable and no sanctions are available for failure to furnish information, records and documents to FIU. FIU has yet to use this power; hence, the effectiveness cannot be assessed.

750. Both the BAFIA s 49(2) and the NRB Act s 84 authorise the NRB to frame Rules and By-laws for regulation of those licensed institutions and to issue necessary orders, Directives and circulars. Under BAFIA s 52, NRB Act s 79(5)(b) and s 84, and under FERA s 14, the NRB has broad powers of investigation and inspection over financial institutions that it regulates. The power under s 52 of BAFIA includes on-site inspection, off-site inspection and special inspections and it empowers the NRB to carry out inspections of banks or financial institutions - its books and accounts, records, and other documents. In terms of clause 40(6) of the NRB Directives to Cooperatives (2003), the NRB has authority to undertake on-site or off-site inspections and supervision of the licensed cooperatives at any time. Under FERA, the Government can inspect the accounts, books and other documents of any licensed money changers/transfers or money remitters (s 14).

751. The NRB can carry out an investigation or inspection on the books and accounts, records, documents or register of banks or financial institutions to determine compliance with the NRB Act or rules, by-laws, orders or directives issued under that Act. The scope of these inspections can extend to the licensed institutions and their directors, officials or employees. During inspections, it is the duty of the licensee, its director or officer /employee to submit all such accounts, books and documents as are in his or her custody or control. Non-cooperation with inspecting officers by any such director or officer attracts sanction under the respective Act (s 100 of NRB Act and s14 of FERA).

752. NRB Act s 84 requires NRB to frame and implement inspection and supervision by-laws conforming to international standards for inspection and supervisions. The NRB has issued Inspection Supervision By-Laws 2003 and has also issued an On-Site Inspection Manual 2002 for licensed banks and financial institutions. These instruments do not however contain any AML/CFT criteria.

753. NRB has not undertaken focused inspections of a licensed financial institution with respect to AML/CFT requirements. Nepal authorities informed the evaluation team that routine supervision also covers CDD compliance and compliance with 2006 KYC Directives issued by the NRB. NRB indicated and that from the first quarter of 2011 they will include compliance with AML/CFT requirements in routine inspections.

754. ***Power to compel production or to obtain access to Records:*** Based on the provisions of BAFIA ss 52 and 55 and of NRB Act ss 79(3)(4)(5) and 82, the NRB can require licensed banks and financial institutions to furnish information and documents on its demand. The NRB Act s 82 obliges banks and financial institutions to furnish particulars of their transactions and financial position to NRB. There is no limitation on the type of information that is required to be furnished. FERA s 11 also empowers the Government or the NRB to order any person to furnish “any statements, books of account or documents for the accomplishment of the objectives of the Act.” There is no need for a court order for calling for information or document.

755. BAFIA s 52 requires the directors and officers of licensed institutions to provide records, data, particulars, information and other documents in his custody and demanded by the inspector within such time as specified by him. Similar power exists in s 79 of NRB Act and s 11 of the FERA. Failure to furnish that information may result in sanctions under the respective Act (s 71 of BAFIA, s 100 of the NRB Act and s 17 of FERA).

SEBON & NEPSE

756. ***Power to monitor and ensure compliance and conduct inspections:*** Under the Securities Act, SEBON has responsibility to license, regulate and supervise the stock exchange and securities business persons (s 5) and has general power to regulate and monitor all activities relating to securities that are carried out by the stock exchanges, securities business persons, their agents and listed companies (s 84). SEBON can also impose terms and conditions (ss 39 and 59) to be met by the stock exchange and intermediaries licensed by it and has power to issue directions under s 87 to all the regulated entities in the securities sector. Fines are prescribed in Securities Act s 101 for non-compliance with the Act, Rules or By-laws issued under the Securities Act. SEBON has not issued any directives relating to AML/CFT for ensuring compliance under the APLA, AML Rules and FIU AML Directives.

757. The Securities Act s 5 empowers SEBON to undertake inspections of the stock exchange and licensed business persons and provides for inspections or inquiries (s 85) and investigations (s 103) by SEBON. The stock exchange (NEPSE) has also have authority (s 45(c)) to inspect stock brokers. The scope of inspections extends to, among other things, compliance with the Act, rules, by-laws and Directives or orders issued under the Securities Act.

758. Though SEBON can ensure compliance of AML/CFT requirements by issuing directives to licensed financial institutions under the Securities Act, SEBON has yet not yet issued any Directives under the Securities Act or under AML Rules.

759. SEBON has not undertaken any inspection or supervision of NEPSE or licensed securities business persons for compliance with AML/CFT requirements. SEBON does not

perceive any potential risk of ML and TF in the securities sector and it faces staff and capacity building constraints that constrain it from effectively supervising licensed entities. Nepal authorities have, however, shown keenness to take appropriate measures to ensure that the entities operating in securities sector combat ML/TF and comply with AML/CFT requirements.

760. NEPSE has authority under s 45(c) of the Securities Act to monitor and supervise compliance of the Securities Act, rules and by-laws by its members (stockbrokers) and is obligated to report to SEBON regarding non-compliance by its members (s 46(b)). NEPSE is mainly concerned with failures of implementing procedural and NEPSE has not focused on ensuring compliance of AML/CFT requirements by its members to date. Section 46 of the Securities Act imposes ongoing information disclosure obligations on NEPSE. Sections 51 and 52 contemplate a formal co-operation mechanism between SEBON and NEPSE for information exchange, regulation and supervision of stock brokers. However, no date on effective implementation of these mechanisms has been provided by Nepal authorities.

761. ***Power to compel production or to obtain access to records:*** SEBON can demand any information from the stock exchange; the stock exchange is obliged to give such information (s 51). Section 82 obliges the securities business persons to submit financial statements to SEBON and the stock exchange. As per ss 86(2) and (3) SEBON can compel the stock exchange or the securities business persons to produce any information, data and statements as deemed necessary. This power is general - there is no need for a Court order - and failure to furnish information or produce such documents may result in fines under s 101(4).

Insurance Board

762. ***Power to monitor and ensure compliance and conduct inspections:*** The Insurance Act s 8 empowers the Insurance Board to register and license insurers, insurance agents, surveyors or brokers and to issue necessary Directives to insurance companies regarding their business. The Insurance Board can impose complete or partial bans on insurers if they violate Directives (s 12A). Under s 36 it can impose fines on any insurer, its director or employee or surveyor or broker or agent for breaches of the Act, Rules, orders or directives issued under the Act who knowingly violates the Insurance Act or the Rules made there under or order or Directives issued by the Board.

763. The Insurance Board has not issued any directives applying AML/CFT compliance obligations to the insurers, brokers, surveyors or agents. In the absence of its own directives the Insurance Board cannot monitor and ensure compliance of AML/CFT requirements under the Insurance Act.

764. Under s 39 of the Insurance Act, the Insurance Board has wide power to make an inquiry or investigation of the insurer, insurance agent, surveyor or broker or other related persons or corporate bodies regarding the insurance business or any other business of any insurer if it has undertaken any other business or 'for any other reasonable cause'. Under that section insurers and their employees must assist by providing the accounts, record, registers, books or any other documents or information sought in inquiry or investigation.

765. ***Power to compel production or to obtain access to records:*** The Insurance Act does not give general powers to the Insurance Board to compel production of or to obtain access to records, documents or information. The obligation of the insurance companies, brokers, agents, and surveyors to submit information under Insurance Act, s 15 is limited with respect to notifying the Insurance Board about dealings with their directors and when inquiries or investigations are undertaken.

766. Insurance Act, s 39 (2) obliges the licensed insurers and intermediaries to submit documents and information sought during an inquiry or investigation. This obligation to furnish information or to produce documents or records is limited to on-site inspections and does not entitle the Insurance Board to supervise the compliance by financial institutions regulated by it by calling for information and record for off-site supervision. The Insurance Act does not give general powers to the Insurance Board to compel production of or to obtain access to all records, documents or information relevant to monitoring compliance by the institutions it regulates, as and when it deems necessary.

Registrar of Cooperatives

767. **Power to monitor and ensure compliance and conduct inspections:** Cooperatives must be registered according to the Cooperatives Act 1991 with the Registrar of Cooperatives and once registered are bound to comply with the Cooperatives Act and Cooperatives Rules issued under the Cooperatives Act. Section s 26(2) allows cooperatives to be licensed from NRB for limited banking transactions subject to the terms and conditions prescribed by the NRB. Nepal authorities informed the evaluation team that the licensing system has been put on hold by the NRB – currently 15 cooperatives are licensed by the NRB to undertake financial activities. There is no specific legal basis, except under AML Rule 9, establishing authority of Registrar to ensure compliance of AML/CFT requirements.

768. The Registrar of Cooperatives has the power under s 35(1) of the Cooperatives Act to inquire into the activities of a cooperative if at least 5% of the members complain to the Registrar. Pursuant to s 35(2) of the Cooperatives Act, if business transactions of any cooperative do not appear satisfactory, the Registrar may inquire into the matter or appoint an official to conduct an inquiry. Every member and employee of the cooperative under s 35(3) must render assistance in every respect by providing information as sought. The Registrar or the official conducting the inquiry must inform the cooperative concerned of the result of any inquiry.

769. Under s 36 of the Cooperatives Act, the Registrar may inspect a cooperative and if he finds that the society has not complied with the Cooperatives Act, Rules or By-Laws issued under the Act, the Registrar may give directions to the cooperative to make “necessary provisions” in order to comply with the Act. Rule 23 of the Cooperatives Rules 1993 empowers the Registrar or any official authorised by him to undertake inspection of any records or documents of a cooperative. That cooperative, its director or officials are required to cooperate with an inspection in this regard. After an inspection, the inspecting official has to prepare a report giving his recommendations. The Registrar must ensure that necessary reforms are made to address the shortcomings listed in the inspection report. No sanctions can be applied for any breaches and only advises to reform the shortcomings can be issued after inspections.

770. Nepal authorities informed the evaluation team that the Registrar of Cooperatives undertakes inspections of cooperatives only with respect to their cooperative-related activities other than financial activities.

771. The inquiry or inspection powers of the Registrar of Cooperative are limited with respect to their scope. No administrative, civil or criminal actions are provided for violations of the Cooperatives Act, Cooperatives Regulations or any order of the Registrar beyond the imposition of fines. The authorities also informed the evaluation team that Nepal has adopted a policy and is developing separate legislation to regulate micro-finance institutions, including cooperatives.

772. To date, no on-site or off-site inspection has been undertaken with respect to AML/CFT compliance in the cooperatives sector. Officials of the Registrar of Cooperatives informed the evaluators that they are keen to ensure compliance of AML/CFT obligations by licensed cooperatives and their supervisory power is affected due to resource constraints.

773. **Power to compel production or to obtain access to records:** The Cooperatives Act ss 23, 33 and 34 and AML Rules 22 and 24 oblige every cooperative to maintain records, books and documents and submit an annual report of its transactions and audit report to the Registrar of Cooperatives. The Cooperatives Act s 35(3) obliges every member and employee of the cooperative to provide such information during inquiry by the Registrar or the official authorised by him.

774. However, the Cooperatives Act and the Cooperatives Rules do not authorise the Registrar to compel cooperatives, their directors or officers, to produce documents and records relating to their transactions as, and when, deemed necessary by the Registrar.

Powers of enforcement and sanctions – R 29 and R 17

ALPA provisions apply to all reporting institutions

775. While ALPA (s 31) empowers the FIU to impose a fine of NRps 500,000 (US\$6,757) on banks and financial institutions and NRps 25,000 (US\$338) to NRps 100,000 (US\$1,351) on non-financial institutions, the sanctioning regime under ALPA s 31 has scope limitation with respect to the following:

- No sanctions for breaches of AML/CFT obligations other than the TTR/STR obligations. (e.g. CDD requirements, timing of identification of beneficial ownership, recordkeeping, etc);
- No sanction for breaches of AML Rules and FIU AML Directives;
- No sanctions can be applied to natural persons e.g. director, manager, secretary or other officer of the reporting institutions;
- No administrative or criminal sanctions for AML/CFT obligations.

776. No sanction has been applied under s 31 by FIUs to date. As stated above in s 3.8 of this report, AML Rules and FIU AML Directives are not enforceable and the designated regulators do not have authority to apply sanctions under ALPA.

Financial Institutions supervised by NRB

777. **Banks and Financial Institutions:** Both the BAFIA and the NRB Act empower the NRB to take wide range of actions against a bank or financial institution for violations of BAFIA, NRB Act, rules, by-laws, orders or directives issued by NRB. The table below illustrates the sanctions available under respective Acts:

Nature of Breach	Available Sanction
Civil Sanctions	
Breach of NRB Act, BAFIA or Rules or By-Laws or orders or directives.	Suspend or cancel or freeze (partially or fully) the business (s 35 BAFIA) Suspend the Board and take control (s 54 BAFIA)
Non-compliance with the conditions of license	Cancel the licence (s 35(2) BAFIA)
Breach of order or Directives	<ul style="list-style-type: none"> • Warnings,

issued by NRB	<ul style="list-style-type: none"> • Advisory letters to end repeated violations and take corrective measures, • Fines (which may extend to the amount related to the violation), • Advice to the Board to take corrective measures, • Restrain distributions of dividends or bonus shares or accepting deposit or advancing credit, • Full or partial ban on activities, • Suspension or cancellation of license • File dissolution proceedings (s 74(1) BAFIA)) • Suspend or terminate the employee (s 100(1) NRB Act)) • (s74(1) BAFIA and s 100 NRB Act)
	Fines which may extend to the amount involved in violation (s 99 NRB Act)
Failure to furnish information/submit documents during inspection /supervision	Fine ranging from NRps 10,000 (US\$ 135) to NRps 50,000 (US\$ 676) (s 74 (2) BAFIA)
Breach by any officer /director - of Act , rules, directives order and failure to furnish information/submit documents during inspection/supervision	<ul style="list-style-type: none"> • Warning • Suspension • Fine not exceeding NRps 500,000 (USD 6,757) • Order the institution to withhold his/her salary and allowances or to remove him/her from the office (s74 (2) BAFIA s 100 (2) NRB Act)
Breach of the NRB Act or other prevailing laws or the terms of license or regulation, Directives or order of NRB	Declare a bank or financial institution as problematic under s 86B NRB Act
Criminal Sanctions	
Carrying out financial transactions without obtaining a license	Fine up to 300% of the amount involved in the transactions or with imprisonment for a term up to three years or with both , and confiscation of the amount involved in the transactions (s 71 (1)(a) and s.70(a) BAFIA)
Violation of BAFIA or any order or directive issued under this Act	Fine equal to the amount involved in the offence or with imprisonment for a term up to one year or with both ,and confiscation of the amount involved in the transactions (s 71 (1)(e) and s 70(c) BAFIA)
Failure to comply with the provisions of NRB Act or Rules or By- Laws, orders or directives	Fine up to NRps one million (USD 13,514) or imprisonment up to three years or both. Such sanctions extend to the officials of the financial institutions also. (s 96 NRB Act)

778. The sanctions under NRB Act ss 96, 99, 100 and BAFIA s 71 and 74 also available to directors or officers or employees. Attempt to commit the offence under s 71 of BAFIA is also punishable with half the prescribed punishment (s 71 (3)). While criminal sanctions can be imposed by courts, civil sanctions can be applied by NRB without court involvement.

779. NRB can apply sanctions available under BAFIA or NRB Act for breaches of AML/CFT Directives issued by it under those Acts. However, except for limited sanctioning power available under s 31 of ALPA, the FIU(NRB) does not have any power to apply any sanction under ALPA for breaches of AML/CFT requirements provided in ALPA, AML Rules or FIU AML Directives.

780. *Money changers/transferors and the money remitters:* Breaches of orders or directives issued by the NRB under the Foreign Exchange (Regulation) Act (FERA) by licensed

institutions attract any or all of the following civil sanctions under s 3A of FERA without court involvement:

- admonition;
- imposition of restrictions on foreign transaction;
- forfeiture of cash deposit; and
- suspension or cancellation of the entity's license.

781. The range of sanctions provided in s 17 of FERA for contravention of the Act or Rules, orders or directions, varies from forfeiture of the foreign exchange related to the offence and imposition of additional fines ranging from the amount involved to three times the amount. If amount cannot be determined, the violator may be fined up to NRps 200,000 (US\$ 2,702). These sanctions also extend to the director, office bearer, employee or agent of the licensed money changer/transferor and money remitter.

782. Having introduced AML/CFT compliance obligations through licensing conditions to money changers/transferors and money remitters, NRB can apply these sanctions for breaches of AML/CFT requirements, but it has not applied any to date.

783. **Application of sanctions by NRB:** NRB's sanctions do not appear to be proportionate or effective. NRB has a range of sanctions available, such as declaring a bank or financial institution as problematic or advisory letters or cautions. In practice, as commonly applied by NRB, these do not appear to be dissuasive or offer any disincentive to the financial institutions licensed by NRB. Further, fines provided under the various statutes appear to be low, also making them non-dissuasive.

784. The instances where the NRB has declared a bank or financial institution as problematic or taken over a bank's management, the grounds for such actions have been mainly non-compliance with capital adequacy requirements, lack of corporate governance, conflict among the Board of Directors and other non-compliance matters relating to lending.

785. The following table indicates the range of sanctions that have been applied by the NRB for non-compliance of the NRB Act, NRB orders, or NRB Directives issued in the last five years. In no cases, sanctions have been imposed for breaches of AML/CFT obligations.

786. These sanctions reflect a combination of instances where the banks or financial institutions have failed to comply with NRB Directives with respect to individual transactions as well as the instances where failure in observing capital adequacy, systems and controls have been observed.

Statistics: Sanctions applied by NRB for breaches of NRB Act, orders or Directives of NRB (not related to AML/CFT requirements) for last 5 years.

Category of Institution	Declaring problematic	Management takeover	Fines	Warning / Caution	Other actions	Suspension of Forex License
	No. of Institutions involved	No. of Institutions involved	No. of Institutions involved	No. of Institutions involved	No. of Institutions involved	No. of Institutions involved
Banks/ Financial Institutions	4	10	4	3	4	1
Money changers	0	0	0	0	0	17

Money Remitters	0	0	0	0	0	2
Co-operatives	0	0	0	0	0	42

Notes: (1) The data of management takeover includes the liquidation, dissolution of Board, change of CEO or removal of Director. (2) The other actions taken by NRB are limiting the loan sanction authority / imposing ceiling on deposit and lending, refund of expenses etc.

787. The criminal sanctions appear to be available in some cases for failure to comply with orders or Directives issued by the NRB, but, in practice, no such criminal penalties have been imposed for any violation of any order, Directives etc and for AML/CFT deficiencies.

788. In 2005, the NRB has issued the KYC norms and it has issued advisory notices to banks in relation to breaches of KYC requirements while opening accounts and those relating to monitoring of sources of funds. NRB has yet not applied any sanction on any money changers / transferor or money remitter or cooperatives licensed by it, to date. Beyond that, no administrative or civil sanctions have been applied by NRB for any breach of AML/CFT requirements.

789. The following table shows the data on such advisory notices from 2006 until 2010.

Advisory Notices issued to banks by NRB for non-compliance of KYC norms

Year	To follow the KYC norms strictly	To obtain self declaration of income source compulsorily	Information bank not complying with KYC norms	To develop and implement KYC policy
	No. of banks involved	No. of banks involved	No. of banks involved	No. of banks involved
2006-2007	1	1	5	0
2007-2008	4	1	6	2
2008-2009	4	2	5	4
2009-2010	7	1	1	0

790. The overall approach in applying sanctions for non-compliances with orders/Directives of the NRB or terms or conditions of license or obligations under the NRB Act appears to be very low. The civil and criminal sanctions prescribed in BAFIA, NRB Act and FERA do not seem to be dissuasive. The actual application of sanctions and fines cannot be regarded as proportionate or dissuasive particularly since the impact of sanctions and fines is low and they have been applied for systemic failures rather than for any breach of AML/CFT requirements.

Financial Institutions supervised by SEBON

791. Under the Securities Act ss 88 and 89, SEBON may suspend or revoke the license of a stock exchange or securities businessperson in case of violation of the Act or the rules and by-laws or order or directions issued under the Securities Act. The license may also be revoked, inter alia in following circumstances:

- violation of the terms of license;
- violation of the Act or the Rules or the by-laws;
- failure to observe any order or direction of SEBON;
- failure to submit financial and transaction related statements to SEBON.

792. Section 101 empowers SEBON to impose fines in the following circumstances:

Nature of violation	Fine (NRps)
Deliberate failure to submit accounts, books, statements reports, information required to be submitted –s 101 (4)	50,000 to 2, 00,000. US\$676 to 2,702
Violation of the Act, Rules or by laws or orders or directions or terms and conditions specified by SEBON. s 101 (7)	25,000 to 75,000. US\$338 to 1,013

793. The sanctions under the Act including advisories under s 87 do not apply to natural persons (e.g. directors or officers or employees of licensed institutions) and the criminal sanctions prescribed in s .101(1)(2)or (3) are available for offences of market fraud, insider trading etc designated in the Act and are not available for breaches of AML/CFT requirements. The sanctioning regime in the security sector does not meet the requirements of the FATF standards.

794. *Application of sanctions by SEBON and NEPSE:* Although the Securities Act authorises SEBON to apply a wide range of administrative and civil sanctions, including fines, suspension or cancellation of licenses, warnings, etc., and initiate criminal action, SEBON has not imposed any sanction on financial institutions licensed and supervised by it for breaches of AML/CFT requirements.

795. The instances where the sanctions have been applied by SEBON include failure to follow measures for safekeeping the application forms in initial public offerings or malpractice relating to application forms or other systemic non-compliance. The following table contains the information about the sanctions applied by SEBON on the financial institutions licensed by it for breaches of the securities laws (but those are not related to breaches of AML/CFT requirements):

Sanctions applied by SEBON (non AML/CFT related)				
Category of Institution	Warning	Fines ³²	Administrative Direction *	Revocation of license
	No. of Institutions	No. of Institutions	No. of Institutions	No. of Institutions
Issue Manager	2	0	0	0
Stock Broker	0	1	1	1

796. Although the Securities Act prescribes various sanctions and authorises SEBON to apply them by way of suspension or cancellation of registration, imposition of monetary penalties, administrative directions, warnings and initiating criminal actions, the application of sanctions for non-compliance with securities laws is very infrequent. The application of sanctions seems very unlikely because of the weak supervision practice by SEBON and a lack of focus with respect to supervision and enforcement. The authorities attributed this to the lack of capacity and manpower in SEBON. The sanctions applied so far by SEBON cannot be regarded as dissuasive and proportionate.

³² The fine (NRps 100,000 (US\$ 1,351)) on a director and administrative direction (restraining a company from buying and selling shares) both applied one stock broker for the same violation.

³³ The information under section 15 of the Insurance Act is limited to furnishing information of dealing in insurance business with its director or his/her family or any corporate body where he/she is a managing agent or partner.

797. The NEPSE informed the evaluation team that it is primarily concerned with deficiencies relating to failures of implementing procedures or other systemic failures in the securities sector and it has not so far inspected or sanctioned its members in relation to any AML/CFT deficiencies

Institutions supervised by Insurance Board

798. Under s 12(A) of the Insurance Act, the Insurance Board can impose a ban (entirely or partially) or cancel any type of business operated by the insurer for the violations of Insurance Board Directives, not maintaining the required accounts or records or if the insurer does not provide information to be provided pursuant to s 15. As stated above, s 15 is not related to the power to ask for any information or compel production of any document and the Insurance Board does not have a general power to compel production of information and records. The sanction under s 12A of the Insurance Act is not available against licensed insurance agents, surveyors or brokers (intermediaries) and cannot be invoked for breach of AML/CFT requirements.

799. The Insurance Board can cancel the registration of a licensed insurer under s13 and that of a licensed intermediary under s 33 if they do any act contrary to the Act or Rules. However, the circumstances under which a license of an insurer (under s 13) or an intermediary (under s 33) can be cancelled by Insurance Board have no connection with AML/CFT requirements.

800. Regulation 11A of the Insurance Regulations 1993 allows the Insurance Board to lift the ban by applying a fine of NRps 10000 (US\$135) for partial ban and NRps 25,000 (US\$338) for complete ban, if the banned insurer shows that the situation warranting the ban does not exist. The provision to convert the ban in very low fines does not have effective deterrence.

801. Under the Insurance Act s36(1), the Insurance Board can impose fines on insurers or their directors/employees, or surveyor, broker and insurance agent; and under s36(2) on insurer or insurance agent or broker in the following circumstances :

Nature of violation	Fines	
	(NRps)	USD
Deliberate violation of the Act or the rules or orders or Directives. [s 36 (1)] Additional fine in case of repeated violation	3,000 to 5,000 500 for each subsequent violation	US\$ 1 to \$67 US\$ 6 for each subsequent violation
Conducting business without following the prescribed procedure. [s 36 (2)]	Up to 10,000	Up to US\$ 135

802. Except for fine under s 36(1), no other sanction is available for natural persons such as directors, managers or secretary or other officers and employees. Section 36(3) provides for criminal sanctions on insurers for deliberate breach in providing accounts, registers, details, information or other document - fine up to NRps 30,000 (US\$ 405) or imprisonment up to two years or both. The Insurance Act is silent about who can initiate criminal action under s 36(3).

803. The sanction under the Insurance Act can not be applied for breach of AML/CFT obligations since the Insurance Board has not issued any directive to introduce compliance obligations of AML/CFT requirements.

804. *Application of sanctions by Insurance Board:* Insurance Act, ss 12(A), 13, and 33 require the Insurance Board to seek clarification within reasonable time stating reasons for proposing relevant sanctions.

805. During the last five years, the Insurance Board has not imposed formal sanctions except for a few instances of monetary fines and advisories for breaches of the Insurance Act and Insurance Regulations. Officials at the Insurance Board advised that the Board generally issues administrative letters to financial institutions to take corrective steps for breaches brought to its notice through a complaint or through an on-site inspection report. In most cases, the breaches are corrected satisfactorily. For the purpose of corrective measures, the insurer is required to submit a commitment letter, action plan, proof of correction etc. In case of difficulties, it is settled by issuing a specific circular/directive to the concerned company. Warning letters and advisories are issued by the Insurance Board in respect of issuance of policies, maintenance of insurance fund, non-compliance with the Insurance Act and its Rules and unhealthy market practices. However, warning letters are also issued directly in case of irregularity/failure for statutory reporting. Before issuing warning letters, the insurer or intermediary is asked to clarify the default in writing.

806. No sanction on an insurance company by way of cancellation of the license has been applied under ss 13 and 33 and during last five years no ban on license or business has been imposed under s 12(A). The authorities have asserted that the power to prosecute or impose a criminal sanction under s 36(3) is not conferred upon the Insurance Board. Criminal action has never been initiated under that section.

807. While the licensing Directives issued by Insurance Board prescribe qualification and disqualification of Boards of Directors of licensed insurers and licensed intermediaries involved in insurance sector; the authorities claimed that the Insurance Board cannot remove any director or change the Board of Directors of such licensed entities since the Insurance Act does not deal with corporate governance and does not empower it to take such actions.

808. The instances of obligation of sanctions by Insurance Board are as follows:

Sanctions applied by Insurance Board 2005-2010 (not related to AML/CFT requirements)					
Institutions	Warning Letters/Notices	Fines			
	No. of entities involved	Reason	No. of institutions	NRps	USD
Insurance Companies	39	Conducting business without receiving premium	7	10000 each	\$135 each
		not making actuarial valuation as per Insurance Act	2	3000 each	\$40.54 each
		Not submitting document for renewal	6	3000 each plus additional 500 for each violation	\$40.54 each plus additional \$ 6.76
Brokers	2	-----	0	-----	-----
Insurance Agents	1	-----	0	-----	-----

809. The advisories and warnings are the lowest form of sanction applied by the Insurance Board. The monetary fines and advisory/clarification notices issued by Insurance Board are not necessarily related to on-site or off-site inspections or for AML/CFT breaches. Most instances involve non-renewal of licenses before a renewal deadline. The power to ban insurance business is further limited by Regulation 11(A) which permits removal of ban by applying monetary fines even before expiry of period of ban. The sanctioning regime in insurance sector is, thus, not effective, proportionate and dissuasive.

Registrar of Cooperatives

810. The Cooperatives Act provides sanctions only by fines imposed by the Registrar. The sanction is available in two circumstances:

- A fine not exceeding NRps 1,500 (US\$20) in case of failure to submit the report pursuant to s 34 or information sought during inquiry initiated under s 35; and
- A fine not exceeding NRps 2,000 (US\$27) on a person, who carries on trade by using the word cooperative though not registered as such.

811. These sanctions do not extend to natural persons viz. directors, officers or employees of the cooperatives. The Cooperative Act does not authorise the Registrar to issue any Directives or circular to cooperatives to prescribe or impose conditions of compliance of AML/CFT requirements and to impose any civil sanction for non compliance of any other provisions of the Cooperatives Act. The Act also does not prescribe criminal sanctions for cooperatives.

812. *Application of sanctions by Registrar of Cooperatives:* There is only one option for sanction (fines) available to the Registrar of Cooperatives. Different offices of the Registrar have primarily applied this sanction for delayed filing or failure to file annual reports. The range of such fines has been from NRps 100 to NRps. 1500 (US\$ 0.57 to 20). The following table indicates instances of such sanctioning by Registrar of Cooperatives during last fiscal year:

Sanctions applied by Registrar of Cooperatives 2009-2010 (unrelated to AML/CFT)		
Number of societies Penalized	Amount NRps.	Amount US\$
1,702	10,58,672	14, 306

813. The stream of sanctions is limited to fines and the range thereof is low. Though it is not clear from the above table how many instances pertain to those cooperatives which are engaging in financial activities (limited banking business), in view of large number of breaches (more than 1,700), it seems possible to gather that the supervisory and sanctioning regime in this sector is weak . Therefore, the sanctioning regime of the Registrar of Cooperatives cannot be said to have any deterrent effect. The available sanction in this sector is not effective, proportionate and dissuasive.

Market Entry- Recommendation 23

NRB

814. All the financial institutions supervised by NRB must be licensed and supervised by the NRB in accordance with the BAFIA, NRB Act and FERA.

815. The grant of a license is subject to fulfilment of a wide range of conditions. As per s 3 of the BAFIA, only a public limited company registered under the Companies Act with prior approval of NRB under NRB Act s 4 can be a bank or financial institution. There is no exemption from this requirement. The authorities clarified during on-site visit that a body corporate that does not have approval from NRB for registration under the Companies Act, cannot seek secure a license under the BAFIA.

816. While seeking approval under s 4, the applicant should submit, among others, the personal details of the promoters. These requirements in themselves do not appear to be sufficient to prevent criminals or their associates from being promoters or having beneficial ownership of the banks or financial institution. The authorities in NRB informed the evaluation team that the personal details about promoters include their name and address, declaration about conviction of any crime involving ‘moral turpitude’,³⁴ and declaration about being in blacklist of Credit Information Bureau, etc. They argue that the fitness test is carried on promoters on the basis of their declaration of ‘no conviction’ of a crime involving ‘moral turpitude’ and verification that they are not in the blacklist of Credit Information Bureau. Further, before granting approval under s 4 of the BAFIA, NRB also issues a 35 day Public Notice inviting public comments on the feasibility and credentials of the applicants and considers the public response/ information while scrutinising the application under s 4.. These requirements might provide certain fitness test on promoters but they are not explicit for fitness and probity test on beneficial owners of the promoters and applicants.

817. NRB can refuse approval under s 5 for a wide range of reasons including that the applicant ‘does not provide a ground to believe that it can carry on financial transactions in a healthy and competitive manner’. These reasons do not have any bearing on integrity, reputation, character or fitness of the beneficial owners of or the persons having controlling interest in the applicant.

818. The BAFIA has certain in-built safeguards to protect regulated entities from being taken over by undesirable persons from promoters. Section 7 of BAFIA mandates every bank or financial institution to set aside at least thirty per cent of its total issued capital for subscription by the general public. Section 9 imposes lock-in of 5 years (from date of commencement of financial transactions) on shares held by promoters and after expiry of said lock-in period; the promoter may sell or pledge such shares subject to the conditions prescribed by the NRB. NRB Directives No. 10 issued under title “Transfer or Sale of Promoters Shares of Licensed Institutions” prescribes that the shares of the promoters or shareholders under the promoters group may be transferred subject to prior approval of NRB that shall be compulsorily obtained through the concerned financial institution. Though under s 9 of BAFIA and NRB Directive 10, NRB could halt acquisition of promoters’ shares by criminals, there is no explicit statutory power for the NRB to stall the acquisition of substantial shares by undesirable persons from public shareholders or to remove the voting powers of any person deemed not to be ‘fit and proper’.

819. Directors are appointed at a general meeting of shareholders of the licensed institution (s 17). A range of qualifications and disqualifications for election or nomination or continuance of

³⁴ Nepal Laws do not define “moral turpitude”. However, authorities advised that Nepali courts interpret ‘moral turpitude’ as crimes involving intent to defraud or an intent to steal as well as crimes involving intentional or reckless infliction of harm to persons or property and sex crimes. Serious offences, such as murder, voluntary manslaughter, kidnapping, sexual assault, robbery, burglary, larceny, aggravated assault, prostitution, and even shoplifting involve ‘moral turpitude.’

the directors is prescribed in s 18. The disqualifications apply to professional directors also (s19). The disqualifications under s 18 include:

- insolvency;
- black listed in connection with a transaction with any bank or financial institution, and three years have not lapsed after removal of the name from the black list;
- outstanding tax liability;
- five years 'cooling period' not lapsed after the conviction by court for criminal charges of 'moral turpitudes';
- conviction by court for corruption or fraud;
- five years 'cooling period' not lapsed after the action taken by NRB regarding not following the NRB Directions;
- five years 'cooling period' not lapsed after removal or suspension by taking over the management by NRB.

820. The scrutiny of the director to be elected is left with the bank or financial institution and except for appointing a professional director under s 12 from the list of professional experts (maintained by NRB under s13), the NRB does not have any role in the appointment or re-appointment or termination of any director, Chairman or CEO of the institution or for approval of any change in the board of directors.

821. The application for license under s 29 should, among others, provide personal details of the CEO and other executive level officers of bank and financial institution. The authorities in NRB informed the evaluators that, while considering the application, NRB looks at the educational qualification, experience and reputation of the CEO and executives. Section 32 empowers NRB to refuse a license if it appears that grant of the license is not appropriate or the details required along with the application are not complete.

822. Neither the approval nor the licensing criteria under BAFIA require any scrutiny by NRB on elected directors and management. However, according to FATF standards, scrutiny by the supervisor should take place prior to appointment of management.

823. Section 3 of Foreign Exchange (Regulation) Act (FERA) allows any person, firm, company or body to carry on foreign exchange transactions after obtaining a license from NRB under the FERA. The FERA is silent on the pre-conditions under which a license may be issued, and does not address the probity or character of the applicant or its shareholders or beneficial owners. FERA s 3(3) authorises the NRB to specify any necessary conditions terms when issuing a FERA license. The NRB has yet to enforce license requirements on forex dealers.

SEBON

824. *Licensing the stock exchange:* SEBON licenses the stock exchange in Nepal. Under s 37 only a body corporate can carry on the activities of a stock exchange. Stock Exchange Operation Regulations 2008 regulation 3, Schedule 3 and Schedule 4 prescribes details, for seeking registration and the license to act as a stock exchange. For shareholders holding 5% or more of the paid up capital of the applicant, information regarding the share ownership of the promoters, full details of the directors, details regarding action taken or pending under the Securities Laws or other prevailing laws against the applicant or its directors or the Chief Executive (regulation 3 and Schedule 3). In practice, the NEPSE is predominantly owned and controlled by the Nepal government.

825. Under Regulation 14, the shares held in the stock exchange cannot be sold until expiry of a period of three years from the date of obtaining the license. After that, any sale in the shares of the stock exchange requires approval of the SEBON and fit and proper data to be provided.

826. A majority of the directors (2/3s) and the chief executive of the stock exchange must meet minimum education and experience requirements. Regulation 17 disqualifies a person from being or continuing to be a director if he is convicted and sentenced for imprisonment against the offence of moral turpitude or corruption or fraud and the cooling period of 5 years from the completion of the term of punishment has not expired. The position of a director or chief executive is automatically terminated from date he attracts any of the disqualifications or loses any of the qualifications and the stock exchange has to inform the SEBON immediately.

827. These disqualifications and other requirements of the Regulations also apply with respect to an independent director appointed pursuant to regulation 19.

828. For the purpose of regulating the affairs of the stock exchange, SEBON can direct the Stock exchange to restructure its Board of directors (s.90(1)(h)). However, neither the Securities Act nor the Exchange Regulations explicitly allow SEBON to have any role in appointment of new directors and to ensure their fitness and probity on the basis of set criteria.

829. The above stated powers do not explicitly prescribe any entry/eligibility norms (except with respect to expertise) for directors and persons holding management functions but the prescription relating to furnishing information, details and documents while seeking license or approval for sale of shares enable SEBON to prevent criminals from holding beneficial ownership or controlling interest in a stock exchange. However, in case of filling the vacancy created by virtue of termination/removal/ retirement, etc. of the directors/Chief Executive, SEBON has no role to scrutinise the integrity, reputation and character of new directors/Chief Executive of the stock exchange.

830. Sections 56 and 57 of the Securities Act requires of license for carrying on the securities business as a pre condition. Section 58(2) provides SEBON with principle-based criteria to assess when considering applications for a securities broking license. The criteria include the 'ability of the applicant to carry on securities business', 'training and educational qualification of its agent' and financial status, social status and character, educational qualification, training and experience of the chief executive, director and agents of the securities business persons. Another condition for granting a license under ss 64 and 65 of the Securities Act is that the securities broker or trader must specify a registered agent.

831. A license to carry on securities business (other than securities broking and investment consultancy service) can be granted by SEBON only to incorporated bodies (s58 (3)). Thus, natural persons can also seek license to act as stock broker, their agents and investment consultant. The Securities Business Persons (Stock Broker, Securities Dealer and Market Maker) Regulations 2008 (Stock Brokers Regulations) and Securities Businessperson (Merchant Banker) Regulations, 2008 (Merchant Bankers Regulations) prescribe the details and documents to be submitted with the application for a license³⁵. The Stock Brokers Regulations and Merchant Bankers Regulations are silent about a 'fit and proper' test or information disclosures with respect to an individual applicant or an agent (except declaration of his

³⁵ As clarified by regulation 16 of the Merchant Bankers Regulations, a licensed Merchant Banker may carry out one or more than one of the following functions:-

- (a) Issue and sales management of securities,
- (b) Underwriting,
- (c) Share registration,
- (d) Portfolio management.

qualification and experience as per Schedule 4 of the Stock Brokers Regulations) of securities broker or securities trader where such applicants are permitted or agents are mandatory. The Act and Regulations are silent regarding eligibility criteria or disqualification for the non-corporate applicant or agents of the stock brokers that are permitted/ mandated by the Act.

832. The authorities informed that only companies are being licensed as stock brokers and merchant bankers. No assessment could be made with respect to any eligibility test for agents, who are natural persons. Nepal authorities informed the evaluation team that stock brokers and merchant bankers licensed so far have all been incorporated companies.

833. The Rules, Regulations and directions issued or terms and conditions imposed by SEBON are enforceable under the Securities Act.

834. Only those applicants who have membership of the stock exchange are eligible to be licensed as a stockbroker or securities dealer or market maker [s 57(2) (c) of the Act and regulation 3 of Stock Brokers Regulations]. Under Regulation 3 of the Stock Brokers Regulations, the application seeking a license as a stock broker, securities dealer and market maker should be filed with recommendation from the stock exchange. while recommending the license, the stock exchange is required to take into account various factors enumerated under regulation 3(2) the Stock Brokers Regulations, but those factors have no relation to reputation, status or character of the beneficial owners of applicants.

835. The application for a license as a stock broker or securities dealer and market maker should be accompanied with various details and documents regarding the applicant company, its promoters, directors and the Chief Executive. These details include name, full address, contact telephone, of shareholders holding five percent or more of the paid up capital, details regarding shares owned or to be owned by the promoters, declaration of applicant or promoters/directors/ Chief executive not being listed in the black list of the Credit Information Bureau. The applicant has also to give detail profile of its promoters/directors/ Chief Executive including permanent address, photograph, qualification, experience, details regarding any action taken or action pending under the securities related laws or any other prevailing laws against themselves or the associates/affiliates (Regulation 3 (2) and Schedules 3, 4 and 5).

836. Under Regulation 13 and 14 of the Stock Brokers Regulations the persons convicted of offence of moral turpitude or corruption or fraud, or the persons who are in the black list of the Credit Information Bureau or the persons who are insolvent are disqualified to be shareholder / owner in those intermediaries. Regulation 17 provides for the educational qualification and experience of the directors and Chief Executives which are sufficient to evaluate the fit and proper test relating to their expertise. Regulation 18 provides for the disqualification of the director / Chief Executive and the grounds of such disqualification include conviction for any criminal offence, failure to submit incomplete statement for the purpose of tax, if the company where such person was earlier a director or Chief Executive remained in the black list of the Credit Information Bureau, etc. The qualifications are to be maintained continuously as required by regulation 19 and failure to meet the qualification would automatically terminate the position of director/Chief Executive.

837. Securities intermediaries are obligated by regulation 16 to report to SEBON, within 7 days, the appointment of new director or Chief Executive, on account of vacancies created due to termination, retirement, resignation etc. along with details of new incumbents as prescribed in Schedule 3 and the evidence proving qualification.

838. The shareholder of the stockbroker, security dealers and market maker can transfer his shares only to the persons who are qualified and are not disqualified. The shares can be sold only on completion of one year of obtaining the license or getting the shares transferred. The

transferor has to submit an application through the concerned intermediary to SEBON for getting the transaction recorded. Such application should have all the details and documents that are required for seeking license.

839. Similar qualifications, disqualifications, information disclosure and declaration requirements are prescribed with respect to authorised representatives (agents of the stock brokers, security dealers and market makers) in regulations 21, 22,23, 24 and 25 of the Stock Brokers Regulations and with respect to the merchant bankers in the Merchant Bankers Regulations. In case of convictions on the grounds of corruption or fraud the disqualification continues until expiry of 5 years of completion of the sentence.

840. The above primary legislations provide for disqualifications so as to prevent the criminals or their associates from holding beneficial ownership in the securities business persons. The laws and regulations provide criteria and basis for emulating the expertise and integrity of the directors and the senior management of the securities business persons.

Insurance Board

841. The Insurance Act does not mandate that only a body corporate can operate the insurance business. Section 10(1) of the Act prohibits any ‘person’ to operate or cause to operate the insurance business without obtaining a certificate under that Act. It follows that a natural person can also operate or cause to operate an insurance business pursuant to registration under the Insurance Act. The Insurance Act and Insurance Regulations 1993 are silent about any registration process if a natural person applies for registration. They do not prescribe any eligibility norms with respect to fitness and probity of the promoters, directors, beneficial owners and persons having controlling interests in the applicant corporate body.

842. The Insurance Act s 10(2) and Insurance Regulation 7 as well as Schedule I of the Insurance Regulations sets out the documents required to be filed along with the application form of the body corporate. While s 10(2) and Regulation 7 prescribe the form and contents of application including name and address of the General Manager, key person and Auditor of the applicant, these requirements are not sufficient to evaluate ‘fit and proper’ test.

843. Section 10(3) authorises the Insurance Board to make necessary investigation/ inquiry on the application, if felt necessary, and to grant or not grant the certificate of registration to the applicant. Such investigation/inquiry seems to be limited with respect to documents and particulars to be furnished along with application form; and not to scrutinise the fitness and probity of the beneficial owners or persons having controlling interests in the applicants.

844. The circumstances listed in s 12 under which the Insurance Board can decline registration are not relevant for assessment of the integrity, reputation or character or background of key persons/employees and beneficial owners of the applicants.

845. Section 30, 30A and 30B provides for registration of Insurance Agent, Surveyor and Broker, respectively. These sections do not seek any details about the applicants’ background, reputation or character. Registration can be granted to Insurance agent who satisfies the prescribed qualification, on the recommendation of the concerned insurer (s 30). The registration can be granted to a surveyor and broker if he satisfies the prescribed qualification (ss 30A, 30B). S 32 enumerates the circumstances under which an Insurance Agent, Surveyor or Broker is disqualified. Those circumstances include conviction and punishment by a court in the offence involving any type of theft, fraud or misappropriation or embezzlement of the property entrusted to applicant.

846. The certificate to insurer, insurance agent, surveyor and broker is issued for a period of one year. A license is renewed on request being with the prescribed fees (Schedule 4 and regulation 9). There is no requirement to undertake any fitness test on the beneficial owners or controlling interests at the time of renewal.

847. Under regulation 14(1) together with Schedule 5 of Part A, an insurer, operating in more than one insurance business is required to submit the information of any change in the fundamental features of the corporate body after the latest annual details, within six month of expiry of each fiscal year. The obligation seems to include obligation to inform any change in management or control in the insurer. But this obligation is limited to a particular class of insurer and; other licensed enteritis are not obligated to intimate or seek prior approval of the Insurance Board in case of any change in management control or share transfer.

848. The Insurance Act and Insurance Regulations do not prescribe any mechanism or regulation with respect to transfer of shares or appointment of management/ directors. In absence of any such regulation/measures the shareholding in the insurer can be freely acquired by any person who might be tainted or undesirable and who may himself get appointed as director or cause to appoint his directors.

849. The Insurance Board has not yet adequately covered CDD measures or the need to establish beneficial ownership and identification of the natural persons behind legal arrangements in the sector.

On-going supervision and Monitoring - Recommendation 23

Banks and Financial Institutions including cooperatives licensed by NRB

850. Banks and financial institutions licensed by NRB are subjected to ongoing supervision based on s 52 of the BAFIA and s 84 of the NRB Act. Inspection Supervision By-Laws, 2003 (Inspection By-Laws) has prescribed detail procedures and guidelines to be followed by the inspecting authority. The NRB can carry out on-site inspection by sending inspection team to the office of the concerned bank or financial institution and off-site supervision by requisitioning detailed statements and information from them (s 52 of BAFIA and by-law 6 of the Inspection By-Laws).

851. There was no separate AML/CFT inspection programme at the time of on-site visit. The authorities advised that starting in the coming year the routine inspections will include an AML/CFT component, and the relevant inspection Departments have been instructed by internal circular to inspect and supervise the compliance of AML/CFT requirements also while undertaking routine inspections. The NRB has yet not developed a risk-based model of supervision that can place greater emphasis upon risk management within the licensed banks and financial institutions.

852. The NRB On-Site Inspection Manual 2002 (s I-C) sets out that onsite supervision is carried out by the Bank Inspection and Supervision Department and the Non-Bank Inspection and Supervision Department. These two departments monitor the activities of banks through regular review of data submitted by them. On-site inspections are conducted at least every two years except for Class A banks which are conducted every year. The Departments prepare detailed work plans for on-site and off-site inspections of banks and financial institutions every year on approval by the Governor. However, the they are not precluded from inspecting and supervising bank and financial institutions that are not included in the work plan (By-law 3 of the Inspection By-Laws).

853. Inspections by the NRB cover both the head office and selected branches of licensed institutions. The corporate head office-level inspections focus on systemic issues such as credit administration, credit policy, etc. and branch level inspections focus on transactional issues such as credit exposure of the branch. Neither level of inspection includes AML/CFT.

854. NRB inspections use the CAMELS model which address capital adequacy, asset quality, management, earnings, liquidity and systems and controls. The NRB officials informed the evaluators that NRB also undertakes special inspections and that are carried out as a follow-up exercise within 6 months of the annual inspection. The special inspection is also triggered by external inputs like complaints from account holders.

855. The following table shows the total number of inspections carried out by the NRB over the period 2006-2010:

General inspections (not specific to AML/CFT) carried out by NRB for last 3 years

Category of FIs	2008		2009		2010	
	No of FIs licensed	No of FIs inspected	No of FIs licensed	No of FIs inspected	No of FIs licensed	No of FIs inspected
A Class	25	25	26	26	27	27
B Class	58	14	63	24	79	50
C Class	78	42	77	36	79	42
D Class	12	7	15	4	18	9

856. The Inspection By-Laws contain a separate Chapter V which provides procedure for off-site supervision. The objective of such supervision is to obtain information relating to financial condition of the bank or financial institution and to ascertain the compliance status of the applicable laws, regulations or Directives on the basis of financial statements and other documents obtained from the concerned bank or financial institution. The compliance review seems to enable NRB to undertake off-site supervision with respect to AML/CFT requirements. The authorities claim that NRB Directive 19 requires reporting to FIU. However, NRB has not conducted any off-site AML/CFT inspections.

857. The Inspection By-Laws and On-site Supervision Manual though provide for procedure of undertaking inspection, making report etc. they do not specifically instruct the inspectors to inspect and give specific recommendation / report with respect to AML/CFT requirements. These documents also do not contain instructions focusing on specific high risk areas. This seems to be a concern with respect to effectiveness and adequacy of NRBs current AML/CFT inspection process.

858. The NRB officials claimed that Inspection by-laws and Manuals reflect international best practices and BIS guidelines and licensed financial institutions are subjected and Core Principles of BASEL for prudential purposes. However, since AML/CFT criteria are still not included in them and NRB has not undertaken any AML/CFT related inspection to date and will include this component in 2011, the compliance of criteria in Rec 23.4 can not be evaluated.

859. The NRB officials claimed that Inspection by-laws and Manuals reflect international best practices and BIS guidelines and licensed financial institutions are subjected and Core Principles of BASEL for prudential purposes. However, since AML/CFT criteria are still not included in them and NRB has not undertaken any AML/CFT related inspection to date and

will include this component in 2011, the compliance of criteria in Recommendation 23.4 can not be evaluated.

860. The authorities informed the evaluation team that the other authorities such as FIU and other law enforcement agencies may inform NRB about any possible ML/FT risks with respect to the banks and financial institutions and NRB is empowered to use the information received from them and use them for more focused on-site / off-site inspections. However, there is no instance cited with respect to such focused inspection.

861. Section 84 of the NRB Act requires the inspecting officials to draw an inspection report and submit the same to the Governor within 15 days of completion of inspection. It was informed during on-site visit that the findings of all inspections are communicated to the banks and financial institutions with advices to correct the shortcomings identified during on-site / off-site inspection. Authorities indicated that banks and financial institutions are mandated to report back compliance to NRB.

862. The authorities also advised that NRB inspections also include a focus on KYC issues. The authorities highlighted verification, on random basis, of KYC documents followed by the banks and financial institutions. However, the evaluation team is of the view that these verifications cannot be considered as thematic AML/CFT supervisions.

Money changers / transferors and the money remitters

863. Section 14 of FERA enables the Government of Nepal and NRB to inspect licensed money changers/transferors and money remitters. The evaluation team was informed that NRB is in process of making Inspection By-Laws for inspection of these financial institutions. While considering the application for license, NRB undertakes some exercise such as on-site/off-site verification of the information furnished by applicant, its infrastructure, tax clearances and verification of antecedents from the records of Office of Registrar of Companies. They also undertake inspection of each money changer/transferor and money remitter once in every year. However, the authorities do not inspect agents of these financial institutions except their master agents. There is no data available to evaluate the implementation and effectiveness of the authority of NRB in this sector.

864. The NRB issues public notices advising public not to undertake these financial activities without license and to deal in such business with only with licensed institutions. Any complaint received about any informal business in this sector is forwarded to Department of Revenue Investigations. NRB does not itself take any action and no sanctions have been applied by NRB in this sector. Wherever the license has been terminated it has been automatic termination on account of expiry of period of license which was not renewed by the licensee. The evaluation team is of the view that the NRB, so far, has not focused on effective supervision of these financial institutions.

SEBON

865. The licensed intermediaries in securities sector and the licensed stock exchange are subjected to ongoing supervision by SEBON based on s 5, s 78(4) and ss 84-86 of the Securities Act. Under the Securities Act s 45(c) and its by-laws, NEPSE has responsibility to monitor and supervise compliance by its members(stock brokers) of the Act, rules, and by-laws. SEBON and NSPSE can undertake on-site, as well as off-site, inspections. The evaluation team was not informed about any procedure and policy laid down by SEBON and NEPSE for inspections and supervision of licensed intermediaries in securities sector. AML/CFT

inspection programme is completely absent in SEBON and NEPSE. Due to the lack of skills, expertise and capacity, supervision and inspection are not carried out by SEBON effectively.

866. According to the ALPA and AML Rules every intermediary in the securities sector is under an obligation to follow the AML/CFT regime which includes identification of customer, reporting of suspicious transaction, maintenance of record, etc. Further, SEBON has duty to supervise entities regulated by it and issue Directives to maintain the standards of AML/CFT. It can take action if any such entity fails to comply with those Directives. However, there is concern regarding implementation of the supervisory and enforcement powers as the SEBON has not been focused on inspection and supervision of the licensed intermediaries with respect to AML/CFT requirements.

867. SEBON/NEPSE has not issued any AML/CFT directives or guidance to intermediaries in order to comply with AML/CFT standards. It has also not yet subscribed to the core supervisory principles of the IOSCO.

Insurance Board

868. The Insurance Board follows the core supervisory principles of the International Association of Insurance Supervisors (IAIS). It conducts on-site and off-site inspection of insurers at head office level as well as branch level. No data is available regarding periodicity of inspections and on inspections of surveyors, insurance brokers and agents.

869. The inspections are categorized in three categories, viz. 'full scope', 'focused' and 'issue based'. These inspections mainly focus on investment criteria, accounting standards and policy related requirements. The Insurance Board has not undertaken any inspection of licensed insurers with respect to KYC/CDD requirements and AML/CFT standards till date. Although the supervisory staff are well experienced compared to other regulators, the Insurance Board has insufficient capacity to effectively supervise this sector.

Guidance for financial institutions (other than on STRs) - Recommendation 25

870. As stated above, the concerned regulators have yet not issued any separate Directives/circulars/ guidance to the licensed financial institutions they regulate. For banking sector, the NBA has suggested draft guidance to serve as a reference guide to the banks. The draft guidelines provide for a broad guidance on AML/CFT framework. SEBON and Insurance Board have shown inclination to issue guidance and Directives to the financial institutions they regulate.

871. Apart from orientation programs as described in this s, the FIU or other regulators have not given any training regarding AML/CFT standards to the financial institutions.

Implementation and Effectiveness

Resources

872. The supervisory capacity of the NRB is still limited due to the lack of supervisory tools, and expertise. Additional supervisors are required to deal with the diversified and geographically scattered financial sector. The officers of the Registrar of Cooperatives involved in supervision of cooperatives also lack knowledge and experience in understanding new methods and techniques involved in financial transactions and AML/CFT requirements.

873. SEBON has a small number of employees with supervisory expertise. It also does not have sufficient technological capacity to effectively supervise and survey the securities sector. It lacks sufficient autonomy and operational independence to fulfil its responsibilities.

874. The position with respect to the Insurance Board is less clear-cut. The licensed insurers, surveyors, brokers and agents operate throughout the country through a branch and agency network but their supervision is vested in just six Insurance Board staff.

875. There are inadequate human resources in SEBON and the Insurance Board to perform effective AML/CFT supervision. The supervisory staff in NRB also needs skill enhancement for AML/CFT supervision. The supervisory staff of all regulators are not yet trained in AML/CFT standards, new methods and techniques involved in financial transactions and modern supervisory and investigative techniques. The authorities of all regulators admit the need to enhance human resources and train their supervisory staff with respect to supervision of AML/CFT requirements.

Supervisory Powers and Procedures:

876. There are no 'fit and proper' criteria or test to ensure that undesirable persons and persons with a criminal background cannot promote or incorporate public limited companies for carrying on financial transactions under the Companies Act or BAFIA. The grounds on which approval can be refused also do not include such tests. With respect to money changers/transferors and money remitters there is no requirement to scrutinize persons when considering an application or license.

877. In the insurance sector, there are no requirements to scrutinise, (either at the time of entry or when there is change of ownership or control), the fitness and probity of the beneficial owners or persons having controlling interests in the insurance companies, insurance brokers, surveyors and agents. The 'fit and proper' test is not applied on the managerial persons of the institutions operating in insurance sector.

878. The regulators do not have any role in the appointment of managerial persons and directors. The role of removing the directors, if they attract disqualification, is left with the concerned financial institutions. The SEBON can direct the stock exchange to restructure its Board of Directors, but it does not have any role in scrutinizing the fitness of directors to be appointed.

879. All the regulators, except Insurance Board, have powers of information gathering and to compel production of documents and records. The information is received through periodical reporting, on-site inspections and occasional instructions. Insurance Board can gather information and records during on-site inspections. The regulators do not require Court approval to enforce these powers and till date their powers to demand information and compel production of records has not been challenged. None of the institutions with whom evaluators interacted expressed any reticence for furnishing information and responding to information requests of the concerned regulator. The governing legislation provide for sanctions for non-compliance though the sanctions are not dissuasive and data on application of sanctions does not suggest any deterrence.

880. All the regulators carry out on-site and off-site inspections of the financial institutions they regulate. However, none of the regulators have so far undertaken any inspection either as a part of routine inspection or as a special or targeted inspection for AML/CFT compliance. There is no evidence that the regulators regularly review policies, procedures, books and records of licensed institutions or entities.

881. The sanctions prescribed in legislation and the data on sanctions applied indicate that the framework does not provide for effective, dissuasive or proportionate sanctions. Where sanctions for non-compliance have been applied, regulators seem to have a soft approach of issuing administrative clarifications/advice/warnings to financial institutions. Other more deterrent actions, such as suspension or revocation of license are rarely applied. Criminal sanctions have never been invoked. So far only one instance of suspension of license by NRB has issued.

882. NRB has never applied any sanctions on money changers/transferors and licensed co-operatives. The application of sanctions by SEBON is rare and it has so far revoked the license of one stock broker. The Insurance Board does not seem to be focused on applying the sanction of suspension or revocation of license and it issues warnings and administrative letters for non-compliance by licensed entities. The Registrar of Co-operatives can impose only monetary fines and the data on application does not indicate that the sanctioning regime in the co-operative sector is effective, dissuasive and proportionate. That being said, the evaluation team believes that if administrative sanctions - particularly warnings, monetary penalties and other soft actions - are being used by regulators then the levels of applied sanctions are too low and can certainly not be considered dissuasive. It is surprising that NEPSE has not identified deficiencies by its member brokers which could justify sanctions.

883. The ALPA came into force in 2008 and the AML Rules became effective in October 2009. The FIU AML Directives for few reporting institutions are recent (last being on 14.04.2010) and their implementation (except by banks and financial institutions to some extent), is ineffective. Regulators have not extended AML/CFT compliance obligations, on the financial institutions they regulate, through directives under the governing legislations. Further, supervision, enforcement and sanctioning powers have yet not been extended by the relevant regulators to AML/CFT deficiencies.

884. The levels of financial penalties and administrative warnings (though not related to AML/CFT deficiencies) suggests that sanctions have been applied by the regulators with respect to technical breaches only, except in the case of the NRB where civil sanctions for non-compliance with KYC norms and other prudential norms relating to business operations have been applied. The overall sanctioning regime ineffective and sanctions are not dissuasive, proportionate and effective. Though the AML/CFT requirements have been in force since 2008, no sanctions have been applied by FIU to date under s 31 of ALPA.

3.10.2 Recommendations and Comments

885. It is recommended that Nepal should:

- Include commodities brokers under the ALPA (s 2(h)) and ensure that all the financial institutions are subject to adequate AML/CFT regulation and supervision.
- Comprehensive enforceable obligations should be established to support full implementation of recommendation 17, 23 and 29.
- an adequate 'fit and proper' test should be laid down for persons who acquire managerial positions and controlling interests in the financial institutions.
- develop and implement a supervisory regime for Postal Savings Banks.
- the Registrar of Cooperatives should consider effective supervision and monitoring of co-operatives.
- all the regulators should issue necessary Directives to the financial institutions they regulate to impose AML/CFT compliance obligations and to extend their supervisory and inspection powers to ensure AML/CFT requirements by financial institutions.

- all the regulators should ensure that their procedures for targeting on-site inspection or undertaking off-site supervision take into account the AML/CFT requirements.
- a review of availability and magnitude of both the levels of sanctions for non-compliance with the AML/CFT requirements should be undertaken.
- ALPA should provide for the widest range of civil, administrative and criminal sanctions for AML/CFT.
- sanctions should also be extended to natural persons e.g. director, manager, secretary or other officers of the financial institutions.
- review the human resources, skills and capacity in SEBON and the Insurance Board and enhance the AML/CFT supervisory capacity of the staff of all regulators.
- consider providing autonomy to SEBON by having its Board and to provide it operational independence in issuing Directives and hiring employees.

3.10.3 Compliance with Recommendations 23, 30, 29, 17 & 25

	RATING	SUMMARY OF FACTORS UNDERLYING THE RATINGS
R 17	NC	<ul style="list-style-type: none"> • No sanctions for breaches of AML Rules and FIU AML directives. • ALPA does not provide for criminal sanctions for non-compliance with all AML/CFT requirements and civil sanctions are limited with respect to TTRs/ STRs. • No sanctions available under ALPA against natural persons e.g. directors, managers, secretaries and other officers. • Sanctions prescribed in the governing legislation and applied so far are not effective, proportionate or dissuasive. • No sanctions applied for AML/CFT deficiencies across all sectors.
R 23	NC	<ul style="list-style-type: none"> • The ALPA does not apply to commodity brokers and a lack of supervisory regime for Postal Savings Banks. • 'Fit and Proper' test not available with respect to persons acquiring managerial positions and controlling interests in financial institutions • No eligibility criteria and 'fit and proper' test on applicants who are natural persons in securities sector. • Lack of fitness test on the beneficial owners or controlling interests at the time of entry or at the time of renewal of licence of insurers • Ineffectiveness due to lack of use of AML/CFT powers of regulators and supervisors.
R 29	PC	<ul style="list-style-type: none"> • ALPA does not apply to commodity brokers. • Lack of supervisory regime for Postal Savings Banks. • Insurance Board lacks power to call for information and record Insufficient and ineffective supervisory regime in securities sector and cooperatives and foreign exchange dealers. • Effectiveness issue: No supervision and inspection of any financial institutions with respect to AML/CFT standards.
R 30	PC	<ul style="list-style-type: none"> • Lack of training to all supervisors. • Lack of sufficient, skilled human and technological resources in SEBON, Insurance Board and Registrar of Cooperatives and supervisors / SROs of DNFBPs.

3.11 Money/Value Transfer Systems (SR VI)

3.11.1 Description and Analysis

886. NRB issues licenses to both money transmitters and money exchanges in Nepal. In September 2010, there were 249 money exchanger principals in Nepal and 52 money transmitter principals. Both money transmitters and money exchanges must apply to the Foreign Exchange Department of the NRB for a license to operate in Nepal. Informal value transfer system providers are illegal in Nepal, although government officials estimated the size of the informal economy to be 10% to 90% of overall Nepal. On the black market, the Nepali Rupee is estimated to be 1 to 2 Rupees per dollar greater than the rate set by the Central Bank, exacerbating the gulf between the formal and informal sectors. The open border with India and the right to bring unlimited Indian and Nepal rupees likely also accounts for sizeable informal economy, according to Nepal public and private sector representatives.

887. Applicants for licenses for money exchanges and money transmitters must submit a (1) good moral character certificate, (2) certifications that they have not been blacklisted by the Central Investigation Bureau; (3) certification that they are mentally sound; (4) certification that their directors are physically capable of performing their jobs; and (5) certification that they have paid their taxes. As part of the evaluation process for a license, the Foreign Exchange Department will review police reports and determine whether the money exchanger or transmitter has registered with the Company Registration Office. The Department also inspects the premises of the business and reviews how much money the business has in their bank account before granting a license.

888. Exchangers and money transmitters are now granted one-year licenses. Money exchangers are required to have paid-in capital of NRps 1 million (US\$13,513). Money transmitters must have paid-in capital of NRps 1 million for domestic remittances and five million NR for international remittances.

889. Principals and agents of money transmitters must become licensed with NRB. Principals are required to maintain a list of agents to assist law enforcement as necessary in Nepal. Agents of money transmitters are typically banks. As an illustration, one money transmitter estimated that 50% of its agents were commercial (Class A) or development (Class B) banks. An estimated 4000 agents of money transmitters operate in Nepal, according to NRB. Many of these are agents of international money transmitters.

890. Money transmitters may only operate through banks and can receive, but not send, international remittances. The average international remittance into Nepal is estimated to be the equivalent to US\$400 to \$500, with remittances through formal channels equalling US\$2.8 billion in 2009, according to NRB. At least 10 to 40% of remittances are estimated by the Nepal government to be sent through informal channels. According to the Central Bank, no estimate of domestic remittances is available.

891. The NRB Supervision Department reportedly conducts annual inspections of money transmitters and money exchanges. The statistics below reflect numbers and de-licensing in 2010:

Institutions Inspected in 2010 for Forex			
Type	Total # except de-licensed	Inspected in 2010	De-licensed
Banks/Fls		42	1
Money changer	210	87	17
Money Transferor	50	8	2

892. The Supervision Department’s inspection manual and inspections do not include any AML/CFT components; rather, they emphasize fit and proper examinations.

893. In 2009 and 2010, the NRB forced 17 money changers and 2 money transmitters to close for failure to renew their licenses and for operating without a license, and for non-compliance with Nepal law.

894. Money transmitters and money exchanges’ representatives in Kathmandu have received basic training on AML/CFT by the FIU. Money transmitter agents of international money transmitters have also received from their international principals on AML/CFT.

895. In meetings with the evaluation team, industry participants provide detailed AML/CFT policies and questionnaires that they presented to potential counterparties specific to AML/CFT risk. In-depth questioning to the participants, however, suggested minimal understanding of the AML/CFT obligations spelled out in the policy, suggesting to the evaluation team that “model” AML policies are used to attract international companies that the industry participants seek to serve as agents of in Nepal.

896. Industry participants acknowledged that they do not collect beneficial ownership information, do not check on the source of funds, and do not generally perform ongoing due diligence of repeat clients. The representatives interviewed did have existing PEP policies and claimed to perform enhanced due diligence on PEPs. The evaluation team finds this claim doubtful in light of the inability of interviewed industry representative to identify the number of PEP clients or whether the definition of PEPs in the money transmitter Directives applied to foreign or domestic PEPs. Large money transmitters that serve as agents of foreign principals appear to perform a check of the UNSCR 1267 and Office of Foreign Asset Control SDN lists at the headquarters and regional levels. No such searches are conducted by their agents, which make up more than 95% of sending locations.

897. Interviewed money transmitters stated that they retained all transaction and customer identification records for six years (one year beyond the tax code’s statutory minimum). Money transmitters interviewed by the evaluation team declined to estimate the number of TTRs they file per week. Overall numbers are likely to be small assuming that average remittances are in the \$500 range or less than 4% of the threshold transaction reporting requirement of NRps 1 million (\$US13,513).

898. Money transmitters and money exchanges have not filed any STRs.

3.11.2 Recommendations and Comments

899. Nepal’s Directives to money transmitters and money exchangers are nearly identical in language and scope to Directives issued to other financial institutions. Thus, the deficiencies in the money transmitter and money exchange Directives are the same deficiencies found in the Directives for other financial institutions.

900. It is recommended that Nepal:

- Incorporate AML/CFT into their inspection manuals for the annual exams of money exchanges and money transmitters.
- Examine not only money transmitter principals, but also agents, for AML/CFT compliance.
- Offer training specific to STR filing for money exchanges and money transmitters, both in Kathmandu and in regional centres, and provide training manuals that money transmitter principals can use to develop modules for agent training across Nepal.
- Consider liberalization of exchange rate policies or developing a remittance initiative providing remitters with incentives to use formal financial channels to boost remittances through formal financial channels.
- Draft guidance specific to money transmitters and money exchanges on their AML/CFT obligations and how to design and implement risk-based management systems, including for PEP identification and transaction monitoring.
- Require money transmitters and money exchanges to collect beneficial ownership information.
- Nepal should amend ALPA, the NRB Act, and promulgate related Directives to require money transmitters to evaluate potential foreign counterparties for AML/CFT risk.

3.11.3 Compliance with SR VI

	RATING	SUMMARY OF FACTORS UNDERLYING THE RATING
SR VI	NC	<ul style="list-style-type: none"> • The application of the FATF Recommendations to MVTS providers suffers from the same deficiencies in regulations or other measures in the areas of CDD, reporting of suspicious transactions, and other sanctions in relation to the rest of the financial sector (see sections 3.1 to 3.10 of this report).

4. PREVENTIVE MEASURES – DESIGNATED NON-FINANCIAL BUSINESSES AND PROFESSIONS

4.1 Customer Due Diligence and Record-Keeping (R 12, applying R 5, 6 and 8 to 11)

Scope issues

901. Section 2(d) of the ALPA defines ‘non-financial institutions’ as follows:

2(d) "Non-Financial Institution" means the following institutions:

(1) Any firm or company other than those stated in Clause (h), registered as per prevailing laws to carry out any trade or business including casino, precious metals.³⁶

(2) Any institution irrespective of whether or not organised or incorporated as per the laws.

(3) Any institution designated as "Non-Financial Institution" by the Government of Nepal through a notice in the Nepal Gazette.

902. This definition (including the designation power in ALPA s 2(d) (3)) is wide enough to include a firm, company or institution that is a DNFBP defined in the glossary to the methodology. However, this section does not include natural persons that are lawyers and notaries, chartered accountants, real estate agents, trust and company service providers (TCSPs) and dealers in precious metals and stones. The Government has not designated any institutions under s 2(d) (3) to date.

903. Although AML/CFT measures prescribed in ALPA and AML rules are identical in their application to all covered DNFBPs the FIU has issued directives to casinos only. Nepal authorities stated that Nepal is gradually planning to cover these sectors in a carefully considered and phased approach to implementation.

904. The ALPA provides that the NRB may determine monetary thresholds applicable to DNFBPs for purposes of triggering CDD and other controls. Such determination have not yet been made,

905. FIU has issued two Directives for casinos, but not yet for other DNFBP. The casino Directives were issued on 1 December 2009 and 14 April 2010 (but, as noted previously, they are not “other enforceable means”).

906. An evaluation of ALPA’s compliance with FATF Recommendations 5, 6, 8 to 11, and 13 to 15 and 21 has already been made in Section 3 of this report, and a number of deficiencies have been noted which apply also to DNFBPs. The following analysis covers only requirements specific to DNFBPs.

³⁶ The reference to “clause h” in this Act is to the definition of “financial institutions” – i.e., class A, B, C, and D financial institutions licensed by the NRB.

4.1 Customer due diligence and record-keeping (R 12) (applying R.5, 6, and 8 to 11)

4.1.1 Description and Analysis

Casinos

907. While gambling is prohibited in Nepal under s 3 of the Gambling Act 1963, the government is permitted under s 8 of that Act to designate certain areas where it is permissible to do so. Under s 45A of the Tourism Act 1978, the Ministry of Tourism has designated casinos in 5-star hotels as “other prescribed tourism enterprises” for the purposes of the Gambling Act. These designations satisfy the requirements of the Gambling Act for the purpose of ensuring that the existing casinos are lawful enterprises in Nepal as only non-Nepalis are permitted to enter and gamble in the casinos.

908. The following list constitutes the main features of casinos in Nepal:

- Slot machines and electronic games, subject to low limits;
- Blackjack, baccarat, roulette, poker, pontoon, paploo, mini-flush, kitty slots, etc;
- On-line gaming / gambling;
- Nepali citizens are not allowed to gamble in casinos. Indians are the major customers.
- All games are played in chips. The chips are available in Indian rupee denomination of 100, 1000, 10,000. Chips can be purchased with foreign currencies such as US dollars, UK pound and Euro or with Indian rupees
- Few customers undertake transactions of US\$1,000 or more.
- Deals/ exchange of chips with other casinos are permissible. The customers can take the chips outside the casino and can game in other casinos with those chips. For chip control, chips have been assigned casino unique visible mark and casinos undertake inventory of chips regularly.
- Although account-based relationships are permitted, the casinos currently do not offer account-based or credit based gaming/gambling, and have no plans to do so.
- There are no VIP rooms for gambling and no ATM facility is provided in casinos.
- All payouts are in cash and no cheque or any other instrument is issued. Casino operators affirmed that it is practically impossible to issue cheque for pay outs.

909. FIU AML directives oblige casinos to require their customers to submit personal details such as name, address, copy of passport/election card and source of income at the entry of a casino. Most of the customers mention business as their source of income and no verification of details is done by casinos. The evaluation team was advised that the casinos do identification at the entrance of the casino only, and not at transaction level; so it is not clear how the link would be established between the transaction and the identified customer.

910. ALPA s 6 requires the casinos to obtain and maintain clear records of identity of customers while establishing the business relationship or while transacting above the prescribed threshold. The FIU AML Directives dated 1 December 2009 issued for casinos broadly reiterate the basic requirements of s 6 of the ALPA and do not make the CDD process dependent on transaction threshold. FIU AML Directive No 1 to Casinos (s 1) requires casino operators to obtain the following information on customers:

- Clear Full Name and Address (including the country);
- Copy of any of Passport and Visa, Certificate of citizenship, Identity Card disclosing nationality;
- Full mailing address for correspondence including permanent/ temporary address;
- Telephone number (if any);

- Source of the money or value;
- Means through which the money or value has been brought and its proof;
- Means for taking won or withdrawal amount;
- Other documents and particulars as deemed necessary by the concerned Casino under the Act; and
- Private interview with the customer, if necessary.

911. If customers refuse to provide this information when attempting to enter a casino they may be denied entry under s 2 of the Directive. A customer's refusal is treated as suspicious for the purposes of the ALPA and under the Directive a STR must be filed with FIU. This requirement does not obligate casinos to refuse entry in or terminate the relationship of customers when it is unable to undertake CDD process – the Directive gives the casino a discretion in this regard..

912. ALPA ss 6(2)(b) and (d) do not satisfy the FATF recommendations on beneficial ownership. While s 6(2)(b) does not require identification of controlling interests, s 6(2)(d) stipulates a certain amount of CDD on immediate beneficiaries rather than on the beneficial owners of the customers. ALPA s 6(2)(c) requires a certain amount of CDD on principals but not on agents. Nepal authorities stated that casinos undertake CDD on customers permitting entry and not of the principal for whom the customers intend to transact. They confirmed that this is due to lack of guidance and awareness on the AML/CFT requirements.

913. FIU AML Directives obligate reporting institutions to classify transactions by identifying the inherent risk as “High”, “Medium” or “Low”. FIU AML Directive No 2 to Casinos dated 14 April 2010 (s 4) lists high risk customers as those who can directly or indirectly assist terrorist activities, terrorist organisations, organised crime, illicit drug or any other crime, transactions by PEPs, etc. However, there is no guidance issued by the FIU to assist casinos to understand the risk-based approach.

914. The directive is silent on whether transactions in casino under US\$3,000 are exempted from CDD measures, or measures detect structuring.

Other DNFBPs

915. There are no procedures, guidelines or codes of conduct that assist with customer identification requirements for DNFBPs other than casinos. During the on-site visit the evaluation team was informed that dealers in precious metals, lawyers and chartered accountants do not undertake any specific customer identification process and do not necessarily know the source of funds of clients.

Applying R 6 - Politically exposed persons

916. There are no relevant provisions relating to PEPs in either the ALPA or the AML Rules. The requirements prescribed in clause 6(3) of Directives dated 1 December 2009 issued to casinos are identical for all reporting institutions and are limited to the extent described in s 3.2 above.

Applying R 8 - Technological developments and non-face-to-face transactions

917. The scope of application of this Recommendation to the DNFBP sector is limited to the extent described in s 3.2 above. Nepalese authorities have asserted that non-face-to-face businesses do not exist in Nepal. It is noted from the information available in the public domain

that on-line gaming / gambling is in practice occurring in Nepalese casinos³⁷. In view of absence of positive obligations cast on the DNFBP sector and any incidental policies and procedures in place, implementation cannot be assessed.

Applying R 9 - Third parties and introduced business

918. The authorities have asserted that third-party introduced business is not permitted in Nepal and this view was shared by all the institutions and private sector with which the evaluation team met.

Applying R 10 - Record keeping

919. The record keeping requirements prescribed in ss 6(3) and 7(4) of ALPA, AML Rule 10 and clause 1 and clause 4 (3) of FIU AML Directives on casinos are identical for all reporting institutions and are limited to the extent described in s 3.5 above. In short, the time limit for keeping CDD records has not been prescribed in s 6 (3) as required by Recommendation 10. Clause 1(4) of FIU AML Directives (dated 1 December 2009) requires the casinos to keep CDD records. The Directives also do not prescribe any time limit for maintenance of records. During on-site visit the casino operators informed the evaluation team that they maintain the customer record for 5 years as required under the Tax Laws.

Applying R 11- Monitoring of transactions and relationship

920. The STR reporting obligations prescribed in s 7 of the ALPA and FIU AML Directives to casinos requires casinos to pay special attention to the suspicious and unusual transactions or unusual patterns of transactions that have no apparent or visible economy or lawful purpose.

Implementation and effectiveness

921. Though the ALPA and AML Rules apply only to casinos and DNFBPs designated in ALPA - s 2(d)(1) & (2). There is no AML/ CFT regime in place for real estate agents and TCSPs. The requirements prescribed in ALPA and AML Rules are not being implemented for these entities.

922. At the time of the on-site visit, the casino sector had been subject to the ALPA requirements for two years, AML Directives for almost one year and the FIU AML Directives for about eight months. Detailed guidance and outreach and training the casino sector has not yet occurred. Supervision for implementation had not yet occurred. Therefore, there was no basis for assessing the effectiveness of implementation of FIU AML Directives.

923. Nepal authorities advised that the government will shortly undertake a formal risk assessment of all sectors, including casinos, so as to effectively implement the FATF Recommendations. The authorities have also taken cognizance of the issues regarding probability of high ML/TF risk in the casino sector.

4.1.2 Recommendations and Comments

924. It is recommended that Nepal should:

- Ensure comprehensive preventative measures for CDD, PEPs, record keeping and transaction monitoring apply to all DNFBP and are enforceable (the ALPA and enforceable Directives).

³⁷ www.nepalonlinecasino.com

- consider, on a risk-sensitive basis, the extent and timing of requirements to DNFBPs.
- undertake a comprehensive study of ML and TF risks from casinos and determine additional measures to be applied to casinos to address AML/CFT risks in the sector.
- provide guidance to the casino operators on how to implement the requirements of law including the FIU AML Directives.
- FIU AML Directive dated 1 December 2009 (s 2) should be amended so that casinos must instantly decline to establish or terminate relationship with customers that fail to provide necessary documentation as opposed to making it voluntary for casinos.

4.1.3 Compliance with Recommendation 12

Rating Summary of factors relative to s.4.1 underlying overall rating

	RATING	SUMMARY OF FACTORS UNDERLYING THE RATING
R 12	NC	<ul style="list-style-type: none"> • Preventative measures in the ALPA do not apply to all DNFBP sectors • The scope of preventative measures applicable to casinos and other DNFBPs are narrow and do not address many of the measures required under the standards. • Enforceability of ALPA measures is limited and the only other instruments for casinos are not enforceable • Extension of the FIU AML Directives to the casino sector is very recent and there is insufficient evidence of effective implementation.

4.2 Monitoring Transactions and Other Issues (R 16, applying R 13 to 15 17 & 21)

4.2.1 Description and Analysis

925. The STR reporting obligations under s 7, and the authority of the FIU under s 10(1)(a) of the ALPA and other obligations under rule 10 of AML Rules apply only to those DNFBPs which are covered in s 2(d) of the ALPA. The obligations under the ALPA to file STRs under s7 are enforceable pursuant to s 31. However, AML Rules and FIU AML Directives are not enforceable. These raise a major scope issue, which affect the ratings for Recommendations 13 and Special Recommendation IV and, therefore Recommendation 16.

926. ALPA obliges all covered DNFBP to investigate and enquire into any transaction which appears to them to be suspicious or transacted with motive of ML or there are “reasonable grounds of suspicion” (s.7 (1) (b)).

927. The ALPA defines the term ‘suspicious transaction’ (s.2 (l)) to mean the transaction of such nature that is ‘impossible in general economic, commercial and business practice’. ‘Transaction’ means any act or agreement to carry out any economic or business activities and the purchase, sale, distribution, transfer or investment and possession of any ‘assets’ (s. 2(c)). The games of chance in casinos do not seem to be covered by definition in s 2(c).

928. Section 7 also addresses the timing of STR reporting and requires filing of STR with FIU immediately after the “event” i.e. transaction (s. 7(1) (c)) and after making an inquiry in case of suspicious transaction of regular customers (s.7 (3)). The STR reporting obligation under s 7(1) (b) combines an obligation to investigate and inquire the transaction for making an opinion/confirmation on suspicious transaction. Thus, the STR can be filed with respect to any suspicious transaction only after the investigation and inquiry of the transaction.

929. Further, STR under s 7 can be filed by DNFBPs when:

- The transaction appears to be ‘suspicious’ or there are ‘reasonable ground for suspicion’ (i.e. transaction is of such nature that is impossible in general economic, commercial and business practice); or
- Transacting is with the motive of asset laundering; or
- The asset is laundered by the transaction.

930. While the first two factors indicate making of opinion on the impossibility of transaction or motive i.e. purpose of asset laundering, the third requires a confirmation that asset is laundered by the transaction. The benchmarks seem very difficult for covered DNFBPs to meet.

931. The definition in ALPA s 2 does not cover attempted transactions. The FIU AML Directives (dated 1st December 2009 and 14th April 2010) issued to casinos create obligation for STR reporting in the case of an attempted transaction regardless of any threshold. The FIU AML Directives of 1 December 2009 and 14 April 2010 issued to casinos list suspicious transactions which should be reported by casinos.

932. The FIU AML Directives to casinos prescribes a threshold of NRps 300,000 (US\$4,054) for TTRs or more in a day for gaming or exchanging casino chips, either for a single or series of transactions. The threshold is determined by integrally connected transactions in one day. However transactions remotely connected or related are not included.

933. ALPA has limitations regarding criminalizing terrorism or TF as discussed in section 2.2 above. The FIU AML Directives (1 December 2009, clause 4(j)(k)) mandate the casinos to file STR with FIU if an individual or organisation involved in terrorist activity comes to casino as customer or any transaction appears to facilitate any terrorist activity or terrorist organisation. The FIU AML Directives (14 April 2010, clause 1 and 2) require casinos to file STR if a customer has committed or caused to commit or attempted to commit the offence of TF and bar them from conducting any transactions with terrorist organisations declared in United Nation Security Council Resolution 1267.

934. The interviewed casino operators conceded that they face difficulties in monitoring customers who take chips outside and those who might undertake multiple transactions which, when aggregated, breach the threshold for TTRs. They also stated that they need appropriate training and guidance in understanding the AML/CFT requirements laid down in ALPA, AML Rules and FIU AML Directives as well as the trends and techniques used in casinos for ML/TF.

935. At the time of the on-site visit, no STRs had been filed by casino operators, or by any other DNFBP.

Tipping-off (R 14)

936. The protection to the casinos, their staff, officials or agents under s 37 of the ALPA is available only if any person suffers loss on account of TTR reporting. Further, there is no protection to the casino operators their directors, officers or employees if they file STRs in good faith with FIU. To this extent the protection is limited.

937. There is no law or regulation prohibiting the casinos, their directors, officers or employees from tipping -off the fact of STRs reporting to FIU. Clause 12 of FIU AML Directives dated December 1 2009 prohibits the casino, its staff, officials or representatives from disclosing any information provided to FIU. This clause does not prohibit the tipping –off the fact of possible STR reporting or furnishing related information to FIU. The Amendment Bill seeks to prohibit the tipping–off and prescribes penalties by way of departmental actions and fines.

Internal controls (R 15)

938. The scope issues/deficiencies with respect to Recommendation 15 in the financial sector (described in s 3.8 above) apply equally with respect to the DNFBPs.

939. FIU AML Directives of 1 December 2009 require casinos to develop internal procedures, policies in respect of prevention of ML/FT activities, customer due diligence, customer acceptance, information management, suspicious transaction detection, record keeping, reporting and process of monitoring customer's transactions as well as assessment of risk. These Directives also declare that Chief of the Casino or the Officer designated by him shall be focal person to comply with the ALPA, FIU AML Directives and other existing laws. The Directives also encourage the casinos to use guidelines laid down by relevant international organisations with respect to CDD.

940. In practice, the casinos have designated junior level officers for compliance management. So far no TTRs/ STRs have been filed by this sector with the FIU and no inspections have been conducted by FIU or MoT. Therefore, the status of compliance is unclear.

941. The other requirements have not been implemented by DNFBPs covered under the ALPA because of lack of guidance. The effectiveness of implementation cannot be demonstrated.

Applying Recommendation 21

942. FIU AML Directives to casinos do not mandate or guide the casinos to give special attention to transactions of customers from country which are non-compliant or which insufficiently apply the FATF Recommendations. The FIU has neither issued any guidance nor has it conducted any training or outreach meeting/workshops to advise casinos of concerns about weaknesses in AML/CFT system of other countries.

4.2.2 Recommendations and Comments

943. It is recommended that Nepal should:

- Introduce appropriate enforceable obligations for the DNFBPs to comprehensively implement STR reporting and related measures.
- Ensure mandatory obligations in ALPA for STR reporting in case of attempted transactions and in relation to TF.
- Amend FIU AML Directives dated 1 December 2009 to include remotely connected or related transaction in threshold for filing TTRs.
- Amend ALPA and FIU AML Directives to ensure protection to DNFBPs and their directors, officers or employees from civil and criminal liability in case of STRs filed/ information shared in good faith.
- Amend language of s 37 of ALPA which gives protection 'only if any person suffers loss on account of TTR reporting.'
- Amend ALPA and FIU AML Directives to prohibit the tipping –off the fact of possible STR reporting or furnishing related information to FIU and prescribe dissuasive sanction for breach of the obligation
- Create effective, proportionate and dissuasive sanctions in the ALPA for non-compliance with all obligations created in ALPA, AML Rules and FIU AML Directives.
- Issue enforceable guidance to the casino sector, especially in relation to the implementation of appropriate internal systems and controls. This is especially important in the context of the on-line casinos/ internet casinos, which pose the greater risk.

4.2.3 Compliance with Recommendation 16

	RATING	SUMMARY OF FACTORS UNDERLYING THE RATING
R 16	NC	<ul style="list-style-type: none"> • STR reporting obligations in the ALPA do not apply to all DNFBP sectors. • Only the basic requirements of the ALPA and the AML Rules apply to casinos, and these do not address much of the issues required under the standards. • Protection for STR reporting and prohibitions of tipping-off not fully incorporated. • No effective implementation of AML/CFT controls by DNFBPs sector for STR reporting and internal controls.

4.3 Regulation, Supervision and Monitoring (R 24-25)

4.3.1 Description and Analysis

944. There is no regulatory and supervisory regime in existence for DNFBPs sector except for casinos, lawyers/notaries and accountants where a licensing regime is in place but supervisory powers are not effective.

Casinos

945. The authorities informed that by an order under s 8 of the Gambling Act the Government has permitted casinos in five star hotels only. A copy of the said order has not been given to the evaluators despite information request made.

946. Licensing and regulatory regime for casinos in Nepal is not properly established through law or rules or regulations. While the Nepal officials claimed that casinos are licensed under s 45A of the *Tourism Act* as 'other tourism enterprises' it is difficult to understand how it is done in absence of requisite 'rules' (prescribed under s 45A) designating casinos as 'other tourism enterprises' and for licensing and supervision requirements.

947. Ministry of Tourism (MoT) has not issued any directives to casinos for compliance with AML/CFT requirements. It is gathered from the news reports and also informed by the authorities interviewed by evaluation team that Government is considering to bring in licensing and regulatory regime and effective AML measures for casinos by separate Act and regulations³⁸.

948. A small Division within the MoT is designated to license and supervise casinos. Licenses are granted subject to following conditions:

- The operation must be in a five star hotel.
- Payment of NRps 20 million (US\$270,280) annually to the Government as royalty.
- Nepalese citizens are not allowed entry and playing in the casinos.
- Indian citizens can play in Indian Rupees and other foreigners in convertible foreign currencies.
- "Entry register" at casino's entrance to keep information of name, address, nationality, passport no., and copy of the identification card of the customers.

³⁸ Bangladesh SUN, Friday 9 July, 2010

- Each casino should provide bi-year periodic report to the MoT mentioning the number of visitors, their nationality and transactions.
- The authorities can inspect the casinos on a regular basis or at any time.
- The NRB gives permission to open foreign currency account as per the recommendation of the MoT.
- MoT can give Directives to the casinos as needed.

949. While under s 47 of the Tourism Act, MoT has wide powers to conduct inspections and to compel production of documents and information from the licensed “other tourism enterprise”, it has not undertaken any inspection of casinos till date. The officials and casino operators informed the evaluators that since commencement of the ALPA on 28 January 2008, the MoT had visited the casino twice and last visit was just 15 days before the on-site visit of evaluation team and the focus of the visit was to oversee compliance of conditions with respect to nationality of customers and royalty amount.

950. During the on-site visit, the authorities conceded that they are considering introducing and implementing AML/CFT requirements on casinos in coordination with the FIU.

951. The range of sanctions under the Tourism Act is very small. MoT may fine of NRps 2,000 (US \$11.50) under s 52; suspension of license up to a maximum period of six months and cancellation of license in case of recurring violation after expiry of suspension period (s 7 and s 45A) would fail to act as a meaningful deterrent. These sanctioning powers do not extend to breaches of AML/CFT requirements by casinos. The MoT has not applied any sanction on any casino so far. The authorities stated that MoT is presently having resource constraints which hinder implementation of their authority and they need capacity building through staffing, training and skill enhancement.

952. For foreign exchange transactions, casinos are required to have a license from the Foreign Exchange Management Department of NRB (FEMD-NRB) under s 3 of FERA and s 63 of the NRB Act. FEMD-NRB has power of information requisition and inspection and to apply sanctions including warnings, de-licensing, and imposition of fines on casinos for non-compliance with the FERA and NRB Rules and Directives (s 17 of FERA and ss 99 and 100 of NRB Act). No data is available on inspections and sanctions by FEMD-NRB for casinos. Hence, effectiveness cannot be assessed.

953. The MoT has not established 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 functions in, or being an operator of a casino. It is confirmed by Nepal Officials during the on-site visit that most of the casinos are owned and managed by a third party viz., National Recreation Centre (NRC) a company registered by the Office of Registrar. There is no ‘due diligence’ or ‘fit and proper’ check on the beneficial owners or controlling interests of casinos and NRC by MoT or Office of Registrar.

954. Absence of rules or regulations for eligibility criteria, details to be furnished by the applicants and absence of any “fit and proper” checks on the operators seeking license and on their management/ controlling interest, affects the assessment and rating with respect to Recommendation 24.

Other DNFBPs

955. None of the other DNFBP sectors is subject to supervision by a competent authority for AML/CFT purpose. Some degree of oversight of the professional activities of the other sectors, however, exists, and may provide some basis for future regulation when the relevant

professions/businesses are brought within the ALPA. However the sanctioning regime lacks dissuasive, proportionate and effective penalties.

956. Real Estate Agents: No registration or licensing regime exists for real estate agents and consequently the authorities have no knowledge of the number of such businesses in existence.

957. Dealers in Precious Metals and Dealers in Precious Stones: There is no supervisor/regulator established for licensing/ supervising and regulating dealers in precious metals and dealers in precious stones in Nepal. Few associations such as Gold and Silver Dealers Association and Nepal Gem and Jewellery Association (NEGJA) have very light self-regulatory roles and they act as trade unions/associations. The Gold and Silver Dealers Association has its central office in Kathmandu and has 2500 members spread over 35 districts. NEGJA is an association of 18 members who deal in gems and stones and it is operating only in Kathmandu. These associations are not “self-regulatory organisations” in the FATF sense, and have no enforcement powers other than to terminate membership. Membership of these associations is not a necessary condition to engage in the business of gold or silver and gems and jewellery.

958. Lawyers and Notaries: By s 8 of the Nepal Bar Council Act 1993 the responsibility for professional standards within the legal profession is vested in the Bar Council of Nepal. The Act authorises the Bar Council to enrol legal practitioners and take action. It can constitute a Disciplinary Committee to deal with complaints against legal practitioners. Though clause 3(w) of the Code of Conduct for Legal Practitioners, 1994 prohibits a legal practitioner from engaging in businesses/ transactions of transfer of property as a broker, lawyers can deal in real estate transactions otherwise than as brokers. Clause 7 of the Code of Conduct provides for punishment in case of violation of code of conduct. The Disciplinary Committee is not functioning effectively. The sanctions provided in this regard include admonishment, suspension/ revocation of license.

959. Chartered Accountants: The Institute of Chartered Accountants of Nepal (ICAN) is an autonomous statutory regulatory body established under s3 of the Nepal Chartered Accountants Act, 1997. Its membership is divided in two classes: Chartered Accountants (CAs) and Registered Auditors (RA) having certificate of auditor under the Auditors Act, 1975. Four classes, ‘A’, ‘B’, ‘C’, and ‘D’ of RAs are registered under the Auditors Act.

960. A person who carries out auditing without obtaining the professional certificate pursuant to the Chartered Accountants Act can be punished under Section 41 with a fine not exceeding NRps 2000 (US \$11.50) or with imprisonment for a term not exceeding three months or with both. Section 18 of the Act provides disqualifications of members and those include conviction of a criminal offence involving moral turpitude, insolvency and person being of unsound mind. The disqualifications do not include other undesirability such as conviction of other offences and crimes or any other ‘fit and proper’ test. ICAN is empowered to formulate ethical standards which are mandatory for all members, and can enforce these through its statutory disciplinary power to suspend the membership.

961. However, membership can be cancelled under s 23 only if membership was obtained by fraud or mistake. The ICAN has not prescribed any code of ethics or conduct for its members for any AML/CFT measures. No training has been given so far to members of ICAN on AML/CFT requirements.

962. Whenever sanctions are applied they are not proportionate and effective. None of the supervisors where they exist have focused to supervise compliance of AML/CFT requirements to date. Application of sanctions for AML/CFT breaches is nil.

Recommendation 25 (Guidance for DNFBPs other than guidance on STRs)

963. The FIU AML Directives to casinos prescribe the AML/CFT requirements by supplementing the provisions of the ALPA and the AML Rules. These Directives do not provide substantive guidance to the casino operators on how to fulfil the prescribed obligations. Other than for casinos no guidance has been issued for DNFBPs. The private sector representatives interviewed by the evaluators confirmed that they face difficulties in understanding AML/CFT-related issues and obligations outlines in the ALPA and AML Rules.

964. The FIU has conducted a half -day workshop (31 August 2010) for representatives of MoT and casinos and for representatives of the Nepal Bar Council, Nepal Bar Association, ICAN, Chartered Accountants Association, and Auditors Association (on 3 September 2010). These workshops were to familiarise the participants about compliance with the ALPA and AML Rules.

965. The FIU has yet not undertaken outreach programmes for the DNFBP sector to provide guidance on the AML/CFT requirements. Regulatory compliance alone however, may not be enough to insulate DNFBPs against liability under the ALPA, AML Rules and FIU AML Directives. The supervisors should also expect the DNFBPs to take preventive measures and provide suitable guidance to them in that regard.

4.3.2 Recommendations and Comments

966. It is recommended that Nepal should:

- Comprehensively regulate and supervise DNFBP sector adopting a risk-based approach.
- Prioritise targeted supervision of the sector for AML/CFT.
- Issue rules under the Tourism Act to declare casinos as ‘other tourism enterprise’ and lay down appropriate licensing and reporting requirements/conditions.
- Provide regulators with the statutory authority to use its powers of inspection, etc., in order to enforce compliance with AML/CFT requirements;
- Give the authorities statutory powers to apply ‘fit and proper’ tests to the owners/controlling interests, operators and managers of the casinos;
- Strengthen the sanctions and make specific provision for sanctions to be applied for breaches of the AML/CFT requirements and relevant instructions that the regulator may issue from time to time;
- Enhance the penalty for failure to file reports and create penalty for obstructing access by the regulator to documents, premises, in order to make sanctions effective and dissuasive ;and
- Broaden the scope of the sanctions that may be applied, so that there is a range of options that might be applied effectively;
- Designate a supervisor/regulator with suitable powers of licensing, supervision, inspection and applying proportionate and dissuasive sanctions for non –compliances by respective sector;
- Provide necessary guidance to casino sector and other DNFBPs when they are included in AML/CFT regime.

4.3.3 Compliance with Recommendations 24 & 25 (criteria 25.1 DNFBP)

	RATING	FACTORS UNDER LYING RATINGS
R 24	NC	<ul style="list-style-type: none"> ALPA does not apply to all DNFBP sectors. No supervisory/regulatory regime for dealers in precious metals and dealers in precious stones No statutory “fit and proper” tests for owners/controlling interests, operators and managers Insufficient range of sanctions available to the MoT to enforce supervisory powers Lack of proportionate and dissuasive sanctions for failure in filing report <p>Effectiveness issue:</p> <ul style="list-style-type: none"> The supervisory regime in sectors where it is available has not yet commenced AML/CFT inspections and it is not effective.
R 25	NC	<ul style="list-style-type: none"> No evidence of appropriate guidance provided to the casinos, Chartered Accountants and Lawyers. No guidance to assist with the implementation of the ALPA, AML Rules and FIU AML Directives to any other sector where they have been applied.

4.4 Other non-financial businesses and professions - Modern secure transaction techniques (R.20)

4.4.1 Description and Analysis

Inclusion of other non-financial businesses

967. Section 2(d)(2) of the ALPA includes any “institution” whether or not organised or incorporated as per the laws. The language of the section is very wide and includes any “institution”, which could include non-financial businesses. Since the ALPA came into force on 28 January 2008, no other institution other than banks and financial institutions regulated by NRB have been called on to comply with the ALPA.

968. Section 2(d)(3) provides for the Government of Nepal to designate by a notice any ‘institution’ as a ‘non-financial institution’ for the purposes of the Act. However, as yet, the power to designate additional non-financial business or professions has not been used. Authorities have expressed that due to resource constraints in Nepal, the decision on whether to designate non-financial institutions under the ALPA will depend on a risk assessment being conducted by Nepal, as well as capacity building and related national priorities.

Modern and secure transactions to address ML/TF risks

969. The authorities advised that Nepal is pursuing the development of mechanisms for modern and secure transactions, however due to lack of resources this is proceeding slowly. In the banking sector, there is a low level of automation and computerization across the banking system. Electronic funds transfer facilities do not yet extend to retail customer on account of cost and implementation issues. For intra-bank transfers, electronic funds transfer facility is available through SWIFT. International wire transfers are also made through SWIFT. There is one clearing house in banking department of NRB for clearing cheques.

970. At a retail level, though credit and debit card facilities are available, the usage thereof is not widespread. There is not much use of credit cards but debit cards have helped in encouraging non-cash transactions. However, debit cards are also not widely prevalent because

the Nepalese market is underdeveloped and in many places swipe machines are not available. Non-cash transactions through Automated Teller Machines (ATMs) are occurring but are not prevalent in small towns and rural areas. Six banks offer credit cards in Nepal.

971. In the securities sector, though the NEPSE was automated in 2007, the clearing and settlement of trade and securities is manual. The exchange verifies the customer’s details before confirming the trade. Any transaction for the value of NRps 50,000 or more has to be made through cheque. The SEBON and NEPSE both have introduced on–line surveillance system to some extent.

972. In the insurance sector, no modern secure techniques are being implemented at present.

4.4.2 Recommendations and Comments

973. Nepal should extend the AML/CFT regime to non-financial businesses and professions (other than DNFBPs) which are prone to risk for ML/TF at present and to other non financial business after the risk assessment.

974. Pursue further measures to develop modern and secure transaction techniques to avoid ML and TF risks from the high usage of cash in the economy.

4.4.3 Compliance with Recommendation 20

	RATING	SUMMARY OF FACTORS UNDERLYING THE RATING
R 20	LC	<ul style="list-style-type: none"> Few measures to develop modern and secure transaction techniques to avoid ML and TF risks from the high usage of cash in the economy.

5. LEGAL PERSONS AND ARRANGEMENTS & NON-PROFIT ORGANISATIONS

5.1 Legal Persons – Access to Beneficial Ownership and Control Information (R 33)

5.1.1 Description and Analysis

975. A variety of forms of legal persons/entities exist in Nepal governed by the Companies Act 2006 as follows:

TYPE OF COMPANY	DESCRIPTION	OWNERSHIP (HOLDING)	NUMBER OF COMPANIES
Public Limited Company	Government Companies	Government Ownership	529
		Joint Ventures	20
	Non-government Companies	100% Nepalese	615
		Joint Ventures	38
Private Limited Company	Single shareholder	Domestic	27,561
	Joint Venture Companies (multiple shareholders)	Domestic joint ventures	52
	Multiple shareholders (100% Nepalese)	Domestic	52,097
	Foreign and Nepalese shareholders	Foreign and domestic	313
	Foreign companies Nepalese liaison office	Foreign	30
	Foreign companies branch office only	Foreign	3

* Effective June 2010

976. A public company requires at least 7 shareholders to register and incorporate. Private companies may have one shareholder or a maximum of 50 to incorporate. Registration and incorporation is required through the Company Registrar's Office in Kathmandu (there are no branch offices) after filing the required statutory documents.

Central Registration System

977. The Company Registrar's Office (CRO) is the central registering authority for all companies in Nepal. There is one office of the CRO located in Kathmandu and falls within the authority of the Ministry of Industry, Commerce and Supplies. The company registration system in Nepal is paper-based. As yet, there are no plans to introduce an electronic or internet-based filing system for company incorporations. According to the CRO officials there are inadequate resources in the CRO to do anything other than file documents presented for incorporation of companies.

Companies

978. Before a certificate of incorporation can be issued the following documents must be filed with the CRO under s 4 of the Companies Act: (1) Memorandum of Association stating the objectives and purposes for which the company will be formed; and (2) Articles of Association outlining the rules and regulations for achieving those objectives and purposes. Under ss 18 and 19 of the Companies Act, the memorandum of association must provide the full names and addresses of its “promoters” and witnesses; indicate the number of shares each promoter subscribes to; and be signed by each promoter. Promoters are deemed directors until other directors are appointed. No additional personal information is required and there is no requirement to list identifying information relating to other shareholders when filing incorporation documentation.

979. CRO officials confirmed that under the Companies Act promoters with issued shares in private companies may immediately transfer those shares to other persons after the incorporation process and that CRO does not, nor is it required to, collect that new shareholder information for its official records.

980. No information on the beneficial owners (as defined by the FATF) of the company being established is collected by CRO nor is it required to be. The information provided in the incorporation process is reviewed by staff at the applicable corporate registry but only to ensure that the entity meets the legal requirements for incorporation. A registration certificate must issue by the CRO within 15 days of the submission of the documents noted above.

981. A company must have a registered office in Nepal under ss 15, 18 and 46(2) of the Companies Act for the purpose of service of legal documents. Also every company must keep a shareholder register containing the following information:

- Full name and address of each shareholder;
- Number of shares subscribed by shareholders;
- Total amount paid by the shareholder and outstanding amount payable for shares;
- Date of registration of his/her name as the shareholder;
- Date when shareholder’s name was struck off; and
- Name and address of the nominee after the death of the shareholder, if such nominee is appointed.

982. Every public company is required to file an Annual Return with the CRO containing limited information on shareholders and debenture holders, past and present, and its directors, managing directors, managers and secretaries, past and present. Information on directors during registration, incorporation and annual reporting is not collected, including checking directors’ names against international terrorist lists (UNSCR 1267) or domestic terrorist lists (UNSCR 1373). Directors and managers of companies may be natural or legal persons.

Nominee Shareholders and Directors

983. The scope of shareholder information required to be collected by each company for its internal records is limited. There is no requirement that the ultimate beneficial owners of shares be identified in corporate records and there is no legal requirement to indicate in these records if, or when, a transfer of shareholding has occurred except in an Annual Return, but this is only at the time of filing the return with the CRO.

984. CRO officials agreed that in light of s 47 of the Companies Act³⁹ there is no bar in the Companies Act or other laws restricting share ownership by way of nominee shareholders – or 3rd party ownership on behalf of a beneficial shareholder. Moreover, there is no prohibition in the Companies Act on directors appointing nominees to act in their place. CRO officials confirmed that the Act does not contain any provision for the disclosure of nominee directors in a company's corporate records. It is possible, therefore, for a nominee director to act on behalf, and at the direction, of an undisclosed principal in the operations of a company.

Company Formation and Service Providers

985. Anyone in Nepal (lawyer, accountant, other professional or layman) may act as a company formation agent and/or company service provider. Company secretaries exist in Nepal but there is no information on how many operate in the country and there is no legislation or regulations regulating their business. Nothing in the Companies Act or other law/regulation requires these third parties to collect and hold any identifying information on shareholders or directors of companies which they form or act for in one or other capacity, including nominee directors or holders of beneficial interests in shares.

Foreign Companies

986. Chapter 16 of the Companies Act applies to foreign companies operating in Nepal. Under s 154(1), no foreign company may carry on any business or conduct any transaction in Nepal without a registered branch or liaison office in Nepal registered with the CRO. The CRO is required under s 154(10) to maintain a separate register in its offices for foreign companies operating in Nepal, including:

- Names and addresses of directors, managers, company secretaries and/or main officers of the company and description of their citizenship; and
- Name and address of the person residing or staying in the Nepal authorised to receive summonses, notices and other legal processes issued in the name of the company.

987. But, there is no requirement for the foreign company itself to maintain any shareholder information including a copy of the shareholder register in its Nepal registered office. Consequently law enforcement authorities in Nepal seeking shareholder information from a foreign company operating in Nepal cannot access that information in Nepal. Information requests would need to be made via the formal MLA process (however, at present, Nepal does not have an MLA Act).

Partnerships

988. Limited liability partnerships are not permitted by law in Nepal. Partnership firms in Nepal bear unlimited liability. They must be registered under the Partnership Act, 1964. Any persons desiring to conduct business in partnership are required to register a firm with a related department such as Department of Commerce, Department of Domestic and Rural Industries, Department of Industries, under ss 5 and 2(e) of the Partnership Act. Registration requires the name and address of the partners and the firm's name together with a statement of the firm's business (s 6). There is no information on the number of business partnerships registered and/or operating in Nepal.

³⁹ Companies Act 2000: The obligation to disclose nominee shareholders exists only if the company asks:

“s.47(1): If a company asks any shareholder to provide information as to what capacity one has obtained the shares with full voting rights registered in his/her name or whether any other person has investment in the shares registered in the name of such shareholder and where there is another person as a [sic] the beneficiary of such shares, as to the identity and nature of the title of that person, it shall be the duty of such shareholder to provide such information to the company within thirty days.”

Private Firms

989. The Private Firm Registration Act, 1958 requires anyone desiring to conduct business alone in the name of firm or business to register (s 3). The person is required to disclose the name and address of the firm, person, his parents, grandparents and other person as required and to state the business of the firm (s 4). A private firm may be deregistered or financially penalized if the required documents are not submitted (s 6 and 7). Such firms bear unlimited liability. There is no information on the number of private firms registered and/or operating in Nepal.

Access to information by competent authorities

990. Regulatory, supervisory and law enforcement authorities (Police, income tax authorities, FIU and SEBON) have a variety of powers that enable them to secure information about the control and ownership of legal persons in Nepal both from publicly available sources and through a variety of coercive measures including police orders and inspections. However, the evaluation team was advised that, for the most part, access to available information was undertaken by informal means (such as simple request by authorities to see the information).

991. Since foreign companies are not required to keep a copy of their shareholder register in Nepal, access to the shareholder register of foreign companies is for the most part non-existent given that (noted above) Nepal has no formal MLA law or procedure. This means that such information is not available at all or not available on a timely basis. Law enforcement authorities may also take statements from witnesses. For publicly available information, those authorities may search the appropriate corporate registries in addition to other publicly available databases relating to companies for any relevant information.

Bearer Shares/ Bearer Share Warrants

992. Shares of Nepal companies must be in registrable form (Companies Act s 46(2)) containing the name of each shareholder on the shareholder register at the company's registered office. CRO officials did confirm, however, that bearer share warrants were permitted under Nepal law and have been issued by companies. Officials were unable to advise how many companies have issued these instruments as no mechanism or procedure exists to collect this information. There are no regulations, Directives or other instruments which address the ML and TF risk in Nepal in relation to bearer share warrants.

Additional elements

993. No measures exist under law, regulation, direction or guidance to facilitate access by financial institutions to the beneficial ownership and control information of companies or other legal entities in order to verify customer identification information.

5.1.2 Recommendations and Comments

994. Nepal's corporate registry and information collection system is rudimentary. It does not focus on obtaining information relating to the beneficial owner or controller of companies. The information maintained (including changes in information) relates solely to persons and other corporations that are the immediate owners or controllers of a company. The registry does not cross-reference applications for company formations against the UN 1267 terrorist list or other lists issued by countries (e.g. the US's OFAC list). Measures such as these could act to mitigate to some extent the threat that arises through the use of legal persons to perpetrate TF.

995. Nepal should ensure that competent authorities have access to accurate and current information on the ultimate beneficial owners and controllers of all legal persons on a timely basis. The current powers of the competent authorities are hampered to the extent that the repositories of information from which the authorities could obtain information do not maintain sufficient beneficial ownership information.

996. The Companies Act permits ownership of companies through bearer share warrants but there are no safeguards in place to ensure that beneficial owners of these instruments are identified or other risks posed by them are mitigated.

- Establish corporate registry and information collection system focused on obtaining information relating to the beneficial owner or controller of companies.
- Cross-reference applications for company formations against the UN 1267 terrorist list or other lists issued by countries (e.g. the US's OFAC list).
- Ensure that competent authorities have access to accurate and current information on the ultimate beneficial owners and controllers of all legal persons on a timely basis.
- Implement safeguards to ensure that beneficial owners of bearer share warrants are identified or other risks posed by them are mitigated
- Implement measures to mitigate the risk of ML posed by the use of nominee directors and the use of nominee shareholders.

5.1.3 Compliance with Recommendations 33

	RATING	SUMMARY OF FACTORS UNDERLYING THE RATING
R 33	NC	<ul style="list-style-type: none"> • No requirement that information on beneficial ownership of legal persons is required to be collected by: the corporate registry; within corporate records held by legal persons; or by company formation agents or service providers. • There are no safeguards under Nepal law to mitigate the risk of ML associated with bearer share warrants. • Law enforcement and other authorities have sufficient powers to access company information, but those powers are not adequate to ensure the existence of adequate, accurate and timely information on beneficial ownership of legal persons, which can be accessed or obtained in a timely fashion. • There are no measures in place to mitigate the risk of ML posed by the use of nominee directors and the use of nominee shareholders.

5.2 Legal Arrangements – Access to beneficial ownership and control information (R 34)

5.2.1 Description and Analysis

997. Nepal authorities insisted in the MEQ and during the on-site visit that Nepal law does not permit the formation or recognise the existence of private trusts. However, the evaluation team noted prior to, and post, the on-site visit that some law firms in Kathmandu advertise trust formation services on the internet.⁴⁰ The team was also advised by a number of private sector businesses, including lawyers, accountants, banks and cooperatives that Nepal permits the formation and operation of trusts in Nepal.

⁴⁰ KTO Inc. at <http://www.ostamyy.com/lawyers/Nepal.htm> (last accessed 6 September 2010).

Trust Law in Nepal

998. From what the evaluation team could discern (in its discussions with the Nepal Bar) the law governing the formation and operation of trusts in Nepal is similar to British common law. The constituent elements of a trust are:

- Settler;
- Trustee;
- Beneficiary(ies); and
- Identifiable trust property.

999. While government authorities were insistent that trusts cannot be formed in Nepal and are not in existence, ss 2(t) and 2(m) of the Income Tax Act 2000 establish a regime to tax trusts and define the words *trust* and *trustee* as follows:

s 2(t) Trust means an arrangement under which a trustee holds assets, but does not include a partnership, a corporate body, or an entity of the type referred to in subparagraph (3) of paragraph (m).

s 2(u) Trustee means an individual or Goothi or corporate body holding assets in a fiduciary capacity, whether held alone or jointly with other individuals or corporate bodies, and includes the following persons-

- (1) any executor or administrator of a deceased individual's estate;
- (2) any liquidator, receiver, or trustee;
- (3) any person having, either in a private or official capacity, the possession, direction, control, or management of the assets of an incapacitated person;
- (4) any person who manages assets under a private foundation or other similar arrangement; and
- (5) any person in a similar position to a person mentioned in subparagraphs (1), (2), (3) and (4).

1000. In addition, a “resident person” is defined in s 2(ao)(3) of the Income Tax Act to include:

in the case of a trust, a trust that-

- (A) is established in Nepal;
- (B) has a trustee that is a resident person for the income-year; or
- (C) is controlled directly or through one or more interposed entities by a person or persons one of whom is a resident person for the income-year

1001. This definition is wide enough to permit the operation of foreign trusts in Nepal and exclude their taxation (in Nepal). There are a number of other provisions in the Income Tax Act 2000 relating to trusts and their taxation. The Companies Act also makes specific reference to trusts and trustees in Part IV on shares and debentures. Nepali lawyers from the Nepal Bar Council confirmed that a variety of trusts may be formed in Nepal including discretionary trusts, express trusts, estate trusts and family trusts and that lawyers are commonly involved in the provision of these services. Accountants also confirmed this.

Central Registration System

1002. Nepal does not have a central trust register or other mechanism to determine the number, nature and business activities of trusts, including foreign trusts, operating in Nepal.

Record Keeping and Financial Reporting Requirements

1003. There are no specific laws in Nepal in relation to record keeping requirements for trusts. However, the Income Tax Act 2000 has clear provisions for the taxation of trusts and, under that Act, taxpayers must keep records for tax purposes for a minimum of 5 years (s 81(2)). But the applicable ss in the Income Tax Act do not require information to be retained in relation to beneficiaries of trusts.

Trust Service Providers

1004. Nepal lawyers, accountants and some banks confirmed that anyone in Nepal can form a trust and/or act as the trustee of a trust. Nepali law does not require those who perform trust services (primarily lawyers and accountants) to obtain, verify, or retain records on the beneficial ownership and/or control of trusts, or to retain copies of trust instruments. Consequently, beneficial ownership information may not be available to competent authorities from these service providers.

Foreign Trusts

1005. There are no impediments in Nepal law to Nepali citizens or residents, including Nepali companies incorporated or registered in Nepal, acting as trustees of foreign trusts in Nepal, given the definition of “resident person” under s 2(a0)(3) of the Income Tax Act (cited above). Financial institutions in Nepal including Banks and Cooperatives, Nepali lawyers and accountants were not able to give any particulars on the number of nature of foreign trusts.

Access to information by competent authorities

1006. Law enforcement, regulatory, supervisory and other competent authorities have powers to obtain or access information held by trustees. These records may include registered trust deeds, accounts and financial statements. For private trusts, the record keeping and financial information, including information about beneficiaries, is limited to the requirements under the Income Tax Act (s 81(2)). There is no specific provision in any law requiring trustees to maintain a register of ultimate beneficiaries. For instance, where a beneficiary of a private trust is a company, the trustee is not required to maintain information about the majority or minority shareholders of that company and so access by competent authorities to information, if any, by trustees will be limited.

1007. Although Nepali law enforcement authorities generally have sound investigative powers, information on beneficial ownership and control in relation to private trusts is not available to competent authorities since there is no obligation to obtain and retain it. Even trust deeds are generally unavailable since there is also no legal requirement on private trusts in any Nepali law to execute these instruments and when they are executed there is no legal requirement stipulating where trust deeds must be kept. Consequently, a trust deed or other such trust instrument is not accessible by competent authorities, unless the trust has been registered in some way – for instance, in relation to a land transfer.

Additional elements

1008. There are no legal, administrative or practical measures in place (as far as the evaluation could tell) to facilitate access by financial institutions to beneficial ownership and control information of trusts, so as to allow them to more easily verify customer identification data.

5.2.2 Recommendations and Comments

1009. While Nepali authorities deny that trusts exist in Nepal, it is clear from statutory provisions in the Income Tax Act 2000, and other provision s in the Companies Act and through discussions with the Nepal Bar Council, that trusts are widely used and taxed.

1010. Nepal should:

- First: acknowledge that trusts may be formed and trust services provided in Nepal. Without first acknowledging this it is unlikely that officials will propose measures designed to mitigate the ML and TF risks associated with these arrangements;

- Second: develop legal requirements to ensure that information on the beneficial ownership and control of private trusts is collected and readily available to competent authorities in a timely manner.

1011. Such measures could include:

- Build on the existing Income Tax Act record keeping requirements by requiring trustees to maintain full information on the trust’s beneficial ownership and control;
- Requiring the location of such information to be disclosed;
- Requiring trust service providers to obtain and maintain beneficial ownership information.

1012. Relevant trust information would then be available to the law enforcement and other competent agencies upon the proper exercise of their existing powers.

5.2.3 Compliance with Recommendation 34

	RATING	SUMMARY OF FACTORS UNDERLYING RATING
R 34	NC	<ul style="list-style-type: none"> • Nepal has no mechanisms in place to prevent the unlawful use of trusts for ML or TF purposes. • Except for taxation records (which do not include beneficial ownership of trust property), there is no requirement to obtain, verify and retain adequate, accurate and current information on the beneficial ownership and control of trusts. • While investigative powers are generally sound, there is no information that is adequate, accurate and timely concerning the beneficial owners of trusts be obtained or accessed by the competent authorities in a timely fashion.

5.3 Non-Profit Organisations (SR VIII)

5.3.1 Description and Analysis

1013. NPOs, including charities, in Nepal are generically referred to as “Associations” or more commonly “NGOs”. The NPO sector in Nepal consists of international non-governmental organisations (INGOs), domestic non-governmental organisations (NGOs); and other charities. NGOs including INGOs are those that meet the purposes of an NGO within the Associations Registration Act.

1014. The total number of NGOs and charities in Nepal is unknown. Various government agencies and information sources provided different statistics on the number of registered and unregistered NGOs and charities. Statistics provided by the Social Welfare Council are as follows:

CLASS OF NPO	NUMBER OF NPOs OPERATING
• NGOs and INGOs registered under the Associations Registrations Act	unknown
• INGOs registered with SWC	223
• INGOs not registered with SWC	unknown
• NGOs (domestic) registered with SWC	30,029
• NGOs (domestic) not registered with SWC	unknown

Legal Framework

1015. Two statutes apply to the NPO/NGO sector, namely, the Associations Registration Act 1977 and the Social Welfare Act 1992. Under the Associations Registration Act, no person shall establish an association without registering under the Act. An association is defined very widely to mean:

“s 2(a): an association, institution, club, circle, council, study centre, etc. established for the purpose of developing and extending social, religious, literary, cultural, scientific, educational, intellectual, philosophical, physical, economical, vocational and philanthropic activities, and also includes the friendship association.”

1016. In order to form such an entity, at least seven persons must file an application with the Chief District Officer (there are 75 districts in Nepal). The application must disclose the name of the Association; the objectives of the Association (which must be linked with one of the activities listed in s 2); the name, address and occupation of each of the members of the Management Committee of the Association; the financial sources of the entity; and the intended address of the entity's office.

1017. Registration under the Associations Registration Act 1977 creates an “autonomous body corporate” (s. 5(1)) without the need to incorporate under the Companies Act. Operating as an association without registration attracts a fine of 2,000 Nepali rupees (US\$ 25.00). Nepal authorities were unable to provide information on the number of fines (if any) that were imposed for failure to incorporate under this Act. However, they did acknowledge two things: (1) the fine is inadequate; and (2) there are many associations operating in Nepal that have not registered under this Act.

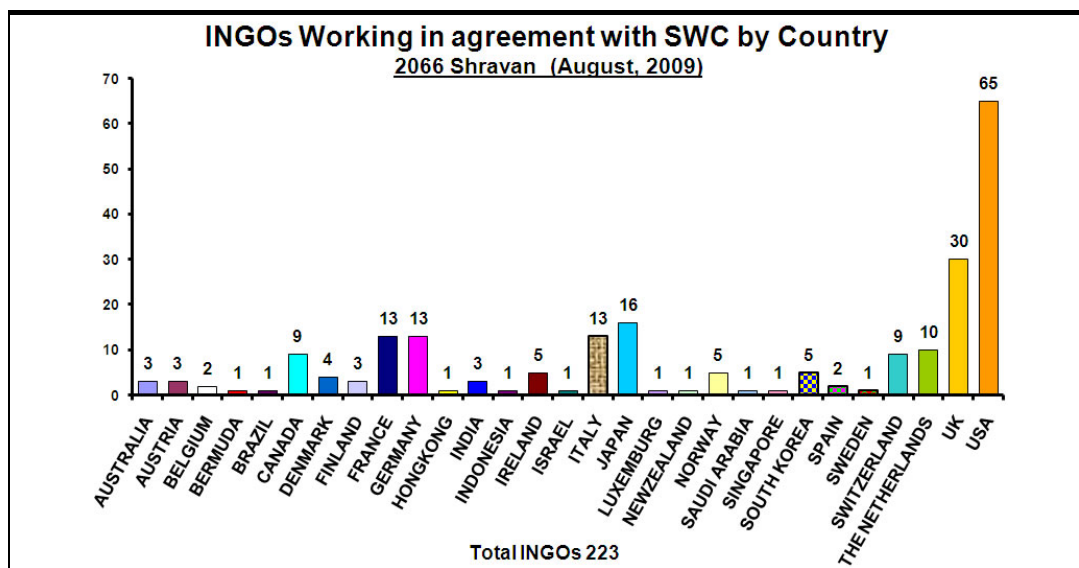
1018. The Social Welfare Act 1992 creates the Social Welfare Council (SWC) as a coordination mechanism for the delivery of social programs in Nepal, including programs delivered by NGOs. NGOs are not required to register under this Act unless they are International NGOs (s 12). The purpose of the SWC is stated in s 5: namely “to make effective co-ordination, mobilization and promotion of the social organisations and institutions, in order to run social activities in a more organised way.” Whether this objective is able to be achieved is questionable given the voluntary nature of registration by domestic NGOs.

1019. As can be seen below, the number of NGOs operating outside the framework of the SWC is unknown, but it was admitted that there is no doubt a large number giving rise to the real possibility if not reality that there is significant duplication of effort in this sector.

Characteristics and Size of the Sector

1020. NGOs play a pivotal role in the socio-economic structure of Nepal but their sector organisation is poor.

1021. The following information was provided in relation to the 223 International NGOs (INGOs) in Nepal:



1022. By sector, the total figures in the first table above were broken down by officials as follows (as can be seen the numbers are inconsistent with the totals above):

NPO's/NGOs REGISTERED WITH SWC (effective September 2010)	
AIDS and Abuse Control	86
Child Welfare	904
Community and Rural Development	16,953
Educational Development	436
Environmental Development	1,260
Handicapped and Disabled	558
Health Services	640
Moral Development	767
Women Services	2,164
Youth Services	4,022
TOTAL	27,790

1023. Nepal authorities were asked to provide the total value of assets within the NPO sector (i.e., all international and domestic NPOs, including charities) for 2009 and 2010. Authorities were unable to provide information in full or in part in relation to that request but did provide the following information:

- Number of NGOs accounted for: 467
- Number of programs operating: 926
- Total approved budgets: \$US69,789,511

1024. Although the total NPO registrations with the SWC exceeded 30,200 in September 2010 SWC officials were only able to provide this limited information for 467 registered NPOs.

Reviews of the domestic non-profit sector

1025. Nepal has not conducted a review of its NPO sector to determine the features and types of NPOs, including charities, at risk of TF, despite a requirement on all APG members since 2005 to do so. When asked by the evaluation team why Nepal has not conducted an APG review under SR VIII the team was advised that Nepal lacked the resources and expertise to do so, but that officials intended to undertake this review as part of the broader government mandate to undertake a comprehensive ML and TF risk assessment leading up to the preparation of a National AML/CFT strategy. No date has been fixed for this national risk assessment as of the date of the on-site evaluation.

1026. SWC officials advised that notwithstanding this planned review including ML and TF risks in the NPO sector, the SWC regularly conducts general reviews of the sector, the last of which conducted three years ago. This study was designed to strengthen institutional capacity. The evaluation team requested a copy of this review, but it was not provided. SWC officials also confirmed that the SWC has not conducted a review of the sector in relation to transparency and good governance. The income tax authority also has not conducted any assessments of the sector.

Outreach to NPO sector concerning terrorist financing issues

1027. There has been no outreach to the NPO sector by the government of Nepal in relation to risks and vulnerabilities of the sector to terrorist abuse. Nor has the SWC or any other government agency issued guidance or advice to NPOs on TF risks or issues.

Monitoring and sanctions

1028. The SWC conducts some monitoring, supervision and evaluation of NGOs that are registered with SWC, however, SWC officials recognised and acknowledged that they lack resources and skills for this purpose and that they cannot monitor, inspect or otherwise deal with NPOs not registered under the Social Welfare Act.

1029. The registration information under the Associations Registration Act is available to competent authorities in Nepal upon request. That information (repeated from above) is:

- the name of the Association;
- the objectives of the Association (which must be linked with one of the activities listed in s2);
- the name, address and occupation of each of the members of the Management Committee of the Association;
- the financial sources of the entity; and
- the intended address of the entity's office.

1030. While registration under the Associations Registration Act is required for all NPOs the incorporation process under the Act is rudimentary and there are no required procedures or requirements under that Act to maintain up-to-date information on board members, senior managers, directors and other staff of NPOs. Nor are there any required procedures under this statute or its rules and regulations to mitigate TF risks by requiring government authorities to check criminal and terrorist lists (including the UN 1267 lists) for board members, senior managers and directors of NPOs. When asked whether SWC staff undertake this check voluntarily the evaluation team was advised that they do not.

1031. SWC officials indicated that NPOs maintain transaction records for indefinite period of time (even though they are not legally required to). They are also required to submit records of

domestic and international transactions that are sufficiently detailed to verify that funds that have been spent in a manner consistent with the purpose and objectives of the organisation to the SWC and tax authorities. The requirement relating to the SWC is a function of s 18 of the Social Welfare Act in relation to the audit function it has. However, this obligation extends only to NPOs regulated with the SWC. A large number of NPOs do not register with the SWC (registration being voluntary).

1032. The Association Registration Act does not contain any record-keeping obligation on NPOs. Is not clear under Nepali law whether there is any legal requirement on non SWC-registered NPOs to maintain records for at least 5 years and to make available domestic and international transactions detailed enough to verify that NPO funds have been expended in a manner consistent with the purpose and objectives of the organisation.

1033. The SWC monitors, supervises and conducts inspections of registered NPOs. Under the Social Welfare Act the only inspection power granted to the SWC is in relation to the accounts of the registered NPOs (s 18(4) and (5)). The following statistics were provided in relation to complaints and action taken in relation to specific NPOs:

NPO	Complaint	Investigation	Action taken by SWC
Nepal Child Welfare	Child sex abuse	8 July 2010	Four employees were fired, Disestablished NPO executive committee
Dalit NGO Federation	Corruption	2010 May 10	SWC has given the instruction to the Dalit NGO Federation about to execute the recommendations which were given by the investigation team in the report.
Sunaulo Prabhat Balgirha	Corruption, not giving salary to employee	20 July 2010	SWC has given the instruction to the Sunaulo Prabhat Balgirha about to execute the recommendation which were given by the investigation team in the report.
Nepal National Dalit Social Welfare Organisation	Dissolve the Kailali District Executive Committee	9 July 2010	SWC has given the instruction to the Nepal National Dalit Social Welfare Organisation about to execute the recommendations, which were given by the investigation team in the report.
Shree Satya Sai Kenda	Misuse of Land	15 Dec 2009	SWC has given the instruction to the Shree Satya Sai Kenda about to execute the recommendation, which were given by the investigation team in the report.
Heifer International	Corruption involving National Director	4 Feb 2010	SWC has given the instruction to the Heifer International about to execute the recommendation, which were given by the investigation team in the report
Chhetrapati Free Clinic, Chhetrapati	Corruption from Chairman of Organisations and from others.	4 June 2009	SWC has given the instruction to the Chhetrapati Free Clinic about to execute the recommendations, which were given by the investigation team in the report.

Information gathering and Investigation

1034. Nepal has not implemented measures to ensure that it can effectively investigate and gather information on NPOs. The information it does have as to the numbers of NPOs operating in the country is scattered and inconsistent.

Responding to international requests for information

1035. Nepal does not have a central authority or procedure in relation to the sharing of information in relation to international information requests. There is some confusion in the SWC as to how such a request would be handled. Some officials in SWC indicated that international information requests would be handled by the FIU, while others stated that they should be managed through the Ministry of Foreign Affairs. Neither the Associations Registration Act nor the Social Welfare Act contains provisions which address this issue. When asked how international requests have been handled to date, the evaluation team was advised that no such requests have been made.

5.3.2 Recommendations and Comments

1036. Nepal's NPO sector is poorly organised, monitored and supervised. While Nepal officials indicated that they believe TF risk in the NPO sector is small, it is difficult to understand how they can maintain this confidence in light of the fact that they were unable to state the size, wealth and activities of the majority of NPOs that operate in Nepal.

1037. Nepal should:

- Seek to better organise its NPO sector by, among other things, establishing a central registry for all NPOs and charities (foreign and domestic);
- Consider mandatory registration/licensing for all NPOs in Nepal;
- Maintain comprehensive information and statistics on all NPOs including sources of funding, size of assets and other key information such as names, addresses and other identification information for directors, senior managers and board members of NPOs;
- Undertake a comprehensive NPO sector review capturing all relevant data necessary to undertake a detailed risk assessment for TF;
- Issue guidelines, information or other material to the sector on TF risks in the sector and how to mitigate those risks;
- Undertake regular outreach to the sector to discuss TF risks, vulnerabilities and other issues, and to explain guidance and other material relevant to mitigating TF risk; and
- Seek to further implement the measures contained in the SR VIII Best Practices paper.

5.3.3 Compliance with Special Recommendation VIII

	RATING	SUMMARY OF FACTORS UNDERLYING THE RATING
SR VIII	NC	<ul style="list-style-type: none">• No review undertaken of the adequacy of domestic laws in the NPO sector.• No periodic reassessments undertaken by reviewing new information on the sector's potential vulnerabilities to terrorist activities.• No outreach to the NPO sector with a view to protecting the sector from TF abuse.• Limited information available on the identity of person(s) who own, control or direct their activities, including senior officers, board members and trustees.• Nepal has not demonstrated that measures are in place to sanction violations of oversight measures or rules by NPOs or persons acting on behalf of NPOs for NPOs other than those registered under the Income Tax Act.

		<ul style="list-style-type: none">• While all NPOs must be registered under the Association Registrations Act, it is acknowledged that not all are.• Enforcement action against non-compliant NPOs has not occurred.
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6. NATIONAL AND INTERNATIONAL COOPERATION

6.1 National Co-Operation and Coordination (R 31 and R 32)

6.1.1 Description and Analysis

1038. Nepal has both formal and informal mechanisms for national cooperation and coordination among the variety of agencies involved in AML/CFT. The formal mechanisms include a National Coordination Committee and a Technical Committee. Informal mechanisms consist simply of the customary free sharing of information among government agencies even when there is a lack of legal framework to exchange information.

National Coordination Committee - Policy Coordination

1039. ALPA s 8 mandates a standing National Coordination Committee (NCC) to “coordinate inter-related entities with regard to asset laundering” and consists of:

- Secretary, Ministry of Finance – Coordinator
- Secretary, Ministry of Law, Justice and Parliamentary System
- Secretary, Ministry of Home
- Secretary, Ministry of Foreign Affairs
- Deputy Governor, Nepal Rastra Bank

1040. The chief of the FIU is the Secretary of the NCC and the FIU acts as Secretariat under the Act. Under the AML Rules the FIU acts as a “focal point of AML/CFT in Nepal” (Rule 6). The purpose of the NCC is to:

- coordinate and recommend policy to the Government on issues of prevention of ML/FT;
- monitor AML/CFT activities;
- obtain membership in international organisations working for the prevention of ML/FT;
- recommend policy, strategy, plans to be adopted by the Government of Nepal;
- implement the policies, strategy and plans adopted by the Government; and
- implementation of the FIU annual report and “other necessary measures.”

1041. The NCC met 10 times prior to the on-site visit. ALPA s 8(3) provides that the NCC’s procedures shall be determined by the NCC itself. However, as of the date of the on-site visit, the committee had not issued any internal procedures and the work of the committee is determined on an *ad hoc* basis. The committee lacks a formal approach to agenda-setting and decision-making and a structured approach to AML/CFT policy formulation and advice to government. Moreover, it appears that there are some key agencies not part of the committee including:

- Attorney-General’s Office;
- Nepal Police;
- Department of Revenue Investigation;
- Department of Customs; and
- Commission for the Investigation of Abuse of Authority (CIAA).

1042. The inclusion of these agencies in the NCC would make sense given their key role in AML/CFT and the fact that some of them are part of the Technical Committee (see below) is irrelevant to whether they should be on the NCC as the NCC is the policy-advice mechanism to government, not the Technical Committee.

Technical Committee - Operational Coordination

1043. Under AML Rule 5 a standing Technical Committee is established among operational agencies and includes:

- FIU;
- DRI (as the AML Department);
- Nepal Police;
- Nepal Rastra Bank (foreign exchange management department as well as Bank and Financial Institution Regulation Department);
- Nepal Securities Board; and
- Insurance Board.

1044. The Technical Committee was established in May 2010 and has met three times as of the on-site visit. The role of this committee, detailed in AML Rule 5, is to assist the FIU to formulate measures or strategies necessary for the “control of the offence” and to implement those strategies; to promote awareness of the need to control of the offence; and perform other functions prescribed by the NCC. When asked what of these functions the Technical Committee has performed, officials advised that the committee was gearing up to prepare a National Strategy on AML/CFT and has assisted the FIU with some awareness raising seminars.

1045. Like the NCC, the Technical Committee has no rules of procedures or formal agenda setting mechanism. Its work is undertaken on an ad hoc, as needed, basis.

1046. Aside from the NCC and Technical Committee there are no inter-agency MoUs that address coordination of AML/CFT efforts in policy and operational activities. Nepal officials advised the evaluation team that inter-agency cooperation in Nepal is not an issue as all agencies undertake high levels of cooperation. But when asked about the input and agency consultation on new amendments to the ALPA which will be submitted to Parliament the team was advised by many of the agencies that they were not consulted and that such matters are “the responsibility of the FIU”.

Integrity of Authorities

1047. All Nepal government officials including those on the two committees discussed above are required to comply with the Code of Conduct and norms for Civil Servants under Civil Servant Act and Rules. All agencies are bound by the Anti-Corruption Act as well. These legal instruments require employees to be dutiful, responsible, accountable, impartial, unbiased etc. No one can disclose any information obtained during the job, except in situation required by the law, during or after. While this is clear, what is not clear is that officials also indicated (as noted above) that there are high degrees of cooperation between agencies even when there is no legal framework to discuss and exchange information.

Adequacy of Resources

1048. While the Nepal FIU acts as the secretariat to the NCC, in reality the FIU is looked to as the most important agency in the AML/CFT framework of Nepal. Other agencies look to the FIU for guidance, policy suggestions and expertise in AML/CFT. This puts a considerable strain on the FIU, as its resources are severely limited even for its primary functions of receiving analysing and disseminating STRs and TTRs. Other agencies need to be more committed and more focused on AML/CFT policy and operational matters by providing staff and resources in their respective areas of expertise to relieve the pressure being placed on the FIU.

1049. All members of NCC are Heads of Government Ministries or statutory bodies and they are required to maintain a high professional standard and integrity including when dealing with confidential matters. Some training on AML/CFT has been provided to key agencies but other agency-specific training needs to enhance staff capacity are still required to ensure effective implementation of the AML/CFT regime and when investigating a serious offence, ML or TF offences, or proceeds of crime investigations.

Additional Elements

1050. Neither the NCC nor the Technical Committee includes representatives from the private sector. And there are no formal mechanisms or frameworks in place to consult with the private sector (financial institutions and DNFBPs) in the course of policy and operational AML/CFT development.

1051. Consultations do occur between the FIU and some private sector agencies and institutions through public awareness sessions on specific topics and through the on-site visit process. But this is undertaken on an ad hoc basis and is not structured.

Effectiveness

1052. Generally, the structure of the NCC and the Technical Committee is acceptable with the need for some changes. There is however a need to formalise the work of both committees and for both to issue rules of meetings and agenda setting to tighten up their work and planning. There is also some duplication between these two committees.

1053. During the on-site visit it became apparent that despite the formation of these groups to share and co-ordinate information and intelligence, there had in practice been a lack of co-ordination. Commitment from all partners in both committees is required to enable effective and timely response to matters when appropriate.

6.1.2 Recommendations and Comments

1054. The following recommendations are made in relation to Recommendation 31:

- Consideration should be given to expanding the membership of the NCC to include Attorney-General's Office, Nepal Police, Department of Revenue Investigation, Department of Customs and Commission for the Investigation of Abuse of Authority given the key roles these agencies have in AML/CFT.
- Both the NCC and Technical Committee need to formalise their meeting and agenda setting process in order to streamline advice.
- Nepal needs to ensure that its AML/CFT coordination committees are used to drive forward reforms to AML/CFT policies on a multi-agency approach and not solely from the FIU.

- Nepal should the two coordination mechanisms to implement AML/CFT policies, including operational level cooperation, information sharing and capacity building more effectively.

6.1.3 Compliance with Recommendation 31

	RATING	SUMMARY OF FACTORS UNDERLYING RATING
R 31	PC	<ul style="list-style-type: none"> • Policy level coordination mechanisms are not being used to effectively develop and implement AML/CFT policies. • Operation-level coordination mechanisms for AML/CFT are not effectively utilised.

6.2 The Conventions and UN Special Resolutions (R 35 & SR I)

6.2.1 Description and Analysis

Ratification and Implementation of UN Conventions

1055. The status of the three relevant UN Conventions in Nepal is as follows:

STATUS OF KEY UN CONVENTIONS			
INSTRUMENT	SIGNED	RATIFIED/ ACCEDED	DATE
(1) Vienna Convention (1989)	n/a	Acceded	24 July 1991
(2) Suppression of the Financing of Terrorism (1999)	No	No	
(3) Palermo Convention (2000)	Yes	No	12 December 2002

1056. Cabinet approvals are being sought by departmental officials to sign and/or ratify the Terrorist Financing and Palermo Conventions in order to comply with FATF's obligations but due to political issues in Parliament, progress on this front is stalled.

1057. Nepal can provide only very limited mutual legal assistance entailing coercive measures – and none at all in relation to drug offences. Given the absence of any provisions enabling interim restraint of suspected proceeds of drugs offending (as noted in s 2.3 of this report) and deficits in Nepal's extradition regime, Nepal does not comply with the identified articles of the Vienna Convention.

1058. Nepal's compliance with the terms of the TF Convention is considerably deficient given that TF is not criminalised. As noted in section 2.2 of this report, even if TF is criminalised via s 4 of ALPA the framing of that section gives rise to significant gaps. As noted, Nepal has not acceded to the Palermo Convention. Nepal does not comply with key requirements of that Convention, notably:

- Contrary to Article 5, participation in an organised criminal group is not criminalised and liability for conspiracy arises in relation to very few offences.

- Contrary to Article 18, Nepal has no capacity to provide coercive mutual legal assistance – whether or not such offending is transnational in nature and involves an organised criminal group.
- Contrary to Article 16, powers of extradition are limited to offences contained in extradition treaties to which Nepal is a party or offences required to be extraditable under a convention to which Nepal is a party, as opposed to all offences punishable by at least 4 years imprisonment – whether or not such offending involves an organised criminal group.
- Contrary to Article 12, there are considerable deficiencies in Nepal’s capacity to freeze and seize assets.

Implementation of UNSCRs

1059. As noted in section 2.4, freezing pursuant to UNSCRs 1267 and 1373 is also deficient in that the FIU AML Directives have dubious legal status and, even if legally valid, are deficient in their terms.

Additional Elements

1060. Nepal has ratified the SAARC Regional Convention on Suppression of Terrorism (which governs extradition for terrorism-related offences) and its Additional Protocol (which requires the criminalisation of TF, the institution of preventive measures, capacity to seize and confiscate terrorist assets, informal and formal cooperation and capacity to extradite). For reasons noted in sections 2 and 6 of this report, Nepal does not fully comply with this Convention or the Protocol.

1061. Nepal has not signed the 1990 Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime, the 2002 Inter-American Convention against Terrorism 1990 Council of Europe or the United Nations Convention against Corruption.

Effectiveness

1062. Nepal has ratified only one of the three conventions required to be ratified (or acceded to) by R 35 and SR I and deficiently complies with all three in ways that significantly impact effectiveness (as detailed above).

6.2.2 Recommendations and Comments

1063. Nepal should redress the following deficiencies:

- the deficits concerning criminalisation of the TF offence;
- the scope of its conspiracy laws (or, alternatively, its failure to criminalise participation in an organised criminal group);
- its capacity to freeze and confiscate terrorist and criminal assets;
- its capacity to provide mutual legal assistance; and
- the deficits identified in this report concerning implementation of the relevant UNSCRs.

1064. Nepal should then expedite efforts to accede to the Palermo Convention and the Convention for the Suppression of Terrorist Financing.

6.2.3 Compliance with Recommendation 35 and SR I

	RATING	SUMMARY OF FACTORS UNDERLYING RATING
R 35	NC	<ul style="list-style-type: none"> Palermo Convention has not been ratified or fully implemented. The TF Convention has not been ratified or fully implemented. Significant deficiencies with implementation of Vienna Convention.
SR I	NC	<ul style="list-style-type: none"> Nepal has not acceded to the Terrorist Financing Convention. Nepal does not comply with UNSCRs 1267 and 1373.

6.3 Mutual Legal Assistance (R 36-38, Special Recommendation V)

6.3.1 Description and Analysis

1065. Nepal has no mutual legal assistance legislation. There is only very limited capacity to facilitate a foreign investigation and no formal mechanisms to deal with requests. MLA requests are handled on a purely ad hoc and unstructured basis.

Widest Possible Range of Mutual Assistance

1066. There are no impediments to investigative agencies in Nepal cooperating with foreign agencies where such cooperation does not entail the use of coercive powers. Accordingly, Nepal can engage in MLA via, for example, the service of documents, the taking of voluntary statements and facilitating voluntary appearances. Specialist powers of investigation are found across acts that create particular investigative agencies and in the Narcotic Drugs (Control) Act 1976. These powers are not conferred in terms that enable their deployment in furtherance of a foreign investigation.

1067. Powers of investigation more generally available are found in the Government Cases Act. These powers are available where there is cause to suspect a “crime”. “Crime” is not defined but is clearly limited to domestic offending (the preamble to the Act, for example, states that the Act’s rationale is the expediency of “providing for cases where the Government is the plaintiff”). To the extent that “crime” and “offence” are interchangeable in Nepali, “offence” is similarly defined in the Interpretation of Laws Act as meaning an act or omission made punishable “by any law for the time being in force”.

1068. Section 12 of ALPA confers powers of investigation and inquiry upon the Department of Revenue Investigation (DRI), as the designated ML investigation agency.⁴¹ Those powers are stated to be exercisable “in course of investigation and inquiry under this Act”. Accordingly, they are not available for the purpose of facilitating investigation by a foreign law enforcement agency in furtherance of an MLA request.

⁴¹ Section 12(a) of ALPA empowers DRI to issue production orders. Section 12(b) confers powers of search and seizure. Section 12(f) empowers DRI to freeze assets “in course of inquiry and investigation of the offence” (which, as noted earlier in this report, relates to the offence of ML under s 3). Section 12(2) enables the DRI to arrest and fine persons who do not comply with such orders.

1069. Section 12(1)(e) of ALPA, however, does envisage a request for assistance from another country. It enables the DRI to issue freezing orders over “assets located in Nepal” when requested pursuant to a treaty or “agreement” or “similar provisions”. This subsection does not fit easily with the declaration, contained in s 12(1), that the conferred powers are available only “where the offence under this Act is committed”. Presumably, the intention is that s 12(1)(e) powers are available only for the purpose of enabling foreign investigations into equivalent offences. Section 12(1)(e) appears to be a specific MLA carve-out that parallels the power under s 12(1)(f) – a power to freeze in a purely domestic context.

1070. Accordingly, within the framework of the Act Nepal appears able to undertake coercive MLA only by effecting freezing action where this is requested by a State Party to a convention to which Nepal is a party (and pursuant to that convention) and where the underlying offence giving rise to the request is ML. The scope of the provision is further constrained by its threshold, which is expressed in terms requiring that ML “is committed” thereby suggesting that the provision is available only post-conviction. The scope of s 12(1)(e) is accordingly very limited. So too is its utility. There is no power to ultimately confiscate any frozen assets pursuant to a foreign request. Further, the legislation is silent as to what considerations might be relevant to the exercise by the DRI of its discretion to accede to a foreign freezing request.

1071. Nepal officials stated that s 9 of the Nepal Treaty Act 1990 enables broader provision of coercive MLA. As noted in section 2.3 of this report, that section provides that, in the event of an inconsistency between domestic law and an international obligation contained in a treaty to which Nepal is a party, the provision of the treaty “shall be as good as Nepalese laws” and the domestic law shall be “void”. However, and as noted in section 2 of this report, the Nepal Treaty Act cannot be invoked as a means of conferring coercive powers that have not been conferred via statute. In other words it cannot fill a void in law. This would be counter to the Constitution, which is expressed to be the “Fundamental Law” of Nepal (Article 1) and which confers rights to property and rights to privacy that are subject only to “laws in force” or provisions “as provided by law”. Clear abrogation by domestic legislation—not international treaty—is required.

1072. In any event, there is no “inconsistent” MLA provision currently in Nepal law that is capable of triggering s 9 of the Nepal Treaty Act. As noted earlier, s 9 was enacted to strike down, without the need for case-by-case Supreme Court intervention, legislation that was incompatible with Nepal’s international human rights related obligations. It has not been used outside that context.

Provision of MLA in Timely, Constructive and Effective Manner

1073. Because Nepal has no mutual legal assistance regime and has acted on few MLA requests (statistics are unavailable), efficient channels of communication are not established. Nepal advised that requests could be forwarded to the Ministry of Law, the Home Office or the Ministry of Finance but the initial point of contact would be a diplomatic mission in the requesting country. However, with no responsibility for managing such requests and no central agency charged with overseeing and monitoring responses to requests there is no mandate to respond within to assistance requests within a reasonable period of time.

No Unreasonable or Unduly Restrictive Conditions on Mutual Assistance

1074. Given there is no mutual legal assistance legislation, there are no legislated restrictions on providing MLA. However, Nepal officials advised that dual criminality would be regarded as a pre-requisite.

1075. The only power to provide coercive mutual legal assistance is under ALPA s 12(e) (asset freezes – discussed above). Although that power appears unfettered, Nepal officials again advised that, in accordance with general practice, dual criminality would be a pre-requisite under that section. Although this requirement would be met as a matter of definition (the s 12(e) power appears to be available only where a request is received in relation to a ML investigation, which is criminalised under s 3 of ALPA), deficiencies in the criminalisation of ML might further restrict the potential utility of ALPA s 12(e).

1076. Because Nepal has no developed MLA case law or practices, the impact of any dual criminality requirement is difficult to assess.

Provision of Assistance Regardless of Existence of Secrecy and Confidentiality Laws

1077. Section 79 of BAFIA (bank secrecy provision) is subject to a law enforcement exception. It is ambiguous whether this exception extends to foreign, or merely domestic, law enforcement. Regardless, consideration of the laws relating to bank secrecy or legal professional privilege becomes relevant only in the context of coercive measures involving search and seizure (or production orders). Nepal has no capacity to deploy such measures for the purpose of MLA.

Powers of Competent Authorities

1078. Powers of competent authorities are not available in response to requests for MLA, regardless of how they are received; and Nepal has no capacity to deploy coercive powers for the purpose of facilitating a foreign TF or terrorism-related investigation or prosecution.

Avoiding Conflicts of Jurisdiction

1079. In the absence of any legislation expressly enabling the provision of MLA, Nepal has not considered mechanisms for considering the issue of prosecution venue.

Additional Element

1080. Powers of competent authorities are not available in response to requests for MLA, regardless of how they are received.

Recommendation 37 (dual criminality relating to mutual legal assistance)

1081. Although Nepal has no capacity to provide MLA via the use of coercive powers, dual criminality is regarded as a prerequisite to the provision of MLA. As noted above, Nepal has rarely provided MLA (and only once provided coercive MLA). Nepal has no case law or established practice concerning the application of the dual criminality requirement. Therefore it is likely that the dual criminality would impede effective cooperation in, for example, providing MLA with respect to ML and TF (given the deficits in Nepal's criminalisation of ML and the failure to criminalise TF).

1082. Nepal cannot provide mutual legal assistance in terrorism-related matters.

Recommendation 38

MLA and Confiscation

1083. As noted, Nepal has no general MLA laws or procedures to provide for effective and timely responses to MLA requests by foreign countries. As previously discussed, s 12(1)(e) of ALPA empowers the DRI to direct freezing action upon a request from another country. No requests have been received. Given the absence of law and of clear and efficient channels of communication (as attested by the only instance of coercive MLA provided to date), Nepal is not able to promptly restrain assets upon request.

Property of Corresponding Value

1084. Although the power conferred by s 12(1)(e) appears to be unfettered (such that it appears to apply whenever a request is received, regardless of whether the assets sought to be frozen are proceeds of crime), Nepali authorities take the view that s 12(1)(e) will apply only to criminal proceeds. On that basis, it would not enable freezing of property of corresponding value.

Coordination of Seizure and Confiscation Actions

1085. The DRI has not entered into any arrangements with counterpart agencies to enable coordination of seizure action.

Asset Forfeiture Fund

1086. Nepal has not established an asset forfeiture fund.

Sharing Confiscated Assets

1087. Consideration has not been given to arrangements with foreign agencies that might enable sharing of confiscated assets.

Additional Element

1088. Nepal cannot confiscate assets pursuant to an MLA request in relation to non-criminal convictions.

Statistics

1089. Nepal provided no statistics on MLA, confiscations or any other matters in relation to MLA. Nepal authorities indicated that in only one instance was coercive MLA provided and this took over six months to complete.

Effectiveness

1090. In the absence of a legislative framework enabling MLA, Nepal cannot provide effective cooperation. Nepal authorities recognise this. A Draft Bill on Mutual Legal Assistance has been prepared.

1091. In terms of processes enabling timely assistance, Nepal provided only one example of a Nepalese agency exercising coercive powers at the behest of a foreign investigative agency. This entailed a request in 2009 from the United States concerning a fraud investigation. The assistance requested required the search and seizure of banking records. The request was sent

and received through diplomatic channels and transmitted through the Ministry of Finance, the Nepal Rastra Bank, the FIU and the Attorney-General's Office. Despite provisions within BAFIA conferring bank secrecy, Nepal provided the banking records consequent upon advice provided by the Attorney-General that espoused the national interest in international cooperation. It took over 6 months for the records to be provided. This instance does not constitute a timely, constructive and effective MLA regime. Outside the dictates of international comity, there was no clear legal basis for the assistance rendered and processing channels were convoluted.

1092. Section 12(1)(e) of ALPA is unlikely to be of value to other countries for the reasons that (i) Nepal cannot supply the sort of coercive MLA that might, in the first place, enable the identification of criminal assets within Nepal, (ii) it probably applies only post-conviction yet (iii) Nepal cannot initiate confiscation action.

6.3.2 Recommendations and Comments

1093. Nepal should:

- Enact comprehensive mutual legal assistance legislation and establish effective procedures to allow it to provide the widest range of mutual legal assistance.
- Comprehensively criminalise ML and TF to address gaps in the offences which may impede the ability to provide mutual legal assistance.
- In the meantime, promulgate and publish procedures enabling the prompt processing of requests for MLA that would apply to requests for non-coercive forms of cooperation.
- The requirement for dual criminality with respect to non-coercive or less intrusive MLA should be reviewed and maintained only if there is a fundamental principle of Nepalese law that requires its application.

6.3.3 Compliance with Recommendations 36 to 38 and SR V

	RATING	SUMMARY OF FACTORS UNDERLYING THE RATINGS
R 36	NC	<ul style="list-style-type: none"> • Nepal does not have MLA laws. • Nepal can provide only extremely limited MLA entailing use of coercive powers. • There are no mechanisms enabling assistance to be provided in a timely, constructive and efficient manner. • Gaps the ML offence and absence of any TF offence may impede Nepal's ability to provide international cooperation
R 37	NC	<ul style="list-style-type: none"> • Mutual legal assistance is not rendered to the greatest extent possible in the absence of dual criminality. • There is no evidence, and no reason to assume, that technical differences in criminalisation would not render dual criminality an impediment to effective cooperation.
R 38	NC	<ul style="list-style-type: none"> • Nepal cannot provide assistance by way of freezing and seizing assets other than in relation to ML-related investigations. • The capacity to freeze in ML-related investigations is not complemented by capacity to confiscate frozen assets. • Gaps the ML offence and absence of any TF offence may impede Nepal's ability to provide mutual legal assistance related to provisional measures and confiscation

SR V	NC	<ul style="list-style-type: none"> • There is no legal basis for the provision of MLA in terrorism-related matters.
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6.4 Extradition (R 37, 39 and SR V)

6.4.1 Description and Analysis

1094. Nepal’s capacity to extradite and the procedures for extradition are governed by the Extradition Act 1988. Nepal has entered into only one extradition treaty (with India).

Dual Criminality and Mutual Assistance

1095. Restrictions on extradition are found in s 12 of the Extradition Act. That section does not impose a dual criminality requirement. However, s 15 confers “special authority” upon the Government, “notwithstanding anything written elsewhere” in the Act, to “annul” any actions against the concerned person and to order his/her release. That power is stated to be exercisable on a range of (stipulated) grounds or for “any reason which Government of Nepal deems proper”. Officials advised that an absence of dual criminality would invariably constitute such a reason.

1096. As noted earlier in this section of this report, it is not clear how the dual criminality requirement is applied in Nepal. There is no reason to assume that it would not impose an impediment to cooperation on account of technical differences in the wording or taxonomy of offences.

Money Laundering as Extraditable Offence

1097. The Extradition Act enables extradition for offences falling within the Act’s definition of “offence”. That definition extends only to offences that are scheduled in a relevant extradition treaty or “stipulated in the convention relating to the extradition of accused or offender to which Nepal is a party”. It was clarified that this latter part of the definition relates to offences that are required to be extraditable under a treaty to which Nepal is a party. In relation to such offences, Nepal can extradite to treaty-partner countries. Nepal is a party to the Vienna Convention. Article 4(2) of that Convention requires ML to be extraditable. Accordingly, Nepal can extradite for ML to the more than 170 countries that are parties to that Convention.

1098. Nepal is also a party to the States of the South Asian Association for Regional Cooperation (SAARC) Regional Convention on Suppression of Terrorism and its Additional Protocol. As noted above, the Convention governs extradition for terrorism-related offences. The Protocol extends the scope of the Convention to TF offences and requires them to be extraditable: Art 12. On this basis, Nepal might extradite for TF to TF Convention State Parties. However, because TF is not criminalised in Nepal, the (de facto) dual criminality requirement is problematic and might reasonably be relied upon to oppose extradition proceedings.

1099. Further impediments to extradition for ML and TF arise via s 18 of the Extradition Act. This provides that if “any country” has “not made provision for fulfilling the requirement of the treaty concluded with Nepal or convention to which Nepal is a party” then the Act “shall not be applicable to such country”. At face value, s 18 offers a viable means for fugitives to contest extradition on the basis that, for example, the requesting country has not met convention or

treaty requirements in any other respects. Indeed, it is arguable (although unlikely) that a deficit in Nepal's own compliance might sustain a challenge to extradition.

Extradition of Nationals

1100. Section 8(1) of the Act precludes the extradition of Nepalese nationals. Instead, authorities are obliged to "initiate proceedings for punishment" within Nepal. Under s 16, "evidence, proofs and documents" from the requesting country "may" be received in evidence notwithstanding their admissibility otherwise. No guidance is provided as to how this discretion should be exercised. Aside from relaxation in the laws of evidence (and, apparently, the fact that the defendant stands trial for a foreign offence), the trial process is that which would apply to domestic offending: s 9.

Cooperation for Prosecution of Nationals

1101. There is no designated central authority for extradition requests. Requests must be received through diplomatic channels. They must append "all relevant evidence". There is no statutory or administrative guidance as to what evidence would be required to establish a prima facie (or conclusive) case or as to how the laws of evidence (as modified to enable receipt of foreign "proofs" etc) might operate.

Efficiency of Extradition Process

1102. As noted, requests must be received through diplomatic channels and must append details of the offender and "all relevant evidence". Upon receipt of a request, the Government may "if it deems necessary" order a court to enquire into the matter: s 4. There are no requirements governing how this discretion must be exercised. The Evaluation Team was advised that the Ministry of Law would at this stage consider whether any of the listed "restrictions on extradition" apply (concerning whether the offence is a political offence and whether any limitation periods have expired) plus whether the person concerned is liable to face the death penalty (not in the Act but of concern in relation to extraditions to India).

1103. If a matter is referred to a court, the Court "shall" order a warrant for arrest: s 5.

1104. Only once the person has been arrested and brought before the Court is the Court empowered to determine if the offence is extraditable, of a political nature or whether there is "sufficient ground" for extradition: s 6. This requirement appears to apply even though the person in question might be Nepalese and, therefore, ineligible for surrender. It was explained that "sufficient ground" connotes the need for a prima facie case.

1105. If these thresholds are met, the Court shall order that the person be held in custody and shall prepare a "report" to the Government setting out the evidence for and against the person: s 7. The Government thereafter is vested with discretion to extradite (or, in the case of a Nepal national, place on trial) the person if it "finds it reasonable": s 8. Where the Government finds it reasonable, a foreign national must be placed in custody for extradition, following which extradition must occur within 60 days (failing which the Supreme Court "may", if it finds it "reasonable", release him/her).

1106. Where a Nepal national is placed on trial, he/she shall be subject to proceedings as though the offence were against Nepal law: s 9. It seems that the "offence" contemplated under s 9 is the offence as framed by the requesting country (albeit a "deemed" offence against Nepal law). Nepal has never used these procedures. Instead, fugitives and other requested persons have been surrendered by way of deportation procedures.

1107. These procedures are not considered to enable prompt extradition. At several points authorisation (presumably high-level) must be obtained from the Government—and there exists an overriding discretion to at any time “annul” the extradition process and release the offender. Although a detainee is entitled to petition the Supreme Court for release 60 days after being “put in custody for extradition”, there are no time restraints upon the court of committal to undertake its preliminary enquiry or to furnish its report. Nor are there any mechanisms facilitating prompt execution. That the Extradition Act has never been used in Nepal is a concern. Deportation is preferred because it is “easier” and “quicker”.

Additional Element

1108. Nepal law does not permit simplified procedures premised upon warrants of arrest or judgments.

Statistics and Effectiveness

1109. The Extradition Act has not been used since enactment. No mechanisms have been put in place to facilitate its use. Its processes give considerable scope for executive intervention. As noted above, it is because of apprehended complexity in the extradition process that deportation has been a preferred mechanism for surrender.

1110. Further, the Act’s failure to provide any guidance as to how Governmental discretion is to be exercised and the apparent requirement that the requesting country fully comply with all provisions of the treaty or convention relied upon renders the extradition process susceptible to legal challenge.

1111. Deportation is not an effective alternative to formal extradition. Nepal officials advised that, when faced with a request for extradition, there are no particular thresholds governing the decision to instead deport. For example, there is no requirement that the requesting country furnish an arrest warrant. Nor is there any necessity for the person to have entered Nepal illegally or to have committed a crime within Nepal. Persons rendered in such an informal manner are likely to have far greater opportunity to challenge their detention in the receiving country.

1112. Nepal has never prosecuted a Nepal national in lieu of extradition. Deportation mechanisms are not a substitute for extradition and do not demonstrate effectiveness.

6.4.2 Recommendations and Comments

1113. Nepal should:

- Use the formal extradition processes under the Extradition Act.
- Comprehensively criminalise ML and TF to address gaps in the offences which may impede the ability to provide mutual legal assistance, including extradition.
- Issue rules under s 19 of the Extradition Act to enable the prompt processing of extradition requests.
- New rules should: (i) establish those factors considered relevant to the exercise of executive discretion under ss 4, 8 and 15 and (ii) designate the persons vested with these discretionary powers authorities should consider the following recommendations.
- Thereafter consider replacing the existing Extradition Act with one that enables, subject to clearly legislated limitations, extradition for a broader range of offences to a broader range of countries and that is more streamlined and less contingent upon to executive authorisation.

6.4.3 Compliance with Recommendations 37 & 39 and SR V

	RATING	SUMMARY OF FACTORS UNDERLYING THE RATINGS
R 39	NC	<ul style="list-style-type: none"> Nepal has not used the Extradition Act (either to extradite a foreign national or to prosecute a Nepali) since its enactment in 1988. The extradition process enables considerable executive intervention and is not likely to enable the swift surrender of requested persons. Gaps the ML offence and absence of any TF offence may impede Nepal's ability to provide mutual legal assistance, including extradition
R 37	NC	<ul style="list-style-type: none"> There is no evidence, and no reason to assume, that technical differences in criminalisation would not render dual criminality an impediment to extradition.
SR V	NC	<ul style="list-style-type: none"> In the absence of a TF offence, any requirement for dual criminality would preclude extradition for TF.

6.5. Other Forms of International Co-Operation (R 40 & SR V)

6.5.1 Description and Analysis

1114. There are few formal gateways in Nepal to permit the effective exchange of information among relevant AML/CFT-related agencies.

Nepal Police

1115. The Nepal Police is a member of the Interpol network, and as such it receives and extends cooperation to its foreign counterparts via information sharing arrangements of Interpol. When a case is not of coercive nature, information can be exchanged via the Interpol channel. The Nepal Police Interpol office can facilitate ML related enquiries from overseas law enforcement agencies. However in the absence of a MLA Act Nepal's ability to provide cooperation is limited.

1116. The Nepal Police also participates in international training courses for police services to allow its staff to build and further develop informal networks and relationship. Information exchange via informal networks is easier and quicker than via the Interpol channel, though information obtained in such a way cannot be used in formal procedures. The Nepal Police do not however maintain statistics on requests from foreign counterparts and so it is difficult to assess the effectiveness of this mechanism.

FIU to FIU information exchange

1117. ALPA s 10(1)(d) permits the FIU to provide information to foreign FIU and international organisations on the "basis of reciprocity". AML Rule 6(f) however requires that an MOU be signed to give effect to the ALPA provision so that informal sharing is not possible.

1118. The Nepal FIU currently has MoUs with Bangladesh, Sri Lanka, Malaysia, Mongolia and Thailand. It has also started negotiation with Japan for a similar arrangement. The FIU was not able to provide statistics on the number of information requests made and received with Bangladesh and Sri Lanka pursuant to the existing MoUs.

1119. In regard to the FIU's co-operation, ALPA does not grant the FIU ability to spontaneously share information with foreign counterparts.

Department of Customs

1120. The Customs Act 2007 does not contain a mechanism for the Customs Department to negotiate or enter into any formal or informal international arrangements with foreign counterparts to exchange relevant information. The Customs Department advised that although it has no such formal arrangements it does share information on an ad hoc reciprocal basis only.

1121. No statistics were provided on how many information requests were made or received by Customs in Nepal.

CIAA

1122. Under the Commission for the Investigation for the Abuse of Authority Act 1991 there is no provision which permits the CIAA to enter into or negotiate international arrangements to permit the exchange of information between foreign counterparts. And as a matter of fact the CIAA does not have any such arrangements in writing with foreign counterparts.

1123. Officials from the CIAA advised that when foreign counterparts request information from the CIAA they seek advice from the Ministry of Foreign Affairs on the proper response. However the CIAA advised that no requests to date have been made.

Supervisor-to-supervisor information exchange

NRB

1124. The central bank and Government of Nepal can also be involved at some stage under ss 79, 80 of *Banks and Financial Institutions Act*. Nepal is member of SASRF (South Asian Securities Regulators Forum). It meets for policy matters and solution of the common problems. Nepal Stock Exchange is member of South Asian Federation of Exchanges. Nepal participates in various international forums related with international cooperation.

Securities Board of Nepal

1125. There is no legal mechanism under the Securities Act which permits SEBON to enter into information sharing arrangements. SEBON confirmed that it has no MoUs or other instruments in relation other sharing of information with foreign counter-parts.

Insurance Board of Nepal

1126. The same comments with respect to SEBON can be made in relation to the Insurance Board of Nepal. No MoUs or other mechanisms are in existence as the governing legislation (the *Insurance Act*) does not ha a provision permitting the entering to of international agreement or arrangements for the sharing of information.

6.5.2 Recommendations and Comments

1127. There are few gateways for the exchange of information in Nepal with foreign counterparts. Nepal should grant relevant authorities with the power to share such information.

6.5.3 Compliance with Recommendation 40 and SR V

	RATING	SUMMARY OF FACTORS UNDERLYING THE RATINGS
R 40	NC	<ul style="list-style-type: none">• FIU cannot share confidential information with foreign counterparts• There are no appropriate procedure or working practices that evidence the widest possible range of international co-operation to their foreign counterparts• The 'standard-operating-procedure' used does not provide clear, effective, prompt and constructive exchanges directly between counterparts.• FIUs ability to share information is also hampered by the absence of conclusion of bilateral agreements which, under ALPA, condition its ability to engage in international exchange of information.
SR V	NC	<ul style="list-style-type: none">• FIU cannot share confidential information with foreign counterparts• There are no appropriate procedure or working practices that evidence the widest possible range of international co-operation to their foreign counterparts

7. OTHER ISSUES

7.1 Resources and Statistics

1128. The text of the description, analysis and recommendations for improvement that relate to Recommendations 30 and 32 is contained in all of the relevant sections of this report.

Additional Details of Training for Staff

1129. Staffs of DRI as the AML Investigation Department, and FIU have been given some training on skill required for AML/CFT measures. Some staff members have been trained by the FIU covering the scope of predicate offences, ML and FT typologies, and in techniques to investigate and prosecute offences. The FIU is also planning training for AML supervisors.

1130. The following statistics are relevant:

Domestic Training/Workshops Conducted by FIU after its establishment	
Participants	Nature
180	First program by FIU in association with APG and BNM
165	Parliamentarians, high level bureaucrats, regulators
210	Chief Executive Officers of Banks and Financial Institutions and chiefs of association of other business including precious metal and stone, casino etc.
50	AML/CFT for compliance officer of financial institution.
50	AML/CFT for compliance officer of financial institution.
50	AML/CFT for compliance officer of financial institution.
50	Government Agencies.
60	Compliance Officers of Bank, finance and Reporting Institution,(Pokhara)
60	Compliance Officers of Bank, finance and Reporting Institution,(Biratnagar)
60	Compliance Officers of Bank, finance and Reporting Institution, (Nepalgunj)
56	NCC Study Program in association with APG
54	Pre ME preparation program in association with APG

International Training Workshops on AML/CFT 2008-2010		
Sponsors	Participants	Nature of training
APG	2	APG on Money Laundering 2008 Typologies workshop
APG	1	2009 APG Typologies Workshop
IMF/India	2	AML/CFT Workshop on Police Development
APG/State of New Jersey	1	Conference to assist Jurisdictions to meet G 20 objectives
Joint India/ IMF	4	AML/ CFT course for Financial Intelligence unit (FIU) Analysts for India and south Asian countries
AUSTRAC	2	AUSTRAC'S AML/CFT Leadership conference
APG/IMF	5	APG/IMF Training Workshop for Jurisdiction undergoing a mutual Evaluation / Assessment
IMF/RBI	2	AML/ CFT Workshop for Financial Supervisors on Practical Aspect of AML / CFT compliance
InWENT/APG	4	Financial Analysis /techniques and /global AMT/CFT Standards
APG	2	APG Assessor Training Workshop

APG/World Bank	1	AG Implementation Issues Working Group SIP Framework for pilot Workshop
SEACEN / World bank	1	SEACEN / World bank Regional advanced Workshop for Banking supervisors on anti- money laundering and counter Financing To Terrorism.

	RATING	SUMMARY OF FACTORS UNDERLYING THE RATINGS
R 30	PC	<ul style="list-style-type: none"> • The FIU has insufficient human and technical resources for effective analysis of STRs and TTRs. • Enforcement agencies including the DR have no training with respect ML and TF investigations. • Supervisory agencies, including the NRB, have insufficient training, human and technical resources to conduct their AML./CFT supervisory role.
R 32	PC	<ul style="list-style-type: none"> • Nepal authorities do not maintain comprehensive statistics. • There is no comprehensive data management system in Nepal. • It is not possible to properly determine effectiveness of due to inconsistency in some instance between information maintained (e.g. FIU and law enforcement).

7.2 Other Relevant AML/CFT Measures or Issues

7.2.1 The Special Court

1131. ML prosecutions are heard before a “Special Court” for money laundering — a court comprised of appellate judges appointed by the Chief Justice. This special court model is contemplated by the Interim Constitution and considers corruption-related offences as well.

1132. The Special Court for money laundering comprises three Court of Appeal Judges, one of whom acts as the President of the court. None of these Judges has had training as to the offence of ML and its potential gravity. As noted in section 2.1 of this report, in light of the inability of counsel to make submissions on sentencing and in light of the only case of ML to be adjudicated upon to date, judicial training on this offence is needed.

TABLES

Table 1: Ratings of Compliance with FATF Recommendations

The rating of compliance vis-à-vis the *FATF Recommendations* has been made according to the four levels of compliance mentioned in the 2004 Methodology⁴² (Compliant (C), Largely Compliant (LC), Partially Compliant (PC), Non-Compliant (NC)), or, in exceptional cases, Not Applicable (N/A).

Compliant	The Recommendation is fully observed with respect to all essential criteria.
Largely Compliant	There are only minor shortcomings, with a large majority of the essential criteria being fully met.
Partially Compliant	The country has taken some substantive action and complies with some of the essential criteria.
Non Compliant	There are major shortcomings, with a large majority of the essential criteria not being met.
Not Applicable	A requirement or part of a requirement does not apply, due to the structural, legal or institutional features of a country e.g. a particular type of financial institution does not exist in that country.

Recommendations	Rating	Summary of Factors Underlying Rating ⁴³
Legal systems		
1 – ML offence	PC	<ul style="list-style-type: none"> • Conversion or transfer covered only if it results in projection of laundered property “as a legally earned asset”. • Concealment or disguise is covered only when committed by third parties. • Does not extend to concealment or disguise of the nature, location and movement of, and rights in relation to, proceeds of crime. • Predicate offences do not cover a range of conduct within each designated category of predicate offence. • Predicate offences do not extend to conduct in another country that, if committed in Nepal, would constitute a predicate offence. • Not all conduct allegedly constituting predicate conduct is clearly identified. • Ancillary offences do not extend to conspiracy and counselling and possibly do not extend to aiding the commission of a predicate offence.
2 – ML offence – mental element and corporate liability	PC	<ul style="list-style-type: none"> • Liability of legal persons is neither clearly enacted in the context of ML nor pursued more generally. • Sanctions are not proportionate, effective or dissuasive. • Ineffective implementation.
3 – Confiscation and provisional measures	NC	<ul style="list-style-type: none"> • Capacity to confiscate proceeds is limited to proceeds of ML, corruption, drugs offending and human trafficking. • No capacity to comprehensively confiscate instrumentalities of predicate offending. • No capacity to confiscate intended instrumentalities of any offences required to be predicate offences. • No capacity to confiscate property of corresponding value. • No capacity to comprehensively seize or freeze proceeds of predicate offences.

⁴² Methodology for Assessing Compliance with the FATF 40 Recommendations and the FATF 9 Special Recommendations, 27 February 2004 (updated as of February 2009).

⁴³ These factors are only required to be set out when the rating is less than “compliant”.

Recommendations	Rating	Summary of Factors Underlying Rating ⁴³
		<ul style="list-style-type: none"> • No capacity to seize or freeze instrumentalities or intended instrumentalities of any offences required to be predicate offences. • Capacity to seize or freeze instrumentalities of ML is not clear. • No capacity to seize or freeze intended instrumentalities of ML • No capacity to seize or freeze property of corresponding value • Mechanisms for the protection of bona fide third parties are onerous, requiring the filing of a writ under the Constitution and proof of infringement of a constitutional right. • No statistics are maintained. • The effectiveness of the restraint and forfeiture regime is significantly compromised by deficient understanding and implementation of legislated powers.
Preventive measures		
4 – Secrecy laws	LC	<ul style="list-style-type: none"> • No explicit provisions enabling the financial institutions to share customer information with other financial institutions to meet the requirements of Recommendations 7 and Special Recommendation VII. • No legal basis for lifting bank secrecy for information sharing between competent authorities domestically or internationally.
5 – Customer due diligence	NC	<ul style="list-style-type: none"> • CDD requirements for most NBFIs are unenforceable • Risk management requirements of banks and NBFIs are unenforceable. • Postal Banks have no AML/CFT obligations. • Lack of enforcement of existing AML/CFT obligations by Nepal government or basic understanding among banks and NBFIs. • Near non-existent understanding of AML/CFT obligations demonstrated by securities industry. • Gaps in statutory and regulatory requirements on when CDD is required. • Absence of clear prohibition on establishing relationships or conducting transactions when incomplete documentation received by customers. • Lack of clear guidance on development of procedural mechanisms for accounting for above-threshold transactions. • Classes of institutions exempted from transaction threshold reports not demonstrated to have lower ML/TF risks, limiting effectiveness. • Non-existence of AML/CFT policies on CDD complying with ALPA at all financial institutions. • Non-inclusion of AML/CFT CDD safeguards into Directives issued by non-NRB regulators or into inspection manuals for financial institutions. • No demonstrable CDD of existing clients by cooperatives. • Absence of CDD requirements for Insurance Board inspection manual, regulations, or Directives. • No requirements to obtain information on the purpose and nature of relationship. • No provisions in Nepal law on obtaining beneficial ownership information of customers. • Deficient requirements on ongoing due diligence. • Lack of training in all industries on CDD requirements both by Nepal government and by corporate entities for staff.
6 – Politically exposed persons	NC	<ul style="list-style-type: none"> • The limited PEP provisions are unenforceable. • Foreign PEPs not considered high-risk. • No reference to beneficial owners. • No guidance to financial industry on development of PEPs policies and procedures. • No senior management approvals required on PEP accounts. • No specific mandates on sources of funds or wealth for PEPs. • Absence of effective PEP procedures at all financial institutions.
7 – Correspondent banking	NC	<ul style="list-style-type: none"> • FIs are not required to gather sufficient information on correspondents. • No obligation on FIs to examine respondent's AML/CFT controls. • Absence of senior management approval mandate. • No requirement to document respective AML/CFT responsibilities of

Recommendations	Rating	Summary of Factors Underlying Rating ⁴³
		each institution.
8 – New technologies & non face-to-face business	NC	<ul style="list-style-type: none"> No requirements on non-face-to-face transactions and technological developments to prevent the misuse of TF and ML No mandates that FIs should be required to have policies and procedures in place on risks of non-face-to-face business.
9 – Third parties and introducers	N/A	<ul style="list-style-type: none"> Nepal law is silent on reliance on third parties in CDD process. The authorities and the private sector agree that in practice no reliance is placed on intermediaries or other 3rd parties. No reference in Nepal law on relationship with third parties that take into account information on countries' application of FATF recommendations.
10 – Record keeping	PC	<ul style="list-style-type: none"> Nepal law does not explicitly require banks or NBFIs to maintain records after termination. Financial institutions are not specifically required to maintain records on business correspondence. Effective implementation has not been established by supervision.
11 – Unusual transactions	NC	<ul style="list-style-type: none"> Financial institutions are not required in law or regulation or other instrument to pay special attention to complex, unusual large transaction or unusual patterns of transactions Financial institutions are not required to ask customers about the background or purpose of unusual transactions and to set forth their findings in writing.
12 – DNFBPs – R.5, 6, 8-11	NC	<ul style="list-style-type: none"> Preventative measures in the ALPA do not apply to all DNFBP sectors The scope of preventative measures applicable to casinos and other DNFBPs are narrow and do not address many of the measures required under the standards. Enforceability of ALPA measures is limited and the only other instruments for casinos are not enforceable Extension of the FIU AML Directives to the casino sector is very recent and there is insufficient evidence of effective implementation.
13 – Suspicious transaction reporting	PC	<ul style="list-style-type: none"> Not all financial institutions are required to report suspicious transactions to the FIU. Deficiencies in the criminalisation of ML in the ALPA, including the scope of predicate offences, narrows the scope of STR reporting obligation in Nepal. In the absence of a clear TF offence, reporting STRs when there are reasonable grounds to suspect TF is not clearly covered. No requirement to report attempted suspicious transactions. The narrow scope of reporting (Class A banks) and low rates of STR reports overall means that effective implementation of reporting obligation cannot be established. Most financial institutions lack understanding of what constitutes suspicious transactions.
14 – Protection & no tipping-off	NC	<ul style="list-style-type: none"> Immunity under ALPA only applicable in case where “loss” occurs. Immunity only applies against civil action (not criminal liability). Tipping off prohibitions do not apply to the fact that an STR is being reported or has been reported. Tipping off prohibition not applicable to attempted suspicious transactions. Tipping off prohibitions not enforceable - no penalty provisions for breach.
15 – Internal controls, compliance & audit	NC	<ul style="list-style-type: none"> No mandatory obligation to establish AML/CFT internal controls. No requirement to maintain an adequately resourced and independent audit function to test compliance (including sample testing) with AML controls. A lack of effectiveness as most financial institutions lack AML/CFT policies, procedures and controls to prevent ML and TF, defining compliance officers' responsibilities, access to information, and chains of command.
16 – DNFBPs – R.13-15 & 21	NC	<ul style="list-style-type: none"> STR reporting obligations in the ALPA do not apply to all DNFBP sectors.

Recommendations	Rating	Summary of Factors Underlying Rating ⁴³
		<ul style="list-style-type: none"> • Only the basic requirements of the ALPA and the AML Rules apply to casinos, and these do not address much of the issues required under the standards. • Protection for STR reporting and prohibitions of tipping-off not fully incorporated. • No effective implementation of AML/CFT controls by DNFBPs sector for STR reporting and internal controls.
17 – Sanctions	NC	<ul style="list-style-type: none"> • No sanctions for breaches of AML Rules and FIU AML directives. • ALPA does not provide for criminal sanctions for non-compliance with all AML/CFT requirements and civil sanctions are limited with respect to TTRs/ STRs. • No sanctions available under ALPA against natural persons e.g. directors, managers, secretaries and other officers. • Sanctions prescribed in the governing legislation and applied so far are not effective, proportionate or dissuasive. • No sanctions applied for AML/CFT deficiencies across all sectors.
18 – Shell banks	NC	<ul style="list-style-type: none"> • No prohibition on financial institutions establishing correspondent relationships with shell banks. • No obligations on financial institutions to ensure that their accounts cannot be used by shell banks.
19 – Other forms of reporting	C	<ul style="list-style-type: none"> • Fully observed
20 – Other NFBP & secure transaction techniques	LC	<ul style="list-style-type: none"> • Few measures to develop modern and secure transaction techniques to avoid ML and TF risks from the high usage of cash in the economy.
21 – Special attention for higher risk countries	NC	<ul style="list-style-type: none"> • Financial institutions are not required to give special attention to business relationships and transactions with persons from countries that do not adequately apply FATF recommendations. • No existing system exists for Nepal authorities to ensure that financial institutions are aware of countries with weak AML/CFT regimes. • No mandate for financial institutions to identify background and purpose of transactions with no apparent economic or visible purpose • No system is in place in Nepal to employ countermeasures against countries that insufficiently apply FATF recommendations.
22 – Foreign branches & subsidiaries	N/A	<ul style="list-style-type: none"> • Nepal financial institutions do not have foreign branches and subsidiaries.
23 – Regulation, supervision and monitoring	NC	<ul style="list-style-type: none"> • The ALPA does not apply to commodity brokers and a lack of supervisory regime for Postal Savings Banks. • ‘Fit and Proper’ test not available with respect to persons acquiring managerial positions and controlling interests in financial institutions • No eligibility criteria and ‘fit and proper’ test on applicants who are natural persons in securities sector. • Lack of fitness test on the beneficial owners or controlling interests at the time of entry or at the time of renewal of licence of insurers • Lack of supervisory powers with respect to AML/CFT requirements for regulators. • Ineffectiveness due to lack of use of AML/CFT powers of regulators and supervisors.
24 – DNFBP: regulation, supervision and monitoring	NC	<ul style="list-style-type: none"> • ALPA does not apply to all DNFBP sectors. • No supervisory/regulatory regime for dealers in precious metals and dealers in precious stones • No statutory “fit and proper” tests for owners/controllers, operators and managers • Insufficient range of sanctions available to the MoT to enforce supervisory powers • Lack of proportionate and dissuasive sanctions for failure in filing report • The supervisory regime in sectors where it is available has not yet commenced AML/CFT inspections and it is not effective.
25 – Guidelines & Feedback	NC	<ul style="list-style-type: none"> • No guidelines have been issued by the FIU to assist reporting institutions on how to implement and comply with their AML/CFT

Recommendations	Rating	Summary of Factors Underlying Rating ⁴³
		obligations in the ALPA, AML Rules and FIU Directives <ul style="list-style-type: none"> • No general or specific feedback by the FIU or other relevant agencies has been provided to reporting institutions on STR reporting provided by FIU to assist reporting institutions. • Directives issued by FIU to reporting institutions do not include ML/FT techniques and methods. • No evidence of appropriate guidance provided to the casinos, Chartered Accountants and Lawyers. • No guidance to assist with the implementation of the ALPA, AML Rules and FIU AML Directives to any other sector where they have been applied.
Institutional and other measures		
26 – The FIU	PC	<ul style="list-style-type: none"> • FIU does not properly undertake analysis of STRs and TTRs. • FIU does not have access directly or indirectly to additional law enforcement or administrative information in order to properly undertake its functions. • FIU cannot gain access to additional information from reporting entities – only information in relation to a particular “transaction”. • FIU lacks operational independence. • Information held by FIU is needs further security protected. • FIU does not publish statistics, typologies or trends in ML and TF. • Absence of comprehensive data management systems for the FIU • 100% dissemination of STRs to law enforcement is ineffective.
27 – Law enforcement authorities	PC	<ul style="list-style-type: none"> • In the absence of TF offences, no clear designation of an investigation authority. • No proper investigation of ML & TF cases, more focus on revenue leakage cases. • Lack of specialized investigative techniques for proper investigation. • DRI does not have any legal authority to postpone or waive the arrest of persons or seizure of money for the purpose of identifying persons involved in ML. • DRI's lack of sufficient resources to properly undertake its ML and TF investigation function undermines effectiveness
28 – Powers of competent authorities	LC	<ul style="list-style-type: none"> • The power of seizing and searching of the financial records are not applicable for all the predicate offences.
29 – Supervisors	PC	<ul style="list-style-type: none"> • ALPA does not apply to commodity brokers. • Lack of supervisory regime for Postal Savings Banks. • Insurance Board lacks power to call for information and record • Insufficient and ineffective supervisory regime in securities sector and cooperatives and foreign exchange dealers. • Effectiveness issue: no supervision and inspection of any financial institutions with respect to AML/CFT standards.
30 – Resources, integrity and training	PC	<ul style="list-style-type: none"> • FIU is not adequately structured, funded, staffed, and lacks sufficient technical and other resources to fully and effectively perform its functions. • FIU staff require specialized training on financial analysis techniques. • No specialized training on ML investigation techniques and no training on TF investigation procedures. • The DRI is not adequately structured or sufficiently resourced. • Insufficient human resource in the AML Unit to conduct effective investigations. • Customs is not adequately structured with sufficient human and technical resources • No training programmes arranged for customs officials. • No training programs have been conducted to implement the requirements under SR IX. • No comprehensive data management in Customs. • Lack of training to all supervisors. • Lack of sufficient, skilled human and technological resources in SEBON, Insurance Board and Registrar of Cooperatives and

Recommendations	Rating	Summary of Factors Underlying Rating ⁴³
		<p>supervisors / SROs of DNFBPs.</p> <ul style="list-style-type: none"> The FIU has insufficient human and technical resources for effective analysis of STRs and TTRs. Enforcement agencies including the DR have no training with respect ML and TF investigations. Supervisory agencies, including the NRB, have insufficient training, human and technical resources to conduct their AML./CFT supervisory role.
31 – National co-operation	PC	<ul style="list-style-type: none"> Policy level coordination mechanisms are not being used to effectively develop and implement AML/CFT policies. Operation-level coordination mechanisms for AML/CFT are not effectively utilised.
32 – Statistics	PC	<ul style="list-style-type: none"> Nepal does not maintain comprehensive statistics Nepal does not maintain comprehensive statistics on provisional measures taken and confiscation of instrumentalities and proceeds of crime. Inconsistencies between the data provided by the FIU and law enforcement agencies indicate that statistics are not well kept, hindering effective implementation of AML/CFT systems. No comprehensive data management by the LEAs. No statistics from law enforcement agencies on any aspects of ML and TF. statistics on cross border currency movement only available from the Tribhuvan International Airport It is not possible to properly determine effectiveness of due to inconsistency in some instance between information maintained (e.g. FIU and law enforcement).
33 – Legal persons – beneficial owners	NC	<ul style="list-style-type: none"> No requirement that information on beneficial ownership of legal persons is required to be collected by: the corporate registry; within corporate records held by legal persons; or by company formation agents or service providers. There are no safeguards under Nepal law to mitigate the risk of ML associated with bearer share warrants. Law enforcement and other authorities have sufficient powers to access company information, but those powers are not adequate to ensure the existence of adequate, accurate and timely information on beneficial ownership of legal persons, which can be accessed or obtained in a timely fashion. There are no measures in place to mitigate the risk of ML posed by the use of nominee directors and the use of nominee shareholders.
34 – Legal arrangements – beneficial owners	NC	<ul style="list-style-type: none"> Nepal has no mechanisms in place to prevent the unlawful use of trusts for ML or TF purposes. Except for taxation records (which do not include beneficial ownership of trust property), there is no requirement to obtain, verify and retain adequate, accurate and current information on the beneficial ownership and control of trusts. While investigative powers are generally sound, there is no information that is adequate, accurate and timely concerning the beneficial owners of trusts be obtained or accessed by the competent authorities in a timely fashion.
International Co-operation		
35 – Conventions	NC	<ul style="list-style-type: none"> Palermo Convention has not been ratified or fully implemented. The TF Convention has not been ratified or fully implemented. Significant deficiencies with implementation of Vienna Convention.
36 – Mutual legal assistance (MLA)	NC	<ul style="list-style-type: none"> Nepal does not have MLA laws. Nepal can provide only extremely limited MLA entailing use of coercive powers. There are no mechanisms enabling assistance to be provided in a timely, constructive and efficient manner. <p>Gaps the ML offence and absence of any TF offence may impede Nepal's ability to provide international cooperation.</p>
37 – Dual criminality	NC	<ul style="list-style-type: none"> Mutual legal assistance is not rendered to the greatest extent possible

Recommendations	Rating	Summary of Factors Underlying Rating ⁴³
		<p>in the absence of dual criminality.</p> <ul style="list-style-type: none"> • There is no evidence, and no reason to assume, that technical differences in criminalisation would not render dual criminality an impediment to effective cooperation. • There is no evidence, and no reason to assume, that technical differences in criminalisation would not render dual criminality an impediment to extradition.
38 – MLA on confiscation and freezing	NC	<ul style="list-style-type: none"> • Nepal cannot provide assistance by way of freezing and seizing assets other than in relation to ML-related investigations. • The capacity to freeze in ML-related investigations is not complemented by capacity to confiscate frozen assets. • Gaps the ML offence and absence of any TF offence may impede Nepal's ability to provide mutual legal assistance related to provisional measures and confiscation.
39 – Extradition	NC	<ul style="list-style-type: none"> • Nepal has not used the Extradition Act (either to extradite a foreign national or to prosecute a Nepali) since its enactment in 1988. • The extradition process enables considerable executive intervention and is not likely to enable the swift surrender of requested persons. • Gaps the ML offence and absence of any TF offence may impede Nepal's ability to provide mutual legal assistance, including extradition.
40 – Other forms of co-operation	NC	<ul style="list-style-type: none"> • FIU cannot share confidential information with foreign counterparts • There are no appropriate procedure or working practices that evidence the widest possible range of international co-operation to their foreign counterparts • The 'standard-operating-procedure' used does not provide clear, effective, prompt and constructive exchanges directly between counterparts. • FIUs ability to share information is also hampered by the absence of conclusion of bilateral agreements which, under ALPA, condition its ability to engage in international exchange of information.
Special Recommendations		
SR I – Implement UN instruments	NC	<ul style="list-style-type: none"> • Nepal has not acceded to the Terrorist Financing Convention. • Nepal does not comply with UNSCRs 1267 and 1373.
SR II – Criminalise TF	NC	<ul style="list-style-type: none"> • TF is not criminalised
SR III – Freeze and confiscate terrorist assets	NC	<ul style="list-style-type: none"> • Directives aimed at ensuring compliance with the UNSCRs are not binding. • The directives preclude transactions rather than requiring that assets be frozen. • Only some of the terrorist entities to which the Directives relate are readily identifiable. • No guidance to reporting entities with respect to compliance. • No procedures enabling delisting or unfreezing. • No procedures enabling access to frozen funds. • The only mechanism for reviewing freezing decisions or protecting third party interests requires the petitioning of the Supreme Court. • There are no powers enabling enforcement of Directives. • No capacity to confiscate frozen assets or to void actions intended to ensure that proceeds of TF or terrorist assets are unable to be confiscated. • Inadequate powers to identify and trace terrorist assets. Levels of compliance with the Directives are low.
SR IV – Suspicious transaction reporting	NC	<ul style="list-style-type: none"> • TF is not formally criminalised in Nepal and there is no clear legal obligation to report TF-related STRs by reporting institutions. • Financial institutions lack understanding of what constitutes TF related suspicious transactions.
SR V – International co-operation	NC	<ul style="list-style-type: none"> • There is no legal basis for the provision of MLA in terrorism-related matters. • In the absence of a TF offence, any requirement for dual criminality would preclude extradition for TF. • FIU cannot share confidential information with foreign counterparts

Recommendations	Rating	Summary of Factors Underlying Rating ⁴³
		<ul style="list-style-type: none"> • There are no appropriate procedure or working practices that evidence the widest possible range of international co-operation to their foreign counterparts
SR VI – AML requirements for money/value transfer services	NC	<ul style="list-style-type: none"> • The application of the FATF Recommendations to MVTs providers suffers from the same deficiencies in regulations or other measures in the areas of CDD, reporting of suspicious transactions, and other sanctions in relation to the rest of the financial sector (see sections 3.1 to 3.10 of this report).
SR VII – Wire transfer rules	NC	<ul style="list-style-type: none"> • No statutes, regulations, and/or Directives on wire transfers.
SR VIII – Non-profit organisations	NC	<ul style="list-style-type: none"> • No review undertaken of the adequacy of domestic laws in the NPO sector. • No periodic reassessments undertaken by reviewing new information on the sector’s potential vulnerabilities to terrorist activities. • No outreach to the NPO sector with a view to protecting the sector from TF abuse. • Limited information available on the identity of person(s) who own, control or direct their activities, including senior officers, board members and trustees. • Nepal has not demonstrated that measures are in place to sanction violations of oversight measures or rules by NPOs or persons acting on behalf of NPOs for NPOs other than those registered under the Income Tax Act and under the FCRA. • While all NPOs must be registered under the Association Registrations Act, it is acknowledged that not all are. • Enforcement action against non-compliant NPOs has not occurred.
SR IX – Cross-border Declaration & Disclosure	NC	<ul style="list-style-type: none"> • Declaration system lacks legal basis. • Applicable for the incoming passengers only at the (one) international airport. • Not all entry points to Nepal are covered by the declaration systems. • Bearer negotiable instruments are not covered in the declaration system • Does not cover Nepali currency. • Does not cover Nepali citizens, only foreigners. • Gold, precious metals are not covered in the declaration form. • Customs Department does not share the information with FIU. • No effective coordination between Customs Department and FIU. • Lack of effective implementation of declaration system. • No effective monitoring system is in place for controlling bulk cash smuggling and cross border illegal movement of gold, precious metals and stones. • No system is in place for confiscating currencies pursuant to UNSCRs sanction lists.

Table 2: Recommended Action Plan to Improve Nepal’s AML/CFT System

AML/CFT SYSTEM	RECOMMENDED ACTION (LISTED IN ORDER OF PRIORITY)
1. General	
2. Legal System and Related Institutional Measures	
2.1 Criminalisation of ML (R 1 & 2)	<p>Nepal should comprehensively criminalise ML in keeping with international standards, and particularly should:</p> <ul style="list-style-type: none"> • Structure the ML offence to cover concealment or disguise by other than a third party. • Extend concealment or disguise to concealment of the nature, location and movement of, and rights in relation to, proceeds of crime. • Supply definitions for the predicate conduct of engaging in “terrorist activities”. • Extend predicate offences to conduct in another country that, if committed in Nepal, would constitute a predicate offence. • Remove the reference to ultimate “investment... as a legally earned asset”. • Give consideration to the utility of a single definition of “proceeds of crime” as opposed to the inconsistent terminology employed in ALPA at present. • Expand the coverage of predicate offences and clearly identify predicate offences rather than generally describing them in the current manner. This may be achieved by adopting a threshold. • Amend the range of ancillary offences to remove inconsistencies between conduct ostensibly criminalised and that which is subject to sanction. • Amend the range of ancillary offences so that conspiracy, counselling and aiding are clearly criminalised. • Ensure proportionate and effective sanctions are available for the ML offence. • Provide greater training with respect to the nature of the offence of ML, including training of investigators, prosecutors and judicial officers within the Special Court.
2.2 Criminalisation of TF (SR II)	<p>Either through amending the ALPA or another statute Nepal should:</p> <ul style="list-style-type: none"> • Establish a clear and comprehensive stand-alone TF offence consistent with the TF Convention and with the elements of SR II; • The new offence should extend to the financing of terrorist organisations and individual terrorists; • Liability for TF should extend to legal persons; • There should be clear ancillary offences to a new TF offence, including aiding, abetting, counselling, inciting, procuring, attempting and conspiring to commit TF; and • Penalties for TF should be proportionate and dissuasive and apply to legal persons.
2.3 Confiscation, freezing and seizing of proceeds of crime (R 3)	<ul style="list-style-type: none"> • Enact legislation enabling comprehensive restraint and confiscation of instrumentalities of crime and proceeds of crime. Even if the ALPA is wide enough to enable provisional restraint of proceeds of any predicate conduct listed under ALPA s 4 (not clear), this is ineffectual given that confiscation under that Act is limited to proceeds of ML only. Coverage provided by other legislation is ad hoc, both in relation to proceeds and instrumentalities. In considering the nature of a comprehensive regime along these lines, Nepal should consider the merits of (i) civil recovery procedures, and (ii) reverse burdens of proof. • New legislation should include a definition of proceeds of crime that contemplates both direct and indirect proceeds, whether or not

AML/CFT SYSTEM	RECOMMENDED ACTION (LISTED IN ORDER OF PRIORITY)
	<p>those proceeds are held in a defendant's name. Such legislation should include appropriate mechanisms for:</p> <ul style="list-style-type: none"> • Ensuring compliance with freezing orders (whether judicial or executive), such as caveats; and • Enabling third party interests to be determined other than via the writ process under the Constitution. <ul style="list-style-type: none"> • Support such legislation with training to LEAs as to the efficacy of proceeds recovery from a deterrence perspective and training in asset-tracing and ML typologies; • Maintain comprehensive statistics on provisional measures and confiscation of instrumentalities and proceeds of crime; and • Enhance the capacity of law enforcement agencies to take actions to freeze, seize and confiscate proceeds of crime.
2.4 Freezing of funds used for TF (SR III)	<ul style="list-style-type: none"> • Provide comprehensive statutory provisions and related mechanisms and procedures to implement SR III, including UNSCR 1267, 1373 and measures to freeze and confiscate terrorist property in other contexts. • At least pending any amendment that might confer similar power upon the FIU, Rastra Bank Directives should be issued. Rather than precluding "transactions", Directives should be expressed in terms that require freezing of assets. • Expedite current plans to roll-out an "e-Network" enabling the FIU to provide up-to-date information as to those entities caught by the Directives and guidance relating to implementation. • Those entities should, as far as possible, be expressly identified in the Directives, rather than being merely described. At the very least, the Directives should identify those "other" organisations that are also said to list terrorists and terrorist entities. • Nepal should consider establishing a domestic listing mechanism and attendant processes to consider de-listing requests and requests for unfreezing. • Any proposals for reform of Nepal's laws governing confiscation should include proposals that enable (i) confiscation of assets frozen pursuant to the UNSCRs, (ii) deployment of powers appropriate to the task of identifying and tracing terrorist assets and (iii) powers to void actions intended to ensure that terrorist assets are unable to be confiscated.
2.5 The Financial Intelligence Unit and its functions (R26)	<ul style="list-style-type: none"> • Ensure sufficient dedicated staff resources are available to meet the FIU's core functions of receipt, analysis and dissemination of information. • Enhance the analytical capacity of the FIU, including effective software tools, dedicated staff and staff training. • Enhance the FIU's operational independence incorporating the separate recruitment, transfer, posting and promotion policy, and allocating a detailed operational and development budget. • The FIU should be relocated to a protected area and security measures should be taken for ensuring the physical security of the information. • Establish an independent IT platform in the FIU for effective online reporting system. • The numbers of staff in the FIU should be increased to handle the regulatory responsibilities smoothly and more specialized training on financial analysis related to ML and TF should be provided to the FIU officials and analysts. • Prepare an operational FIU manual for effective working of the FIU, including all aspects of receipt, analysis and dissemination and other core functions of the FIU. • Maintain a comprehensive database on STRs and TTRs. • Ensure the spontaneous information exchange with other FIUs.

AML/CFT SYSTEM	RECOMMENDED ACTION (LISTED IN ORDER OF PRIORITY)
	<ul style="list-style-type: none"> • Ensure the periodic publication including the statistics, trends and typologies of ML/TF.
2.6 Law enforcement, prosecution and other competent authorities (R 27 & 28)	<ul style="list-style-type: none"> • Establish a permanent AML Department (either within DRI or elsewhere). • The AML department should establish a dedicated ML/TF Investigation Unit with posting sufficiently skilled officials. • AML Department should develop and implement internal procedural manual as per Rule 40 of AML Rules to perform the task as assigned in the ALPA and AML rules. • Specialized trained officials should be posted in the AML Unit. Staff posted in the AML Unit should have specialised training and adequate experience in ML/TF. • DRI should be adequately resourced and all Law Enforcement Agencies should maintain comprehensive data to analyse the effective investigations, trends and typologies. • Technical Committee may ensure the coordination among the investigation agencies and the FIU regarding the effective investigation mechanism. • Specialized investigation techniques should be applied for ML and TF investigation procedure and laws and regulations should be amended to legalize the systems. • Training programs on Financial Investigative Techniques and other specialized training programs should be organised for the Investigators regularly. • All Law Enforcement Agencies should maintain comprehensive data on investigation, seizure of assets, confiscation and convictions. This may also be the remit of the prosecutors.
2.7 Cross-border Declaration & Disclosure (SR IX)	<p>Establish a comprehensive system to implement SRIX, including undertaking the following:</p> <ul style="list-style-type: none"> • identify false declarations or non declarations. • Include all instruments defined as currency and bearer negotiable instruments in the declaration form and passenger, cargo and postal streams. • Gold and other precious metals should be included in the declaration forms. • Nepali Citizen should be included in the declaration system. • Implement and enforce the existing declaration requirements for all the incoming and outgoing passengers. • ensure effective monitoring mechanism for preventing illegal bulk cash smuggling with the exported or imported goods by covered van or lorry at the time of crossing the border. • Customs should forward all the declared information to the FIU. • Domestic and international cooperation should be ensured regarding information sharing. • Customs authority should ensure electronic database for the currency movement and other precious metals movement information. • The Customs Department should be adequately structured and supported by technical and other resources to perform its functions effectively to meet the requirements FATF standards. • Nepal should fully implement the FATF Best Practices Paper for SR IX.
3. PREVENTIVE MEASURES – FINANCIAL INSTITUTIONS	
3.1 Risk of ML or TF	
3.2 Customer due diligence, including enhanced or reduced measures (R 5 to 8)	<p>In relation to Recommendation 5:</p> <ul style="list-style-type: none"> • Amend the ALPA to include penalty provisions for violations of CDD obligations so that CDD provisions of ALPA are enforceable. • Amend ALPA, BOPA, the AML Rules, and Directives for banks, cooperatives, insurers, and securities-related businesses to

AML/CFT SYSTEM	RECOMMENDED ACTION (LISTED IN ORDER OF PRIORITY)
	<p>expressly ban anonymous accounts and to include penalty provisions in underlying statutes, rules and Directives.</p> <ul style="list-style-type: none"> • Delete provision in BOPA s 3 that allows the opening of fictitious accounts “as otherwise permitted in law” to close a loophole allowing fictitious accounts. • Extend AML/CFT obligations to postal banks throughout the amendment of ALPA and issuance of Directives. • Revise NRB and industry-specific regulator supervision manuals for banks and all NBFIs covered by FIU AML Directives to include AML/CFT obligations following amendment of ALPA to allow penalties for failure to comply. • Raise the fine of NRps 10,000 (US\$135) under BOPA for fictitious and false accounts so that it is effective and dissuasive. • The FIU should offer sweeping and detailed AML/CFT training specific to CDD to all banks, savings and lending cooperatives, insurers, securities-related businesses, money transmitters and money exchanges. • Close gaps between ALPA and Directives that allow ambiguity on whether CDD is required for pre-existing customers that transact below thresholds by amending ALPA. • Amend Directives to make it clear that business relationships must not be established absent complete CDD. Filing of a STR should not be an out for a bank or NBFi. • Once finalized, in accordance with FATF standards, incorporate the Nepal Banker’s Association model AML/CFT policies into Directives to be issued by FIU to give them the force of law. • Introduce measures applicable to financial institutions and NBFIs which prohibit establishing a relationship or processing transactions with or for individuals whose identities cannot be verified. • Offer specific training to Cooperatives Department on CDD obligations. • Direct the Securities Board to revise its Directives to specifically include AML/CFT obligations. • Explicitly clarify in FIU AML Directives when powers of attorney are permitted for representatives of legal persons and legal arrangements per criteria 5.4. • Introduce enforceable obligations on banks and NBFIS requiring them to collect and review information related to changes of legal ownership of clients. • Amend ALPA, AML Rules, and Directives to require obliged entities to obtain and record beneficial ownership information. • In order to enhance CDD requirements, conduct a detailed study of the existing of holding company structures, legal trusts, and the use of power of attorney to further legal arrangements. • Impose a requirement applying to all financial institutions that mandates the collection of information on the intended nature of the business relationship. • Revise FIU AML Directives to ensure that they explicitly require that private banking customers, legal persons and arrangements, such as trusts and companies using nominee shareholders or bearer shares, are classified as high-risk. If, as stated by Nepali regulators, these practices are illegal, Nepal should revise its statutes to prohibit. • Provide specific guidance to banks and NBFIs on risk management and ongoing due diligence policies and procedures, including on PEPs, after revising ALPA, AML Rules, and Directives to include enforcement mechanisms on risk management that are presently unenforceable. Supervisory inspection manuals should be revised for all industries to include AML/CFT inspections that include inspection and testing of risk management systems. • Re-examine categories identified as “normal risk,” such as public companies and exempt customers, as part of national ML threat assessment in light of corruption and insider trading allegations.

AML/CFT SYSTEM	RECOMMENDED ACTION (LISTED IN ORDER OF PRIORITY)
	<p>In relation to Recommendation 6:</p> <ul style="list-style-type: none"> • Revise ALPA, AML Rules, and Directives to impose penalties for failure to design and implement adequate PEP policies. • Revise ALPA and Directives to ensure that, at a minimum, foreign PEPs are considered high-risk. • Have the FIU provide specific and detailed guidance on PEP policies and procedures to financial institutions. • Revise Directives to explicitly state that beneficial owners associated with PEPs are high-risk. • Have the FIU offer training specifically on PEPs, procedures and transaction threshold and suspicious reporting obligations. • Include analysis of PEPs policies and procedures in supervisory inspection manuals and make violations subject to penalty. • Revise FIU AML Directives to mandate that sources of wealth and funds of PEPs, including beneficially owned institutions, are disclosed when establishing a relationship or conducting transactions. • Require senior management approval for PEP account opening and management. <p>In relation to Recommendation 7:</p> <ul style="list-style-type: none"> • Impose enforceable obligations under Nepal law on financial institutions to gather sufficient information about respondent institutions to understand fully the nature of the respondent's business, including quality of supervision, whether the parties have been subject to any ML or TF investigations or regulatory action. • Require financial institutions to assess respondent's AML/CFT obligations and whether they are adequate. • Require senior management approval before establishing new correspondent accounts. • Require documentations of AML/CFT responsibilities of any potential correspondent. • Offer training to institutions on establishment of correspondent banking relationships and AML/CFT obligations and red flags associated with foreign correspondents. <p>In relation to Recommendation 8:</p> <ul style="list-style-type: none"> • Require financial institutions through statute, rules, and FIU AML Directives to put policies in place and take measures needed to prevent misuse of technological developments in ML or TF schemes. Ensure the enforceability of legal mandates. • Mandate that financial institutions develop policies and procedures to address specific risks of non-face-to-face business relationships or transactions, including specific and effective CDD procedures. • Offer training to financial institutions on laws, once implemented, on non-face-to-face transactions and legal strictures. • Include in supervisory inspection manuals for financial sector a review of policies and procedures on non-face-to-face business relationships and transactions, subject to fine for failure to comply.
3.3 Third parties and introduced business (R 9)	<p>It is recommended that Nepal either:</p> <ul style="list-style-type: none"> • Explicitly prohibit reliance on intermediaries or other third parties for performing some of the elements of CDD; or • Introduce measures setting out the criteria under which they are allowed to do so.
3.4 Financial institution secrecy or confidentiality (R 4)	<ul style="list-style-type: none"> • The law/ regulation should provide basis for information disclosure/sharing between financial institutions with respect to correspondent banking accounts, introduced business and wire transfers. • Establish a clear legal basis for lifting bank secrecy for sharing

AML/CFT SYSTEM	RECOMMENDED ACTION (LISTED IN ORDER OF PRIORITY)
	information between competent authorities domestically and internationally.
3.5 Record keeping and wire transfer rules (R 10 & SR VII)	<p>In relation to R 10:</p> <ul style="list-style-type: none"> • Explicitly state in statute, rules, and/or Directives that financial institutions maintain records for at least five years following termination of an account. • Specify that financial institutions have a legally enforceable obligation to comply. • Supervise financial institutions to ensure compliance with record keeping obligations. <p>In relation to SR VII:</p> <ul style="list-style-type: none"> • Enact laws that would introduce a mandatory requirement that financial institutions need to comply with the SR VII obligations. • Make it a mandatory requirement that, for all wire transfers of €/US\$1,000 or more, ordering financial institutions collect originator information in conformance with SR VII. • Oblige financial institutions for cross-border wire transfers of €/US\$1,000 to include full originator information in the message or payment forms accompanying wire transfers. • Require financial institutions for domestic transactions to include full originator information in the message or payment forms accompanying wire transfers. • Oblige all intermediary and beneficiary financial institutions in a payment chain to ensure that all originator information that accompanies a wire transfer is transmitted with the transfer.
3.6 Monitoring of transactions and relationships (R 11 & 21)	<p>In relation to Recommendation 11:</p> <ul style="list-style-type: none"> • Issue an enforceable requirement for all financial institutions to pay attention to all complex, unusual large transactions, or unusual patterns of transactions, that have no apparent or visible economic or lawful purpose. • Require financial institutions to examine as far as possible the background and purpose of unusual transactions and to set for their findings in writing and maintain such findings for five years. • Provide specific training and written guidance to financial institutions on unusual transactions. <p>In relation to Recommendation 21:</p> <ul style="list-style-type: none"> • Implement an effective system for transmission of information and advisories to financial institutions on AML/CFT deficiencies of high-risk jurisdictions. • Require financial institutions to give special attention to business relationships and transactions with persons from countries that do not adequately apply FATF recommendations. • Provide enforceable guidance to financial institutions on how to implement risk management systems, including those related to customers and transactions from high-risk jurisdictions. • Mandate that financial institutions identify the background and purpose of transactions deemed suspicious because they have no apparent economic or visible purpose and to record their findings in writing. • Provide for an effective system for Nepal to take counter-measures to countries that do not sufficiently apply the FATF Recommendations.
3.7 Suspicious transaction reports and other reporting (R 13-14, 19, 25 & SR IV)	<p>Recommendation 13 and SR IV:</p> <ul style="list-style-type: none"> • Include an enforceable obligation in law or regulation that the STR obligation covers proceeds from all offences required to be included as predicate offences. • Establish a clear mandatory obligation to report STRs in relation to

AML/CFT SYSTEM	RECOMMENDED ACTION (LISTED IN ORDER OF PRIORITY)
	<p>TF.</p> <ul style="list-style-type: none"> • Extend the STR filing obligation to postal savings banks. • Require STRs for attempted suspicious transactions. • Support the enhanced scope, quality and quantity of STR reporting. This may include providing STR-specific training for all financial institutions and regulators. A specific component on how to check for terrorist-financing links (referencing software and websites) of individuals conducting transactions or establishing business relationships should be provided. • Provide, through the FIU, specific guidance to financial institutions on how to develop AML/CFT policies including on terrorism and TF and sanction financial institutions that fail to develop and provide them to the FIU. <p>Recommendation 14:</p> <ul style="list-style-type: none"> • Amend the ALPA to delete the requirement for loss to occur before immunity from action occurs. • Amend the ALPA to make it clear that immunity from “action” for disclosure of information in relation to STRs (including the fact that a STR will be filed or has been filed) done in good faith includes immunity from criminal prosecution as well as civil or administrative action. • Amend the ALPA to clarify that the prohibition on tipping off relates also to the fact that an STR or related information may or will be filed, or has been filed, with the FIU. • Amend the ALPA to provide that the personal names and details of financial institution staff required to file STRs are kept confidential by the FIU. • Amend the ALPA to further provide that tipping off prohibitions also apply to attempted suspicious transactions • Amend the ALPA to provide sanctions for breaches of the tipping off prohibitions. <p>Recommendation 25:</p> <ul style="list-style-type: none"> • The FIU and regulatory authorities should establish appropriate guidance for reporting institutions to implement their AML/CFT obligations. • The FIU should provide appropriate general and specific STR-related feedback to reporting institutions to assist them to file STRs and to improve the quality of their reporting. • The FIU and/or regulatory bodies should provide reporting institutions with information on current methods and techniques of ML and.
3.8 Internal controls, compliance, audit and foreign branches (R 15 & 22)	<ul style="list-style-type: none"> • Create mandatory obligations for reporting institutions to establish AML/CFT internal compliance programme. • Provide that the internal audit function including sample testing in all sectors should be independent and adequately resourced. • Extend the responsibilities of compliance officers to overall compliance. • Provide guidance on compliance officer functions and responsibilities in relation to AML/CFT. • Obligate reporting institutions to establish on-going employee training programmes on AML/CFT and employee screening procedure.
3.9 Shell banks (R 18)	<ul style="list-style-type: none"> • Amend the statutory framework to bar financial institutions from entering into or continue correspondent banking relationships with shell banks. • Nepal should amend ALPA, the NRB Act, and promulgate related Directives to require financial institutions to conduct a review to satisfy themselves that respondent financial institutions in a foreign

AML/CFT SYSTEM	RECOMMENDED ACTION (LISTED IN ORDER OF PRIORITY)
	country do not permit their accounts to be used by shell banks.
3.10 The supervisory and oversight system: competent authorities and SROs. Role, functions, duties and powers (including sanctions) (R 23, 29, 17 & 25)	<ul style="list-style-type: none"> • Include commodities brokers under the ALPA and ensure that all the financial institutions are subject to adequate AML/CFT regulation and supervision. • Comprehensive enforceable obligations should be established to support full implementation of recommendation 17, 23 and 29. • an adequate 'fit and proper' test should be laid down for persons who acquire managerial positions and controlling interests in the financial institutions. • develop and implement a supervisory regime for Postal Savings Banks. • the Registrar of Cooperatives should consider effective supervision and monitoring of co-operatives. • all the regulators should issue necessary Directives to the financial institutions they regulate to impose AML/CFT compliance obligations and to extend their supervisory and inspection powers to ensure AML/CFT requirements by financial institutions. • all the regulators should ensure that their procedures for targeting on-site inspection or undertaking off-site supervision take into account the AML/CFT requirements. • a review of availability and magnitude of both the levels of sanctions for non-compliance with the AML/CFT requirements should be undertaken. • ALPA should provide for the widest range of civil, administrative and criminal sanctions for AML/CFT. • sanctions should also be extended to natural persons e.g. director, manager, secretary or other officers of the financial institutions. • review the human resources, skills and capacity in SEBON and the Insurance Board and enhance the AML/CFT supervisory capacity of the staff of all regulators. • consider providing autonomy to SEBON by having its Board and to provide it operational independence in issuing Directives and hiring employees.
3.11 Money value transfer services (SR VI)	<ul style="list-style-type: none"> • Incorporate AML/CFT into their inspection manuals for the annual exams of money exchanges and money transmitters. • Examine not only money transmitter principals, but also agents, for AML/CFT compliance. • Offer training specific to STR filing for money exchanges and money transmitters, both in Kathmandu and in regional centres, and provide training manuals that money transmitter principals can use to develop modules for agent training across Nepal. • Consider liberalization of exchange rate policies or developing a remittance initiative providing remitters with incentives to use formal financial channels to boost remittances through formal financial channels. • Draft guidance specific to money transmitters and money exchanges on their AML/CFT obligations and how to design and implement risk-based management systems, including for PEP identification and transaction monitoring. • Require money transmitters and money exchanges to collect beneficial ownership information. • amend ALPA, the NRB Act, and promulgate related Directives to require money transmitters to evaluate potential foreign counterparties for AML/CFT risk.
4. PREVENTIVE MEASURES – NON-FINANCIAL BUSINESSES AND PROFESSIONS	
4.1 Customer due diligence and record-keeping (R 12)	<ul style="list-style-type: none"> • Ensure comprehensive preventative measures for CDD, PEPs, record keeping and transaction monitoring are apply to all DNFBP and are enforceable (the ALPA and enforceable Directives) . • consider, on a risk-sensitive basis, the extent and timing of

AML/CFT SYSTEM	RECOMMENDED ACTION (LISTED IN ORDER OF PRIORITY)
	<p>requirements to DNFBPs.</p> <ul style="list-style-type: none"> • undertake a comprehensive study of ML and TF risks from casinos and determine additional measures to be applied to casinos to address AML/CFT risks in the sector. • provide guidance to the casino operators on how to implement the requirements of law including the FIU AML Directives. • FIU AML Directive dated 1 December 2009 (s 2) should be amended so that casinos must instantly decline to establish or terminate relationship with customers that fail to provide necessary documentation as opposed to making it voluntary for casinos.
4.2 Suspicious transaction reporting (R 16)	<ul style="list-style-type: none"> • Introduce appropriate enforceable obligations for the DNFBPs to comprehensively implement STR reporting and related measures. • Ensure mandatory obligations in ALPA for STR reporting in case of attempted transactions and in relation to TF. • Amend FIU AML Directives dated 1 December 2009 to include remotely connected or related transaction in threshold for filing TTRs. • Amend ALPA and FIU AML Directives to ensure protection to DNFBPs and their directors, officers or employees from civil and criminal liability in case of STRs filed/ information shared in good faith. • Amend language of s 37 of ALPA which gives protection 'only if any person suffers loss on account of TTR reporting.' • Amend ALPA and FIU AML Directives to prohibit the tipping –off the fact of possible STR reporting or furnishing related information to FIU and prescribe dissuasive sanction for breach of the obligation • Create effective, proportionate and dissuasive sanctions in the ALPA for non-compliance with all obligations created in ALPA, AML Rules and FIU AML Directives. • Issue enforceable guidance to the casino sector, especially in relation to the implementation of appropriate internal systems and controls. This is especially important in the context of the on-line casinos/ internet casinos, which pose the greater risk.
4.3 Regulation, supervision and monitoring (R 24-25)	<ul style="list-style-type: none"> • Comprehensively regulate and supervise DNFBP sector adopting a risk-based approach. • Prioritise targeted supervision of the sector for AML/CFT. • Issue rules under the Tourism Act to declare casinos as 'other tourism enterprise' and lay down appropriate licensing and reporting requirements/conditions. • Provide regulators with the statutory authority to use its powers of inspection, etc., in order to enforce compliance with AML/CFT requirements; • Give the authorities statutory powers to apply 'fit and proper' tests to the owners/ controlling interests, operators and managers of the casinos; • Strengthen the sanctions and make specific provision for sanctions to be applied for breaches of the AML/CFT requirements and relevant instructions that the regulator may issue from time to time; • Enhance the penalty for failure to file reports and create penalty for obstructing access by the regulator to documents, premises, in order to make sanctions effective and dissuasive ;and • Broaden the scope of the sanctions that may be applied, so that there is a range of options that might be applied effectively; • Designate a supervisor/regulator with suitable powers of licensing, supervision, inspection and applying proportionate and dissuasive sanctions for non –compliances by respective sector; • Provide necessary guidance to casino sector and other DNFBPs when they are included in AML/CFT regime.

AML/CFT SYSTEM	RECOMMENDED ACTION (LISTED IN ORDER OF PRIORITY)
4.4 Other non-financial businesses and professions (R 20)	<ul style="list-style-type: none"> Nepal should extend the AML/CFT regime to non-financial businesses and professions (other than DNFBPs) which are prone to risk for ML/TF at present and to other non financial business after the risk assessment. Pursue further measures to develop modern and secure transaction techniques to avoid ML and TF risks from the high usage of cash in the economy
5. LEGAL PERSONS AND ARRANGEMENTS & NON-PROFIT ORGANISATIONS	
5.1 Legal Persons – Access to beneficial ownership and control information (R 33)	<ul style="list-style-type: none"> Establish corporate registry and information collection system focused on obtaining information relating to the beneficial owner or controller of companies. Cross-reference applications for company formations against the UN 1267 terrorist list or other lists issued by countries (e.g., the US's OFAC list). Ensure that competent authorities have access to accurate and current information on the ultimate beneficial owners and controllers of all legal persons on a timely basis. Implement safeguards to ensure that beneficial owners of bearer share warrants are identified or other risks posed by them are mitigated.
5.2 Legal Arrangements – Access to beneficial ownership and control information (R 34)	<ul style="list-style-type: none"> First: acknowledge that trusts may be formed and trust services provided in Nepal. Without first acknowledging this it is unlikely that officials will propose measures designed to mitigate the ML and TF risks associated with these arrangements; Second: develop legal requirements to ensure that information on the beneficial ownership and control of private trusts is collected and readily available to competent authorities in a timely manner. <p>Such measures could include:</p> <ul style="list-style-type: none"> Build on the existing <i>Income Tax Act</i> record keeping requirements by requiring trustees to maintain full information on the trust's beneficial ownership and control; Requiring the location of such information to be disclosed; Requiring trust service providers to obtain and maintain beneficial ownership information. <ul style="list-style-type: none"> Relevant trust information would then be available to the law enforcement and other competent agencies upon the proper exercise of their existing powers.
5.3 Non-profit organisations (SR VIII)	<ul style="list-style-type: none"> Seek to better organise its NPO sector by, among other things, establishing a central registry for all NPOs and charities (foreign and domestic); Consider mandatory registration/licensing for all NPOs in Nepal; Maintain comprehensive information and statistics on all NPOs including sources of funding, size of assets and other key information such as names, addresses and other identification information for directors, senior managers and board members of NPOs; Undertake a comprehensive NPO sector review capturing all relevant data necessary to undertake a detailed risk assessment for TF; Issue guidelines, information or other material to the sector on TF risks in the sector and how to mitigate those risks; Undertake regular outreach to the sector to discuss TF risks, vulnerabilities and other issues, and to explain guidance and other material relevant to mitigating TF risk; and Seek to further implement the measures contained in the SR VIII Best Practices paper.
6. NATIONAL AND INTERNATIONAL CO-OPERATION	

AML/CFT SYSTEM	RECOMMENDED ACTION (LISTED IN ORDER OF PRIORITY)
6.1 National co-operation and co-ordination (R.31)	<ul style="list-style-type: none"> • Consideration should be given to expanding the membership of the NCC to include Attorney-General's Office, Nepal Police, Department of Revenue Investigation, Department of Customs and Commission for the Investigation of Abuse of Authority given the key roles these agencies have in AML/CFT. • Both the NCC and Technical Committee need to formalise their meeting and agenda setting process in order to streamline advice. • Nepal needs to ensure that its AML/CFT coordination committees are used to drive forward reforms to AML/CFT policies on a multi-agency approach and not solely from the FIU. • Nepal should the two coordination mechanisms to implement AML/CFT policies, including operational level cooperation, information sharing and capacity building more effectively.
6.2 The Conventions and UN Special Resolutions (R.35 & SR.I)	<p>Nepal should address the following deficiencies:</p> <ul style="list-style-type: none"> • the deficits concerning criminalisation of the TF offence; • the scope of its conspiracy offences (or, alternatively, its failure to criminalise participation in an organised criminal group); • its capacity to freeze and confiscate terrorist and criminal assets; • its capacity to provide mutual legal assistance; and • the deficits identified in this report concerning implementation of the relevant UNSCRs. <p>Nepal should then expedite efforts to accede to the Palermo Convention and the Convention for the Suppression of Terrorist Financing.</p>
6.3 Mutual Legal Assistance (R 36-38 & SR V)	<ul style="list-style-type: none"> • Enact comprehensive mutual legal assistance legislation and establish effective procedures to allow it to provide the widest range of mutual legal assistance. • Comprehensively criminalise ML and TF to address gaps in the offences which may impede the ability to provide mutual legal assistance. • In the meantime, promulgate and publish procedures enabling the prompt processing of requests for MLA that would apply to requests for non-coercive forms of cooperation. • The requirement for dual criminality with respect to non-coercive or less intrusive MLA should be reviewed and maintained only if there is a fundamental principle of Nepalese law that requires its application.
6.4 Extradition (R.39, 37 & SR V)	<ul style="list-style-type: none"> • Use the formal extradition processes under the <i>Extradition Act</i>. • Comprehensively criminalise ML and TF to address gaps in the offences which may impede the ability to provide mutual legal assistance, including extradition. • Issue rules under s 19 of the <i>Extradition Act</i> to enable the prompt processing of extradition requests. • New rules should: (i) establish those factors considered relevant to the exercise of executive discretion under ss 4, 8 and 15 and (ii) designate the persons vested with these discretionary powers authorities should consider the following recommendations. • Thereafter consider replacing the existing Extradition Act with one that enables, subject to clearly legislated limitations, extradition for a broader range of offences to a broader range of countries and that is more streamlined and less contingent upon to executive authorisation.
6.5 Other Forms of Co-operation (R.40 & SR V)	<ul style="list-style-type: none"> • There are few gateways for the exchange of information in Nepal with foreign counterparts. Nepal should grant relevant authorities with the power to share such information.
7. OTHER ISSUES	
	<i>There are no recommendations for this section.</i>

Table 3: Authorities' Response to the Evaluation

Nepal's Progress after Mutual Evaluation

S.N.	Activities	Completed	Major issues
1	Amendment of the AML Act	May 24, effective from 1 June, 2011	Better criminalize ML/TF, extensive preventive, provisional, supervisory, coordinative and investigation measures
2	Ratification of TF Convention	June 24, 2011	Offences become part of the AML Act
3	Ratification of the Palermo Convention	June 24, 2011	Offences may become part of the AML Act
4	Ratification of UN Convention against Corruption	Feb. 24, 2011	Offences may become part of the AML Act
5	FIU Directives to Auditors	Dec. 1, 2010	Covers the issues of CDD, Reporting, Risk Management etc.
6	FIU Directives to Lawyers/Notaries/Deed Writers	Dec. 1, 2010	Covers the issues of CDD, Reporting, Risk Management etc.
7	FIU Directives to Dealers in Precious Metal and Stones	Dec. 16, 2010	Covers the issues of CDD, Reporting, Risk Management etc.
8	FIU Operational and Analysis Manual	14 December 2010	Provides for operational system, roles and responsibilities and analysis procedures and disseminations
9	MLA Bill	At the Parliament	Mutual legal assistance
10	Amendment of Extradition Act	At the Parliament	Enhances existing extradition measures
11	Organized Crime Bill	At The Cabinet	Provides for criminalizing and controlling organized crimes
12	Establishment of new AML Investigation Department	June, 2011	
13	AML/CFT Strategy	Final stage	[Prepared with the TA of IMF] Attempt to address deficiencies identified by MER, ICRG and other reports
14	STRs	Increasing	Received: 457 Disseminated: 386
15	Investigation		Final stage: 24
16	Prosecution	4	(two after ME)
17	Convictions	2	(one after ME)
18	Sponsorship to Bhutan Membership		
19	Creation of sub sectoral committees	Implementation as Sub-NCC	Legal, Supervisory, Investigation, International Legal Cooperation and core Group as sub-committees
20	AML/CFT Risk Assessment	Undergoing	World bank has been requested to technically support
21	TA and T		APG, IMF, World Bank and Australia, USA, Germany, South Korea; and Chinese Taipei

ANNEXES

Annex 1: Abbreviations

Annex 2: All Bodies met during the on-site visit

Annex 3: Provisions of key laws, regulations and other measures

Annex 4: List of all key laws, regulations and other material received

Annex 1: Abbreviations

ABBREVIATION	FULL TERM
ALPA	Asset (Money) Laundering Prevention Act 2008
AML	Anti-money laundering
AML/CFT	Anti-money laundering/countering the financing of terrorism
AML Rules	Asset (Money) Laundering Prevention Rules 2009
APG	Asia/Pacific Group on Money Laundering
ATM	Automatic teller machine
BOPA	Banking Offence and Punishment Act 2008
BNI	Bearer negotiable instruments
CDD	Customer due diligence
CEO	Chief Executive Officer
CIAA	Commission for the Investigation of the Abuse of Authority
CTR	Cash transaction report
CIP	Customer Identification program
DNFBP	Designated non-financial businesses and profession
DRI	Department of Revenue Investigation
FATF	Financial Action Task Force
FNCCI	Federation of Nepalese Chambers of Commerce and Industries
FERA	Foreign Exchange (Regulation) Act 1962
FI	Financial Institution
FIU	Financial intelligence unit
IAIS	International Association of Insurance Supervisors
ICRG	International Cooperation Review Group
IMF	International Monetary Fund
IOSCO	International Organisation of Securities Commissions
IT	Information technology
KYC	Know your customer
LeT	Lashkar-e Taibai
LEA	Law enforcement agency
ME	Mutual evaluation
MER	Mutual evaluation report
ML	Money laundering
MLA	Mutual legal assistance
MLAT	Mutual legal assistance treaty
MOU	Memorandum of understanding
MVT	Money value transfer
NBA	Nepal Bankers Association
NBFI	Non-bank financial institution
NEPSE	Nepal Stock Exchange
NGO	Non-governmental organisation
NPO	Non-profit organisation
NRps	Nepali Rupees
NRB	Nepal Rastra Bank
OFAC	Office of Foreign Assets Control
Palermo Convention	UN Convention Against Transnational Organised Crime
PEP(s)	Politically exposed person(s)
Q&A	Question and answer
RI(s)	Reporting institutions(s)
SAARC	South Asian Association for Regional Cooperation
SEBON	Securities and Exchange Board of Nepal
SRO	Self-regulatory organisation
STR(s)	Suspicious transaction report(s)
SWC	Social Welfare Council
TF	Terrorist financing
TTR(s)	Threshold transaction report(s)
UN	United Nations
UNSCR	United Nations Security Council Resolution
USD	United States Dollar
Vienna Convention	UN Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances

Annex 2: All Bodies Met During the On-site Visit

GOVERNMENT AGENCIES	
Commission for the Investigation of Abuse of Authority	Ministry of Law and Justice
Department of Commerce	Ministry of Home
Department of Cooperatives	Ministry of Tourism
Department of Customs	Nepal Bar Council
Department of Revenue Investigation	
Department of Tax	Nepal Law Commission
Election Commission	Nepal Police
Financial Information Unit	Nepal Rastra Bank
Immigration Department	Office of Attorney General
Institute of Chartered Accountants	Office of the Companies Registrar
Insurance Board of Nepal	Securities Board of Nepal (Beema Samiti)
Ministry of Finance	Social Welfare Council; Social Welfare Council
Ministry of Foreign Affairs	
PRIVATE SECTOR	
Action Aid International	Himalayan General Insurance Company
Agriculture Development Bank	Kalyan Saving Cooperative
Bank of Kathmandu	Kumari Pati Lalitpur
Brahma Kumari	Nepal Gold and Silver Dealers Association
Casino RAD, Radisson Hotel	NABIL Bank
Cepred Nepal	Standard Chartered Bank
Elite Capital Ltd	

Annex 3: Provisions of key laws, regulations and other measures

Asset (Money) Laundering Prevention Act, 2008

Date of Authentication and publication:

14 Magh, 2064 (28 January, 2008)

Preamble: Whereas it is expedient to provide for the prevention of laundering of criminal proceeds, the Legislature-Parliament has enacted this Act.
Act No. 34 of the Year 2008

Chapter – 1

Preliminary

1. **Short Title, Extent, and Commencement:** (1) This Act shall be cited as "Asset (Money) Laundering Prevention Act, 2008".
 - (2) The Act shall apply all over Nepal and to any person or corporate body, irrespective of where they are residing, or located, who remits, transfers or sends assets generated from the offences under this act from Nepal to abroad or abroad to Nepal.
 - (3) The Act shall come into force immediately.
2. **Definition:** Unless the subject or context otherwise requires, in this Act, -
 - a) "Investigation Officer" means a personnel so appointed or designated as per Section 15
 - b) "Offence" means the offence so designated under chapter-2.
 - c) "Transaction" means any act or agreement made in order to carry out any economic or business activities and the term also means the purchase, sale, distribution, transfer or investment and possession of any assets.
 - d) "Non-Financial Institution" means the following institutions:-
 - (1) Any firm or company other than those stated in Clause (h), registered as per prevailing laws to carry out any trade or business including casino, precious metals.
 - (2) Any institution irrespective of whether or not organised or incorporated as per the laws,
 - (3) Any institution designated as "Non-Financial Institution" by the Government of Nepal through a notice in the Nepal Gazette.
 - e) "Designated or as designated" means designated or as designated in this Act or Rules thereof.
 - f) "Department" means the Asset Laundering Investigation Department pursuant to Section 11.
 - g) "Bank" means a bank licensed under the prevailing bank and financial institution law by Nepal Rastra Bank to carry out 'A' class financial transactions.
 - h) "Financial Institution" means financial institution licensed under the prevailing bank and financial institution law by Nepal Rastra Bank to carry out 'B', 'C', and 'D' class financial transactions and the term also means the cooperatives, Or person, firm, company or institution licensed to carry out foreign exchange business or purchase and sell foreign currency, OR any company licensed for insurance business, insurance broker and also securities market or business operated as per prevailing laws.
 - i) "Financial Information Unit" means the Financial Information Unit instituted pursuant to Section 9.
 - j) "Rastra Bank" means Nepal Rastra Bank established under the prevailing Nepal Rastra Bank law.
 - k) "Public Servant" means any individual supposed to be public servant as per prevailing laws.
 - l) "Suspicious Transaction" means the transaction of such nature that is impossible in general economic, commercial and business practice.

- m) "Asset" means any moveable, immovable, tangible or intangible property.
- n) "Government Office" means the Land Revenue Office, Office of the Company Registrar and the term also means any entity so designated by the Government of Nepal through publishing a notice in Nepal Gazette.

Chapter-2

Provisions Relating to Offences

3. Asset not to Be Laundered: (1) No person shall launder or cause to launder assets.
 (2) Any person committing acts pursuant to Sub-Section (1) shall be deemed to have committed offence as per this Act.

4. Offence of Asset Laundering:

It shall be the offence of asset laundering if any person owns, possesses or uses, utilizes or consumes or displays or does any transaction of the asset that person has earned directly or indirectly acquired or received from tax evasion or terrorist activities or terrorist financing or any or all of the following offences and from the investment of such property in any manner, as a legally earned asset or assists the person who has acquired such property to conceal the source of such property or to disguise, hide or transfer such property so as to avoid legal action against such person.

- a) Offences under the prevailing arms and ammunitions laws,
- b) Offences under the prevailing foreign exchange regulation laws,
- c) Offences of murder, theft, cheating, forgery of documents, counterfeiting, abduction or hostage taking under the concerned prevailing laws,
- d) Offences under the prevailing drug control laws,
- e) Offences under the prevailing national park and wildlife conservation laws,
- f) Offences under the prevailing human trafficking and transportation control laws,
- g) Offences under the prevailing cooperatives laws,
- h) Offences under the prevailing forest laws,
- i) Offences under the prevailing corruption control laws,
- j) Offences under the prevailing bank and financial institution laws,
- k) Offences under the prevailing banking offence and punishment laws,
- l) Offences under the prevailing ancient monuments conversation laws,
- m) Other offences under any other law that Government of Nepal prescribes by publishing a notice in the Nepal Gazette.

Clarification: For the purpose of this Section it shall be the offence of financing of terrorist activities if any person by any means collects or provides to any person any amount with the intention that such amount should be used or in knowledge that it is to be used in order to carry out any act which constitutes an offence within the scope of the following conventions or any other act intended to cause death or serious bodily injuries to an individual.

- (1) Tokyo Convention on Offences and Certain Other Acts Committed on Board Aircraft, 1963,
- (2) Hague Convention for the Suppression of Unlawful Seizure of Aircraft, 1970,
- (3) Montreal Convention for the Suppression of Unlawful Acts Against the Safety of Civil Aviation, 1971,
- (4) Convention on the Prevention and Punishment of Crime Against Internationally Protected Persons Including Diplomatic Agents, 1973,
- (5) International convention Against the Taking of Hostages, 1979,
- (6) SAARC Regional Convention on Suppression of Terrorism, 1987,
- (7) Any Convention against Terrorist Activities which Nepal is a party to.

5. Not to Attempt, Abet or Provoke: No one shall attempt, abet or incite others to commit offences stipulated in this chapter.

Chapter -3

Provision Relating to Identity, Transactions and Details of the Customers

6. Customers to be Identified: (1) Any bank, financial institution or non financial Institution shall maintain clear record of identity of a person while establishing any kind of business relationship with such person or while transacting the amount above the threshold, either in a single transaction or in series of transactions as prescribed by Rastra Bank from time to time by publishing a notice.

(2) Bank, financial institution or non-financial institution, while identifying the customer as per Sub-Section (1), shall cause the person establishing business relationship or having transactions with it to submit the documents as follows:-

- (a) In case of a natural person his/her name, family surname, copy of citizenship or passport including other necessary documents that substantiate his/her permanent residential address and profession or business,
- (b) In case of the person or firm except those provided in Clause (a), copy of the document certifying incorporation, establishment or registration of the institution, documents that mention name, surname, address, profession, business of board of directors and executive director or proprietor of firm or partners of partnership firm,
- (c) In case of business relation or transactions to be established or made on behalf of someone else, documents relating to principal's identity, address including power of attorney clarifying the business of the principal,
- (d) Name, surname, address of close relative, person or institution benefiting from business transaction,
- (e) In case of transactions made through negotiable instruments, name, surname and address of the issuer and payee of such instrument,
- (f) Other documents as prescribed by the Financial Information Unit from time to time.

(3) Bank, financial institution or non-financial institution shall maintain a separate record of documents and transactions of each customer, pursuant to Sub-Section (2), including date and nature of transactions, type of account and code number.

7. Liability of Government Entity, Bank, Financial Institution and Non-Financial Institution:-(1) The government entity, bank, financial institution and non-financial institution shall fulfil the following responsibilities for the purpose of this Act:-

- (a) To maintain records of amount transacted beyond the threshold prescribed by Rastra Bank at a single or in a series of transactions by a person,
- (b) To investigate and inquire any transaction which appears to be suspicious or transacted with the motive of asset laundering or so laundered or there are reasonable grounds for suspicion,
- (c) To inform the Financial Information Unit about the transactions mentioned in Clause (a) within seven days of event and the transactions mentioned in clause (b) immediately after the event.

(2) In case, anything happens to be omitted in the information reported to the Financial Information Unit pursuant to Sub-Section (1) or anything different from original information or particulars received from the concerned person during the transaction is subsequently received, the concerned entity, bank, financial institution or non financial institution shall promptly report such details to the Financial Information Unit.

(3) Notwithstanding anything in Sub-Section (1), in case there is any suspicion on the transactions of persons having regular business relation or transactions, the concerned entity, bank, financial institution or non-financial institution shall inform the Financial Information Unit after making an inquiry.

(4) The bank, financial institution, or non-financial institution shall maintain a secured record of transaction referred to in this Section at least for a period of five years from the date of such transaction.

Chapter – 4

Provisions for Coordination Committee and Financial Information Unit

8. Formation of Coordination Committee: (1) There shall be a Coordination Committee constituted as follows to coordinate inter-related entities and to provide necessary suggestions to the Government of Nepal with regard to the prevention of asset laundering:-

- (a) Secretary, Ministry of Finance – Coordinator
 - (b) Secretary, Ministry of Law, Justice and Parliamentary System –Member
 - (c) Secretary, Ministry of Home –Member
 - (d) Secretary, Ministry of Foreign Affairs –Member
 - (e) Deputy Governor, Nepal Rastra Bank - Member
- (2) The chief of the Financial Information Unit shall act as a secretary of the Coordination Committee constituted pursuant to Sub-Section (1) and the Financial Information Unit shall work as Secretariat of the Coordination Committee.
- (3) The procedures of meeting of the Coordinate Committee pursuant to Sub-Section (1) shall be as determined by the committee itself.

9. Financial Information Unit: (1) There shall be a Financial Information Unit in Rastra Bank for collection and analysis of information relating to asset laundering.

- (2) The Governor of Rastra Bank shall appoint the chief of the Financial Information Unit from among the officers of Nepal Rastra Bank, not lower in rank than a First Class Officer.
- (3) The Office of the Financial Information Unit shall be placed in Nepal Rastra Bank and the Rastra Bank shall provide the staff required for it.

10. Functions, Powers and Duties of Financial Information Unit: (1) In addition to the functions, powers and duties mentioned elsewhere in this Act, the functions, powers and duties of the Financial Information Unit shall be as follows:-

- (a) To regularly obtain details of transactions under Section 7 from government entities, bank, financial institution and non-financial institution and maintain records thereof upon conducting an analysis,
 - (b) In case the notice, details and documents reported to it require an inquiry and investigation on asset laundering, conduct preliminary inquiry and send details thereof to the concerned Department, government entity, bank, financial institution and non-financial institution,
 - (c) To communicate the Department with extensive details relating to the report received pursuant to Clause (a) or if upon inquiry pursuant to Clause (b) the transaction appears suspicious or arises any suspicion or any reasonable ground exists so as not to believe the transaction.
 - (d) To share with the Financial Information Units of other country and international organisation and institutions notice, details and documents regarding asset laundering on the basis of reciprocity and receive such notice from concerned country and international organisation and institution,
 - (e) To inspect transactions and records of bank, financial institution and non financial institution, to obtain any information or clarification about such transactions and records and to obtain their copies where necessary,
 - (f) To manage required training programs for the staffs of government entities, Departments and Financial Information Unit for prevention of asset laundering,
 - (g) To carry out other functions as prescribed.
- (2) The entity with a legal mandate to regulate bank, financial institution and non-financial institution may receive information from the Financial Information Unit and may provide information available with it to the Unit.
- (3) The Financial Information Unit may give necessary directives to the concerned bank, financial institution and non-financial institution about the method, form, time and other procedures regarding reporting of details, statistics, notices and information pursuant to Clause (a) of Sub-Section (1) and it shall be the duty of such bank, financial institution and non-financial institution to abide by such directives.

Chapter -5

Provisions for Formation of the Department and its Functions, Duties and Powers

11. Establishment of the Department: (1) The Government of Nepal shall establish an Asset Laundering Investigation Department to investigate against and inquire into the offences under this Act.

- (2) The chief of the Department shall be a first class officer of civil service.
- (3) The organisational structure of the Department and required number of staff shall be as prescribed by the Government of Nepal.
- (4) The Government of Nepal may designate any entity to conduct investigation and inquiry of the offences pursuant to Sub-Section (1) until the Department is established.

12. Powers of the Department regarding Investigation and Inquiry: (1) The Department may exercise the following powers in course of investigation and inquiry of the offences under this Act: -

- a) To order any concern government entity, bank, financial institution or non-financial institution to submit to the Department within a particular time period the relevant document, evidence or other required matters that are in possession of such entity, bank, financial institution and non-financial institution,
- b) To conduct search of any concerned government entity, bank, financial institution or non-financial institution or any other places, to seize, take into possession the relevant document, deed, material evidence and other evidence by issuing to the concerned official an acknowledgement of such seizure and possession,
- c) To order the concerned official of the government entity, bank, financial institution or non-financial institution, other staff or a concerned person who, the Department believes, possesses information on relevant facts to appear to the Department to give statement,
- d) To release, upon interrogation, taking statement or clarification pursuant to Clause (c), the concerned person on the condition that s/he signs a document to appear to the Department whenever required or s/he appears on reporting dates given; Or release under obligation to appear on given dates by taking bail or guarantee where there exist reasonable grounds to believe that such person becomes fugitive or order the detention where s/he fails to post the bail or guarantee, subject to approval by the District Court,

Provided that the concerned person shall not be detained for a period longer than the period such person has to serve in prison upon conviction.

- e) To order the concerned entity to freeze assets, located in Nepal, of the concerned person where such a request is received from any nation where the offence under this Act is committed or from any other international organisation in accordance with the provision of bilateral or multilateral treaty or agreement which Nepal is a party to or any similar provisions,
 - f) To cause to freeze assets relating to the offence under this Act in course of inquiry and investigation of the offence.
- (2) In case, in course of investigation and inquiry of the offence under this Act, any concerned official, staff or representative of any government entity, bank, financial institution or non financial institution disobeys the Department's order to submit any documents or any other matters, freeze assets or provide information about any matter, or in case any official or staff of such entity, bank, Financial institution disobeys the Department's order to appear before the Department, the Department may arrest and require such person to abide by the Department's order by imposing fine up to one thousand rupees on such person.

Chapter-6

Provisions on Investigation and Inquiry

13. Complaint: (1) Any person, who has knowledge that somebody has committed, is going to commit or is committing any act constituting an offence under this Act, may submit a complaint, application, information or notice to the Department in writing or oral form.

(2) The Department shall register complaint, application, information or notice if it is received in writing pursuant to Sub Section (1) and the Department shall transcribe the oral complaint, application, information or notice it receives and then register it.

14. Investigation and Inquiry: (1) The Department shall conduct necessary investigation and inquiry if it receives information through a complaint pursuant to Section 13 or through information pursuant to Section 10 (1) (c) or through any other means or source that any offence under this Act has been committed, is being committed or is going to be committed.

(2) Where the Department receives information that any offence under this Act has been committed, is being committed or is going to be committed and there is reasonable ground to believe that the person involved in the offence may abscond or destroy, hide or alter evidence or document, the Department may conduct immediate investigation activities including taking into custody any document or asset by conducting search of the place where the offence is taking place or has taken place or by arresting the person involved in the offence.

(3) The Department shall obtain opinion of government attorney while conducting investigation and inquiry pursuant to Sub-Section (1).

15. To Appoint or Designate Investigation Officer: (1) The Department may appoint or designate any officer of the Department or other officer of the Government of Nepal or that of any public institution as an investigation officer to conduct investigation and inquiry of the offences under this Act.

(2) The Department, while appointing or designating any other officer of Government of Nepal or that of public institution as an investigation officer, shall consult the chief of the concerned entity or institution.

16. Functions, Duties and Powers of the Investigation Officer: (1) The functions, powers and duties of the investigation officer appointed or designated pursuant to:

Section 15, shall be as follows:-

(a) To take necessary action by arresting the suspect promptly,

(b) To conduct or cause to conduct search of any office, residence, building, warehouse, vehicles or any place in course of investigation and inquiry,

(c) To exercise other powers vested to the Department.

(2) The investigation officer may, while proceeding pursuant to Sub-Section (1), keep the suspect on obligation to appear before the department on given dates, release him/her by obtaining bail or guarantee or detain the suspect, subject to the approval of the court where the suspect fails to post the bail or guarantee.

17. To Keep Under Custody for Investigation and Inquiry: (1) The investigation officer may, by issuing detention letter, detain the person against whom proceedings have been initiated as per this Act if there exist sufficient grounds to believe that such person may demolish or destroy any evidence or create obstruction or adverse influence in investigation and inquiry proceedings.

(2) Where the investigation and inquiry against the arrestee requires more than twenty-four hours' time, the investigation officer shall produce the suspect before adjudicating officer and detain the suspect as remanded.

(3) The Department shall, while producing the suspect for remand as stipulated under Sub-Section (2), clearly mention the charges against the detainee, reasons and grounds thereon, description of suspect's statement, if any, and the reason to detain the suspect for investigation.

(4) If remand is requested for investigation and inquiry pursuant to Sub-Section (3), the adjudicating officer may, after reviewing the concerned documents and whether or not the investigation and inquiry has been satisfactory, remand the suspect for ninety days, not exceeding thirty days at a time.

(5) In case remand is requested as per Sub-Section (2), the detainee may petition before the adjudicating officer thereby stating reasons and grounds for him not to be remanded.

18. Order for Freezing Assets: (1) The Department or investigation officer may, where there exists reasonable ground during the investigation and inquiry conducted pursuant to this Act that any one is likely to transfer, sell or hide or disguise in any manner the property generated from offence, order the concerned entity to prevent any transfer, mortgage or sell of such assets for a fixed period of time.

(2) In case a written order is made to freeze assets pursuant to Sub-Section (1), the concerned entity shall freeze such assets, preventing it from being transferred or mortgaged or sold.

(3) The Department may, as per the report of the investigation officer, impose fine up to fifty thousand rupees to the chief of the concerned entity who does not freeze the assets in contravention to the order issued pursuant to Sub-Section (1).

19. Freezing of Account or Transactions: Notwithstanding anything mentioned in the prevailing laws, the Department may, if it receives information during investigation and inquiry of the offence under this

Act that anyone has maintained account or has transaction with any bank, financial institution or non-financial institution, issue an order to the concerned bank, financial institution or non-financial institution to promptly freeze such transactions or bank account.

Provided that the Department shall make a request through diplomatic channel to freeze the transaction or account operated with a bank, financial institution, non-financial institution or person from abroad.

20. Seized Assets and Documents to Be Kept Secured: The investigation officer shall keep in secured manner the assets and documents seized in course of inquiry and investigation under this Act.

21. Support of Other Entities May Be Obtained: (1) The Department may, in course of investigation and inquiry under this Act, demand assistance from any entities or public institution and it shall be the duty of such entities and institutions to assist the Department at the time of demand.

(2) The Department may also demand assistance from Nepal police in course of inquiry and investigation of offence under this Act. It shall be the duty of the concerned police officer or the police personnel to assist the Department whenever demanded.

(3) The Department may, if it deems that the nature of offence under investigation and inquiry requires consultation with or participation of any expert working with any entity in investigation and inquiry, request the concerned entity to depute the expert to the Department for some time and such entity shall, notwithstanding anything contained in existing law, where it receives such a request from the Department, depute such expert to the Department.

22. Filing a Case: (1) If it is evident from investigation and inquiry that one has committed an offence under this Act, the Department shall write to the concerned government attorney for a decision on whether or not to file a case against such person.

(2) The Department shall, where in response to writing pursuant to Sub-Section (1) it receives concerned government attorney's decision to file a case, file the case before the court as prescribed by the Government of Nepal through a notice in Nepal Gazette.

23. Limitation: There shall be no limitation to file a case relating to the offence under this Act.

24. Government to Be Plaintiff: The Government of Nepal shall be the plaintiff in the case relating to an offence under this Act.

25. No Obstacle to Sue Under Prevailing Laws: (1) If any act constituting an offence under this Act is also punishable under any other existing law, one may also be charged under such law.

(2) If it is evident from investigation of an offence under any existing law that one has committed an offence under this Act, the entity or officer conducting investigation and inquiry of such offence shall inform the same to the Department.

26. Confidentiality: (1) No Investigation Officer or any staff or person involved in the investigation and inquiry shall, unless the prevailing law otherwise requires, breach confidentiality of any matter or document s/he encounters with during investigation and inquiry or while performing his/her duty.

27. Automatic Suspension: Any official or staff of any bank, financial institution or non-financial institution or civil servant shall be deemed to be automatically suspended for a period he/she is detained as per this Act or until the case filed against him/her pursuant to Section 22 is settled.

28. Assets Deemed to be Gained from Asset Laundering: If in comparison to the income source or financial condition one charged of an offence under this Act has larger assets, lives unnaturally higher standard of life, or is proved to have provided donation, grant, gift, loan, contribution or will of the value more than one's capacity, one shall prove the source of earnings and in case one fails to do so, such assets shall be deemed to have been generated from commission of offences under this Act.

29. Offence not Required to be Established: Notwithstanding anything mentioned in this Act or in the existing laws, the commission of acts or offences mentioned in Section 4 shall not need to be established to punish one for the offence mentioned in Section 3. And the mere fact that acts or offences mentioned in Section 4 were not prosecuted or such prosecutions were unsuccessful shall not bar the punishment of offence mentioned in Section 3.

Chapter-7

Penalty

30. Punishment to the Offender: (1) Any person who has committed offence under Section-3 shall be liable to following sentences on the basis of gravity of the offence:-

- a) In case a person or bank, financial institution or non-financial institution has committed offence, fine equivalent to the claimant value of the offence or imprisonment from one year to four years to the person or staff of a bank, financial institution or non financial institution who has committed offence or in case such offender is not identified the official in charge of the institution at the time of commission of the offence,
- b) In case a public servant or official, chief or staff of a bank, financial institution or non-financial institution has committed offence, the person shall be liable to ten percent additional sentence to the sentence mentioned in Clause (a).

(2) Anyone attempting the commission of offence or assisting or inciting the commission of offence under this Act shall be liable to half of the sentence to be awarded to the commission of the offence.

31. Imposing Fines: (1) Bank or financial institution not reporting information to the Financial Information Unit pursuant to Section 7 and Section 10 (a) shall be liable to fine of five hundred thousand rupees and non financial institution to twenty five thousand to one hundred thousand rupees depending upon the gravity of non-compliance.

(2) The Financial Information Unit shall decide penalty pursuant to Sub-Section (1) and person not satisfied with the penalty may make an appeal before the Appellate Court within thirty five days from the day fine is awarded.

32. Punishment for Concealing or Destroying Evidences: Any person who commits the offence of concealing or destroying evidence related to acts deemed to be an offence under this Act shall be liable to the imprisonment of one month to three months and/or fine of fifty thousand rupees to one hundred thousands rupees in accordance with the gravity of offence and the person assisting the commission of such act shall be liable to half of such punishment.

33. Punishment for Obstruction: If any person obstructs the proceedings of investigation and inquiry undertaken under this Act, the adjudicating officer may, on the basis of investigation officer's report, punish him/her with a maximum imprisonment of six months and/or a maximum fine of five thousand rupees.

34. Assets to be confiscated: (1) Any assets obtained from an offence under this Act and further assets generated from such asset and assets used for commission of such offence shall be confiscated.

(2) In case entitlement to assets pursuant to Sub-Section (1) has been transferred to someone else with a quoted value of such asset, the quoted value shall be treated as that mentioned in promissory deed.

Chapter –8

Miscellaneous

35. Seizure of Passport: Notwithstanding anything mentioned in prevailing laws, the Department may, where necessary, issue an order to the concerned office not to issue new passport or to seize already issued passport, depending upon the gravity of the offence.

36. Assets to Be Released: In case the asset frozen pursuant to Section 18 proves to have no criminal origin, the Department if case has not been filed, or the court hearing the case if the case has been filed, shall order the concerned authority which has frozen the asset to release such assets and the concerned entity shall release such assets upon such order.

37. Not to be Liable for Providing Information: In case any loss occurs to a person because of submission of information to the Financial Information Unit by a government entity, bank, financial institution or non-financial institution or by a staff, official or agent of such bank, financial institution or non-financial institution as per the provision mentioned in Section 7 and Clause (a) of Section 10, no

such entity, bank, financial institution or non-financial institution or staff, official or agent of such entity, bank, financial institution or non-financial institution shall be liable to any action.

38. Auction to be Made: (1) Where, upon being stored for a long period, the goods seized in relation to offence punishable under this Act are likely to suffer any damage or breakage due to stain or any other cause; rot; depreciate in value or where it is not possible to maintain or preserve the goods due to lack of space for storage, the same may be auctioned by fulfilling the procedures as prescribed by the prevailing laws.

(2) The proceeds obtained from auction sale pursuant to Sub-Section (1) shall be balanced in the deposit account and if it is subsequently decided to give such goods back to the owner, the owner shall be entitled to the amount received from such auction.

39. Departmental Sanction to the Staff involved in Investigation and Inquiry: If any Investigation officer or staff of the Department acts with mala-fide intention to cause troubles or tension to anyone in course of investigation and inquiry of the offences under this Act, the secretary of the concerned ministry where the investigation officer is the chief of the department himself or the chief of the department shall award departmental sanction notwithstanding whatever is mentioned in prevailing laws.

40. Provisions Relating to Delivery of Notice: (1) Notwithstanding anything contained in the prevailing laws, a summon to be served to a foreign national in connection with an offence under this Act shall be served to the office or representative of such person in Nepal, if any, and the notice so served shall be deemed to have been duly served.

(2) In case no office or representative as stipulated under Sub-Section (1) exists, the notice shall be served to the main place of business of such person or his/her permanent residential address or the mailing address if provided by him/her in course of business, through telex, tele-fax or other means of telecommunication or through registered mail and the summon so served shall be deemed to have been duly served.

(3) Notwithstanding anything mentioned in Sub-Section (1) or (2), this section shall not bar to serve the summon to the foreign national as per the specific provision contained in the treaty which Nepal or the Government of Nepal is a party to, if there is any.

41. Notice to be Published: In case a notice or summon can not be served to any person as per this Act or any other prevailing law because the address of such a person is not identified or because of any other reason and a report thereof is received, a notice containing a brief detail of the case shall be published in national level newspaper (in English daily in case of foreign national) at least twice requiring the concerned person to appear within thirty days before investigating authority or adjudicating authority where charge has been filed. If such notice is so published, it shall be deemed to be duly served to such person, notwithstanding anything contained in prevailing laws.

42. Order to Freeze the Assets of a Foreigner: (1) If any foreign person does not appear before the investigation officer as per the notice or even after summon is served pursuant to Section 40, the investigation officer may issue an order to be effective until such person appears before the investigation officer, to keep the assets, entitlement, interest or concern within Nepal in status quo or to prevent it from being taken out of Nepal if the person has any such assets, entitlement, interest or concern and it shall be the duty of all concerned to comply with such order.

(2) The investigation officer shall impose fine not exceeding Rupees one hundred thousand rupees on any person not complying with the order issued pursuant to Sub-Section (1). The losses or harm caused to the Government of Nepal or public institution, if any, due to such non compliance of the order, shall also be recovered from such person.

43. No Obstruction to Adjudication and Settlement Proceedings: Notwithstanding anything mentioned in prevailing laws, no death of the suspect before or after the filing of charge shall bar the adjudication and settlement proceedings of a case under this Act.

44. Waiver of Penalty: The investigation officer may present an accused person cooperating with the investigation and inquiry proceedings as a prosecutor's witness and may provide such person with full or partial waiver of penalty in the case initiated under this Act.

Provided that notwithstanding anything mentioned in this Act or in prevailing laws a lawsuit may be reregistered against such person if his cooperation could not be corroborated by other evidence or if such

accused makes statement before the adjudicating officer against the cooperation extended to the investigation and inquiry officer.

45. Reward: (1) Any person who files complaint or provides information and cooperates with the inquiry and investigation or evidence collection shall be entitled to receive ten percent of the claimant value or rupees one million, whichever is lower, if allegation is established.

(2) In case the persons pursuant to Sub-Section (1) are more than one, such amount shall be distributed proportionately.

46. Rules May be formulated: The Government of Nepal may frame necessary Rules for implementation of the objectives of this Act.

Asset (Money) Laundering Prevention Rules, 2009

In exercise of the power under Section 46 of Asset (Money) Laundering Prevention Act, 2008, the Government of Nepal has formulated the following Rules.

Chapter-1

Preliminary

1. Short Title and Commencement: (1) These Rules shall be cited as "Asset (Money) Laundering Prevention Rules, 2009" (2) These Rules shall come into force at once.
2. Definition: Unless the subject or context otherwise requires, in this Rules,-
 - (a) "Act" means Asset (Money) Laundering Prevention Act, 2008.
 - (b) "Customer" means individual, firm, company, organisation or entity having business relation with the bank, financial institution or non-financial institution.
 - (c) "Technical Committee" means the committee formed pursuant to Rule 5.
 - (d) "Directives" means the Directives issued by the Financial Information Unit pursuant to Rule 7.
 - (e) "Regulatory Body" means the entity or officer authorised by the existing law to regulate any business.
 - (f) "Coordination Committee" means the coordination committee formed pursuant to Section 8 of the Act.
 - (g) "Reporting Institution" means bank, financial institution, non-financial institution and government entity having obligation to report information and particulars to the Financial Information Unit as per the provisions of the Act, Rules and the Directives.

Chapter-2

Threshold Transaction and Functions of the Coordination Committee and the Technical Committee

3. Threshold Transaction: (1) Nepal Rastra Bank may, while prescribing the threshold of transaction for the purpose of Section 6 (1) of the Act, prescribe different threshold for different transaction by taking into account the area, subject matter and the nature of the transaction involved.
 - (2) Nepal Rastra Bank may, while prescribing the threshold pursuant to Sub Rule (1), consult the regulatory body.
 - (3) Nepal Rastra Bank shall, while prescribing or amending the threshold pursuant to Sub Rule (1), publish a public notice thereof.
4. Functions of the Coordination Committee: (1) The Coordination Committee may, for the purpose of Section 8 of the Act, furnish recommendations to the Government of Nepal on the following matters.
 - (a) Prevention of the offence;
 - (b) Monitoring of the activities made for the prevention of the offence;
 - (c) Obtaining the membership of the international organisations working for the prevention of the offence;
 - (d) The policy, strategy, plans to be adopted and made by the Government of Nepal and the implementation of the decisions made;
 - (e) Implementation of the annual report of the FIU on the prevention of the offence;
 - (f) Other matters as deemed necessary by the committee.(2) The coordination committee may, while furnishing recommendations pursuant to Sub Rule (1), furnish the recommendations to the concerned ministry as per necessity based on the subject matter or straight to the office of the Prime Minister and the Council of Ministers.

5. Formation of the Technical Committee: (1) For the purpose of assisting the Financial Information Unit to execute the objective of the Act, there shall be a Technical Committee constituted as follows:
- (a) Chief, the Financial Information Unit Coordinator
 - (b) Representative, the Department Member
 - (c) Representatives, Nepal Rastra Bank (one from each of the Foreign Exchange Department and the Regulation Department) Members
 - (d) Representative, Nepal Police Member
 - (e) Representative, Nepal Securities Board Member
 - (f) Representative, Insurance Board Member
 - (g) Deputy Director, Financial Information Unit Member Secretary
- (2) The Technical Committee shall assist the Financial Information Unit in the following functions:
- (a) Formulation of measures or strategy necessary for the control of the offence;
 - (b) Implementation of the measures or strategy formulated pursuant to (a);
 - (c) Promotion of awareness for the control of the offence;
 - (d) Performing other functions prescribed by the Coordination Committee.
- (3) The coordinator may call the meeting of the Technical Committee as per necessity and the meeting procedure shall be as fixed by the committee itself.
- (4) Officials of the concerned authority or any other expert may, as per necessity, be invited to the meeting of the Technical Committee.

Chapter-3

Functions, Duties and Power of the Financial Information Unit

6. Functions, Duties and Power of the Financial Information Unit: In addition to the functions, duties and power stated in Section 10 of the Act, the functions, duties and power of the Financial Information Unit shall be as follows:
- (a) Function as a focal point for the prevention of money laundering;
 - (b) Write to the concerned organisation to freeze the property for 30 days at maximum if the analysis of the transaction or the information, particulars received from the reporting institution presents reasonable ground to believe that the property involved in the suspicious transaction is likely to be transferred, sold or in any manner transformed or changed unless frozen at once;
 - (c) Install and operate electronic information network for the control of the offence;
 - (d) Receive information from the regulatory body on whether or not the reporting institutions regulated by the concerned regulatory body has acted in accordance with the Act, these Rules and the Directives;
 - (e) Share with the reporting institution and the regulatory body the information received from foreign state or international organisations regarding the individuals and organisations involved in the offence and the states with weak mechanisms for controlling the offence;
 - (f) Sign Memorandum of Understanding with the Financial Information Unit of other country for the purpose of Section 10 (1) (d) of the Act;
 - (g) Obtain, as an FIU, membership of international organisations working for the prevention money laundering;
 - (h) Conduct or cause to conduct training, seminar, study, research and make publication and transmission about the offence and its control in coordination with the regulatory body, bank, financial institutions and non-financial institutions so as to promote public awareness;
 - (i) Prepare and submit long term action plan to the coordination committee and annual action plan to Nepal Rastra Bank;
 - (j) Maintain record of the information and particulars relating to the tasks the FIU performs;
 - (k) Submit annual FIU report of performance to the coordination committee and Nepal Rastra Bank within three months from the completion of the fiscal year;

7. Power to Issue Directives: (1) The Financial Information Unit may, for the purpose of controlling the offence, issue directives from time to time to the reporting institutions on the following matters in a way that does not contradict with the Act and these Rules:
- (a) Customer Identification, Introduction and Acceptance Procedure,
 - (b) Identification of Suspicious Transaction,
 - (c) Modes of reporting Suspicious Transaction,
 - (d) Record of the transaction and business relation, particulars to be mentioned in such records and management and security of the record,
 - (e) Diligence on and control of the transaction and internal inspection,
 - (f) Other necessary matters.
- (2) It shall be the duty of the employee and official of the concerned institutions to comply with the directives issued by the Financial Information Unit pursuant to Sub Rule (1).

Chapter-4

Obligation of the Regulatory Body, Reporting Institutions and Natural Person

8. Power to Designate Regulatory Body: The Government of Nepal may, if there is no regulatory body to regulate any institutions obliged by the Act and these Rules to report to the Financial Information Unit, designate any regulatory body in consultation with the Coordination Committee to regulate such institution or person.
9. Obligation of Regulatory Body: The regulatory body shall have the following obligation in relation to the prevention of the offence:
- (a) Execute or cause to execute the Act, these Rules and the Directives,
 - (b) Issue necessary directives to the institutions it regulates,
 - (c) Inspect and supervise whether or not the concerned institutions or person has complied with (a) and (b),
 - (d) Provide the Financial Information Unit with the report of the inspection and supervision conducted pursuant to (c).
10. Obligation of the Reporting Institution: In addition to the obligation mentioned in the Act, the reporting institution shall have the following obligation:
- (a) Maintain record of the transaction as prescribed by the Financial Information Unit,
 - (b) Update customer profile of the existing customer as prescribed by the Financial Information Unit and submit the record thereof to the FIU within 5 years from the date these Rules come into force,
 - (c) Maintain a separate confidential record of the suspicious transaction duly signed by the concerned officer and the chief of the office,
 - (d) Designate a high ranking managerial level official as a compliance officer and provide the Financial Information Unit with the name, address and contact number of the compliance officer,
- Provided that in case of the government office the chief of the office or any officer designated by him may perform the task of the compliance officer.
11. Obligation of the Compliance Officer: The obligation of the Compliance Officer designated pursuant to Rule 10 (d) shall be as follows:
- (a) Function as focal point to perform tasks in accordance with the Act, these Rules and the Directives,
 - (b) Cause to maintain secure record of transaction,
 - (c) Provide information about suspicious or other necessary transaction to the Financial Information Unit through letter or electronic means of communication like fax, email,
 - (d) Provide information about transaction of the branch offices to the Financial Information Unit in a regular basis.
12. Obligation of Natural Person: It shall be the obligation of the concerned natural person to provide information and particular to the Financial Information Unit if such natural person is so required by the Act and the Directives issued in exercise of the power granted by these Rules.

Chapter-5

Complaint, Inquiry and Investigation

13. Complaint may be lodged through electronic means of communication: A person lodging complaint with the Department pursuant to Section 13 of the Act can lodge the complaint through electronic means of communication such as fax and email.
14. Anonymous Complaint may be lodged: If anyone lodging complaint pursuant to the Act and these Rules wishes to remain anonymous, he can request such anonymity and the details like his name and address shall not be disclosed.
15. Format of Complaint Register: The Department shall register the complaints it receives in a register as prescribed in schedule-1.
16. Copy of the Evidence may be given: If the person lodging complaint before the Department as per the Act and these Rules submits any evidence along with the complaint, the Department can give the complainant the attested copy of the evidence submitted.
17. Appointment of the Investigation Officer: (1) The Department, while appointing or designating Investigation Officer, shall appoint or designate in a form as prescribed in schedule-2.
(2) While appointing or designating the Investigation Officer pursuant to Sub Rule (1), the time period within which the inquiry and investigation are to be completed and the name of the supporting staffs shall be mentioned.
(3) The investigation officer shall, if the investigation is not completed within the time period stipulated pursuant to Sub Rule (2), request the Department with reason for additional period of time.
(4) If an additional period of time is requested as per Sub Rule (3), the Department may, based on the nature of the inquiry and investigation, extend the time not exceeding 35 days at a time for a maximum period of 120 days.
18. Format of Subpoena: The Department shall, while issuing notice to someone to appear for interrogation or statement or clarification in course of the inquiry or investigation, subpoena the concerned person in a form as specified in shedule-3.
19. Format of Arrest Letter: The Department or the investigation officer shall, while arresting someone in course of inquiry or investigation, give the concerned person an Arrest Letter as specified in schedule-4.
20. Format of Detention Letter: The Department or the investigation officer shall, if someone needs to be detained in course of inquiry or investigation, give the concerned person a Detention Letter as specified in schedule-5.
21. Search and Seizure: (1) The investigation officer shall, while entering in someone's house or compound for the purpose of search in course of the inquiry or investigation, give notice of the search and prepare seizure report of the goods seized, if any.
(2) For the purpose of Sub Rule (1) the format of search notice shall be as prescribed in schedule-6 and seizure report in schedule-7.
(3) The investigation officer shall, if he needs to take with him the cash, kind or any other goods seized during search conducted as per Sub Rule (1), prepare the acknowledgement of his taking away of such goods and shall hand the paper over to the official of the bank, financial institution and non-financial institution if the search is conducted in such institution. If the search is conducted elsewhere, the acknowledgement shall be given to the landlord or the owner of the goods or the person taking charge of the goods. If such concerned person is not available or if such person does not accept to receive such acknowledgement, the investigation officer shall hand it over to the representative of the local body.
(4) If the representative of the local body as mentioned in Sub Rule (3) is not available, the receipt shall be posted in the spot where the seizure report is created and it shall be mentioned in the seizure report.

- (5) Posting of the acknowledgement as prescribed in Sub Rule (4) shall be deemed as concerned person receiving the acknowledgement.
22. Format of Dating Record: The Department shall, while keeping the suspect on dating obligation, create attendance record as specified in schedule-8 and give the suspects summons in a form as specified in schedule-9.
 23. Format of Bail/Guarantee: (1) The Department or the investigation officer shall use the form as specified in schedule-10 for the purpose of bail or guarantee from the suspects.
(2) The suspect shall sign a document as specified in schedule-11 if he posts the property of his ownership as bail or guarantee and other person shall sign a document as specified in schedule 12 if he posts the property of his ownership as bail or guarantee for the suspect.
 24. Supplementary Statement Permitted: The investigation officer may, if he thinks it necessary in course of inquiry or investigation to take information about the offence or the accused, take supplementary information or statement from the person having such information.
 25. Format of Order to freeze or control property, account and transaction: (1) While taking into control or freezing the property, account or transaction relating to the offence, the Department shall take into control or freeze the same by issuing an order in a form as specified in schedule-13.
(2) While freezing the property, account or transaction pursuant to Sub Rule (1), the claim, lien or right over such property, account or transaction may also be frozen.
 26. Format of Inquiry or Investigation Report: The investigation officer shall, upon completion of inquiry or investigation, submit the report thereof in a form as specified in schedule-14.
 27. Format of Charge Sheet: The Department shall, while filing a case, prepare and file a charge sheet in a form as specified in schedule-15.
 28. Stay or postponement of the complaint: The Department may stay the following complaints:
 - (a) The complaint that is not related to the offence,
 - (b) The complaint that does not require proceeding based on the available evidences,
 - (c) The complaint devoid of new evidence and details but is related to the complaint that was once stayed.
 29. Information may be received through the Financial Information Unit: The Department may, if any information or particular needs to be sought from any institution of the foreign country in course of inquiry or investigation, seek such information or particular through the Financial Information Unit.
 30. Record of the Freezing and Freed to be kept: (1) The Department shall, if it receives bail or guarantee from the suspect or on his behalf pursuant to Rule 23 or has taken into control or frozen any property, account or transaction pursuant to Rule 25, maintain a record thereof.
(2) The details including registration number of the complaint, name, family name, address, property, account, transaction and asset of the suspect, date of order issued to control or freeze the property, name of the office that takes into control or freezes the property, date and reference number of the letter written requiring the property to be taken into control or frozen shall be mentioned in the record maintained as per Sub Rule (1).
(3) The Department shall, if the property taken into control or frozen pursuant to Sub Rule (1) gets freed, update the record thereof accordingly.
 31. Freezing to be undone and assets to be returned: (1) The Department shall, if it has frozen in course of investigation any person's property, account, passport or asset guarantee received on his behalf, undo the freezing within 30 days from the date the decision, if any, is made not to sue such person.
(2) In case the suspects gets acquitted from the charges filed under the Act and the decision is made not to make an appeal against the acquittal, the court shall undo the freezing of the

account, passport, property, transaction of the suspect within 30 days from the date the statutory limitation for appeal expires.

32. Investigation Officer may be changed: If any investigation officer fails to perform the designated tasks for whatsoever reason or there exists reasonable ground to infer that it is not appropriate to have the investigation officer perform the designated tasks, the Department may appoint or designate another investigation officer in his place with explanation of the change.
33. Expert's Service may be received: The Department may receive the service of an expert of any discipline if such service is required in course of inquiry or investigation.
34. Expenses may be approved: The chief of the Department may approve the justifiable expenses, devoid of receipt, made by the investigation officer in course of the inquiry or investigation.

Chapter-6

Miscellaneous

35. Oath to be taken: The person working as the investigation officer, supporting officer or expert pursuant to the Act and these Rules shall, prior to taking on duties, take an oath before the chief of the Department as prescribed in schedule-16.
36. Writing to maintain record: If the Department files charge or takes any action against any bank, financial institution or non-financial institution or any person, institution, the Department shall inform the concerned institution or regulatory body of such action.
37. Fine Procedure: (1) Where the Financial Information Unit is to fine any bank, financial institution or non-financial institution as per Section 31 of the Act, the concerned bank or institution shall be informed of the activities resulting to fine, grounds and reason for fine and the proposed amount of fine. Such bank or institution shall be given 7 days time to defend itself.
(2) Where the Department is to fine any person as per Section 12 (2) and 18 (3) of the Act, the concerned person shall be informed of the activities resulting to fine, grounds and reason for fine and the proposed amount of fine. Such a person shall be given 7 days time to defend himself.
(3) The Financial Information Unit or the Department may fine the institution or person if the institution or person fails to submit defense in accordance with Sub Rule (1) or (2) or the submitted defense is not satisfactory or reasonable.
38. Shielding performance in good faith: No charge or legal proceeding shall be initiated against the officials of the Financial Information Unit and the Department for any acts they perform in accordance with the Act and these Rules in good faith.
39. Confidentiality: (1) The information, particulars and documents received by the Financial Information Unit in accordance with the Act, these Rules or Directive shall remain confidential under Section 3 of Right to Information Act, 2008.
(2) The information, particular and documents as mentioned in Sub Rule (1) shall not be provided to other entity except to the Department, investigation officer or the court.
(3) No information and copy of the documents received by the Department in accordance with the Act and these Rules shall be given to any entity or person except to the concerned investigation officer or the court.
40. Manual: (1) The Financial Information Unit may develop and implement necessary manual to perform the tasks it is required to perform as per the provisions of the Act and these Rules.
(2) The Department may develop and implement internal manual to perform the tasks it is required to perform as per the provisions of the Act and these Rules.
(3) The reporting institution may develop and implement internal procedure to perform the tasks it is required to perform as per the provisions of the Act, these Rules and the Directives.

Nepal Rastra Bank - Financial Information Unit

Anti-Money Laundering Directive # 1 Banks and Financial Institutions

17 August 2009

In exercise of the power under Section 10(3) of Asset (Money) Laundering Prevention Act, 2008 the FIU has issued the following directives to bank and financial institutions ("A","B" and "C" class) licensed by Nepal Rastra Bank.

1. Customers to be clearly identified (Know Your Customer) and records thereof maintained

1. Bank and financial institutions shall obtain documents and particulars and maintain identity of customers as per Annex-1 while opening customer's account, dispersing loan to customer, transfer of foreign currency through Draft, T.T. Mail, Telegraphic transfer as well as accepting remittance through such Draft, T.T. Mail and Telegraphic transfer or making payments, entering into transactions relating to currency or currency substitution as well as establishing any types of business relationship or transactions with the customer, including the letters of credit.
2. Bank and financial institutions may obtain other additional information as required other than the particulars stated in Annex 1.
3. Bank and financial institutions shall verify whether particulars stated in Annex 1 is available or not with respect to the existing customers and in the case of non-availability such particulars shall be obtained and up dated.
4. Bank and financial institutions shall assign a staff in every office /branch to certify the documents to be submitted as per Annex –1 and other documents the customers are required to submit to the banks and financial institutions.

2. Particulars to be provided by customer:

It shall be the obligation on the part of the concerned customers to provide the particulars as requested by bank and financial institutions as per Section 1 of this directive. Bank and financial institutions shall have the right to instantly decline to conduct any transaction or establish business relationship with those customers who fail to provide or is not able to provide the particulars for whatsoever reason. Where the establishment of business relationship may not be denied owing to prevalent of an otherwise circumstance, the transactions with such customer shall be treated as doubtful and submit the particulars submitted to the Financial Information Unit as per Annex 3.

3. Particulars regarding transactions of threshold amount or in excess of such threshold to be submitted.

- (1) Bank and financial institutions shall submit the particulars of transactions of following threshold or in excess of such threshold within 7 days from the date of transaction to the Financial Information Unit as per Annex -2 format.
 - (a) Credit and debit transaction of rupees **one million or more** in the account of any person or entity either by single or multiple transactions through any mode in a day.
 - (b) Payment or remittance of rupees **one million or more** by any person or entity to any person or entity through single or multiple transactions in a day.
 - (c) Exchange transactions of rupees **Five Hundred Thousand** or more provided to any person or entity through single or multiple transactions in a day.

Clarification: With respect to foreign currency transactions, the amount stated above shall mean the amount derived by multiplying the same at the prevailing exchange rate on that date.

2. With respect to the amounts received in deposit by the bank and financial institutions in excess of rupees one million, a separate procedural mechanism for the operation and accounting for such transaction shall be implemented. Further, the record shall also be updated by obtaining the disclosure from the concerned customer as to the source of such transactions.
3. Particulars of doubtful transactions irrespective of whether pertain to the stipulated limit or in excess or short of such limit shall also be submitted disclosing under the suspected transactions.

4. Exemption from Reporting Obligation:

Notwithstanding anything stated in clause 3 of this directive, bank and financial institutions are not required to submit information/particulars to the Financial Information Unit as to the transactions conducted through the following government entity, organisation, office, or individual accounts.

- (a) Transactions of Nepal government, office or entity under Nepal government or any office, company, organisation, institution partially or substantially owned by Nepal government.
- (b) Transaction of entities established under special statutes.
Clarification: for the purpose of this section, entities established under special statutes mean entities established under especially promulgated the statutes.
- (c) Transaction of bank and financial institutions within itself, with other bank and financial institutions or government entities.
- (d) Transaction of public limited companies with other public limited companies, government and semi government offices, organisations, institutions, company or entity, entities established under special statutes.
- (e) Transactions of insurance companies relating to reinsurance business.
- (f) Transactions of any bank and financial institutions with respect to extension of loan or providing services to its customer as per the prevailing law.
- (g) Transactions of bank and financial institutions regarding service and facility provided to own staff.
- (h) Transactions with United Nations, office under the said institution and specialized agencies of this organisation and international organisations,
- (i) Transactions of diplomatic mission and other offices of foreign governments.
Provided that this exemption shall not apply to suspicious transactions.

5. Statement of suspicious transactions to be submitted.

1. Bank and financial institutions shall, immediately, provide information to the financial information Unit as per the format specified in Annex 3 in case the following circumstances exist:
 - (a) Transactions which apparently does not commensurate with general financial condition of the customer.
 - (b) Transactions, the nature of which does not match with the particulars furnished.
 - (c) Transactions which are generally not possible in the process of any particular trade or business or the transaction of abnormal nature.
 - (d) Abnormal increment or change in any customer's financial or business transaction.
 - (e) Transaction for which the source of income is not disclosed or for which no satisfactory information could be received.
 - (f) Transaction with customer who has not fulfilled procedure of Customer Due Diligence (CDD) or is not able to do so.
 - (g) Any transaction which appears to be facilitating directly or indirectly to any form of terrorist activity, terrorist organisation or criminal activity.
 - (h) Transactions relating to individual or organisation who has been declared by Nepal government as 'Individual or organisations involved in terrorist or criminal activities' or that relating to individual or organisations placed in the list of terrorist or criminal by the United Nations through adoption of various resolutions.
 - (i) Transactions which may have direct or indirect links with the individual or organisation involved in terrorist activity or criminal activity or transactions of any related person.
 - (j) Any transaction which is otherwise suspected or being carried out with the purpose of money laundering or encouraging terrorist or criminal activities or any transactions which is suspicious.
 - (k) Transactions which seems abnormal or suspicious in any respect.
 - (l) Transactions of individual or organisation who are suspected of carrying suspicious transactions.
 - (m) Other transactions specified by Financial Information Unit from time to time.
2. The bank and financial institutions shall maintain records of information provided to the Financial Information Unit as suspicious transactions in a separate register as specified in Annex- 4, and keep under the custody of Compliance Officer.
3. There shall no limit of transaction for submission of information on suspicious transactions.

6. Classification and mitigation of risk

1. Bank and financial institutions shall classify the transactions of its customers by identifying the inherent risks on the basis of the quantum, nature and scope of the transaction. Such classification shall be made at least as follows:
 - (a) High risk transactions
 - (b) Risk transactions
 - (c) Low risk transactions
2. Classification of transactions as per Sub-clause 1 shall be reviewed from time to time. Provided that highly risk transactions shall be reviewed every three months.
3. For the purpose of classification as per Sub-clause 1, customer having abnormal type of transactions; individuals who have/had occupied higher rank in politics, business, administration as well as in social and financial sectors; conduit transaction (non face to face transaction) ; firm, company, organisation or entity having no particular regulatory or supervisory authority; customers carrying out international transactions and customer of the countries not adopting the necessary measures for the prevention of money laundering and financing of terrorism shall be classified as high risk transactions.
4. The Board of Directors of the bank and financial institutions shall, at least on quarterly basis, discuss on setting up and improving mechanisms to prevent customer's suspicious and abnormal transaction or money laundering and make necessary arrangement for this effect. 5. Report on review of risks as per this directive shall be submitted to the Financial Information Unit every six month, beginning from the first month of the fiscal year.

7. Compliance Officer

1. Bank and financial institutions shall assign a higher managerial level staff in its corporate office as the compliance officer. Such officer will perform as a focal point to conduct activities according to Anti-Money Laundering Act, directive of Financial Information Unit and other prevailing laws. Particulars regarding name, address, contact number as well as email of the officer shall be filed with the Financial Information Unit.
2. Bank and financial institutions shall also assign responsibility, as required, to branch/office staff to provide information as per sub-clause (1) to the designated compliance officer.

8. Responsibility of Compliance Officer

The responsibilities of Compliance Officer shall be as follows:

- (a) To perform and cause to perform activities as required to be followed by the reporting institution under Anti-money Laundering Act, rules, directive, order, circular issued under the said Act as well as other related statutes.
- (b) To identify the customer as required by the legal instruments including the Asset (Money) Laundering Prevention Act and rules, directive, order, circular issued under the said Act.
- (c) To maintain and cause to maintain updated record of Customer Due Diligence information as per sub-section (b).
- (d) To properly maintain the record of transaction exceeding the threshold and suspected transactions.
- (e) To submit information of transactions as per sub-section (d) to Financial Information Unit within the stipulated time.

9. Responsibility of Bank and Financial institutions.

1. Bank and financial institutions shall make necessary arrangement confirming the authority of the Compliance Officer to obtain and file all information to the Financial Information Unit.
2. It is the responsibility of concerned bank and financial institutions to make an arrangement for conducting the activities of submitting information as per Anti-money Laundering Act, rules or issued directives, order, circulars under such act or other relevant statutes from a in secured place maintaining confidentiality.
3. It shall be responsibility of the Chief Executive Officer of the concerned bank and financial institutions to review on quarterly basis as to whether or not the provisions of Anti-money laundering Act, and rules, directive, order or policy formulated under such act are complied with and submit a report to Financial Information Unit completing the review of the same in three months from the end of fiscal year. Further, a brief summary relating to this shall also be disclosed in the annual report of the institution.

10. Procedures of filing particulars

1. Bank and financial institutions shall submit the information and particulars to be provided to the Financial Information Unit with respect to transactions exceeding the threshold as per Annex-2 and list of suspicious transactions as per Annex- 3 through the Compliance officer.
2. The Compliance officer may provide information regarding suspected or other transaction to the Financial Information Unit in a letter or through electronic means of communication such as fax and e-mail. If information is provided through electronic means like fax, email the same shall be confirmed immediately through other means.
3. Where any particular is found to have been omitted in the information filed with the Financial Information Unit or where different particulars or information, other than particulars and information reported while conducting such transaction is received afterward, the bank and financial institutions shall immediately inform the Financial Information Unit of such differences.

11. Internal directives

1. In compliance with the Asset (Money) Laundering Prevention Act, rules and this directive, the Bank and financial institutions shall prepare and implement necessary guidelines in respect of prevention of money laundering activities and inform the Financial Information Unit along with a copy of such documents. The guidelines shall contain procedures relating to Customer Due Diligence, customer acceptance, customer identification, and process of monitoring customer's transactions as well as process of risk management.
2. With respect to Customer Due Diligence, the Bank and financial institutions may also use the relevant guidelines laid down by the international organisations and the use of such guidelines shall be informed along with a copy of the guidelines to the Financial Information Unit.

12. Information and training

Bank and financial institutions shall make necessary internal arrangements to prevent money laundering as well as financing of terrorist activities and provide necessary training and information to its employees for the same.

13. Monitoring and regulation

1. The Financial Information Unit may monitor or cause to monitor from time to time regarding the compliance of provisions of Asset (Money) Laundering Prevention Act and rules, bylaws, directives or orders issued under this Act.
2. It shall be the duty of the concerned bank and financial institutions to provide all necessary cooperation in the monitoring process conducted as per sub-clause- 1.

14. Maintenance of secrecy

Bank and financial institutions or any staff, official or representative thereof shall not disclose any information provided to the Financial Information Unit nor divulge the facts/confidentiality of the document that has come into knowledge during investigation and enquiry or during the execution of own duties to any other persons including the customers through any means except under the circumstances as may be required under the prevailing laws.

15. Penalty and Actions

The Financial Information Unit may impose penalty to the bank and financial institutions as provided under the Anti-money Laundering Act for failing to provide within stipulated time the information which are required to be submitted to the FIU as per Asset (Money) Laundering Prevention Act and Rules, Bylaws, directives or order. Action shall be initiated pursuant to the Asset (Money) Laundering Prevention Act against those breaching the provisions of the Asset (Money) Laundering Prevention Act and the rules, By-laws, directives or order issued under the Act.

Annex -1

Procedure regarding Customer Due Diligence (Know Your Customer)

1. Bank and financial institutions shall obtain following documents from the customers depending on the type of the customer. Further, where necessary, private interview of the customer shall also be taken.

(A) **Relating to customer deposit**

(a) **Personal Accounts**

1. Clear Name and surname
2. Name of father or husband
3. Permanent address (Supporting documents are to be submitted. Such documents may be Certificate of Citizenship, Passport, electricity and water bill and location map prepared by bank staff on site visit (if necessary), voter identity Card, land ownership document etc.)
4. Temporary Address
5. Date of birth
6. Telephone number (if available)
7. Citizenship/passport (number and description)
8. Copy of identity card in case of an employee of the Government of Nepal or of the entity owned by the Government of Nepal.
9. Photo
10. Other required documents (may be specified by bank and financial institution themselves.)

(b) **Accounts of Partnership or Proprietorship firm**

- (1) Name of the firm
- (2) Address
- (3) Telephone/mobile number (if available)
- (4) Name and address of all partners (including phone number)
- (5) Photo of partners
- (6) Firm registration certificate
- (7) Partnership Deed
- (8) In case of partnership firm, authorisation letter regarding operation of financial and administrative transaction.
- (9) Other required documents (maybe specified by bank and financial institutions themselves.)

(c) **Accounts of Companies**

- (1) Name of company
- (2) Address of head office.
- (3) Full address (including phone, fax)
- (4) Certificate of incorporation and Operating license, Memorandum of Association and Article of Association
- (5) Name and address of Board of directors (phone number, if available)
- (6) Photos of members of the Board of Directors.
- (7) Board resolution authorizing opening and operation of the account
- (8) Authorisation by Board of directors to Chief Executive Officer or other officer for conducting financial transactions.
- (9) Other required documents (may be specified by bank and financial institutions themselves.)

(d) **Accounts of Club/Non-governmental Organisation**

- (1) Name of Club and Non-governmental Organisation
- (2) Address
- (3) Certification of registration
- (4) Constitution of the Organisation or clubs.
- (5) Name and address of Executive committee (telephone No. if available)
- (6) Telephone No.
- (7) Executive committee's decision regarding opening of account

- (8) Photos of directors/members of working committee of club and Non-governmental Organisation
 - (9) Authorisation for the operation of accounts financial transactions.
 - (10) Other required documents (may be specified by bank and financial institutions themselves.)
- (e) **Account of Cooperatives**
- (1) Name of Institution
 - (2) Address
 - (3) Telephone No. (if available)
 - (4) Constitution
 - (5) Name and address of Board of Directors (telephone number, if available)
 - (6) Photos of Board of Directors.
 - (7) Certificate of Registration
 - (8) Board's resolution regarding opening of account and authorisation to conduct financial transactions.
 - (9) Other required documents (may be specified by bank and financial institutions themselves.)
- (f) **Accounts of Public and Private Trust (Guthi)**
- 1. Name
 - 2. Address
 - 3. Telephone No. (if available)
 - 4. Constitution of the trust
 - 5. Agreement relating to the establishment of the Trust.
 - 6. Name and address of management trustee.
 - 7. Photos of trust members.
 - 8. Certificate of Registration
 - 9. Name and address of member of Board/Management Committee.
 - 10. Resolution of Board/Management committee regarding opening of account and authorisation to conduct financial transactions.
 - 11. Other required documents (may be specified by bank and financial institutions themselves.)
- (g) **Accounts of School, Campus or other educational entity**
- (1) Name of School or Campus
 - (2) Address
 - (3) Constitution or Memorandum of Association and Article of Association
 - (4) Certificate of Approval
 - (5) Name, address, telephone number and photo of chief executive of the School or Campus.
 - (6) Name and address of member of Board/Management committee (telephone number if available).
 - (7) Resolution of Board/Management committee regarding opening of account and authorisation to conduct financial transactions.
 - (8) Other required documents (may be specified by bank and financial institutions themselves).
- (h) **Accounts of International Non-governmental Organisation**
- (1) Name of Organisation
 - (2) Address
 - (3) Copy of agreement with Social Service National Coordination Council, if available.
 - (4) Copy of agreement with Nepal Government, if any.
 - (5) Recommendation letter from concerned country or embassy.
 - (6) Charter of the organisation
 - (7) Name, address, telephone number and photos of two principal executives of the organisation and documents confirming the address.
 - (8) Name, address and photos of representative or chief appointed by the Nepal office of such organisation and documents confirming the address.
 - (9) Organisation's authorisation to open account and authorisation for financial transactions.

- (10) Other required documents (may be specified by bank and financial institutions themselves).
- (i) **Account of Foreign Individual**
- (1) Name, family name and address.
 - (2) Name of father or husband
 - (3) Copy of the valid visa
 - (4) Copy of passport
 - (5) Recommendation letter of the organisation s/he is working in (if an employee)
 - (6) Address and contact place in Nepal
 - (7) Other required documents (may be specified by bank and financial institutions themselves).
- (j) **Accounts of Foreign Company**
- (1) Documents relating to incorporation of the foreign company.
 - (2) Memorandum of Association and Article of Association of the company.
 - (3) Letter of authorisation to open account and authorisation to conduct financial transaction provide by the foreign (*parent*) company.
 - (4) Documents confirming registered and business address.
 - (5) Name, address, telephone number and photos of two principal executives of foreign company and documents confirming the address.
 - (6) Address in Nepal and contact person.
 - (7) Other required documents (may be specified by bank and financial institutions themselves).
- (k) **Accounts of Diplomatic Mission/Embassy**
1. Letter of Mission/Embassy
 2. Authorisation of operation of the account
 3. Name, address, photo of the account operator and documents confirming the address.
 4. Other required documents (may be specified by bank and financial institutions themselves.)
- (l) **Accounts of Non-Resident Nepalese.**
1. Name, surname and address.
 2. Name of father or husband
 3. Documents disclosing source of income
 4. Agreement with employer organisation/Appointment letter.
 5. Copy of passport
 6. Address and contact place in Nepal.
 7. Other required documents (may be specified by bank and financial institutions).
- (b) **Customer with no account in the concerned bank**
- With respect to the customers requesting remittance to other place and customers requesting payment of remittance, the bank and financial institutions shall identify such customer appropriately and maintain the records of name and addresses of such customers safely so as to be able to retrieve at the time of need.

Annex-2

Threshold Transaction Report (TTR) Form for Banks and Financial institutions

Name of Reporting Institution:

S.N.	Name and address of the person holding account (including legal)	Branch	Date of Transaction	Nature of transaction	Account type and No.	Amount involved	Remarks

Signature :
 (Compliance Officer or authorised officer)
 Name :
 Designation :
 Phone :
 Email :
 Fax :
 Date :

Annex-3

Suspicious Transaction Reports (STR) Form for Banks and Financial institutions

- A. Reporting Institution:
 1. Name of the Institution/Branch
- B. Details of Customer:
 1. Name of account holder/s/customer
 2. Address:
 3. Profession (if applicable):
 4. Nationality (if applicable):
 5. Other account(s) number (if any)
 6. Other business (if any) Father/Mother's name (if applicable)
 7. Date of birth/establishment:
- C. Account/Transaction Details:
 1. Account number/Transactions:
 2. Nature of the account/transaction*
 (Current/saving/loan/other, pls. specify)
 3. Nature of ownership: (Individual/partnership/
 company/other, pls. specify)
 4. Date of operation/transaction:
 5. Other account(s) number/transaction (if any)
 6. Amount:
 7. Others:
 * Cash/Transfer/Clearing/TT/etc. Add paper if necessary.
- D. Reason for considering the transaction(s) as unusual/suspicious?
 a. Identity of client
 b. Activity in account
 c. Background of client
 d. Multiple accounts
 e. Nature of transaction
 f. Value of transaction
 g. Other reason (pls. specify)
- E. Suspicious Activity Information
 Summary characterization of suspicious activity:
 a. Corruption/Gratuity e. False statement h. Structuring
 b. Cheque fraud f. E or wire fraud (debit/credit i. Mysterious
 or other card) Disappearance/behavior
 c. Tax evasion g. Identity Theft j. Counterfeit instrument
 d. Loan fraud h. Terrorist financing k. Misuse of Position or self
- F. Has the suspicious transaction/activity had a material impact on or otherwise
 affected the financial soundness of the bank/fi? Yes No.
- G. Has the bank/FI taken any action in this context? If yes given details.

Signature (compliance Officer of authorized Officer):	
Name :	
Phone :	Email:

Nepal Rastra Bank - Financial Information Unit

Anti-Money Laundering Directive # 2 Banks and Financial Institutions 14 April 2009

In exercise of the power under Section 10(3) of Asset (Money) Laundering Prevention Act, 2008 and Rule 7(1) of Asset (Money) Laundering Prevention Rules, 2009 the FIU has issued the following directives to bank and financial institutions licensed by Nepal Rastra Bank for the submission of the suspicious transactions and risk management.

1. Nature of the Transaction Need to be Reported

Bank and financial institutions shall, immediately, provide information to the financial information Unit about the act/activities/transaction when they found any national or foreigner citizen, customer, firm, company, corporation or agency is involved or attempted to involve in money laundering, terrorist financing or any other related crimes or activities mentioned hereunder, as per the Asset (Money) Laundering Prevention Act, 2008, Asset (Money) Laundering Prevention Rules, 2009 and Directives Issued by FIU.

- 1.1 Any act or attempt to inward or outward remittance, transfer, change of place or any other similar acts, of assets (including cash), material or instruments used thereof, which is proceed of crime earned in Nepal or foreign or prohibited by any prevailing law.
- 1.2 Directly or indirectly acquire, hold, possess or use of any proceed of crime held in Nepal or foreign land or investment return of such property or any increment from such property or use, hold, possession of such property as legally earned, or any other activities which are intended to hide the source of such property or assisting to transform, hide or relocate of such property with the motive of protecting the people who receive such property from legal action.
- 1.3 Any direct or indirect involvement in any crime, attempt of crime, assistance, or provocation in Nepal or foreign.
- 1.4 Any rejection, hesitation or effort to hide information which needs to provide as per the Asset (Money) Laundering Prevention Act, Rules and Directives.
- 1.5 Any leak of information provided or necessary to provide under the Asset (Money) Laundering Prevention Act, 2064, to unrelated party or any other person.
- 1.6 Any change in ownership, possession, use, receive, transfer or attempt for this of assets or cash of the customer related to crime to the other customer.
- 1.7 Any involvement in financial or other crime or attempt or provocation for this.
- 1.8 Any information related to identification of the customer or institutions involved in crime.

2. Identification, Control in Transaction and Information of Terrorist

- 2.1 Reporting institutions shall not conduct any transactions with the terrorist organisation like All Quida, Taliban and other groups, organisation or individuals and any groups, organisations or individuals related to them which are listed as terrorist by resolution 1267 of United Nations, Security Council.
- 2.2 If any transaction which comes under clause 2.1 is found with the reporting institution, it is necessary to immediately suspend such transaction and report it as Suspicious Transaction Report and other law enforcement government agencies.
- 2.3 It is the duty of reporting institutions to make necessary arrangement for the identification and control of institutions, groups or customers under clause 2.1 getting information from the website of United Nations via <http://www.un.org/sc/committees/1267/pdf/consolidatedlist.pdf>
- 2.4 Reporting institutions shall not conduct any transactions with the terrorist groups, organisation or individuals and any groups, organisations or individuals related to them which are listed as terrorist by SAARC, European Union and other Inter Governmental international or regional organisations. If any transaction is found with reporting institution, it is necessary to immediately suspend such transaction and report it as Suspicious Transaction Report and other law enforcement government agencies.

- 2.5 Except otherwise mentioned in prevailing Nepal law, reporting institutions shall not conduct any transactions with the terrorist groups, organisation or individuals and any groups, organisations or individuals related to them which are listed as terrorist by different foreign. If any transaction is found with reporting institution, it is necessary to immediately suspend such transaction and report it as Suspicious Transaction Report and other law enforcement government agencies.
- 2.6 Any crime which comes under following international instruments should be reported immediately to Financial Information Unit as Suspicious Transaction Report.
1. Tokyo Convention on Offences and Certain Other Acts Committed on Board Aircraft, 1963,
 2. Hague Convention for the Suppression of Unlawful Seizure of Aircraft, 1970,
 3. Montréal Convention for the Suppression of Unlawful Acts Against the Safety of Civil Aviation, 1971,
 4. Convention on the Prevention and Punishment of Crime Against Internationally Protected Persons Including Diplomatic Agents, 1973,
 5. International convention Against the Taking of Hostages, 1979,
 6. SAARC Regional Convention on Suppression of Terrorism, 1987,
 7. UN Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances, 1988,
 8. UN Convention for the Suppression of the Financing of Terrorism, 1999,
 9. UN Convention Against Transnational Organised Crime, 2000,
 10. UN Convention Against Corruption, 2003,
 11. Decision No 1267 and other related decision of UN Security Council,
 12. Any Convention against Terrorist Activities to which Nepal is a party.

3. Other Ground for Suspicious Reporting

- 3.1 The situation which contains any of the following grounds during the transaction or attempt of transaction with any Nepali or foreign customer the reporting institutions can take it as general ground for suspicion.
1. If it is found that any one is earning assets (including cash) without paying or tax evasion, custom, land revenue, electricity bill, water bill, phone bill and any other revenue or government fee.
 2. If anyone is living different, unbelievable, unnatural lifestyle or involved in economic transaction or activities which is not seems to be supported by his profession, business or activities.
 3. If any there is any unexpected economic growth or position without any reasonable cause.
 4. If any there is any unexpected change in previous financial status or involved in any procurement, construction, business or such act is not matching with income or economic position.
 5. If source of income is not available or stated or provided information is not satisfactory.
 6. If any act or transaction is not found reasonable or conducted with unrelated party or without any objective.
 7. If, without any reason, the customer identification and any other legal information is not available or seems reluctant to provide such information.
 8. If it is found that the number of transaction are conducted below the threshold which need to be reported to the Financial Information Unit.
 9. If any transaction which is related to the person who are under investigation or search of Police, CIAA, Tax, Revenue Investigation or any other crime investigating agencies for any crime.
 10. If reporting institution also feels doubt with any transaction related to the customer who are facing action or in the process of action by any regulatory authority like Nepal Rastra Bank, Beema Samiti, Securities Board, Stock Exchange, Company Registrar, Cooperative Registrar, Bar Council, Chartered Accountant Association, etc.
 11. If it is doubtful due involvement with the black listed or high risk person maintained by Credit Information Center or institution itself.

- 12.If it is found that the customer is under the inquiry, investigation or action of any foreign crime investigating agency or regulatory authority or government.
- 13.If it is found that the asset is earned by the crime or misbehavior against, child, women or orphan and any other customer.
- 14.If it is found that the asset is earned forcefully or by using forceful measure or compelled to pay.
- 15.If it is found that the asset is earned by smuggling, illegal profession, trade, business, thieving, robbery, piracy, illegal production, misuse or illegal transportation.
- 16.If it is found that the asset is earned by the offences under the prevailing arms and ammunitions laws.
- 17.If it is found that the asset is earned by the offences under the prevailing foreign exchange regulation laws.
- 18.If it is found that the asset is earned by the offences of murder, theft, cheating, forgery documents, counterfeiting, kidnap or abduction under the concerned prevailing laws.
- 19.If it is found that the asset is earned by the offences under the prevailing drug addiction control laws.
- 20.If it is found that the asset is earned by the offences under the prevailing national park and wild animals conservation laws
- 21.If it is found that the asset is earned by the offences under the prevailing human trafficking and taking of hostages control laws.
- 22.If it is found that the asset is earned by the offences under the prevailing cooperatives laws.
- 23.If it is found that the asset is earned by the offences under the prevailing forest laws.
- 24.If it is found that the asset is earned by the offences under the prevailing corruption control laws.
- 25.If it is found that the asset is earned by the offences under the prevailing bank and financial institution laws.
- 26.If it is found that the asset is earned by the offences under the prevailing banking crime and punishment laws.
- 27.If it is found that the asset is earned by the offences under the prevailing ancient monuments conversation laws.
- 28.If it is found that the asset is earned by the offences under the prevailing consumer protection, black market control and competition laws.
- 29.If it is found that the asset is earned by the offences under the prevailing company, commerce, supply, transport business laws.
- 30.If it is found that the asset is earned by the offences under the prevailing education, health, drugs, and environment laws.
- 31.If it is found that the asset is earned by the offences under the prevailing foreign employment laws.
- 32.If it is found that the asset is earned by the offences under the prevailing lottery, gambling and charity laws.
- 33.If it is found that the asset is earned by the offences under the prevailing insider trading, securities and insurance laws.
- 34.If it is found that the asset is earned by the offences under the prevailing negotiable instrument laws.
- 35.If it is found that the asset is earned by the offences under the prevailing election laws.
- 36.If it is found that the asset is earned by the offences under the prevailing intellectual and industrial property laws.
- 37.If it is found that the asset is earned by the offences under the prevailing communication, transmission, and advertisement laws.
- 38.If it is found that the asset is earned by the offences under the prevailing land, house and property laws.
- 39.If it is found that the asset is earned by the offences under the prevailing custom, revenue and tax laws.
- 40.If it is found that the asset is earned by the offences under the prevailing immigration, citizenship and passport laws.

- 41.If it is found that the asset is earned by the offences under the prevailing nongovernmental organisation laws.
- 42.If it is found that the asset is earned by the crimes like trafficking of migrants, extortion and hostage.
- 43.If it is assisting directly or indirectly to the terrorist organisations or individuals as prescribed by government of Nepal or terrorist organisations or organised criminals or other criminals including illicit drugs listed by United Nations through different resolutions.
- 44.If it is found reportable based on the news or commentary provided by the national or international news agencies about any individual or organisation.
- 45.If it is found related with any person who is involved in suspicious transaction, or seem doubtful and promotes money laundering, terrorist or any other criminal activities or look unnatural or suspicious.
- 46.If anyone often comes for transaction at pick hour or only in crowd.
- 47.If anyone tries to establish close unnecessary or unnatural relation with the employees.
- 48.If same address was provided for different unrelated customers.
- 49.If anyone did his transaction which can be comfortable with other means in cash or tries to escape from threshold by making multiple transactions or prefer to do transaction in cash though by nature such transaction does not seems comfortable with cash.
- 50.If any transaction was conduct or attempted without permission or renewal of permission while it is necessary to do so.
- 51.If such transaction comes under suspension on the basis of the ground provided by regulator or higher authority.
- 52.If there is unbelievable or unnatural change in economic position of any customer related to any firm, company, institution or agencies during transaction.
- 53.If it is found suspicious on the basis of any other reason or assisting or advising above mentioned activities.
- 54.If reporting institutions found any transaction suspicious on the basis of prevailing any laws.

3.2 Reporting institutions can take following events as basis for suspicion for the Deposit and other financial transactions.

1. If anyone opens or try to opens account without providing supporting documents or hesitate to complete all process or unable to provide identification documents or tries to provide wrong, forge, incomplete, unbelievable or confused identity, or such identity is new or foreign or provides different identity in different times or try to introduced himself only on the basis of others identity.
2. If shows unnecessary interest in suspicious transaction or makes unnecessary and unnatural queries about the internal management of such transaction.
3. If customer deposits huge amount which is not supported by the profession mentioned by him, or deposits huge amounts without mentioning source or deposits multiple small amount without mentioning source or huge amount is deposited breaking previous trend without sufficient source.
4. If often withdrawal and deposit near or below to threshold are conducted.
5. If any account receives deposits from different ways or withdrawals, or there is cross transaction between the customers which are not related with each other or any individual account transmit or receives amount from unrelated person or business institution's account.
6. If multiple inward or outward remittance transaction is conducted with the person from country or region where terrorist organisations are more active.
7. If unnatural huge amount is transferred to any foreign citizen, tourist, student, visitor, worker or recently migrated person's account or receives from the country or region where terrorist organisations are more active.
8. If any account is used as means of collecting or dispensing money without any reason.
9. If any account highly operates or remain unused without any reason.
10. If money is deposited in different accounts or account of different persons by making small parts or transaction is done from different place without any reason.
11. If any amount deposit in small parts in various account is collected without any reason.

12. If, during the business of firm, company or organisation, transaction or transfer of amount from the account of the firm, company or organisation to account of the individuals or vice versa, or there is growth or personal transactions in comparison to institutional transaction.
 13. If there is growth or personal transactions of the office bearers in comparison to their firm, company or organisation's transaction.
 14. If there is doubt that any transaction is promoting criminal act or receiving amount from such.
 15. If amount is deposit from different instrument to the account which are not related to legal business.
 16. If anyone hesitates to make transaction or search any other means or tries to escape reporting to Financial Information Unit or any other agencies while knowing that transactions which are above threshold are reported.
 17. If shows reluctance to provide necessary information to the transaction which is above threshold.
 18. If little or artificial information is provided.
 19. If try to use unethical means, force or any other favor to prevent transaction from reporting.
 20. If there is unnatural deposit or withdrawal of the amount.
 21. If any one pays large amount of loan of bank or financial institution without having sufficient reason or source.
 22. If anyone automatically clarify or try to clarify legality of amount or transaction without necessary or asked.
 23. If there is only cash transaction which by nature of institution, amount or transaction need to be done through negotiable instruments.
 24. If cash is handled unnaturally bind or packing while bringing it in or taking out.
 25. If any one comes for deposit or withdrawal without knowledge of such amount.
 26. If anyone shows confused, nerves, hurry, or want to be reserve at the time of transaction.
 27. If he accepts involvement in crime or talks so or it seems that he is under watch by any other.
 28. If there is multiple transaction without any reason in the country or the people from there where AML/CFT regime is poor.
 29. If unrelated third party is unnaturally, unnecessarily or more active in the transaction.
 30. If anyone tries to complete transaction by paying more without any reason.
 31. If there is multiple transaction in the account of institutions or its officials in addition to regular service and facilities.
 32. If there is no consistency between the source and amount of the account holder.
 33. If there is any mishandling or misuse of foreign exchange.
 34. If anyone fails to provide information about the receiver of the money.
 35. If there is any violation of Bank and Financial Institutions Act, Banking Crime and Punishment Act and Directives of Nepal Rastra Bank during the opening of account, withdrawal, Investment, loan, settlement of loan and use of loan.
 36. If there is unnatural inflow or outflow in the accounts of the firm, company, organisation or person involved in such organisations which are not regulated or where no system of economic inspection is developed.
 37. If there are various deposits in the account of foreigner or the person who is in foreign.
- 3.3 Reporting Institutions can take following events as basis for suspicion for the loan and other transactions.
1. If tax is not clear even if the financial statement submitted for the purpose of obtaining loan shows that it is taxable.
 2. If anyone tries to get loan from false statement.
 3. If the amount of loan is not used for the stated objective or misused or loan is not paid on the basis of false or unnatural or artificial reason.
 4. If loan is settled in an emergency without any reason, or paid from the amount which don't have valid source.
 5. If settlement of the loan is not supported by the economic status.
 6. If there is unnatural deposit in the loan account or if anyone tries to money laundering by using such account.

7. If loan is settled by unrelated third party without any valid objectives.
- 3.4 Reporting Institutions can take following events as basis for suspicion for the remittance or fund transfer.
1. If anyone denies, provides false statement or hesitate to provide necessary information at the time of transferring or receiving amount.
 2. If tries to transfer or receive any amount which is not consistent with the information provided to reporting institution.
 3. If the source of amount is not mentioned or information provided for this are not sufficient while transferring money.
 4. If customer does mention or denies or try to hide the objective of the transfer or remittance, or transfer or receives amount from unrelated person, institutions or agencies.
 5. If anyone receives or transfer multiple or big amount from certain country, place or institution without any reason or transfer such amount to other place immediately.
 6. If anyone transfer or receives amount differently from the way of his professional objective or transfer or receives from different place.
 7. If anyone transfer or receives multiple transactions which are under threshold or it is found that such activity is conduct by both party with shared interest.
 8. If anyone request for the transfer with the payment in target as cash without any reason.
 9. If anyone makes multiple transfer below threshold to escape from the threshold transaction reporting.
 10. If the amount received from foreign country to any institutions account immediately transferred to any others name or account or transferred to any individuals account.
 11. If there is multiple claims for the amount received from one person.
 12. If anyone receives multiple amount from different places.
 13. If anyone use different track to transfer the amount ignoring the usual way.
 14. If anyone lies to provide identity of the transferor though there are sufficient ground to show his knowledge on that.
 15. If anyone tries to transfer or receive amount if suspicious way.
 16. If a small capital holder tries to transfer or receive huge amount unreasonably.
- 3.5 Reporting Institutions can take following events as basis for suspicion for the Money Exchange.
1. Any exchange on which anyone tries to buy or sale the foreign currency in higher and lower than prescribed rate.
 2. Any exchange on which anyone converts or tries to convert small denomination currency or cheque or other amount in single higher denomination currency, cheque or any other negotiable instrument.
 3. Any exchange on which anyone tries to exchange only in higher denomination currency.
 4. Any exchange on which customer fails to submit necessary documents.
 5. Any exchange which is not consistence with the information provided to reporting institutions.
 6. Any exchange which looks not possible on the basis of economic status of the customer.
 7. Any exchange on which source of income is not provided or the information is not sufficient.
 8. Any exchange which is belongs with the person who has already attempted for the suspicious exchange.
 9. Any exchange which seems not possible or doubtful on any ground.

4. Classification of Risk

- 4.1 Reporting institutions shall keep following customers and transactions in high risk on the basis of customer, amount of transaction, nature and place.
1. Any person or transaction which can directly or indirectly assist to terror, terrorist activities, terrorist organisation, organised crime, illicit drug and any other types of crime.

2. Any transaction related with the people who are in high position of politics, business, society, financial, administration, etc., their available relatives and associated firm, company or organisation.
 3. Any firm, company, organisation or agencies which don't have regulator and supervisor and their transaction.
 4. Any transaction which can conduct without being face to face.
 5. Any transaction which belongs with non residential.
 6. Any transaction with the citizen or others of the country who has not enforced AML/CFT measures.
 7. Any transaction with the citizen or institutions of the country on which United Nation or any Inter Governmental International Organisations has imposed sanctions or warned.
 8. Any customer who are well known as money launderer or involved in any other financial crime.
 9. Any transactions which are related to the person or their related who is known/heard as offender of tax evasion, custom, or any other revenue.
 10. Any transaction related to offshore bank or financial institutions.
 11. International transaction.
 12. Any transaction with the resident of the country which is categorized as non-cooperative by Financial Action Task Force and transaction with the citizen of the countries which has not adopted necessary standard for AML/CFT.
 13. Any transaction with the citizen or institutions of the country which is not serious on the matter of customer identification.
 14. Any transaction with the customer to whom the regulatory authority of respective country has warned.
 15. Any other transaction which are considered as high risk by reporting institutions itself on the basis of their nature of work, workplace or activities.
- 4.2 Reporting institutions shall keep following customers and transaction in risky.
1. Any transaction which can be conducted by misuse of technology.
 2. Any transaction with the firm, company, institution or business which are not regulated.
 3. Any transaction with the firm, company, institution or businesses which are not publishing financial statement or bound to publish that.
 4. Any business or transaction which mostly used to do transaction in cash.
 5. Any transaction with the nonprofit making domestic or international organisation and person thereto.
 6. Any transaction with non financial institutions like Casino, Real Estate, Gems and Jeweler, Travel Agencies, or other non regulated business or profession.
 7. Any other transaction which are considered as risky by reporting institutions
- 4.3 Reporting institutions shall keep following customers and transaction in normal risk.
1. Any customer or transactions who publish their report for general public.
 2. Any customer or transactions that are regulated and supervised by their regulator and supervisor.
 3. Any other transaction related to the person who does not comes under the high risk and risky category and exempted for the threshold transaction reporting by Financial Information Unit.
 4. Any other transaction which are considered as normal risk transaction by reporting institutions.

5. Identification of the Risk

Reporting institution shall establish relation only after getting identification of the customer at least for following transaction.

1. For the starting of business relation.
2. For the transaction above threshold.
3. For the cross broader or wire transfer.
4. For the prevention of suspicious activities/transaction.
5. For the transaction with risky or possible risk customer.
6. Any other conditions determined by reporting institution on the basis of evaluation of risk related its business and possible risk.

6. Report shall be sent on Separate form

- 6.1 Reporting institution shall submit report of the inward or outward remittance and any other transactions above threshold separately.
- 6.2 Reporting institutions shall submit the source of the amount as mentioned by the customer while sending the threshold report of rupees five millions.

Note: Address to Send Reports

Nepal Rastra Bank
Financial Information Unit
Baluwatar, Kathmandu
Phone 4419804, 4419805, 4419807 (Ext. 414, 414, 418)
Fax 4441051
Email: reportfiu@nrb.org.np

ANNEX 4: LIST OF ALL LAWS, REGULATIONS AND OTHER MATERIAL RECEIVED

STATUTES

Asset (Money) Laundering Prevention Act 2008
Arms and Ammunition Act 1962
Banking Offence and Punishment Act 2008
Banks and Financial Institution Act 2006
Bar Council Act 1993
Black-marketing and Other Social Offences and Punishment Act 1975
Chartered Accountants Act 1997
Commission for the Investigation of Abuse of Authority Act 1991
Companies Act 2006
Consumer Protection Act 1998
Cooperatives Act 1992
Copyright Act 2002
Customs Act 2007
Evidence Act 1974
Explosives Act 1961
Export and Import (Control) Act 1957
Extradition Act 1988
Foreign Exchange (Regulation) Act 1962
Forest Act 1993
Gambling Act 1963
Good Governance (Management and Operation) Act 2008
Human Trafficking and Transportation (Control) Act 2007
Income Tax Act 2000
Interim Constitution of Nepal 2007
International Financial Transaction Act 1998
Interpretation of Laws Act 1954
Motor Vehicles and Transport Management Act 1993
Narcotic Drugs (Control) Act 1976
National Parks and Wildlife Conservation Act 1973
Nepal Rastra Bank Act 2002
Nepal Trust Act 2008
Non-Resident Nepali Act 2008
Postal Act 1963
Prevention of Corruption Act 2002
Protection of Records Act 1989
Right to Information Act 2007
Securities Act 2007
Tourism Act 1978
Treaty Act 1990
Wealth Tax Act 1990

RULES AND REGULATIONS

Asset (Money) Laundering Prevention Rules 2009
Commission for the Investigation of Abuse of Authority Rules 2002
Cooperatives Rules 1993

Mutual Funds Regulations 2010

Securities Central Depositories Services Regulations 2010

Stock Exchange Operation Regulations 2008

DIRECTIVES

FIU AML Directives to Government Agencies (Government Agencies Directives No. 1)

FIU AML Directives Bank and Financial Institutions

FIU AML Directives on Suspicious Transactions and Risk Management to Bank and Financial Institutions (Directive No. 2)

FIU AML Directives to the Casinos

FIU AML Directives on Suspicious Transactions and Risk Management to Casino licensed by the Government of Nepal (Directive No. 2)

FIU AML Directives to Insurer, Insurance Agent, Surveyor and Broker (Directive 1 to Insurance Professional)

FIU AML Directives to Money Remitters/Transferor

FIU AML Directives on Suspicious Transactions and Risk Management to Remittance and Money Transfer Company licensed by Nepal Rastra Bank (Directive 2)

FIU AML Directives to Money Changer

FIU AML Directives on Suspicious Transactions and Risk Management to Money Changers licensed by Nepal Rastra Bank (Directive 2)

FIU AML Directives issued by Financial Information Unit to Companies Licensed to do Securities related Business under Securities Related Act, 2006 (Securities Related Directive No1)

FIU AML Directive issued by Financial Information Unit to Saving and Credit Cooperatives and Multiple Cooperatives involved in Saving and Credit Business (Cooperative Directive No.1)

Nepal Rastra Bank Directive 19/067