

# The Financial Action Task Force: An introduction

The Financial Action Task Force (FATF) is a Paris-based intergovernmental organization that was founded with the objective of promoting effective implementation of laws, regulations, and other measures for combating money laundering (ML), financing of terrorism (FT), and similar threats to financial integrity. One of FATF's key outputs is a series of Recommendations that set international standards for combating ML and FT. Donors can use these Recommendations to help developing countries increase their financial integrity and stability, and to prevent risks related to ML and FT in their own operations.



The FATF is a Paris-based organization founded in 1989 by a Group of Seven (G-7) summit in Paris. The organization initially consisted exclusively of developed countries, but now includes some developing countries as well. The FATF currently comprises 34 member jurisdictions and two international organizations; it represents most major financial centres in all parts of the globe.<sup>1</sup>

The FATF can be rightly considered as the main global body that sets standards and supervises the fight against ML and FT. It was established to develop and promote policies to combat ML and FT, as well as to assist with effective implementation of legal, regulatory, and operational measures for combating these crimes, and it relies on a combination of annual self-assessments and periodic mutual evaluations to do so. To become part of the FATF, a candidate country must comply with a set of legal and institutional requirements.<sup>2</sup> The FATF has no enforcement capability, but it can suspend member countries that fail to comply on a timely basis with its standards.

## The FATF standards

When it was established in 1989, the FATF was charged with examining ML techniques and trends, in particular, reviewing actions that states had already taken to fight ML and proposing further measures to combat the problem. As a result of this process, in 1990, the FATF issued a report containing a set of 40 recommendations (The Forty Recommendations)

– a comprehensive plan of action to counter ML. In 2003, the FATF revised its original recommendations (FATF 2003).

Since the terrorist attacks of September 11, 2001, the FATF has redirected its efforts to focus on FT as well as ML. On October 31, 2001, the FATF issued a new set of guidelines and a set of nine recommendations specifically focused on FT (IX Special Recommendations). The complete FATF Recommendations were revised most recently in 2012 to address other threats (most notably, the financing of proliferation of weapons of mass destruction). This last revision sets forth a strong, clear set of standards and provides governments with tools to take action against financial crime and fully integrate the IX Special Recommendations with the measures against ML.

Despite the limited membership of the FATF and the soft law nature of its Recommendations, the FATF standards constitute one of the most successful cases of international cooperation in penal and regulatory matters. They are the basis of the existing anti-money laundering (AML) and counter terrorism financing (CFT) paradigm and have been extensively mirrored in the laws of both member and non-member countries. They also have been translated into international binding instruments such as the European Union AML directives.

The current FATF standards consist of 40 consolidated recommendations that include administrative and regulatory measures to prevent proceeds of crime from entering into the legitimate financial system as well as substantial recommendations regarding criminal law and procedure.<sup>3</sup>

## The Mutual Evaluation Process and its application to developing countries

The FATF standards are used as a basis for conducting peer reviews, called “mutual evaluations,” of each member country's AML/CFT regime. Each evaluation involves a year-long process that includes an on-site visit by a team composed of several assessors from other member jurisdictions and headed by a representative of the FATF secretariat. Based on a pre-established methodology, the assessment team prepares

### Box 1: The New FATF Standards

The new FATF Recommendations, approved in 2012, are grouped into the following seven categories: (1) anti-money laundering and combating the financing of terrorism (AML/CFT) policies and coordination, (2) ML and confiscation, (3) terrorist financing and proliferation, (4) preventive measures, (5) transparency and beneficial ownership of legal persons and arrangements, (6) powers and responsibilities of competent authorities and other institutional measures, and (7) international cooperation.

More broadly, the FATF standards deal with four areas of concern:

- (i) criminalizing ML, FT, and related crimes;
- (ii) strengthening the methods of tracing, freezing, and confiscating the proceeds of illegal activity;
- (iii) implementing regulatory tools to prevent the use of the financial system for the purpose of ML, FT, and other related crimes (including preventive measures to be taken by financial institutions and other businesses and professions, measures to ensure transparency in the ownership of legal persons, and the establishment of competent authorities with appropriate functions); and
- (iv) improving powers, mechanisms, and arrangements to cooperate with other countries.

a draft mutual evaluation report that is discussed, amended, and ultimately agreed to at the following FATF Plenary meeting.<sup>4</sup> Each assessment is conducted in accordance with a specific methodology (FATF 2004, 2013). Not only is this methodology a key tool to assist assessors in preparing mutual evaluation reports, but it is also useful for countries that are reviewing their own systems, including, for example, in conjunction with technical assistance programs.

The FATF mutual evaluation process is an unusual case of international oversight designed to encourage compliance with international rules. Since 2004, each of the 34 FATF member jurisdictions has undergone a mutual evaluation. Each mutual evaluation report includes a detailed description of the country's AML/CFT regime as well as a rating for its degree of compliance with each of the Recommendations.<sup>5</sup> Following each mutual evaluation, the FATF monitors the evaluated country in regard to specific Recommendations for which it received a low rating. The FATF requires each evaluated country to provide a series of periodic follow-up reports detailing its progress until a satisfactory level of compliance with the Recommendations has been achieved. In cases where progress is not considered satisfactory, the FATF Plenary takes a series of gradual steps, which may include a letter from the FATF president to the country's appropriate government official, a high-level mission from the FATF to the country, a public statement, and, ultimately, consideration of whether a country's membership should be suspended.

The mutual evaluation process has been set up to provide a framework for a global, unified, and methodical approach to assessments. The uniform and objective approach helps to ensure resource savings and helps to avoid duplicating efforts.

Although the FATF's membership is limited and its standards do not have the binding force of a treaty, the mutual evaluation process provides incentives for member as well as non-member countries to improve their AML/CFT regimes. The mutual evaluations help member countries identify areas where ML and FT risks are high, thereby assisting them in prioritizing interventions and allocating resources efficiently. This is especially crucial for developing countries. Additionally, the four possible ratings of compliance (compliant, largely compliant, partially compliant, and non-compliant) for each Recommendation provide a simple and immediate way to assess the extent to which a country complies (or does not comply) with the standards. Furthermore, the public reports have a fundamental informative value, providing stakeholders with an official assessment of a country's regulatory framework and implementation. The media's attention to FATF reports has steadily increased in recent years, making deviations from the FATF standards more costly and less tolerable for countries. The assessments also incentivize comparative studies of national AML/CFT regimes and the dissemination of knowledge on the most common and serious deficiencies.

The main weakness of the mutual evaluation process is that it provides only a limited analysis of the effectiveness and implementation of each country's AML/CFT system, beyond the legal framework. This concern emerged clearly through three rounds of evaluation and led the FATF to issue a new methodology for assessing compliance with its Recommendations in 2013 (FATF 2013). The new assessment process focuses more on how effective each country's AML/CFT measures are in practice and includes two inter-linked components:

- (i) a technical compliance assessment, which addresses the specific requirements of the FATF Recommendations as they relate to the country's relevant legal and institutional framework; and
- (ii) an effectiveness assessment, which determines how well the legal and institutional components work together when implemented to meet a set of defined outcomes that are central to a strong AML/CFT system.

Assessing both technical compliance and effectiveness should present an integrated analysis of a country's compliance with the FATF standards.

The 36 FATF members are not the only countries that engage in a mutual evaluation process of compliance with international AML/CFT standards. While most FATF member countries are also OECD members, the FATF mutual assessment methodology has also been applied in other jurisdictions. FATF-style regional bodies (FSRBs) have been established in eight regions to promote the FATF standards outside of the 36 FATF members. These eight FSRBs work together with the actual FATF members to create a network of nearly 200 countries. They are considered FATF "associate members" and engage in their own evaluation process. Many countries in the developing world that are not members of FATF itself have become subject to FATF's standards as a result of the establishment of these regional bodies.

## Box 2: The FSRBs

The 8 FATF “associate members” include the following organizations:

- (i) the Asia/Pacific Group on Money Laundering (APG),
- (ii) the Caribbean Financial Action Task Force (CFATF),
- (iii) the Council of Europe Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (MONEYVAL),
- (iv) the Eurasian Group (EAG),
- (v) the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG),
- (vi) the Financial Action Task Force on Money Laundering in South America (GAFISUD),
- (vii) the Inter Governmental Action Group against Money Laundering in West Africa (GIABA), and
- (viii) the Middle East and North Africa Financial Action Task Force (MENAFATF).

## Relevance to development agencies

FSRBs apply the mutual assessment methodology when engaging in evaluations at the regional level. In addition, the FATF itself examines the AML/CFT frameworks of developing countries that are not FATF members as well as other countries with weak AML/CFT regimes.

### The FATF standards and non-FATF members

Beginning in 1999, the FATF launched an initiative to identify jurisdictions with AML weaknesses (regardless of whether or not they were FATF members). It singled out a list of 23 countries that it perceived to be non-cooperative with the global fight against ML and FT, calling them “non-cooperative countries or territories.”<sup>6</sup> By October 2006, each of the countries originally on this blacklist had taken the necessary steps to be removed from it. The FATF continued this process with increased vigour in 2009 following a call by the Group of Twenty (G-20) to publicly identify high-risk jurisdictions and issue regular updates on jurisdictions with strategic deficiencies. Since June 2009, the FATF’s International Cooperation Review Group (ICRG) has been coordinating a worldwide review of all jurisdictions with deficient AML/CFT regimes (regardless of whether they are members of FATF or of an FSRB).

Following each Plenary meeting, the FATF issues two lists:

- (i) a list identifying jurisdictions with strategic AML/CFT deficiencies, but that have agreed to develop an action plan with the FATF; and
- (ii) a “Public Statement” list that identifies jurisdictions that have strategic AML/CFT deficiencies and either have not committed to an action plan with the FATF or have not made sufficient progress in addressing those deficiencies.

Another FATF-based mechanism that provides information on developing countries is the permanent assessment program jointly run by the World Bank, the International Monetary Fund (IMF), and the FATF itself. This program, launched in 2002, conducts AML/CFT assessments in different countries using the FATF methodology. Under the program, assessments of countries’ AML frameworks – thus far undertaken by the FATF and the FSRBs – would also be conducted by the IMF and the WB with the support of external experts, often affiliated with FATF/FSRBs.

Both the mutual evaluation process, with its expanded scope and coverage, and blacklisting process make available invaluable information on developing countries. Donor agencies can leverage this information when working with developing countries in two main ways: (i) internally, as input into risk assessment processes, and (ii) externally, as a way to identify areas for possible capacity building and technical assistance.

### Risk assessments

Most bilateral and multilateral donor agencies have adopted frameworks for assessing different types of fiduciary risk in the countries where they provide funding (partner countries). This is done as part of an effort to reduce the risk of fraud and corruption and ensure that funds provided are used for their intended purposes. Corruption and governance risk assessments are conducted by drawing on a variety of assessments produced by different organizations. For example, donors often use Public Expenditures and Financial Accountability (PEFA) country reports to assess corruption risks related to the public financial management system of a country. For instance, the UK Department for International Development (DfID), relies significantly on PEFA reports when conducting fiduciary risk assessments (FRAs). Similarly, donors can use FATF reports to assess the particular corruption risks stemming from ML and the level of opacity of the financial system. An opaque financial system enables corruption (among other things) because it allows both the corruptors and the corrupted officials to conceal the proceeds of their crimes, thus facilitating both bribe-giving and bribe-receiving.

Donor agencies can use FATF mutual evaluations and follow-up reports not only as a snapshot of a country’s AML framework at a certain point in time, but also to get an overview of its development over time and to gain an understanding of the country’s political will to counter ML and corruption. The list of NCCTs – and how countries react to being placed on this list – may inform donors about the extent of political commitment within a country. Failure to take steps to strengthen its AML/CFT framework should be a risk factor a donor agency considers before deciding to provide aid – or at least certain types of aid (e.g., budget support) – to a partner country. Similarly, donor agencies can use FATF evaluations and blacklists as leverage when discussing possible aid programs with non-compliant jurisdictions.

As an example, DfID (2011), within the framework of its Fiduciary Risk Assessments, recommends the use of reports issued by the FATF and FATF-style bodies to assess a country’s “trajectory of anti-corruption reforms” and particularly to weigh





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the partner government's commitment to implement measures that can help prevent corruption. Notably, reforms aimed at implementing an AML regime hardly ever occur in a void, but are often adopted in conjunction with anti-corruption reforms, which reinforces the validity of FATF reports as proxies for understanding a country's anticorruption environment.

### Input into technical assistance and capacity building programs

FATF reports identify weaknesses and gaps in countries' AML frameworks and help establish priority areas that need to be addressed. Donor agencies can use this information when making funding decisions about technical assistance in partner countries. Once priorities have been identified, donor agencies may consider providing technical assistance either directly or through well-established institutions, such as the Stolen Asset Recovery Initiative (StAR) or the International Centre for Asset Recovery (ICAR). Information from FATF reviews is also useful for countries that are reviewing their own systems, including, for example, in conjunction with requests presented to donors for support and technical assistance.

### Box 3: The Inter-American Development Bank's Program for Stability and Fiscal and Financial Transparency

An insightful example of the above approach is the IDB's Program for Stability and Fiscal and Financial Transparency. This program has, among other things, allocated a pool of funds aimed at supporting partner countries in their efforts to establish systems to prevent ML and FT and to improve their record of compliance with the FATF Recommendations. The program's rationale is provided by the recognition that a country's failure to comply with the FATF standards, and particularly the threat of blacklisting, can have significant repercussions on its ability to draw foreign investment and can ultimately hamper the achievement of development goals. In other words, compliance with the standards (as costly as it may be) may be considered as an investment into the country's development (Masciandaro 2013).

The first round of interventions under the program focused on ensuring the compliance of 12 countries in the Latin America and Caribbean region with FATF recommendations 1 and 2. These recommendations require the development and implementation of national risk assessments and national coordination plans, implementation of FATF's risk-based approach, and the enhancement of the capacity of public agencies responsible for AML/CFT and supporting regulatory reforms.

## Endnotes

<sup>1</sup> The FATF is housed at the headquarters of the Organisation for Economic Co-operation and Development (OECD) in Paris. Although it occasionally relies on some OECD staff, the FATF is not part of the OECD. The full list of FATF members and observers is available at: <http://bit.ly/1BHQm8d>

<sup>2</sup> The eligibility criteria for countries to be considered for FATF membership can be found at <http://bit.ly/1xLYTpi>

<sup>3</sup> The published standards also include interpretive notes and a glossary (FATF 2012).

<sup>4</sup> The FATF Plenary is the organization's decision-making body. It currently meets three times a year.

<sup>5</sup> All mutual evaluation reports are available at <http://bit.ly/17ptFDX>. The methodology applied until the third round of mutual evaluations was based on the following compliance ratings: compliant, largely compliant, partially compliant, and non-compliant. In exceptional circumstances a specific FATF Recommendation could also be rated as not applicable.

<sup>6</sup> This list was called the "NCCTs" list or "FATF blacklist." The use of the term "non-cooperative" is debatable and was occasionally criticised as misleading. A number of the countries on the list simply lacked the infrastructure or resources to cope with the relatively sophisticated financial criminals who tried to operate in their territories. Moreover, the financial systems of some of those countries were remarkably underdeveloped to such an extent that the risk of their abuse for ML/FT purposes was limited. On this point, see the brilliant contribution of Sharman (2011).

<sup>7</sup> See <http://bit.ly/1FyRaR1>

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