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The Financial Action Task Force: An Overview

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Summary

The National Commission on Terrorist Attacks Upon the United States, or the 9/11 Commission, recommended that tracking terrorist financing "must remain front and center in U.S. counterterrorism efforts" (see *The 9/11 Commission Report: Final Report of the National Commission on Terrorist Attacks Upon the United States*, U.S. Government Printing Office, July, 2004. p. 382). As part of these efforts, the United States plays a leading role in the Financial Action Task Force on Money Laundering (FATF). The independent, intergovernmental policymaking body was established by the 1989 G-7 Summit in Paris as a result of growing concerns among the summit participants about the threat posed to the international banking system by money laundering. After September 11, 2001, the body expanded its role to include identifying sources and methods of terrorist financing and adopted nine special recommendations on terrorist financing to track terrorists' funds. The scope of activity of FATF was broadened as a result of the 2008-2009 global financial crisis, since financial systems in distress can be more vulnerable to abuse for illegal activities. More recently, the FATF added the proliferation of financing of weapons of mass destruction as one of its areas of surveillance. In April 2012, the member countries adopted a remodeled set of Forty Recommendations and renewed the FATF's mandate through December 31, 2020. This report provides an overview of the task force and of its progress to date in gaining broad international support for its recommendations.

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Introduction

The Financial Action Task Force on Money Laundering is composed of 35 member countries and territories and two regional organizations[1] and was organized to develop and promote policies to combat money laundering and terrorist financing, referred to as anti-money laundering/combatting the financing of terrorism (AML/CFT) measures.[2] The FATF relies on a combination of annual self-assessments and periodic mutual evaluations that are completed by a team of FATF experts to provide information and to assess the compliance of its members to the FATF guidelines. FATF has no enforcement capability, but can suspend member countries that fail to comply on a timely basis with its guidelines. For instance, the FATF warned Turkey in early 2013 that its membership would be suspended unless it became more aggressive in criminalizing money laundering. The FATF is housed at the headquarters of the Organization for Economic Cooperation and Development (OECD) in Paris and occasionally uses some OECD staff, but the FATF is not part of the OECD. The presidency of the FATF is a one-year appointed position, currently held by Mr. Juan Manuel Vega-Serrano from Spain, who will serve through June 30, 2017, when Mr. Santiago Otamendi of Argentina will assume the presidency. At the ministerial meeting in April 2012, the member countries renewed the FATF's mandate through December 31, 2020.

The FATF focuses on six key areas that are intended to reduce the potential for the abuse of financial systems and financial crimes.

- *FATF Recommendations*. The FATF issued its Forty Recommendations to serve as global standards to protect the integrity of the international financial system and enhance international cooperation on AML/CFT by increasing transparency and assisting countries in successfully taking action against the illicit use of their financial system.
- *High-risk and Noncooperative Jurisdictions.* FATF attempts to identify those countries that are not complying with the FATF recommendations. On the basis of reviews by the International Co-operation Review Group (ICRG), jurisdictions may be publicly identified in one of the two FATF public documents that are issued three times a year: (1) FATF's *Public Statement* identifies jurisdictions that have strategic AML/CFT deficiencies and to which countermeasures apply and jurisdictions which have deficiencies but have not made progress in addressing the deficiencies or have not committed to an action plan to address the

[1] The FATF members are Argentina, Australia, Austria, Belgium, Brazil, Canada, Denmark, Finland, France, Germany, Greece, Hong Kong, Iceland, India, Ireland, Italy, Japan, Luxembourg, Malaysia, Mexico, Netherlands, New Zealand, Norway, People's Republic of China, Portugal, Russian Federation, Singapore, South Africa, South Korea, Spain, Sweden, Switzerland, Turkey, United Kingdom, and United States (Israel and Saudi Arabia have observer status); the two international organizations are the European Commission, and the Gulf Cooperation Council. The following organizations have observer status: Asia/Pacific Group on Money Laundering; Caribbean Financial Action Task Force; Council of Europe Select Committee of Experts on the Evaluation of Anti-Money Laundering Measures; Eastern and Southern Africa Anti-Money Laundering Group; Financial Action Task Force on Money Laundering in South America; other international organizations including the African Development Bank; Asia Development Bank; European Central Bank; International Monetary Fund; Organization of American States, Organization for Economic Cooperation and Development; United Nations Office on Drugs and Crime; and the World Bank.

[2] To be admitted to the FATF, a country must (1) be fully committed at the political level to implement the 40 recommendations within a reasonable time frame (three years) and to undergo annual self-assessment exercises and two rounds of mutual evaluations; (2) be a full and active member of the relevant FATF-style regional body; (3) be a strategically important country; (4) have already made the laundering of the proceeds of drug trafficking and other serious crimes a criminal offense; and (5) have already made it mandatory for financial institutions to identify their customers and to report unusual or suspicious transactions.

deficiencies; and (2) *Improving Global AML/CFT Compliance: On-Going Process* in which the FATF identifies those jurisdictions that have AFL/CFT deficiencies but have provided a high-level political commitment to address the deficiencies through a plan developed with the FATF.

- *Financing of Proliferation.* The FATF updated its standards to include measures on the implementation of targeted financial sanctions related to proliferation of weapons of mass destruction.
- *Mutual Evaluations.* The FATF conducts peer reviews of each member on an ongoing basis to assess levels of implementation of the FATF Recommendations, providing an in-depth description and analysis of each country's system for preventing criminal abuse of the financial system.
- *Methods and Trends.* FATF monitors and updates the constant evolution of the methods used to launder proceeds of criminal activities and finance illicit activities. Recently, FATF surveyed the vulnerability of Hawalas and other similar service providers to money laundering and terrorist financing as a result of their use of nonbank settlement methods. The FATF also surveyed the vulnerabilities and risks of the diamond trade to money laundering, including production, rough diamond sale, cutting and polishing, jewelry manufacturing, and jewelry retailers.
- *Corruption.* FATF focuses on the linkage between corruption and money laundering, both of which are generally committed to obtain or hide financial gain.

The Mandate

When it was established in 1989, the FATF was charged with examining money laundering techniques and trends, reviewing the actions which had already been taken, and setting out the measures that still needed to be taken to combat money laundering. In 1990, the FATF issued a report containing a set of 40 recommendations,[3] which provided a comprehensive plan of action to fight against money laundering. Following the terrorist attacks of September 11, 2001, the FATF redirected its efforts to focus on money laundering and terrorist financing. On October 31, 2001, the FATF issued a new set of guidelines and a set of eight special recommendations on terrorist financing.[4] At that time, the FATF indicated that it had broadened its mission beyond money laundering to focus on combating terrorist financing and that it was encouraging all countries to abide by the new set of guidelines. A ninth special recommendation was added in 2005. In 2005, the United Nations Security Council adopted Resolution 1617 urging all U.N. Member States to implement the FATF 40 recommendations on money laundering and the nine special recommendations on terrorist financing.

The FATF completed a review of its mandate and proposed changes that were adopted at the May 2004 ministerial meeting. In 2006, FATF adopted a new surveillance process, known as the International Cooperation Review Group, to identify, examine, and engage with vulnerable jurisdictions that are failing to implement effective AML-CFT systems. In addition, the FATF revised its mandate in 2008 to indicate that FATF "will intensify its surveillance of systemic criminal and terrorist financing risks to enhance its ability to identify, prioritize, and act on these

[3] For the 40 recommendations, see http://www.oecd.org/document/28/0,3343,en_32250379_32236930_33658140_1_1_1_1,00.html.

[4] *FATF Cracks Down on Terrorist Financing*. Washington, FATF, October 31, 2001, p. 1.

threats." The FATF also expressed its support for the development of national threat assessments through best practice guidance and the establishment of stronger and more regular mechanisms for sharing information on risks and vulnerabilities. In addition, the FATF indicated its determination to remain at the center of international efforts to protect the integrity of the global financial system against new risks from criminals and terrorists.

At the G-20 (Group of 20) Summit in Pittsburgh in 2009, the national leaders affirmed their commitment to deal with tax havens, money laundering, corruption, terrorist financing, and prudential standards. They called on the FATF to improve transparency and exchange of information so countries can fully enforce their laws. The G-20 members also called on the FATF to issue a public list of high-risk jurisdictions. In 2010, the FATF published guidelines for insurance companies and the cross-border transportation of cash and bearer bonds. The FATF also adopted a set of guidelines regarding tax amnesty laws and asset repatriation. In 2010, the FATF also published a report on the vulnerabilities of free trade zones for misuse in money laundering and terrorist financing. At the conclusion of the November 2010 G-20 Summit in Seoul, the members urged the FATF to "update and implement" the FATF standards calling for transparency of cross-border wire transfers, beneficial ownership, customer due diligence, and due diligence for "politically exposed persons."

At the Cannes 2011 Summit, the G-20 leaders declared that "corruption is a major impediment to economic growth and development," and encouraged all jurisdictions to adhere to the international standards in the tax, prudential, and AML/CFT areas. The leaders also stated that, "We stand ready, if needed, to use our existing countermeasures to deal with jurisdictions which fail to meet these standards" (par. 36).[5] The G-20 leaders also stated:

> We support the work of the Financial Action Task Force (FATF) to continue to identify and engage those jurisdictions with strategic Anti-Money Laundering/Counter-Financing of Terrorism (AML/CFT) deficiencies and update and implement the FATF standards calling for transparency of cross-border wires, beneficial ownership, customer due diligence, and enhanced due diligence.

At the November 4-5, 2012, meeting of G-20 finance ministers and central bank governors in Mexico City, the officials reaffirmed their support for FATF by concluding that "we remain committed and encourage the FATF to continue to pursue all its objectives and notably to continue to identify and monitor high-risk jurisdictions with strategic Anti-Money Laundering/Counter-Terrorist Financing (AML/CFT) deficiencies."[6] In addition, the final communique from the July 2013 meeting of G-20 finance ministers and central bank governors in Moscow concluded:

> We reiterate our commitment to FATF's work in fighting money laundering and terrorism financing and its key contribution to tackling other crimes such as tax crimes, corruption, terrorism, and drug trafficking. In particular, we support the identification and monitoring of high risk jurisdictions with strategic AML/CFT deficiencies while recognizing the countries' positive progress in fulfilling the FATF's standards. We encourage all countries to tackle the risks raised by opacity of legal persons and legal arrangements....[7]

Subsequent G-20 summits have issued similar statements of support for the FATF. At the G-20 summit in 2016 in Hangzhou, China, the leaders stated their continued support for the FATF and

[5] *Cannes Summit Final Declaration*, G-20, November 4, 2011.

[6] *Communique of Ministers of Finance and Central Bank Governors of the G-20*, Mexico City, 4-5 November 2012, par. 20.

[7] *Communique: G-20 Meeting of Finance Ministers and Central Bank Governors*, Moscow, July 20, 2013, para. 20.

emphasized the importance of financial transparency to "protecting the integrity of the international financial system" and to preventing the misuse of the financial system for corruption, tax evasion, terrorist financing, and money laundering. To this end, the G-20 directed the FATF to develop additional proposals for the G-20 on ways to "improve the implementation of the international standards on transparency, including on the availability of beneficial ownership information of legal persons and legal arrangements, and its international exchange."[8]

On February 15, 2012, the FATF members adopted a revised and updated set of the FATF Forty Recommendations, which added the proliferation of financing of weapons of mass destruction to FATF's areas of surveillance. The new mandate is intended to (1) deepen global surveillance of evolving criminal and terrorist threats; (2) build a stronger, practical, and ongoing partnership with the private sector; and (3) support global efforts to raise standards, especially in low-capacity countries. In addition, the revised recommendations address new and emerging threats, while clarifying and strengthening many of the existing obligations. The new standards strengthen the requirements for higher-risk situations and allow countries to take a more focused approach to areas where high risks remain or where implementation could be enhanced. The standards also significantly strengthen requirements in the area of transparency regarding the adequate, accurate, and timely information on the beneficial ownership and control of legal persons and arrangements to address issues of tax transparency, corporate governance, and various types of criminal activity.

The risk-based approach adopted by FATF encourages countries to identify, assess, and understand the risks posed by money laundering and terrorist financing and to adopt the appropriate measures to address those risks, providing for a more flexible set of measures for countries to target resources in the most effective way. In addition, the new standards address the challenge of terrorist financing by integrating standards for combating terrorist financing throughout the Recommendations, thereby eliminating the need for the nine Special Recommendations that had supplemented the Forty Recommendations. In particular, the new standards recommend that terrorist financing should be criminalized (Recommendation 5); that countries should implement targeted financial sanctions related to terrorism and terrorist financing (Recommendation 6); that countries should implement targeted financial sanctions related to the prevention, suppression, and disruption of proliferation of weapons of mass destruction and its financing (Recommendation 7); and that countries review their laws and regulations to ensure that nonprofit organizations are not used to finance terrorism (Recommendation 8).

The FATF also has identified trade-based money laundering (TBML) as an issue for its members.[9] According to the FATF, TBML involves the exploitation of the international trade system for the purpose of transferring value and obscuring the true origins of illicit wealth. This process is defined as disguising the proceeds of crime and moving value through trade transactions to legitimize their illicit origin and varies in complexity, but typically involves the misrepresentation of the price, quantity, or quality of imports or exports.[10]

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[8] *G-20 Leader's Communique: Hangzhou Summit*, Hangzhou, September 5, 2016, para. 20.

[9] CRS Report R44541, *Trade-Based Money Laundering: Overview and Policy Issues*, by Rena S. Miller, Liana W. Rosen, and James K. Jackson.

[10] Financial Action Task Force (FATF), *Trade Based Money Laundering*, June 23, 2006. The basic techniques of trade-based money laundering (TBML) include over- and under-invoicing of goods and services, multiple-invoicing of goods and services; over- and under-shipment (i.e., short shipping) of goods and services; and falsely described goods and services, including phantom shipping.

In addition to TBML, criminal organizations and terrorist financiers use the international financial system itself and the physical movement of cash through couriers to disguise their activities. In particular, criminal organizations and terrorist financiers take advantage of the size and complexity of the international trade and finance system to obscure individual transactions through (1) the complexities involved with multiple foreign exchange transactions and diverse trade financing arrangements; (2) the comingling of legitimate and illicit funds; and (3) the limited resources that most customs agencies have available to detect suspicious trade transactions.[11] Also, money launderers have exploited vulnerabilities in the use of letters of credit and other financial arrangements that are necessary for facilitating cross-border trade to launder funds. According to FATF, TBML techniques "vary in complexity and are frequently used in combination with other money laundering techniques to further obscure the money trail."[12]

Despite the recognition that the rapid growth and complexity of the international trade and financing system has multiplied the opportunities for abuse of this system by money, recommendations specifically to counter TBML are not included in the current set of FATF 40 Recommendations. FATF, however, has occasionally issued stand-alone reports that address TBML and best practices.[13]

Surveys conducted by the FATF indicate, however, that there is no comprehensive data set on the extent and magnitude of the TBML issue. In part, the FATF determined that this lack of data reflected the fact that most jurisdictions do not identify TBML as a separately identifiable activity under the general topic of money laundering and, therefore, did not collect data on this specific type of activity. The FATF also concluded that most jurisdictions do not offer training specifically related to TBML activities that assist trade and finance specialists in identifying TBML activities.[14] As part of its efforts to promote best practices regarding training for detecting TBML, the FATF recommended that jurisdictions develop training programs that are specific to TBML and could focus on financial and trade data analysis for identifying trade anomalies and identifying criminal activities, among other reforms.[15]

In addition to the revised and updated Recommendations, the FATF members adopted on April 20, 2012, a new mandate for the FATF and renewed FATF's mandate through December 31, 2020. The new mandate specifies a number of functions and tasks for the FATF, including the following:

1. Identifying and analyzing money laundering, terrorist financing, and other threats to the integrity of the financial system, including the methods and trends involved; examining the impact of measures designed to combat misuse of the international financial system; supporting national, regional, and global threat and risk assessments.
2. Developing and refining the international standards for combating money laundering and the financing of terrorism and weapons proliferation.
3. Assessing and monitoring its members through "peer reviews" (mutual evaluations) and follow-up processes to determine the degree of technical compliance, implementation, and effectiveness of systems to combat money laundering and the financing of terrorism and proliferation; refining the standard

[11] FATF, *Trade Based Money Laundering*, June 23, 2006.

[12] FATF, *Trade Based Money Laundering*, June 23, 2006.

[13] FATF, *Best Practices on Trade-Based Money Laundering*, June 20, 2008.

[14] FATF, *Best Practices on Trade-Based Money Laundering*, June 20, 2008.

[15] Ibid.

assessment methodology and common procedures for conducting mutual evaluations and evaluation follow-up.

4. Identifying and engaging with high-risk, noncooperative jurisdictions and those with strategic deficiencies in their national regimes, and coordinating action to protect the integrity of the financial system against the threat posed by them.
5. Promoting full and effective implementation of the FATF Recommendation by all countries through the global network of FATF-style regional bodies and international organizations; ensuring a clear understanding of the FATF standards and consistent application of mutual evaluation and follow-up processes throughout the FATF global network and strengthening the capacity of the FATF regional bodies to assess and monitor their member countries.
6. Responding as necessary to significant new threats to the integrity of the financial system consistent with the needs identified by the international community, including the United Nations Security Council, the G-20, and the FATF itself; preparing guidance as needed to facilitate implementation of relevant international obligations in a manner compatible with the FATF standards.
7. Assisting jurisdictions in implementing financial provisions of the United Nations Security Council resolutions on nonproliferation, assessing the degree of implementation and the effectiveness of these measures in accordance with the FATF mutual evaluation and follow-up process, and preparing guidance as needed to facilitate implementation of relevant international obligations in a manner compatible with the FATF standards.
8. Engaging and consulting with the private sector and civil society on matters related to the overall work of the FATF, including regular consultation with the private sector and through the consultative forum.
9. Undertaking any new tasks agreed by its Members in the course of its activities and within the framework of this Mandate and taking on these new tasks only where it has a particular additional contribution to make while avoiding duplication of existing efforts elsewhere.

In February 2016, the FATF released an updated strategy to increase efforts by the FATF members to address what it determined as an intensification of global terrorist threats. The new strategy consists of (1) the framework, mechanisms, and actions that are in place; (2) the current threats that are faced; and (3) the key policy objectives and the priority actions the FATF and the global network will take in its fight against terrorism and terrorist financing.[16]

Progress to Date

An essential part of the FATF activities is assessing the progress of its members in complying with the FATF recommendations. As previously indicated, the FATF attempts to accomplish this activity through assessments performed annually by the individual members and through mutual evaluations. As part of an ongoing process, the FATF completes mutual evaluations of all the FATF members. According to the FATF assessment of February 2016, only a few countries are considered to be noncooperative countries. The countries in this group include Iran and the Democratic Peoples' Republic of Korea (North Korea), which FATF considers to have significant

[16] *Consolidated FATF Strategy on Combatting Terrorist Financing*, Financial Action Task Force, February 19, 2016, p.1.

deficiencies in its anti-money laundering and terrorist financing regime; FATF urged other jurisdictions to protect themselves by applying countermeasures. In June 2016, the FATF suspended countermeasures against Iran for 12 months to monitor its progress in implementing an Action Plan. If, at that time, the FATF determines that Iran has not demonstrated "sufficient" progress, calls for countermeasures will be reimposed. If, however, Iran has met its commitments, the FATF would consider additional steps. Nevertheless, the FATF indicated that it remained concerned with terrorist financing issues relevant to Iran and the threats it poses to the international financial system. Iran urged the FATF members to "continue to advise their financial institutions to apply enhanced due diligence to business relationships and transactions" with Iranian individuals or institutions.[17]

The FATF identified nine countries—Afghanistan, Bosnia and Herzegovina, Ethiopia, Iraq, Lao PDR, Syria, Uganda, Vanuatu, and Yemen—that have remaining deficiencies in addressing AML/CFT issues, but have made a high-level political commitment to address their deficiencies.[18] Other countries that are improving their AML/CFT regimes, but are considered to have strategic AML/CFT deficiencies for which they have developed an action plan with the FATF, are Albania, Angola, Argentina, Cuba, Iraq, Kenya, Kuwait, Kyrgyzstan, Mongolia, Namibia, Nepal, Nicaragua, Papua New Guinea, Tajikistan, Tanzania, and Zimbabwe.

In addition to monitoring the progress of countries in meeting the FATF recommendations regarding AML/CFT, the FATF has taken a number of steps since the 2008-2009 financial crisis to protect the international financial system from abuse. These actions include identifying jurisdictions that may pose a risk to the international financial system and updating reports on such topics as Best Practices on Confiscation (asset recovery); best practices on Managing the Anti-Money Laundering and Counter-Terrorist Financing Policy Implications of Voluntary Tax Compliance Programs; and Trade Based Money Laundering. In addition, FATF issued a statement on February 22, 2013, indicating that it intended to suspend Turkey's membership in the organization as a result of its "continued failure to take action to fully criminalize terrorist financing and establish an adequate legal framework for identifying and freezing terrorist assets consistent with the FATF Recommendations."[19] The FATF encouraged Turkey to (1) adopt legislation to remedy deficiencies in its terrorist financing laws and (2) establish a legal framework for identifying and freezing terrorist assets consistent with the FATF Recommendations. In February 2014, FATF indicated that Turkey had taken steps toward improving its CFT regime by complying with the FATF standard on criminalizing terrorist financing through court decisions and, therefore, did not suspend Turkey's membership. The FATF indicated, though, that it remained concerned over Turkey's framework for identifying and freezing terrorist assets.[20]

The FATF faces a number of difficulties in determining how fully member countries are complying with the special recommendations. A large part of this difficulty arises from the challenges in reaching a mutual understanding of what the recommendations mean and how a country should judge its performance relative to the recommendations, since the recommendations are periodically revised and new methodologies for analyzing money laundering and terrorist financing evolve over time. In addition, a number of the recommendations require changes to laws and other procedures that take time for member countries to implement. To assist member countries in complying with the recommendations, the

[17] FATF Public Statement, February 24, 2017.

[18] *Improving Global AML/CFT Compliance: On-going Process*, Financial Action Task Force, February 24, 2017.

[19] *Outcomes of the Plenary Meeting of the FATF, Paris, 17-19 October 2012*, FATF, October 19, 2012.

[20] FATF Public Statement, February 14, 2014.

FATF has issued various interpretative notes to clarify aspects of the recommendations and to further refine the obligations of member countries.

In February 2004, the FATF adopted a revised version of the 40 recommendations that significantly broadened the scope and detail of the recommendations over previous versions. Also, the FATF adopted a new methodology to track and identify money laundering and terrorist financing that applied to the 40 recommendations and the eight (nine) special recommendations. As a result of the significant length and additional detail of these new requirements, the FATF decided that it would no longer conduct self-assessment exercises based on the previous method, but will initiate follow-up reports to mutual evaluations.

In 2005, the FATF issued revised standards related to wire transfers of funds. The new standards require financial institutions to include the name, address, and account number of the originator on all fund transfers. The standards also lower the reporting threshold from $3,000 to $1,000. Two FATF-style regional bodies were also created—the Eurasian Group and the Middle East and North Africa Financial Action Task Force. The first round of mutual evaluations for these two bodies was scheduled for 2006. In 2007, the FATF adopted new measures to protect the international financial system from abuse, including calling on Iran to strengthen its money-laundering and counter-terrorist financing controls and a new commitment to produce a regular global threat assessment detailing key issues of concern related to criminal and terrorist financing.

Since the start of the global financial crisis, the FATF has taken a number of steps to help governments guard against abuse of their financial systems by groups or individuals engaging in terrorist financing or money laundering. As part of these efforts, the FATF has done the following:

- Issued a statement warning all FATF members and all jurisdictions to protect their financial systems from risks associated with Iran's failure to address ongoing deficiencies in its anti-money laundering regime and in combating financial terrorism
- Completed an analysis of the impact of the global financial and economic crises on international cooperation in the area of money laundering and terrorist financing and reported to the G-20 in September 2009 on responses to the financial crisis.
- Completed a report on the potential for money laundering and other vulnerabilities in the football (soccer) sector.[21]
- Issued a list of best practices that can assist member countries in implementing measures to freeze the assets or funds of terrorists or of terrorist-related activities. The FATF argues that freezing these assets or funds is important because it (1) denies funds to terrorists, which forces them to use more costly and higher-risk ways to finance their operations; (2) deters those who might be willing to finance terrorism; and (3) is one element of a broader effort to follow the money trail of terrorists, terrorist groups, and terrorist activity.
- Issued a report on money laundering and the risk posed under New Payment Methods (prepaid cards, mobile payments, and Internet payment services).[22]

[21] Money Laundering Through the Football Sector, July 2009.

[22] *Money Laundering Using New Payment Methods*, Financial Action Task Force, October 2010.

- Completed research on the use of Trusts and Company Service Providers for money laundering, indicating that Trusts and Company Service Providers have often been misused, wittingly or not, in money-laundering activities.[23]
- Published a report on the rise in organized piracy on the high seas and related kidnapping for ransom.[24]
- Published a report analyzing money-laundering methods used for corruption, identifying key vulnerabilities of the current AML/CFT system, and discussed the barriers for the recovery of corrupt proceeds once they are discovered.[25]
- Published a report on the extent and nature of trade-based money laundering, which FATF identifies as one of the three main methods by which criminal organizations and terrorist financiers move money for the purpose of disguising its origins and integrating it back into the formal economy.[26]
- Published a report on the illegal money flows associated with money laundering and trafficking in human beings and smuggling of migrants.[27]
- Published a report on money laundering and financial inclusion, which focuses on AML/CFT measures that meet national goals of facilitating access to formal services for financially excluded and underserved groups, including low-income, rural, and undocumented groups.[28]
- Published a report on the vulnerabilities of legal professionals in witting/unwitting criminal ML/TF activities, sometimes because a legal professional is required to complete certain transactions, and sometimes to access specialized legal and notarial skills and services which could assist the laundering of the proceeds of crime and the funding of terrorism.[29]
- Published a report on the vulnerability of politically exposed persons, which is defined as an individual who is or has been entrusted with a prominent public function that potentially can be abused for the purpose of committing money laundering offenses and related activities, including corruption and bribery, as well as conducting activity related to terrorist financing.[30]
- Approved a report on money laundering counterfeiting currency and the risk that counterfeit currency can seriously destabilize a country's currency and as such represents a serious threat to national economies. The report examines the methods that are used for putting the proceeds of the illicit trade in counterfeit

[23] *Money Laundering Using Trust and Company Service Providers*, Financial Action Task Force, October 2010.

[24] *Organized Maritime Piracy and Related Kidnapping for Ransom*, Financial Action Task Force, July 2011.

[25] *Laundering the Proceeds of Corruption*, Financial Action Task Force, July 2011.

[26] *APG Typology Report on Trade Based Money Laundering*, Financial Action Task Force, July 20, 2012.

[27] *Money Laundering Risks Arising From Trafficking in Human Beings and Smuggling of Migrants*, Financial Action Task Force, July 2011.

[28] *Anti-Money Laundering and Terrorist Financing Measures for Financial Inclusion*, Financial Action Task Force, February 2013.

[29] *Money Laundering and Terrorist Financing Vulnerabilities of Legal Professionals*, Financial Action Task Force, June 2013.

[30] *Politically Exposed Persons*, Financial Action Task Force, June 2013.

currency into the regular financial system and how counterfeit currency is used for the purpose of terrorist financing and other crimes.[31]

- In October 2013, the FATF published a report on the use of Hawala organizations to launder money and finance terrorist activities.[32]
- In October 2014, FATF published a report on the use of legal and beneficial ownership information regarding corporate entities to prevent the circumvention of anti-money laundering and terrorist financing measures in ways that can disguise and convert the proceeds of criminal activity before introducing them into the financial system.[33]
- The FATF published a report in July 2015 on the growing use of gold in place of cash and traditional financial markets as a method for laundering funds as regulators and law enforcement measures have become more successful in the traditional financial markets.[34]
- In October 2015, FATF published a report detailing the laundering of funds through the physical transportation of cash.[35]
- In February 2016, the FATF published new guidelines for a risk-based approach for evaluating money or value-transfer services, or financial services that involve the acceptance of cash, checks, or other financial instruments through a clearing network.[36]
- In June 2016, the FATF published a report on the consolidated standards on information sharing.[37]
- In September 2016, the FATF published a report at the request of the G-20 on ways to improve the implementation of the international standards on transparency, including on the availability of beneficial ownership information, and its international exchange.[38]

As the FATF begins its fourth round of country evaluations, it adopted in 2013 a new methodology for countries to use in evaluating their compliance with the FATF Recommendations.[39] The Methodology is composed of two components:

1. The first is a technical compliance assessment that will address the specific requirements of each of the FATF Recommendations, principally as they relate to

[31] *Money Laundering and Terrorist Financing Related to Counterfeiting of Currency*, Financial Action Task Force, June, 2013.

[32] *The Role of Hawala and Other Similar Service Providers in Money Laundering and Terrorist Financing*, Financial Action Task Force, October, 2013.

[33] Transparency and Beneficial Ownership: FATF Guidance, October, 2014.

[34] Money Laundering/Terrorist Financing Risks and Vulnerabilities Associated With Gold, Financial Action Force, July, 2015.

[35] *Money Laundering Through the Physical Transportation of Cash*, Financial Action Task Force, October, 2015.

[36] *Guidance for a Risk-Based Approach: Money or Value Transfer Services*, Financial Action Task Force, February, 2016.

[37] *Consolidated FATF Standards on Information Sharing*, Financial Action Task Force, June, 2016.

[38] *FATF Report to the G-20: Beneficial Ownership*, Financial Action Task Force, September, 2016.

[39] *Methodology for Assessing Technical Compliance With the FATF Recommendations and the Effectiveness of AML/CFT Systems*, Financial Action Task Force, February, 2013.

the relevant legal and institutional framework of the country, and the powers and procedures of competent authorities.

2. The second is an effectiveness assessment that will assess the extent to which a country achieves a defined set of outcomes that are central to a robust AML/CFT system and will analyze the extent to which a country's legal and institutional framework is producing the expected results.

In December 2016, the FATF released its third mutual evaluation report on the United States.40 The report noted the unique role the United States and the dollar play in the international financial markets. The United States is the largest economy and the dollar serves essentially as the global reserve currency. A triennial survey of the world's leading central banks conducted by the Bank for International Settlements in April 2016 indicates that the daily trading of foreign currencies through traditional foreign exchange markets totaled $5.1 trillion.[41] In addition to the traditional foreign exchange market, the over-the-counter (OTC)[42] foreign exchange derivatives market reported that daily turnover of interest rate and nontraditional foreign exchange derivatives contracts reached $2.7 trillion in April 2016. The BIS data also indicate that 88.0% of the global foreign exchange turnover in April 2016 was in U.S. dollars. The FATF noted that this unique role "creates significant exposure to potential money laundering activity and risks of cross-border illicit flows."[43] The FATF also concluded that, "The U.S. also faces significant risks from [terrorist financing] and is vulnerable to such abuse because of the unique scope, openness and reach of its financial system globally, and the direct threat posed by terrorist groups to U.S. interests."

Although the FATF generally gave the United States high marks for its efforts to combat money laundering and terrorist financing, it observed some areas where it recommended the United States could improve. These areas include the following:

- Significant gaps in the regulatory framework, including minimal coverage of certain institutions and businesses (investment advisers), lawyers, accountants, real estate agents, trust and company service providers, other than trust companies.
- Minimal measures are imposed on designated nonfinancial businesses and professions, other than casinos and dealers in precious metals and stones.
- Lack of timely access to adequate, accurate, and current beneficial ownership information.
- No uniform approach to state-level anti-money laundering efforts and are uncertainties about the priority that states give money laundering.
- The main money laundering vulnerabilities were in the cash, banking, money service businesses, casino, and securities sectors, and were characterized as use of cash and monetary instruments in amounts under regulatory record-keeping and reporting thresholds; opening bank and brokerage accounts using nominees

[40] *Anti-Money Laundering and Counter-Terrorist Financing Measures: United States Mutual Evaluation Report*, Financial action Task force, December, 2016.

[41] *Triennial Central Bank Survey, Foreign Exchange Turnover in April 2016*, Bank for International Settlements, September 2016, p. 9.

[42] The over-the-counter foreign exchange derivatives market is an informal market consisting of dealers who custom-tailor agreements to meet the specific needs regarding maturity, payments intervals, or other terms that allow the contracts to meet specific requirements for risk.

[43] *United States Mutual Evaluation Report*, p. 5.

to disguise the identity of the individuals who control the accounts; creating legal entities without accurate information about the identity of the beneficial owner; misuse of products and services resulting from deficient compliance with anti-money laundering obligations; and merchants and financial institutions wittingly facilitating illegal activity.

- The main terrorist financing threats and vulnerabilities include raising funds through criminal activity, individuals raising funds under the auspices of charitable giving but outside of any charitable organization, individual contributions and self-funding; moving and placing funds through banks, licensed money service businesses, unlicensed money transmitters and cash smuggling; and potential emerging threats from global terrorist activities, cybercrime and identity theft, and new payment systems.
- Fundamental improvements are required in order to protect legal persons, and to a lesser extent legal arrangements, from money laundering/terrorist financing abuse, and ensure that the competent authorities have timely access to beneficial owner information. Major improvements are needed to apply appropriate preventive measures to all financial institutions and designated nonfinancial businesses and professions, in particular to high-risk situations, and to undertake effective supervision of all sectors.
- While the financial intelligence system is broadly robust, its effectiveness is somewhat impaired by technical gaps that limit the information available to competent authorities at any given point in time.[44]

Role of the IMF and World Bank

Between 2002 and 2003, the International Monetary Fund (IMF) and the World Bank participated in a year-long pilot program to conduct assessments of national approaches to detecting and controlling money laundering and terrorist financing in various countries[45] using the methodology developed by the FATF.[46] In March 2004, the IMF and World Bank agreed to make the program a permanent part of their activities. The IMF has worked with the World Bank and the FATF to conduct over 70 AML/CFT assessment and has contributed to the design of AML/CFT-related program measures, and provided a large number of technical assistance and research projects, at an annual cost of approximately $6 million.[47] The FATF has incorporated an AML/CFT evaluation as part of its annual Article IV country consultations,[48] and country Financial Sector Assessment Programs (FSAP).[49] In 2009, the IMF spearheaded a donor-sponsored trust fund to

[44] Ibid, p. 5-6.

[45] This group of countries is not the same as those surveyed by the FATF, although there is some overlap in coverage between the FATF and the IMF/World Bank assessments.

[46] *Twelve-Month Pilot Program of Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) Assessments: Joint Report on the Review of the Pilot Program*. The International Monetary Fund and the World Bank, March 10, 2004.

[47] *Anti-Money Laundering and Combatting the Financing of Terrorism (AML/CFT) Report on the Effectiveness of the Program*, International Monetary Fund, May 11, 2011, p. 37.

[48] An Article IV consultation, required by Article IV of the IMF's Articles of Agreement, is part of the IMF's surveillance program of member countries' economic and financial policies and includes discussions with government and central bank officials and representatives of business, labor, and civil society.

[49] The Financial Sector Assessment Program (FSAP) is a comprehensive and in-depth analysis of a country's financial sector. The assessment is composed of two components: a financial stability assessment, and a financial development

finance technical assistance in AML/CFT to strengthen AML/CFT regimes. In a public statement, the IMF indicated that

> ... it is concerned about the possible consequences money laundering, terrorist financing, and related governance issues have on the integrity and stability of the financial sector and the broader economy. These activities can undermine the integrity and stability of financial institutions and systems, discourage foreign investment, and distort international capital flows. They may have negative consequences for a country's financial stability and macroeconomic performance, resulting in welfare losses, draining resources from more productive economic activities, and even have destabilizing spillover effects on the economies of other countries. In an increasingly interconnected world, the negative effects of these activities are global, and their impact on the financial integrity and stability of countries is widely recognized.[50]

The IMF's efforts are driven in part by its conclusion that money laundering, terrorist financing, and associated criminal activities are crimes that have real effects on the economy, on financial sector stability, and on external stability more generally. In general, the potential economic effects that arise from such financial crimes are the following:[51]

- Loss of access to global financial markets.
- Destabilizing capital inflows and outflows. Money laundering or terrorist financing activities may give rise to significant levels of criminal proceeds or "hot money" flowing into and out of financial institutions in a country in ways that are destabilizing. In such cases, financial flows are not driven by the economic fundamentals, but by differences in controls and regulations that make money laundering a safer activity in some countries than in others.
- Financial Sector Fraud. Money laundering may also be associated with broader problems of financial sector fraud. Such fraud can undermine confidence in a country's financial system, which can lead to large outflows of capital from the banking system, or the loss of access to international financial markets as a result of deterioration in the country's reputation.
- Financial Sector Supervision. Money laundering and terrorist financing may reflect deeper problems with the supervision of the financial system in a country. Where important financial institutions within a country are owned or controlled by criminal elements, the authorities may encounter difficulty supervising these institutions or in identifying and addressing problems before domestic financial stability is undermined.
- Economic Paralysis. Incidents of terrorism and terrorist financing may undermine the stability of a country's financial system, either as a result of a history of terrorist incidents or through the effect of a single, but significant, incident.
- Tax Fraud. Money laundering associated with tax fraud potentially can undermine financial or macroeconomic activity by (1) affecting the government's revenue stream to a point where its fiscal balance is significantly undermined; and (2) threatening the stability of a country's banking system through volatile financial inflows and outflows by injecting large amounts of "hot money" arising

assessment.

[50] *The IMF and the Fight Against Money Laundering and the Financing of Terrorism*, International Monetary Fund.

[51] *Anti-Money Laundering and Combatting the Financing of Terrorism (AML/CFT) Report on the Effectiveness of the Program*, Annex 4.

from tax evasion. The IMF estimates that large-scale tax fraud is the most prevalent and significant of all proceeds-generating crimes.

- Problems with economic policymaking. Where the illegal sector forms a significant part of the economy and criminal proceeds remain in cash outside the banking system, such activities can distort consumption, investment and savings, trade and exchange rates, and the demand for money. As a result, official data on economic fundamentals may not fully reflect the underlying economic realities and economic policymakers may be thwarted in assessing the state of the economy and in making economic policy.
- Adverse effects on growth. Corruption, especially corruption at the national level, has the potential to negatively affect fiscal balances, foreign direct investment, and growth. In extreme cases, unchecked criminal activity can threaten state functions and the rule of law, with associated adverse economic effects.
- Money laundering, terrorist financing, and related crimes may undermine the stability of the country in which they originate and have adverse spillover effects on the stability of other countries.

In 2011, the IMF published the results of its assessment of the effectiveness of the AML/CFT program.[52] This survey concluded that

- Of the 161 countries surveyed between 2004 and 2011 by the IMF, compliance with all of the FATF Recommendations was 42.5% and full compliance on any of the FATF Recommendations was rare, occurring in just 12.3% of the cases. The survey also indicated that it appears to be easier for countries to adopt legislation and to establish government institutions than it is to ensure that the system functions well on an ongoing basis.
- Compliance is expensive because countries must invest in building institutions and promote active interagency coordination and international cooperation in order to achieve relatively high levels of compliance. As a result, countries with higher per capita income levels and more well-developed frameworks for financial regulation and fighting corruption have achieved relatively high levels of compliance. Compliance by many emerging-market and low-income countries, however, is impeded by a relatively poor understanding of AML/CFT best practices, inadequate budgets for training staff, and the absence of important preconditions (e.g., rule of law, transparency, and good governance) for the effective implementation of AML/CFT measures.
- The costs of performing a country evaluation are high in terms of time and resources for both the country being assessed and for the assessors. An IMF assessment of the criteria set out in the FATF assessment methodology requires that the assessor bodies engage in long missions, extensive interviews with a broad range of representatives of the official and private sectors (both financial and nonfinancial), and protracted follow-up discussions. Some of these costs are shared with other assessor bodies.
- Country assessments attempt to focus not only on the country's formal compliance with the AML/CFT recommendations, but on how effectively the standards have been implemented.

[52] *Anti-Money Laundering and Combatting the Financing of Terrorism (AML/CFT) Report on the Effectiveness of the Program.*

- The comprehensive nature of the current methodology for assessing a country's compliance with the AML/CFT standards in some cases does not allow assessors the flexibility of focusing on issues that may be of greatest relevance to a particular country.

As a result of the conclusions reached above, the IMF and the World Bank proposed two changes in the AML/CFT policy framework:

1. Future assessments should adopt a more flexible, targeted approach, since most of the IMF's members have undergone an initial assessment. This approach will concentrate on (1) areas where countries have a record of poor compliance; (2) key or core areas of the standard or where the standard has been amended; and/or (3) areas where individual countries face particular risks, either domestic or cross border.
2. Country assessments should be conducted with a more targeted, risk-based approach aimed at assessing a country's compliance with the AML/CFT standards. It is anticipated that such an approach would allow assessors to engage in more targeted and focused assessments based on the circumstances of the country whose framework is being assessed. FATF moved in this direction when it adopted its new methodology in 2012.

Issues for Congress

Following the 9/11 attacks, Congress passed P.L. 107-56 (the USA PATRIOT Act) to expand the ability of the Treasury Department to detect, track, and prosecute those involved in money laundering and terrorist financing. In 2004, the 108th Congress adopted P.L. 108-458, which appropriated funds to combat financial crimes, made technical corrections to P.L. 107-56, and required the Treasury Department to report on the current state of U.S. efforts to curtail the international financing of terrorism. The experience of the Financial Action Task Force in tracking terrorist financing, however, indicates that there are significant national hurdles that remain to be overcome before there is a seamless flow of information shared among nations. While progress has been made, domestic legal issues and established business practices, especially those that govern the sharing of financial information across national borders, continue to hamper efforts to track certain types of financial flows across national borders. Continued progress likely will depend on the success of member countries in changing their domestic laws to allow for greater sharing of financial information, criminalizing certain types of activities, and improving efforts to identify and track terrorist-related financial accounts.

The economic implications of money laundering and terrorist financing pose another set of issues that argue for gaining greater control over this type of activity. According to the IMF, money laundering accounts for between $600 billion and $1.6 trillion in economic activity annually. Money launderers exploit differences among national anti-money laundering systems and move funds into jurisdictions with weak or ineffective laws. In such cases, organized crime can become more entrenched and create a full range of macroeconomic consequences, including unpredictable changes in money demand, risk to the soundness of financial institutions and the financial system, contamination effects on legal financial transactions, and increased volatility of capital flows and exchange rates due to unprecedented cross-border transfers.[53]

[53] The IMF and the Fight Against Money Laundering and the Financing of Terrorism. IMF Factsheet, April 2003. http://www.imf.org/external/np/exr/facts/aml.htm.

Author Information

James K. Jackson
Specialist in International Trade and Finance

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