

INTERNATIONAL MONETARY FUND AND WORLD BANK

**Anti-Money Laundering and Combating the Financing of Terrorism:  
Observations from the Work Program and Implications Going Forward**

**Supplementary Information**

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Contents	Page
Acronyms.....	3
I. Findings from the AML/CFT Assessments.....	5
A. Compliance with the FATF Recommendations.....	5
B. Comparison with Assessments Under the Old Standard and Methodology .....	12
C. Issues of Application and Interpretation .....	16
D. Assessment Logistics and Process .....	16
II. Experience with Technical Assistance.....	18
A. Technical Assistance Provided .....	18
B. Lessons Learned.....	24
C. Technical Assistance by Region .....	27
III. Implementing the Revised AML/CFT Standards: DNFBPs.....	38
A. Characteristics and Practices.....	38
B. Implementing AML/CFT Obligations .....	39
C. Experiences with Assessments.....	43
IV. Implementing the Revised AML/CFT Standard: Remittances.....	44
A. Characteristics and Practices.....	45
B. Implementing AML/CFT Obligations .....	45
C. Ongoing and Completed Work .....	46

V. Implementing the Revised AML/CFT Standard: Non-Profit Organizations .....	52
A. Characteristics and Practices.....	53
B. Implementing CFT Obligations .....	55
C. Experiences with Assessments.....	56
VI. List of Bank/Fund AML/CFT Publications.....	56

Tables

1. Profile of Overall Compliance with FATF Recommendations .....	9
2. FATF Recommendations Rated Partially Compliant and Non-Compliant .....	10
3. Average Size of ROSC-Assessment Mission Teams, 2004–2005.....	17
4. Bank/Fund TA Projects: January 2004 to June 2005 Projects by Region, Topic, and Modality .....	<b>Error! Bookmark not defined.</b>

Figures

1. Compliance with AML/CFT: All Countries Assessed .....	11
2. Comparison of Compliance Levels between Old & New Methodology of Low-, Middle-, and High-Income Countries .....	15
3. TA Project by Category and Region.....	21

Boxes

1. Examples of Innovative Modalities for TA Delivery .....	19
2. Highlights of TA in Africa.....	28
3. Highlights of TA in Asia Pacific .....	30
4. Highlights of TA in Eastern and Central Europe.....	32
5. Highlights of TA in the Middle East, Central Asia, and Caucasus.....	33
6. Highlights of TA in Latin America and the Caribbean.....	35
7. List of FSRBs and Other Regional Bodies by Region.....	37
8. Bank’s Activities on Remittance .....	48
9. Study of Remittance Service Providers in the United States.....	50

## ACRONYMS

AML	Anti-Money Laundering
APEC	Asia Pacific Economic Corporation
APG	Asia-Pacific Group on Money Laundering
ARS	Alternative Remittance Systems
BPP	Best Practices Paper
BRCA	Bilateral Remittance Corridor Analysis
CAS	Country Assistance Strategy
CDD	Customer due diligence
CFATF	Caribbean Financial Action Task Force
CFT	Combating the Financing of Terrorism
CIS	Commonwealth of Independent States
CPSS	Committee for Payment and Settlement Systems
DNFBP	Designated non-financial businesses and professions
EAG	Eurasian Anti-Money Laundering Group
ESAAMLG	Eastern and Southern Africa Anti-Money Laundering Group
FATF	Financial Action Task Force
FIRST	Financial Sector Reform and Strengthening Initiative
FIU	Financial intelligence unit
FSA	Financial Sector Assessment
FSAP	Financial Sector Assessment Program
FSSA	Financial System Stability Assessment
FSRB	FATF–Style Regional Bodies
FT	Financing of terrorism
GAFISUD	South American Financial Action Task Force
GEP	Global Economic Prospects
GIABA	Groupe Inter-gouvernemental d’Action contre le Blanchiment d’Argent en Afrique Ouest
IAE	Independent AML Expert
IFI	International Financial Institutions
IMF	International Monetary Fund
IMFC	International Monetary and Financial Committee
IN	Interpretative Note
MENAFATF	Middle East and North Africa FATF
ML	Money laundering
MLA	Mutual Legal Assistance
MONEYVAL	Council of Europe Group on Money Laundering
NBFI	Non-bank financial institution
NCCT	Non-Cooperative Countries and Territories
NPO	Non-profit organization

OFC	Offshore Financial Center
ROSC	Report on the Observance of Standards and Codes
RSP	Remittance Services Provider
SR	Special Recommendations
SRO	Self-Regulatory Organization
STR	Suspicious Transaction Report
TA	Technical Assistance
TCSP	Trust and Company Services Provider
UN	United Nations
UNCTC	United Nations Counter Terrorism Committee
UNODC	United Nations Office on Drugs and Crime

## I. FINDINGS FROM THE AML/CFT ASSESSMENTS

1. **This Section is divided into four parts.** The first part presents the findings concerning overall compliance with the revised standard and methodology and the second part compares these findings to those of assessments under the old methodology. The third part discusses interpretative and application issues and the fourth describes logistical issues based on the experience of the assessments carried out to date.

### A. Compliance with the FATF Recommendations

2. **Table 1 provides an overview of compliance with the revised standard** according to each individual FATF Recommendation.<sup>1</sup> Figure 1 provides a bar chart for the compliance of all jurisdictions assessed and Table 2 ranks individual FATF Recommendations by how frequently they were rated in the two lowest grades—non-compliant or partially-compliant.

3. **Based on the assessments the following general conclusions on the performance of the assessed countries can be drawn:**

#### Overall level of compliance

- **The overall level of compliance is low for all assessed countries.** 21 percent of all recommendations were rated fully compliant, 24 percent were rated largely compliant, 29 percent were rated partially compliant, and 26 percent non-compliant.
- **Overall compliance is better for the 40 AML Recommendations (47 percent rated fully or largely compliant) versus only 33 percent fully or largely compliant for the CFT Special Recommendations.**

#### Legal systems

- **Of twelve assessed high- and middle-income countries, all have criminalized money laundering.** However, in five cases (42 percent), the list of money laundering offences does not fully comply with the standard because it does not cover all the relevant circumstances reflected in the standard. Of six assessed low-income countries, 3 have recently passed AML laws, at least three, countries were still in the process of passing drafted legislation.
- **44 percent of assessed countries were rated non-compliant** on criminalizing the financing of terrorism (SR II).
- **International cooperation (including mutual legal assistance) was generally rated favorably** in assessments, though no countries were considered fully compliant, in part because of incomplete implementation. Dual criminality measures impeded the

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<sup>1</sup> According to the revised methodology, a four-grade rating system was used: compliant (C), largely compliant (LC), partially compliant (PC), and non-compliant (NC).

effectiveness of international cooperation in three countries and relevant international conventions were not ratified in one country. Low-income countries generally had only limited legal frameworks for international cooperation. In practice, this has meant that the authorities' power to cooperate is rarely impeded by legal procedural requirements; however, the absence of clear legal rules renders the process of cooperation more ad hoc and less systematic.

- **No country was rated non-compliant with the requirement to sign, ratify and fully implement the Vienna, Palermo, and 1999 Terrorist Financing conventions** (Recommendation 35), only 6 percent of assessed countries were rated fully compliant, 33 percent were largely compliant, and 61 percent were partially compliant.
- **Most countries' bank secrecy laws were positively assessed** as not inhibiting the implementation of the FATF Recommendations.

#### **Preventative Measures—Financial Institutions**

- **All assessed high- and middle-income countries have adopted a range of preventive measures** applicable to the prudentially-regulated financial sectors (the banking, securities, and insurance sectors), but implementation is uneven. No countries were fully compliant, and a large percentage of the countries were non-compliant with the Recommendation requiring enhanced due diligence for politically exposed persons.<sup>2</sup> Many of the assessed low-income countries had only begun the process of creating regulatory frameworks. Where such frameworks were present, they only covered the banking sector.
- **61 percent of assessed countries were non-compliant with the FATF Recommendation (SR IV)** that compels reporting of transactions when there is suspicion that there are funds linked to terrorism;
- **Compliance regarding basic AML/CFT preventative measures is low**
  - For customer due diligence (CDD) (Recommendation 5), no countries were rated compliant, 33 percent were considered largely compliant, 67 percent were partially compliant or non-compliant.
  - For suspicious transaction reporting (STR) (Recommendation 13), only 6 percent were considered compliant, 22 percent largely compliant, 33 percent partially compliant, and 39 percent non-compliant.

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<sup>2</sup> Politically Exposed Persons (PEPs) are individuals who are or have been entrusted with prominent public functions in a foreign country, for example Heads of State or of government, senior politicians, senior government, judicial or military officials, senior executives of state owned corporations, important political party officials. Business relationships with family members or close associates of PEPs involve reputational risks similar to those with PEPs themselves.

- **Generally, the effectiveness of the supervisory systems remains a concern.** Even among assessed high- and middle-income countries, the supervisory framework did not yet cover all aspects of the relevant Recommendations. In addition, sanctioning powers needed to be either strengthened or streamlined. Assessors expressed a general concern that the supervisors did not have sufficient means to perform their supervisory duty effectively and such capacity issues were particularly acute in the assessed low-income countries.

### **Preventative Measures—Designated Non-Financial Businesses and Professions (DNFBP)**

- **No countries were fully compliant** and a large percentage of assessed countries were non-compliant with the recommendations concerning DNFBPs. Even where AML/CFT requirements had been fully extended to DNFBPs, implementation was weak.
- **The observed weaknesses in DNFBP preventative measures were not uniform** (see Section III for a more detailed discussion). Of the sectors covered, the casino sector is the most heavily supervised and extension of the AML/CFT obligations has been the least problematic. Similarly, as customer identification and record-keeping are essential elements of the notary's role in many jurisdictions, few issues have been encountered regarding their new AML/CFT compliance. At the other end of the spectrum, implementing the Recommendation requiring that lawyers report suspicious transactions under certain circumstances is problematic in almost all jurisdictions. Real estate agents and dealers in precious metals and stones have posed a different kind of problem, as they tend to be unfamiliar with AML/CFT issues and these professions typically have had no pre-existing supervisory structure.
- **Breaking down the findings by income groups, the assessed low-income countries were universally non-compliant on Recommendations 12 and 16** (CDD and STR respectively) and 83 percent non-compliant on Recommendation 24 (supervision). The assessed middle-income countries were 80 percent partially compliant and 20 percent non-compliant on R 12 and 16, and 20 percent largely, 20 percent partially, and 60 percent non-compliant on R 24. The assessed high-income countries received ratings on R 12 similar to those of the middle-income countries (71 percent partially and 29 percent non-compliant), did somewhat better on R 16 (14 percent largely, 57 percent partially, and 29 percent non-compliant), and on R 24 (14 percent largely, 43 percent partially and 43 percent non-compliant).

### **Law Enforcement**

- **With respect to FIUs (Recommendation 26), 6 percent were rated compliant,** 39 percent largely compliant, 6 percent partially compliant, and 50 percent non-compliant. This indicates some major shortcomings in an area that is critical to AML/CFT efforts. The observed weaknesses in the high- and middle-income countries concerned lack of resources, failure to provide adequate feedback to the reporting institutions, and insufficient analysis of the suspicious transaction reports.

No assessed low-income country had an operational FIU, although some jurisdictions had set up units performing some FIU-related functions.

- **Compliance regarding SR III on freezing and confiscation of terrorist assets is weak.** No countries were fully compliant, 11 percent largely compliant, 50 percent partially compliant, and 39 percent non-compliant. Despite identified flaws in the legal framework, the assessed countries have adopted transitional measures to implement UN Security Council Resolution 1267 and successor resolutions on terrorist financing.
- **Many assessors noted that even where legal provisions and law enforcement powers were in place, ML/FT investigations and prosecutions were limited.**

Table 1. Profile of Overall Compliance with FATF Recommendations

FATF Recommendations	Compliant (in percent)	Largely Compliant (in percent)	Partially Compliant (in percent)	Non- compliant (in percent)	Assessed Jurisdictions (number)
<b>The Forty Recommendations</b>					
1 - ML offence	17	39	28	17	18
2 - ML offence—mental element and corporate liability	33	33	17	17	18
3 - Confiscation and provisional measures	11	44	39	6	18
4 - Secrecy laws consistent with the Recommendations	61	28	11	0	18
5 - Customer due diligence	0	33	56	11	18
6 - Politically exposed persons	6	17	17	61	18
7 - Correspondent banking	17	22	22	39	18
8 - New technologies & non face-to-face business	28	11	28	33	18
9 - Third parties and introducers	29	14	43	14	14
10 - Record keeping	39	33	11	17	18
11 - Unusual transactions	22	33	22	22	18
12 - DNFBP—R.5, 6, 8-11	0	0	56	44	18
13 - Suspicious transaction reporting	6	22	33	39	18
14 - Protection & no tipping-off	39	22	28	11	18
15 - Internal controls, compliance & audit	17	28	39	17	18
16 - DNFBP—R.13-15 & 21	0	6	44	50	18
17 - Sanctions	6	33	39	22	18
18 - Shell banks	33	39	17	11	18
19 - Other forms of reporting	44	17	6	33	18
20 - Other NFBP & secure transaction techniques	24	12	12	53	17
21 - Special attention for higher risk countries	22	17	33	28	18
22 - Foreign branches & subsidiaries	13	27	40	20	15
23 - Regulation, supervision and monitoring	0	28	56	17	18
24 - DNFBP - regulation, supervision and monitoring	0	11	28	61	18
25 - Guidelines & Feedback	0	33	28	39	18
26 - The FIU	6	39	6	50	18
27 - Law enforcement authorities	28	28	28	17	18
28 - Powers of competent authorities	67	11	22	0	18
29 - Supervisors	28	28	33	11	18
30 - Resources, integrity and training	6	28	44	22	18
31 - National co-operation	17	33	39	11	18
32 - Statistics	0	33	28	39	18
33 - Legal persons—beneficial owners	28	33	28	11	18
34 - Legal arrangements – beneficial owners	70	10	10	10	10
35 - Conventions	6	33	61	0	18
36 - Mutual legal assistance (MLA)	28	33	33	6	18
37 - Dual criminality	39	28	22	11	18
38 - MLA on confiscation and freezing	22	17	44	17	18
39 - Extradition	39	22	17	22	18
40 - Other forms of co-operation	44	17	22	17	18
<b>Nine Special Recommendations</b>					
SR.I - Implement UN instruments	11	22	50	17	18
SR.II - Criminalize terrorist financing	11	28	17	44	18
SR.III - Freeze and confiscate terrorist assets	0	11	50	39	18
SR.IV - Suspicious transaction reporting	6	22	11	61	18
SR.V - International cooperation	17	28	22	33	18
SR.VI - AML requirements for money/value transfer services	35	24	29	12	17
SR.VII - Wire transfer rules	17	17	17	50	18
SR.VIII - Nonprofit organizations	17	17	28	39	18
SR.IX - Cash Couriers	15	0	31	54	13

Source: Assessment Reports

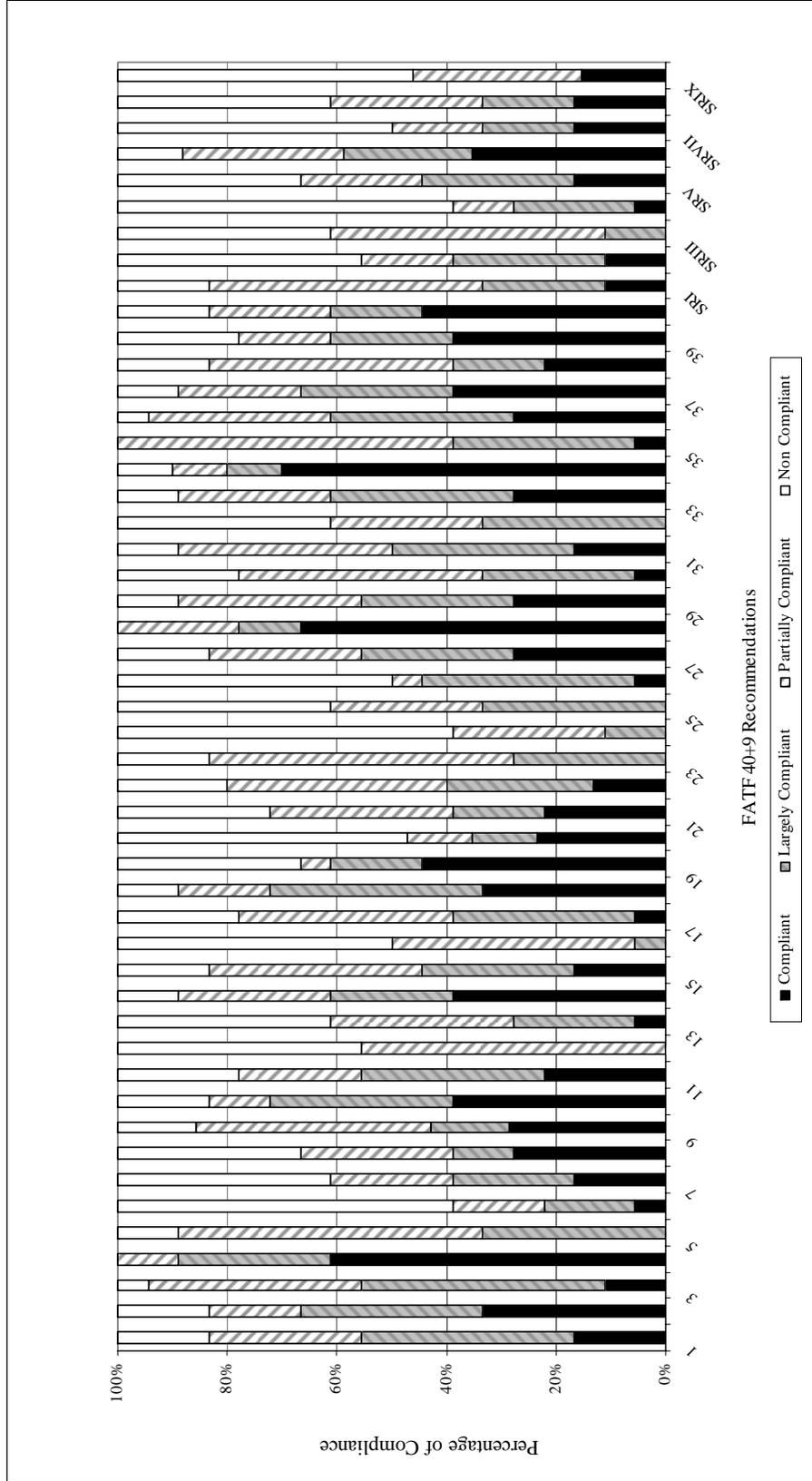
Table 2. FATF Recommendations Rated Partially Compliant and Non-Compliant

Proportion of jurisdictions <sup>1/</sup>	Nine Special Recommendations	Proportion of jurisdictions <sup>1/</sup>	Nine Special Recommendations
16/18	SR.III - Freeze and confiscate terrorist assets	12/18	SR.VIII - Nonprofit organizations
11/13	SR.IX - Cash Couriers	11/18	SR.II - Criminalize terrorist financing
13/18	SR.IV - Suspicious transaction reporting	10/18	SR.V - International cooperation
12/18	SR.I - Implement UN instruments	7/17	SR.VI - AML requirements for money/value transfer services
12/18	SR.VII - Wire transfer rules		
	<b>FATF Recommendations</b>		<b>FATF Recommendations</b>
18/18	12 - DNFBP-R.5, 6, 8-11	10/18	26 - The FIU
17/18	16 - DNFBP-R.13-15 & 21	9/18	31 - National co-operation
16/18	24 - DNFBP - regulation, supervision and monitoring	8/18	1 - ML offence
14/18	6 - Politically exposed persons	8/18	3 - Confiscation and provisional measures
13/18	13 - Suspicious transaction reporting	8/18	11 - Unusual transactions
13/18	23 - Regulation, supervision and monitoring	8/18	27 - Law enforcement authorities
12/18	5 - Customer due diligence	8/18	29 - Supervisors
12/18	25 - Guidelines & Feedback	7/18	33 - Legal persons-beneficial owners
12/18	30 - Resources, integrity and training	7/18	14 - Protection & no tipping-off
12/18	32 - Statistics	7/18	19 - Other forms of reporting
11/17	20 - Other NFBP & secure transaction techniques	7/18	36 - Mutual legal assistance (MLA)
11/18	7 - Correspondent banking	7/18	39 - Extradition
11/18	8 - New technologies & non face-to-face business	7/18	40 - Other forms of co-operation
11/18	17 - Sanctions	6/18	2 - ML offence-mental element and corporate liability
11/18	21 - Special attention for higher risk countries	6/18	37 - Dual criminality
11/18	35 - Conventions	5/18	18 - Shell banks
11/18	38 - MLA on confiscation and freezing	5/18	10 - Record keeping
9/15	22 - Foreign branches & subsidiaries	4/18	28 - Powers of competent authorities
8/14	9 - Third parties and introducers	2/10	34 - Legal arrangements – beneficial owners
10/18	15 - Internal controls, compliance & audit	2/18	4 - Secrecy laws consistent with the Recommendations

Source: Assessment Reports

1/ Ratings were not recorded for all recommendations in some assessments. Proportion represents the number of jurisdictions adversely rated out of total jurisdictions assessed for each recommendation.

Figure 1. Compliance with AML/CFT: All Countries Assessed



Source: Assessment Reports

## **B. Comparison with Assessments Under the Old Standard and Methodology**

4. **The revision of the FATF 40 AML Recommendations in 2003 and the adoption of the Special Recommendations on Terrorist Financing in 2001 required a fundamental revision of the Assessment Methodology**, which was adopted by the FATF in February, 2004 and endorsed by the Bank/Fund Boards in March 2004.

5. The new standard and methodology differed from the old in several critical ways, including:<sup>3</sup>

- **The 2004 Methodology contains over 200 essential criteria, 20 sub-criteria and 35 additional criteria, as compared to 120 criteria under the 2002 Methodology.**
- **There are significant differences between the two methodologies with respect to the Special Recommendations on Terrorist Financing**, owing to the fact that the FATF developed and endorsed a number of interpretative notes, guidance and best practices after its endorsement of the 2002 Methodology. The most significant changes concern criteria relating to SR III (Freezing and Confiscating Terrorist Assets), SR VI (Alternative Remittance) and SR VII (Wire Transfers), for which the FATF issued interpretative notes in 2003.
- **Strengthened and expanded preventive measures for financial institutions.** For example, following the enhancement of the FATF Recommendation 5, there are more detailed criteria concerning the conduct of customer due diligence (CDD) with respect to the circumstances under which CDD is to be conducted, the timing of verification, measures to be taken with respect to existing customers and conditions under which simplified customer due diligence may be allowed.
- **Preventive measures are to apply to a designated set of non-financial businesses and professions where they prepare for, or carry out, certain types of transactions.** The designated non-financial businesses and professions are: casinos; real estate agents; dealers in precious metals and stones; lawyers, notaries and other independent legal professionals; accountants; and trust and company service providers.
- **There are more explicit and detailed requirements for setting up an FIU.** While the old methodology has included some requirements for setting up an FIU, the new

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<sup>3</sup> See *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; Supplement 1* (Washington: IMF/WB: March 16, 2004) for more detail. The old methodology also used a four-level rating system—compliant, largely compliant, materially non-compliant, and non-compliant.

methodology provides specific essential criteria for FIUs' functions, independence, and access to information arrangements.

- **With respect to international cooperation, there are more developed and refined requirements concerning mutual legal assistance (MLA)** and a much greater recognition and specification of the measures needed for non-MLA cooperation, amongst FIUs but also for law enforcement, regulators, and other competent authorities. The requirements also articulate more precisely the need to eliminate measures that hinder and prevent international co-operation.
- **Enhanced attention to the effectiveness of implementation of AML/CFT measures.** Compliance under the 2004 Methodology requires effective implementation, in addition to the adoption of laws, regulations and other measures. To receive a compliance rating countries must not only adopt appropriate laws, regulations and other measures, but also implement and utilize them.

6. **Comparison of the assessments performed under the old and new methodologies indicates that overall compliance ratings have gone down.** Comparing samples of assessed countries indicates that the level of compliance of the sample assessed under the old methodology was 62 percent compared to 45 percent for the sample assessed under the new methodology. Differences are large both for the 40 Recommendations (compliance falls from 67 to 44 percent) and the CFT Recommendations (58 percent to 33 percent). The comparison is based on the 18 countries assessed under the new methodology (comprising 7 high-income, 5 middle-income, and 6 low-income countries) and a sample of 18 countries of similar size and composition taken from the 41 countries assessed under the old methodology (as reported under the pilot program). Of the 18 countries assessed under the new methodology, only 11 of the assessment findings have been finalized (to date).

7. **The results from the sample of countries assessed under the old methodology and the 18 countries assessed under the new methodology reveals two major differences.** For the 40 AML Recommendations the level of non-compliance<sup>4</sup> is lower in the sample of countries assessed under the old methodology (17 percent) than is non-compliance in the sample of countries assessed under the new methodology (26 percent). With regard to the CFT Special Recommendations the increase in non-compliant ratings under the new methodology was far more pronounced—39 percent in countries assessed under the new methodology compared with 20 percent in the sample of countries assessed under the old methodology.

8. **Changes in ratings are also evident with respect to some key AML and CFT Recommendations.** For example, 40 percent of the countries assessed under the new methodology were rated non-compliant on the criminalization of the financing of terrorism

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<sup>4</sup> Partially compliant, materially non-compliant, and non-compliant ratings.

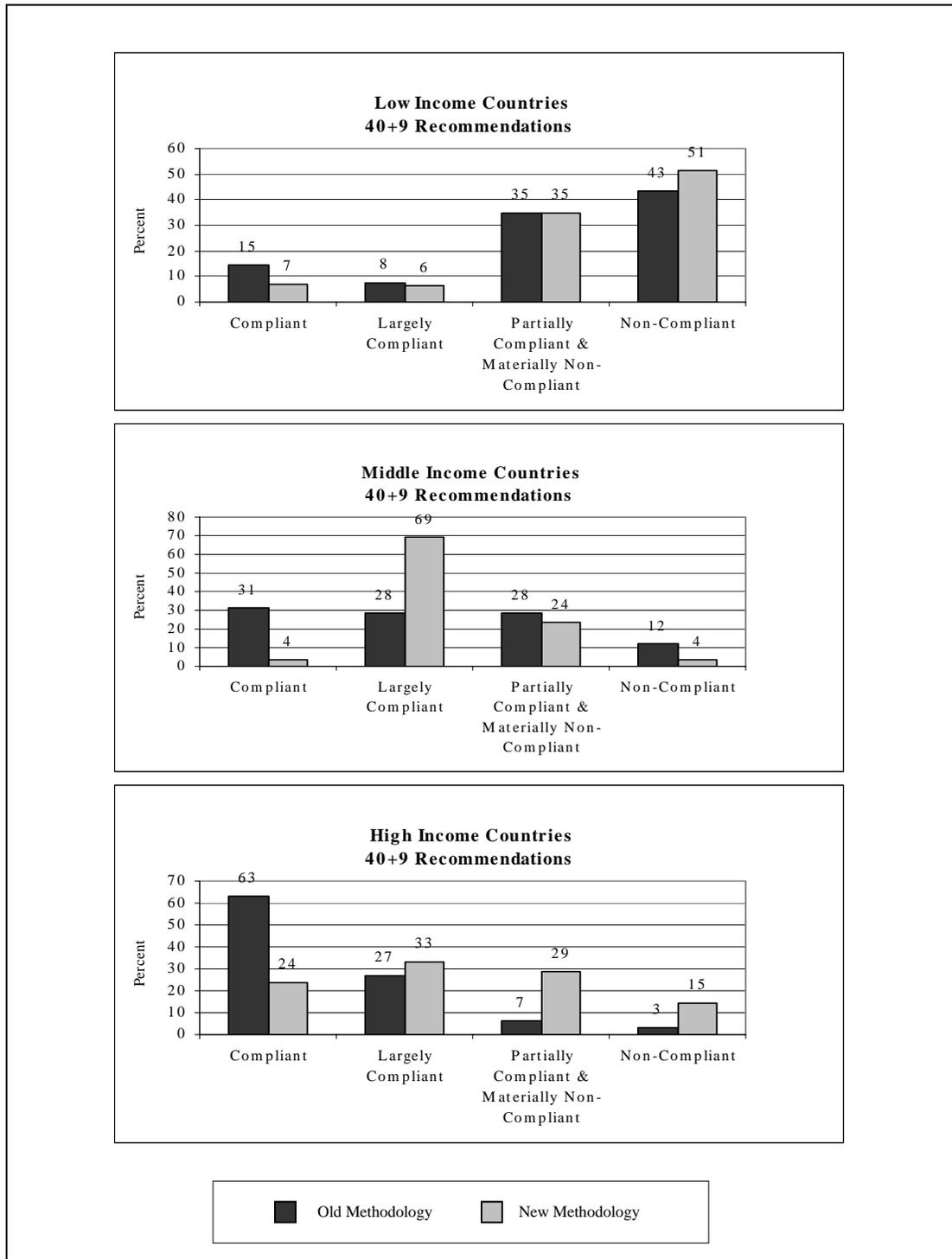
and 64 percent on FT STR Reporting (SR IV), as opposed to 33 percent and 28 percent respectively for the sample of countries assessed under the old methodology.

9. **Also, no countries were rated fully compliant with the Recommendation for CDD requirements under the new methodology**, as opposed to 22 percent of the sample of countries assessed under the old methodology. Similarly, only 7 percent of countries received a rating of fully compliant with the STR requirements under the recommendations, down from 39 percent under the old methodology.

10. Differences are observable for assessed countries in all income groups (see Figure 2), although the trend is not uniform.

- **Assessed low-income countries have had difficulty achieving high compliance ratings under either methodology**, reflecting in part the very rudimentary nature of their AML/CFT regimes. However, the ratings under the new methodology are somewhat worse. Among the assessed low-income countries 23 percent of the recommendations were found to be compliant or largely compliant under the old standard, compared to 13 percent under the revised standard. These countries' ratings for CFT compliance were particularly affected, going from 14 percent compliant or largely compliant under the old methodology to 2 percent under the new.
- **Assessed high-income countries had significantly lower compliance levels under the new methodology than the old.** Under the old methodology, 90 percent of their recommendations were rated compliant or largely compliant, compared to 57 percent under the new methodology, which could mean that the expansion of the standard and the greater precision of the methodology has had a greater effect on countries whose AML/CFT regimes were already established
- **Assessed middle-income countries were the only sub group which showed higher ratings under the new methodology**, with 73 percent of recommendations rated compliant or largely compliant compared to 59 percent before.

Figure 2. Comparison of Compliance Levels between Old & New Methodology of Low-, Middle-, and High-Income Countries



Source: Bank/Fund staff

- Under the old methodology, 27 of the 40 and 7 of the 8 Special Recommendations were rated in the assessments, and under the new methodology all 40 and all special Recommendations were rated in the assessments.

- The sample countries assessed under the old methodology included 18 high-income, 18 middle-income, and 5 low-income countries; the sample countries assessed under the revised methodology included 7 high-income, 5 middle-income and 6 low-income countries.

### C. Issues of Application and Interpretation

11. **Analysis of the assessments has identified issues in the application and interpretation of the revised standard** relating to: (i) the consistency in applying the methodology; and (ii) interpretation of the FATF standard, including:

- **Assessors often base their judgment of effectiveness on statistical information, which is open to divergent interpretations.** In a number of cases, divergence in the use of statistical information has led to different assessments of comparable situations in assessed countries.
- **Some Recommendations (such as those relating to customer due diligence or supervision) require a single aggregate rating for compliance** in wide variety of financial sectors. Given the differences in compliance that may exist between sectors, aggregate rating in such cases may be misleading and certainly lacks transparency.
- **Strengths or weaknesses observed under one Recommendation can have an effect on the rating of other recommendations.** For example, failure to criminalize terrorist financing might affect compliance with STR and FIU requirements among others. Absent clear guidance, different assessors have rated these related Recommendations differently.
- **Some features of the AML/CFT regime are rated under more than one Recommendation**, i.e., “Regulation and supervision” and “Ongoing supervision and monitoring” (R. 23 & R. 29), which leads to analytical inconsistencies.
- **The great variety in the operational rules and guidelines adopted by countries in the implementation of AML/CFT measures for DNFBCs requires assessors to undertake case by case review of arrangements in each sector** and make more independent judgments about their reasonableness and effectiveness, adding a greater degree of subjectivity to their findings. Moreover, the absence of any concrete preventative measures specified for NPOs under SR VIII makes assessment even less precise, as assessors may have to examine a wide range of oversight practices to see if the overall environment achieves the objectives set in the standard.
- **Finally, some criteria also appeared to be difficult to assess in largely cash-based economies.**

### D. Assessment Logistics and Process

12. **There are three stages to the AML/CFT assessment:** (i) preparation (based primarily, but not exclusively on the assessed country’s response to a self-assessment questionnaire); (ii) on-site visit; and (iii) finalization of reports (Detailed Assessment Report and Report on the Observance of Standards and Codes). The preparation generally required three weeks of work prior to the start of the assessment with the onsite visits usually lasting for 12–17 days each for a team of three to five experts. The experience is that following the on-site visit, an additional three weeks of processing time, in total, were required to finalize

the draft report. However, finalization of the report usually required a four to six-months period following the on-site mission to allow for feedback from stakeholders.

13. **The logistics for assessments under the revised standard have been a challenge for all countries and assessors.** This is especially problematic for low-income countries, where capacity constraints have often led to difficulties in completing the assessment questionnaire and other elements of the preparatory process. Some high- and middle-income countries also experienced difficulties in completing the questionnaire. Incomplete pre-mission information places a significant burden on assessors during the onsite visit. The self-assessment questionnaire needs further development and should be focused more on the essential criteria listed in the methodology. Furthermore, for low-income countries, some consideration should be given to providing assistance for completing the self-assessment questionnaire.

14. **For the assessors, the addition of ten or so new sectors (DNFBP and NPO) to each AML/CFT assessment has added considerable resource demands.** Typically two, and sometimes three, entities have roles in the organization and regulation of each of the new areas (e.g., for lawyers, the Justice Ministry may have responsibility for the legal framework, the bar/law society for ongoing oversight, and the courts may play a role in disciplining and sanctioning). Assessors need to meet with (i) each authority to evaluate the framework of oversight; (ii) professional associations; and (iii) practitioners to gauge the effectiveness of implementation. As each additional sector assessed requires three to four meetings, proper coverage of all relevant DNFBPs adds an additional 10 to 20 meetings. As a result of the increased resource demands, the average size of an AML/CFT mission team has increased. Table 3 illustrates the average size of an AML/CFT mission team in comparison to teams used for other ROSCs.

15. **With the inclusion of DNFBPs, assessment reports have grown in length.** The draft detailed assessment reports compiled for the first nine reports prepared using the revised methodology run from 100 to 195 pages in length.

Table 3. Average Size of ROSC-Assessment Mission Teams, 2004–2005  
( Number of persons)

Type of ROSC	Number of Persons
STA- Data	5.2
FAD- Fiscal	3.1
MFD- IAIS principles	1.0
IOSCO principles	1.0
Financial Transparency Code	1.0
Basel core principles	2.0
AML/CFT standard	4.0

Source: The Standards and Codes Initiative – Is it Effective? And How Can it be Improved?  
Background Paper - Supplement 1, Table 25 and staff estimates

## II. EXPERIENCE WITH TECHNICAL ASSISTANCE

16. **During the period January 2004–June 2005, countries have increased their demands for anti-money laundering and combating the financing of terrorism (AML/CFT) technical assistance (TA).** Factors influencing the growth in demand include countries' efforts to implement the more rigorous and extensive AML/CFT standard, a greater awareness of the AML/CFT requirements, lack of experience and capacity to implement these measures, and referrals from agencies such as the United Nations Counter Terrorism Committee (UNCTC) and the FSRBs to the Bank/Fund. The Bank/Fund have continued to collaborate with donor countries and organizations in this respect.

17. **One objective of the strategy for the delivery of TA is to have it gradually evolve from primarily short-term initiatives (with some exceptions), to more substantive, tailor-made programs that are sustainable over the longer-term.** Some of the more recent TA projects have been designed to provide multi-disciplined, sequenced and prioritized assistance spanning several months or even several years. These projects require a significant commitment of financial and human resources. In the 18 months between January 2004 and June 2005, the Bank/Fund delivered 210 TA projects (169 field and 41 HQ-based projects). In so doing, the Bank/Fund have become major providers of AML/CFT TA.

This section provides an overview of the type of TA which was delivered as well as a regional breakdown on the Bank/Fund experience.

### A. Technical Assistance Provided

18. **The primary objective of TA provided by the Bank/Fund is to assist countries in the implementation of the full AML/CFT standard.** In order to meet this objective, TA included (i) designing institutional frameworks; (ii) legislative drafting and the provision of legal advice; (iii) enhancing financial supervisory regimes; and (iv) building capacity of financial intelligence units and other agencies.

#### **The Fund/Bank have utilized different modalities in delivering TA:**

- Traditional workshops and seminars;
- Video conferencing (Global Policy Dialogues) (See Box 1);
- Multi-year (Capacity Enhancement Program) (See Box 1);
- Appointment of mentors and peripatetic advisors;
- In addition the Fund/Bank have produced several publications on a wide range of AML/CFT topics (see Section VI).

### Box 1: Examples of Innovative Modalities for TA Delivery

#### **Global Policy Dialogue Series**

The Global Policy Dialogue Series is a live video conference with AML/CFT policy makers from five or more countries, experts in the region and Bank/Fund experts. The Dialogue Series which started in January 2002 is now in its 3rd series. The first Global Policy Dialogue Series “Combating Financial Abuse” reached more than 700 policy makers and senior government officials from 42 countries from all over the world, while the second Global Policy Dialogue “Strengthening Collaborative Process to Build an Effective AML/CFT Regime” reached approximately 600 public and private sector representatives from 24 countries around the world. The third series “New International Standards on AML/CFT,” has reached, as of June 2005, 425 participants from 33 countries in East Asia, Latin America and Caribbean, and Africa regions. More are planned for Middle East and North Africa, Eastern Europe, and South Asia. In addition, a fourth Dialogue Series is now being considered to address common challenges faced by many developing countries, “How to Build an Effective AML/CFT Regime in a Cash-based Economy.”

#### **Capacity Enhancement Program**

The Bank in conjunction with the Fund has developed a new multi-year AML/CFT capacity enhancement program. The program offers countries the tools, skills and knowledge to build or strengthen their institutional, legal and regulatory frameworks to successfully implement their national action plan on AML/CFT through comprehensive training and policy discussions. It is currently being piloted in 7 countries. A set of comprehensive training modules which cover multidisciplinary areas is now offered to countries and to 8 other TA providers that participated in the “train-the-trainers” workshop in May 2005. The countries are beginning to take ownership of the training product by customizing contents and training fellow officials and employees of financial institutions according to their individual country action plan on training.

19. **The Fund/Bank have delivered a significant amount of TA on a bilateral and regional basis.** Of the 169 field missions, 130 were classified as bilateral missions providing country-specific TA, 12 were workshops held for the primary benefit of one country, and 27 were workshops held for the benefit of an entire region. Fifty-two of the field-based projects were conducted in the Asia Pacific region, 40 in the Latin America and Caribbean region, 28 in Africa, 24 in Eastern Europe, and 25 in the Middle East and Central Asia region (see Figure 3).

The combined 210 field missions and HQ-based projects can be further broken down into functional categories. Legal drafting work accounted for 64 projects (including 28 HQ-based), general institution building for 75, while specific work with FIUs was the subject of 27 projects and work with financial sector supervisors of 34. There were 10 global dialogue video conferences.

Table 4. Bank/Fund TA Projects: January 2004 to June 2005  
Projects by Region, Topic, and Modality

Category	Bilateral Mission	Bilateral HQ	Regional HQ	Bilateral Workshop	Regional Workshop	Total
<b>Africa</b>						
Institution Building	14	–	–	–	2	16
Legal framework	6	7	–	–	2	15
Supervision	2	–	–	–	–	2
FIUs	2	–	–	–	–	2
Global Dialogue	–	–	2	–	–	2
Total	24	7	2	–	4	37
<b>Asia Pacific Region</b>						
Institution Building	19	2	–	2	4	27
Legal framework	10	6	–	1	1	18
Supervision	6	–	–	1	1	8
FIUs	6	–	–	–	1	7
Global Dialogue	–	–	1	–	–	1
Total	41	8	1	4	7	61
<b>Eastern and Central Europe</b>						
Institution Building	7	–	–	–	1	8
Legal framework	1	–	2	2	2	7
Supervision	3	–	–	–	2	5
FIUs	6	–	–	–	–	6
Global Dialogue	–	–	–	–	–	–
Total	17	–	2	2	5	26
<b>Middle East, Central Asia, and Caucasus</b>						
Institution Building	13	1	–	–	1	15
Legal framework	6	5	–	–	1	12
Supervision	–	–	–	1	1	2
FIUs	–	–	–	2	–	2
Global Dialogue	–	–	3	–	–	3
Total	19	6	3	3	3	34
<b>Latin America and Caribbean</b>						
Institution Building	6	–	–	2	1	9
Legal framework	2	8	–	–	2	12
Supervision	11	–	–	1	5	17
FIUs	10	–	–	–	–	10
Global Dialogue	–	–	4	–	–	4
Total	29	8	4	3	8	52
<b>Grand Total</b>	<b>130</b>	<b>29</b>	<b>12</b>	<b>12</b>	<b>27</b>	<b>210</b>

Source: Bank and Fund

Category Definitions

**Institution Building:** Comprehensive capacity building on multiple areas of the AML/CFT system including the design of institutional, legal, and regulatory frameworks, the training of government officials on several AML/CFT specialties and the assessment of countries' needs.

**Legal Frameworks:** Adapting legal systems to international AML/CFT standards.

**Supervision & Regulation:** Strengthening the AML/CFT aspects of supervisory practices in financial and non-financial institutions.

**Financial Intelligence Units:** Creation and strengthening of FIUs.

**Global Dialogue:** Regional video-conference for TA coordination and lessons learned.

Figure 3. TA Project by Category and Region

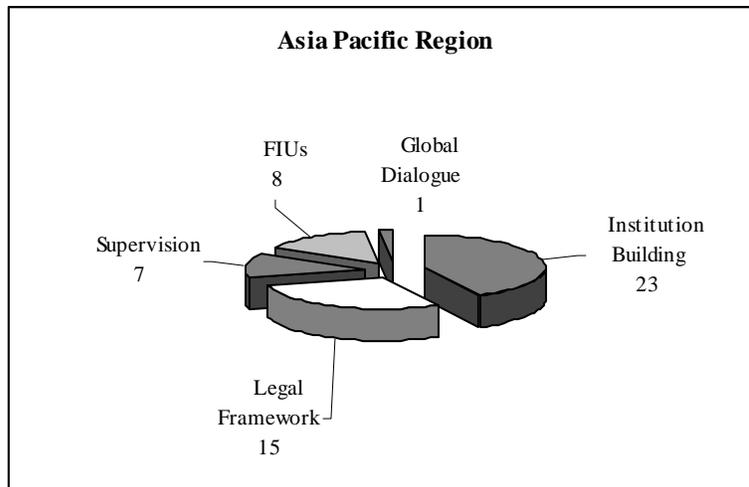
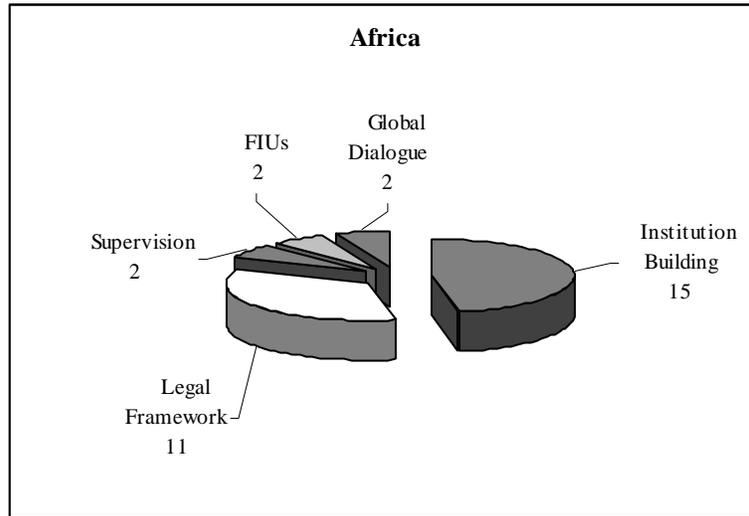


Figure 3. TA Project by Category and Region (cont.)

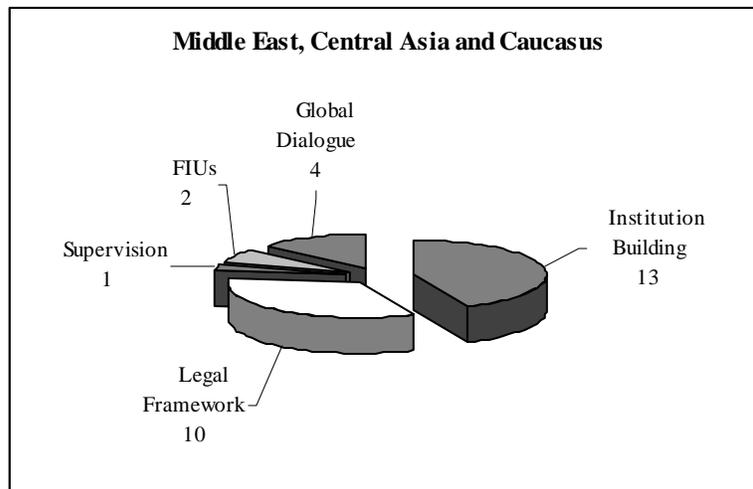
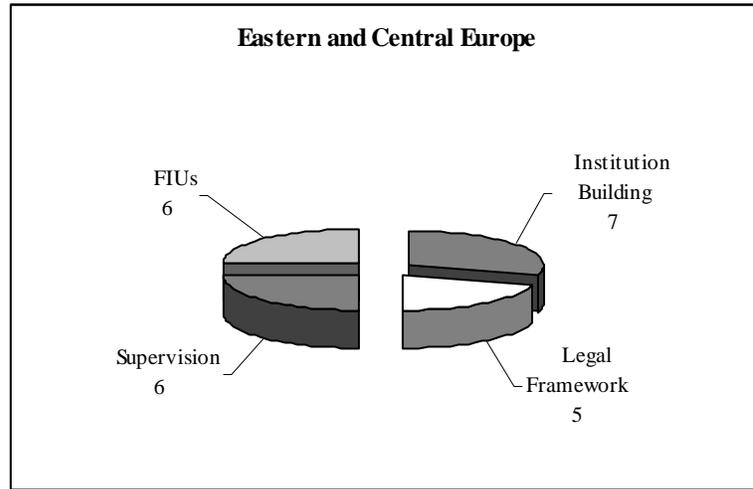
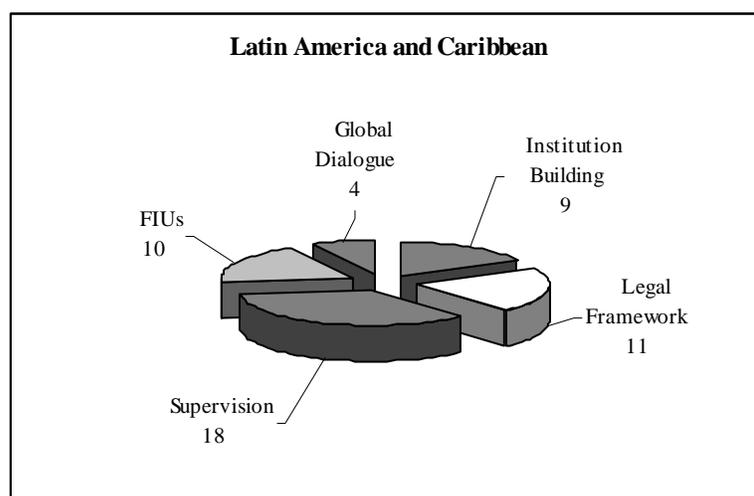


Figure 3. TA Project by Category and Region (concluded)



**TA provided to countries has yielded the following results:**

- **Countries are at various stages of adopting AML/CFT legislation on the basis of the TA provided.** Of the 64 legal drafting projects, at least seven countries have adopted legislation incorporating recommendations made by the missions. Authorities from ten countries have accepted the recommendations of staff regarding AML/CFT laws being considered for enactment and have incorporated the recommended provisions in their draft AML/CFT laws. The authorities in these countries are in various stages of submitting the draft AML/CFT laws to their legislature for consideration and ultimate enactment.
- **Considerable work has also been undertaken in developing supervisory guidance, inspection manuals and more recently, guidance notes.** In six instances, initial assistance was followed-up by subsequent visits to regulatory authorities to monitor their progress in implementing the new supervisory techniques. In four instances, Fund staff provided support to regulators as they undertook their first on-site examinations using the examination manuals developed with Fund assistance.
- **TA provided has contributed to the establishment or strengthening of FIUs.** FIU-related projects contributed to the establishment of one FIU and in the strengthening of six FIUs. The other FIU-related missions provided countries with advice on how to establish an FIU and make it operational and build capacity of FIU officials.
- **Regional workshops on AML/CFT have been successful in providing training to approximately 1000 officials from 111 countries.** The workshops targeted mainly countries with significant FT and ML issues in the various regions. The workshops have concentrated on drafting of legislation, primarily CFT legislation, building the capacity of FIU and criminal justice officials and training financial sector regulators.

Workshops were also held for regulators of company and trust service providers and non-profit organizations.

- **The legislative drafting workshops supported the efforts of officials from various countries in crafting new laws, particularly on CFT, or amending existing laws.** Since the time of these workshops and other similar workshops conducted the previous year, eight countries have passed CFT laws and 12 countries are considering passing AML/CFT legislation. The capacity building workshops concentrated on building the technical expertise of FIU, prosecutorial and other criminal justice officials on the receipt and analysis of financial information and the subsequent dissemination of intelligence, the investigation and prosecution of money laundering cases and the process of forfeiting the proceeds of crime. These workshops have increasingly provided more practical hands-on training in response to requests from member countries.
- **As a result of bilateral and regional workshops for financial sector supervisors, a number of countries are at various stages of developing risk-based supervisory frameworks including overall strategies and supervisory tools.** Fifteen countries developed either supervisory guidelines and/or inspection manuals. Two workshops catered specifically to insurance supervisors, while another focused on the supervision of trust and company service providers.

20. **TA coordination with external partners continues to be a key objective of Fund/Bank efforts.** The Fund/Bank meet regularly to discuss ongoing and new TA projects and to coordinate activities in conjunction with the plenary meetings of the FATF and FSRBs (see Box 7 for listing of countries covered by FSRBs). In addition, TA coordination meetings are held with other donor organizations including through informal contact with strategic partners (e.g., the Egmont Group of Financial Intelligence Units, FATF, UN-CTC, and UN-ODC), and key bilateral donors. There is significant emphasis on regional training sessions through the Fund and Bank training institutes.

21. **The Bank has begun work on developing TA Strategies to provide TA and work in partnership with the regions at multilateral and bilateral levels.** The TA Strategy includes identifying champion countries in the region that will encourage other countries to develop effective AML/CFT programs.

22. **The Fund's Pacific Financial Supervision Technical Assistance Centre serves 15 countries** (not all are Fund member countries). The mandate of the centre's financial sector expert now includes AML/CFT for all financial sector activity.

## **B. Lessons Learned**

### **What Has Worked Well**

23. **Staff has, within limitations, moved effectively to develop appropriate responses to the increasing demand for TA.** The Bank/Fund have adjusted the modalities of delivery

of TA, changed the mix of the staff expertise, and increased coordination with other TA providers. Specifically, this included:

- **Developing strategic and targeted TA programs.** This involved assisting countries to identify gaps in their AML/CFT frameworks and thereafter to design corrective action plans. Where political will and ownership are present, staff is successfully delivering multi-phased TA programs.
- **Building core teams of experts with the necessary operational knowledge.** This was achieved by recruiting experts with substantial operational experience in all the related disciplines and by intensifying the Fund and Bank research activities.
- **Adapting tools to increase cost efficiency while maintaining effectiveness.** This has included regional training programs, train-the-trainers efforts, mentoring programs, distance learning, leveraging existing technical assistance centers (e.g., regional technical assistance centers, Bank and Fund training institutes) and training initiatives.
- **Intensifying partnerships with other TA providers.** This entails collaboration and coordination on all aspects of TA, including design, delivery, sharing of experts, and funding. Staff has worked closely with UN, other international financial institutions, specialized organizations (e.g., Egmont Group), and key bilateral providers.
- **Using assessments as a basis for targeted TA.** In countries with rudimentary AML/CFT systems, the development of a TA program based on the findings of an assessment has the following advantages: (1) The assessment work and accompanying recommendations to facilitate the development of a more accurate and focused TA plan; (2) The political dynamics following acceptance of the assessment findings can be leveraged; and (3) Already available expert resources can be more effectively utilized.

### **Challenges and Areas for Improvement**

24. **While the Fund/Bank have been providing TA, countries confront the following challenges** in implementing the recommended reforms:

- **Corruption and Weak Governance.** Corruption in some countries undermines the effectiveness of AML/CFT measures. In environments where corruption is prevalent, legislators are less likely to enact strong and effective AML/CFT laws and key institutions (courts, law enforcement and supervisory agencies) may be hindered from carrying out their official duties in an effective manner. Development of an AML/CFT regime in such an environment also requires the establishment of an effective anti-corruption framework.
- **Achieving sufficient political commitment.** The absence of strong political commitment at the level of policy makers and legislators is a significant hindrance to

the development and implementation of a robust AML/CFT framework. In some countries, the dedication of officials at the technical level of supervisory and law enforcement authorities is hampered by lack of political commitment of government and parliament to pass legislation and assign the necessary resources.

- **High start-up and ongoing costs to implement the AML/CFT standard.** Regardless of country income level, the establishment of effective AML/CFT regimes requires significant expenditure to develop appropriate institutions, recruit personnel, train staff, and acquire resources (e.g., technology).
- **Low-income countries face resource constraints in implementing AML/CFT regimes.** As a result of competing demand for limited resources, AML/CFT will not necessarily emerge as a national priority in many countries.

25. **As indicated in the section on the experience of assessments, many countries are finding that their current regimes fall short of the newly revised, rigorous AML/CFT standard.** Where appropriate, countries could adopt a phased approach towards achieving full implementation of the standard. Proper sequencing of TA is crucial and countries need guidance in addressing their shortcomings in the most efficient manner. Priority could be placed on the following: (i) criminalization of ML/TF activities; (ii) safeguarding the international payments system by implementing effective preventive measures in the banking system, including the global network of correspondent accounts, and wire transfers; (iii) asset freezing and forfeiture regimes; (iv) cooperation and information sharing arrangements; and (v) financial intelligence units. Countries should decide on the amount of attention to place on DNFBPs in light of the size and vulnerability of the sector to ML/TF. It will also be important to create in-country TA coordination mechanisms, to enhance local “ownership” of various TA initiatives by the authorities and to promote the effective implementation of AML/CFT measures by the relevant authorities.

### **Resource Considerations**

26. **Mobilization of resources to support an intensive AML/CFT TA program has been a challenge.** The staff’s ability to assist countries with implementing the revised standard is determined by available resources. The IMF’s administered accounts to support AML/CFT have been substantially committed as has the funding from the FIRST Initiative for middle income countries. Earlier proposals by the Fund’s staff for creation of funding vehicles through contributions by interested donors, including a trust fund, have not met with success. Given the clear and urgent need to support countries in the implementation of the more comprehensive revised standard, the staff would again request the donor community to commit additional resources.

### C. Technical Assistance by Region

#### Africa

##### *TA Delivered*

27. **While only a few countries in Africa have implemented AML/CFT regimes, most have only rudimentary AML/CFT measures in place or none at all.** Countries in this region face a number of challenges in instituting adequate AML/CFT regimes. These include, in many instances, the absence of basic legal and institutional frameworks, as well as inadequate financial, human, and technological resources to ensure effective compliance with AML requirements.

28. **Much of the TA provided focused on legislative drafting to help countries address vulnerabilities to money laundering and terrorist financing** (see Box 2). Other TA initiatives involved training criminal justice officials and helping national authorities develop AML/CFT strategies. TA has been delivered to countries bilaterally and regionally. Some regional assistance has been delivered to member countries of the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG) and to western African countries comprising the *Groupe Inter-gouvernemental d'Action contre le Blanchiment d'argent en Afrique Ouest* (GIABA).

In addition to the categories listed above, staff also assisted in the training of evaluators on the AML/CFT methodology for GIABA, and FIU and criminal justice officials on the implementation aspects of their AML/CFT frameworks. Training was also provided to financial sector supervisors in developing supervisory guidance and inspection manuals.

**Due to difficulties in ESAAMLG's mutual evaluation process, some of its member countries delayed receiving TA pending the completion of their mutual evaluation reports.** In an effort to support the region's mutual evaluation process, FATF has agreed to a proposal for a TA needs assessment of each ESAAMLG member country to be followed by the provision of assistance to meet the identified needs. FATF indicated that the proposal should not be seen as a substitute for a mutual evaluation program.

## Box 2. Highlights of TA in Africa

### **Designing Supervisory Tools for African Countries**

Four countries in Southern and East Africa received focused training and support in developing their bank supervisory frameworks to specifically address AML/CFT risks. TA activities delivered within this framework focused on two main aspects: i) providing one-on-one guidance to and working together with supervisors in drafting risk-based AML/CFT inspection procedures for core activities, products, services, and operations identified as high risk; and ii) testing the adequacy of the newly-developed inspections procedures during limited-scope on-site reviews of selected financial institutions, within each country. In the latter, Fund staff and experts provided advice on the effective implementation of procedures. In total, inspection procedures for at least 10 financial activities were drafted/developed by country supervisors and six financial institutions were selected and received limited-scope on-site AML/CFT reviews by the supervisors who were subject to the training.

### **Workshop for Criminal Justice Officials**

The Fund's Legal Department delivered a follow-up AML training workshop to criminal justice officials of Eastern and Southern African countries in Maputo, Mozambique, May 16–20, 2005. The workshop was attended by participants from Botswana, Lesotho, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, Tanzania, Uganda, and Zambia. The workshop aimed at training prosecutors and other criminal justice officials in the practical aspects involved in investigating and prosecuting money laundering cases. The workshop also covered forfeiting the proceeds of crime and gathering evidence for these cases. Participants were asked to apply the theory learned in the early part of the week to a case study. The case study was from the region and involved the prosecution of money laundering and the forfeiture of the proceeds of crime. Participants were required to make various applications and presentations in a “mock hearing” before two judges, who were participants as well. The participants found the whole exercise extremely useful, especially the practical applicability for the cases they were handling.

### **TA Program for Portuguese-Speaking Countries**

The Bank is currently leading a TA program, in cooperation with the Portuguese Ministry of Justice and FIRST Initiative, designed to disseminate and strengthen AML/CFT frameworks in six Portuguese-speaking countries. This project is in four phases (see below) and revolves around the organization of a workshop which was held in Lisbon in May 2005. Raising awareness of the link between stable and sound development and AML as well as the importance of inter-agency and international cooperation are key components of this program. This TA program represented a unique opportunity for the targeted countries to receive advice from AML/CFT experts from Brazil, Portugal, and international organizations on how to develop and enhance their AML/CFT regime, taking into account the new international standard. Each country will adopt action plans to address weaknesses in the AML/CFT framework.

### ***Going forward***

The Fund and Bank have various AML/CFT projects underway in Africa.

29. **Due to the rudimentary nature of the AML/CFT legal framework of a number of African countries, legislative drafting will continue to be an important aspect of TA delivery.** Efforts will also continue to train criminal justice officials, financial sector

regulators, and to develop FIUs. Africa will continue to be an important region in the ongoing work on remittances.

**30. To deepen political commitment, outreach and awareness-raising will continue to be important components of the TA program.** Bilateral and regional workshops, the Global Dialogue Series, and the Capacity Enhancement Program will be important vehicles to accomplish this goal.

The Fund/Bank support the strategy, endorsed by FATF, of conducting TA needs assessments and are willing to participate in the process and thereafter to assist in providing targeted TA to ESAAMLG countries. The Fund/Bank will continue efforts to strengthen the operational capacity of ESAAMLG in Eastern and Southern Africa and assist GIABA in West Africa where possible.

In addition to the above new approaches, to aggressively address the specific needs of each country, efforts would be directed at (i) coordination of AML/CFT activities with the regional African technical assistance centers (East and West AFRITAC); (ii) recruiting peripatetic advisor(s) to provide intermittent assistance to a group of countries in the region; and (iii) delivering additional awareness raising seminars to Parliamentarians and senior government officials to sensitize them about the importance of establishing sound and effective AML/CFT regimes in their countries.

## **Asia Pacific Region**

### ***TA Delivered***

**31. TA has varied significantly in this region.** TA provided to the region has been divided between countries that are taking initial steps to establish AML/CFT regimes and others trying to deepen their AML/CFT frameworks. Some countries in the region received TA to develop the legal framework for AML/CFT and to establish effective FIUs. Other countries with more developed AML/CFT infrastructure received TA that was designed to strengthen capacity in their FIUs, criminal justice systems and financial sector regulatory regimes. At a regional level, capacity-building TA was also provided to train FIUs, criminal justice officials, and bank supervisors (see Box 3). Needs assessments missions focusing on the identification of gaps and developing priorities for these countries have been an important tool for devising TA for the region. Financial sector supervisors were trained in developing supervisory strategies and guidelines. In one instance assistance was provided in developing an MOU with a foreign supervisor. In addition, staff participated in two training workshops for assessors.

### Box 3. Highlights of TA in Asia Pacific

#### **Legal Drafting in the Pacific**

As part of the Pacific Project, LEG has been reviewing and strengthening countries' AML/CFT legal framework. Since end-2001, in one Pacific country, stemming from the commitment and efforts of the authorities and the work of two LEG missions in November 2002 and May 2003, and the LEG expert for the Pacific region between April and August 2004, the Financial Transactions Reporting Act 2004 was enacted in December 2004. Amendments proposed by LEG to the existing Proceeds of Crime Act 1997 and the Mutual Assistance in Criminal Matters Act 1997 have also been adopted in early 2005. These three Acts provide a substantial legal framework for the country.

#### **Training of Financial Sector Supervisors**

This program which was jointly hosted with the Asian Development Bank (ADB), focused on the development of supervisory guidelines and oversight for AML/CFT compliance (off-site monitoring and on-site inspection), and supervisory action against non-compliance. The seminar also invited experts from the private sector, including compliance officers for AML/CFT at banks as well as experts on internal and external audit functions for AML/CFT internal controls. Following the lectures by the experts, the participants, who were divided into six groups, worked on reviewing a mock internal control procedures of a bank (prepared by the Fund-ADB staff) and presented identified weaknesses. At the end of the seminar, the participants also worked on developing and presenting a strategy for each jurisdiction to enhance the AML/CFT supervisory regime.

#### **Remittance Project in conjunction with the Asia-Pacific Economic Cooperation (APEC) Body**

Since 2002, the Bank has been providing TA to countries in the region pursuant to the Asia-Pacific Economic Cooperation (APEC) Initiative on Remittance Systems.<sup>1/</sup> In May 2005, the Bank organized a Policy Dialogue on remittances in Bangkok, Thailand as a follow-up of the 2004 symposium.<sup>2/</sup> A CD-ROM including all the presentations at the policy dialogue will be published. The Bank is also preparing a final report to APEC Finance Ministers and Deputies in September 2005 in Jeju, Korea.<sup>3/</sup>

<sup>1/</sup> The initiative is co-chaired by Japan, Mexico, Singapore, Thailand, and the United States.

<sup>2/</sup> APEC Symposium on Alternative Remittance Systems (ARS): Shaping the Remittances Market by Shifting to Formal Systems, June 3-4, 2005, Tokyo, Japan.

<sup>3/</sup> The Bank prepared and presented two reports to the APEC Finance Ministers' Meeting (FMM) in 2003 and 2004. The report presented to the FMM in September is a final report of the APEC Initiative on Remittance Systems.

#### ***Going Forward***

**32. TA efforts will continue to focus on individual country needs including legislative drafting assistance for those countries with no or weak AML/CFT laws, and capacity building of FIUs, criminal justice officials and financial sector supervisors.** To the extent that microfinance institutions become vulnerable to money laundering and terrorist financing, TA programs will be developed to help countries integrate this sector into the AML/CFT regime without unintended consequences on the access to finance by any segment of society. The Bank will continue implementing its Capacity Enhancement Program.

**33. The Bank and UNODC identified a mentor to be placed for the Indochina region to provide long-term TA to support countries' efforts to adopt and implement**

**AML/CFT.** The mentor is expected to start his work in October 2005 for two years. He will assist in developing FIUs, training law enforcement and other agencies, and facilitating inter-agency and international cooperation. The mentor will work with national authorities in countries that are beginning to undertake AML/CFT initiatives.

More efforts are now being made to enhance collaboration and coordination among TA providers, including the TA donor and providers meetings held during the APG annual meetings.

## **Eastern and Central Europe**

### ***TA Delivered***

34. **Regional projects included participation in MONEYVAL training and awareness-raising seminars and assisting MONEYVAL in the training of its evaluators in the use of the latest assessment methodology.** Delivery of a series of regional training workshops is ongoing at the Joint Vienna Institute and other venues, including training on drafting of legislation to counter terrorist financing and capacity building training of criminal justice officials in relation to implementation aspects of their AML/CFT legislation, as well as targeted AML/CFT training for financial sector supervisors and FIUs.

35. **At the individual country level, delivery of TA has included intensive needs assessments and assistance in the creation and strategic development of the basic framework for AML/CFT in a number of countries in the Balkan region and some CIS countries.** For countries with more developed systems, TA has been provided to address specific gaps, with the objective of improving the effectiveness of current arrangements. Increasingly, emphasis in the TA is being placed on strengthening FIUs, the role of nonbank financial institutions and designated nonfinancial businesses and professions and the training of criminal justice officials.

36. **In addition to drafting and reviewing AML/CFT laws and regulations, TA outputs have included strategy documents, action plans, and needs assessments.** Assistance has been provided to FIUs in planning and enhancing their organization, operations and structure, and in formalizing arrangements for information flow and inter-agency cooperation, both domestic and cross border. Assistance has been provided to financial regulators in the drafting of regulations and guidance notes for the financial sector, and in developing on-site inspection procedures for AML/CFT. A range of country-specific training and awareness-raising seminars have also been delivered (see Box 4).

### ***Going Forward***

37. **Continued strong demand for TA is anticipated across the region.** As some countries move closer to EU membership, their requests for TA may be increasingly addressed to EU agencies instead of the Bank/Fund. In the interim, however, there is considerable scope to assist countries in Central and Eastern Europe, particularly in the Balkan region. There are many providers of AML/CFT and related technical assistance

currently active in Central and Eastern Europe. Coordination of our respective efforts will continue to be essential for efficient TA delivery.

#### Box 4. Highlights of TA in Eastern and Central Europe

##### **Training on the implementation of the standard**

In May 2005, LEG organized a workshop on implementation of AML/CFT standards for FIU and criminal justice officials of Bulgaria, Croatia, The Former Yugoslav Republic of Macedonia, Moldova and Romania. The topics discussed were practical issues related to implementation of AML/CFT provisions and in particular, the issues relating to financial investigations, collecting evidence by the police and prosecutors and bringing cases to court in ML/FT related prosecutions. Several concrete cases of ML and TF, from the experience of the represented countries, were presented.

##### **Developing the AML/CFT framework in the Balkans**

In one Balkan country, the Fund during 2004/05 gave assistance to: (1) redraft the current AML law (planned for consideration in parliament by end-2005); (2) plan the ongoing development of the financial intelligence unit; (3) redraft and develop AML/CFT regulations and guidance notes to help supervised financial institutions to comply with the AML law; (4) develop on-site inspection procedures for the central bank; and (5) deliver a package of seminars and other training to relevant institutions. As a result, and with appropriate political support, the country concerned should be in a position to achieve compliance with the main components of the international standard for AML/CFT during 2006, although achieving full implementation of effective measures will take longer and require ongoing international support.

##### **Mentor for the region**

The World Bank and UNODC are jointly sponsoring an AML/CFT mentor for two years to assist countries of Eastern Europe and Central Asia to develop robust AML/CFT regimes. The mentor is providing training to countries on AML/CFT, including assistance in legislative drafting and FIU development. The mentor is collaborating with the IMF on projects for the region.

#### **Middle East, Central Asia, and Caucasus**

##### ***TA Delivered***

38. **A significant program of TA is being developed for the Caucasus region**, ranging from targeted TA to improve the effectiveness of measures in place in certain countries to assisting in the development of basic legal, institutional, and supervisory structures for AML/CFT in some CIS countries. Other Fund/Bank TA initiatives have included a workshop for bank supervisors, another on the regulation/oversight of non-profit organizations and alternative remittance systems, an awareness raising seminar for senior officials of the Middle East and North Africa FATF (MENAFATF), one of the new FSRBs in the region, and advice in designing a curriculum for a certification program for compliance officers (see Box 5). Staff has also participated in a small number of seminars/workshops hosted by regional organizations. Country-specific TA has involved three legislative drafting missions and one mission that addressed implementation issues related to the AML/CFT program as

well as a number of workshops on drafting of AML/CFT laws and training of FIU and criminal justice officials.

39. **The World Bank and UNODC are jointly sponsoring an AML/CFT mentor in the Countries of Central Asia.** This mentor is coordinating closely with the Fund in all TA projects in Central Asia which have included a series of FIU workshops in all Central Asian countries. The Fund/Bank supported the U.A.E.'s Hawala conference series and also published a book of the proceedings of one recent conference: "Regulatory Frameworks for Hawala and Other Remittance Systems."

#### Box 5. Highlights of TA in the Middle East, Central Asia, and Caucasus

##### **Legislative drafting in the MENAFATF region**

A legal drafting mission worked with the authorities in one country in reviewing and strengthening a draft AML/CFT law. The country subsequently enacted the AML/CFT law several months after the mission, having amended the earlier draft law to incorporate some of the Fund's recommendations.

##### **Needs Assessment for MENAFATF Member Countries**

A major initiative was the development of a technical assistance needs assessment questionnaire for MENAFATF. The questionnaire was distributed by the secretariat and has already been completed by four of the fourteen member countries. The questionnaires will be utilized at a TA donor forum will coincide with a plenary meeting scheduled for the third quarter of 2005.

##### **Comprehensive Program of Assistance**

Following an AML/CFT assessment, in October 2003, a TA action plan was proposed to the assessed country by the Bank, comprised of two main components: building the FIU and a training program for the banking industry. Two phases were planned, one for the general framework, one for the implementation. Each concerning two modules. The first module was to help the existing board of the FIU to operate the unit, first by organizing the structure, the decision process, the profiles of the agents and the methods of analysis. The second one was devoted to raising awareness for managers and officers of the banks, with a "training the trainers" session for all. The program was built with the collaboration of France, which financed it on a priority governmental plan, and started in March 2005. The main results are the current legislative drafting and the progress made by the FIU.

#### ***Going Forward***

40. **Given the limited AML/CFT infrastructure of the majority of the Middle East and Central Asia countries, TA needs are considerable.** The World Bank/UNODC mentor is dedicating substantial efforts to donor coordination in Central Asia as well as with EAG. In the near-term, legal drafting and capacity building including development of skills of financial sector regulators are anticipated to be priorities. Some AML/CFT work in Central Asia has been subject to postponements due to recent political unrest.

The most important platform for the overall development of TA initiatives in the region will be continued support for the development of the two new FSRBs. However, since they are both at an early stage of formation, it will be some time before they are able to act as effective regional coordination mechanisms. A central component of the strategy for the region will be the assessor training which will assist these organizations in their preparations to undertake mutual evaluations. It will also be critical to continue the TA needs assessment initiatives to better understand country-specific TA needs. The EAG will be sharing its own TA needs assessments with donors in a conference in December 2005. An expansion of TA to the Middle East is expected in light of the important needs of the region. We expect that the regulation of the informal funds transfer and non-profit sectors will continue to be areas of specific focus in MCD regional TA initiatives.

## **Latin America and the Caribbean**

### ***TA Delivered***

41. **After an initial high level of demand for assistance with respect to the banking sector in 2004, the demand for TA has shifted to new areas especially the insurance sector and FIUs.** The insurance sector has historically been slower in the implementation of AML/CFT standards and financial intelligence units, which have been recently created in many countries of the region, are in need of training and capacity enhancement (see Box 6). During the last year, there were two regional training seminars for insurance regulators on AML/CFT supervision (one for Latin America and one for the English speaking Caribbean). In addition, two country-specific TA missions were undertaken for insurance regulators (one in South America and one in the Caribbean) while another regional training workshop is being planned for the Caribbean later in 2005. With the cooperation of CFATF, a first of its kind training program for Trust and Company Service Provider (TCSP) regulators on the supervision for AML/CFT compliance was conducted. Legislative drafting and FIU related TA has been provided to several WHD countries, including a legislative drafting workshop on CFT for nine South American countries, and a seminar on AML/CFT for FIU and Criminal Justice Officials for 12 Central and South American countries.

Training of mutual evaluators in coordination with each of the two FSRBs of the region (CFATF and GAFISUD) continued; staff participated in four training sessions.

## Box 6. Highlights of TA in Latin America and the Caribbean

### **Workshop on CFT Legislative Drafting**

In collaboration with the United Nations Office on Drugs and Crime (UNODC) and the Ministry of Foreign Affairs of Peru, the Legal Department, delivered a five-day regional legislative drafting workshop on CFT in Lima, Peru from March 1–5, 2004. The workshop was attended by 33 participants from 9 South American countries: Bolivia, Brazil, Chile, Colombia, Ecuador, Paraguay, Uruguay and Venezuela. Participants included prosecutors, investigators, banking supervisors and legal drafters. The workshop included presentations, discussions, and a significant amount of legislative drafting on the criminalization of the financing of terrorism; freezing, seizing, and confiscating terrorist assets; reporting suspicious transactions related to terrorist financing; international cooperation; informal remittance services; information required in wire transfers and treatment of non-profit organizations. The seminar's objective was to acquaint participants with the international legal requirements relating to the various components of a comprehensive CFT framework.

### **Training of Insurance Supervisors**

In response to a request from a group of Caribbean countries a regional training program was conducted for insurance supervisors. This sector has historically been considered weak in the implementation of AML/CFT standards. The program focused on the development of risk-based AML/CFT supervision and controls under the new FATF standards. Topics covered at the workshop included cross-border supervision and cooperation, internal controls and fraud prevention, money laundering/terrorism techniques, and cases in the insurance sector, corporate governance and its supervision, risk management systems and controls, consolidated supervision, off-site and on-site inspections and financial analysis and reinsurance risk.

The workshop was supplemented by case studies, including an AML/CFT working group project that brought together the AML/CFT and prudential elements. It also included presentations from a leading regional insurance company. From participant feedback received so far, the workshop was considered a success and very practical for the work of the insurance supervisors.

### **Training for the Private Sector on Developing a Risk-Based Approach to AML/CFT**

The World Bank launched in 2005 a TA program that is designed to deliver long-term TA that is tailored to the specific challenges of one country. This country's FIU, with the support of the World Bank, hosted a two-day conference for the local financial community to help it assess the risks of ML/TF sector by sector. AML/CFT experts from the country, the World Bank, and the United Kingdom spoke about the major crimes in the country that generate proceeds, the flow of funds in the country related to ML, the vulnerabilities of the remittance and banking and insurance sectors to ML/TF, and private sector approaches to building risk models to support AML/CFT. On the second day, involving more than 100 representatives from 12 financial sectors, representatives for each sector identified, categorized, and measured the risks of ML/TF that their sector encounters by focusing on the client base and business products/services. The long-term goals of the conference were to encourage financial institutions across the board to develop their own risk analysis, including risk models, related to AML/CFT and prompt the financial sector trade associations to develop best practices of their members over the medium term.

*Going Forward*

42. **Many countries in the region still face significant weaknesses in the core sectors, (especially insurance and securities) due to capacity and institutional constraints both in terms of financial and human resources.** In others, the existence of significant offshore financial sectors, for instance, calls for enhanced attention, resources and TA for regulators of these sectors if weaknesses in the regime are to be addressed in a timely manner. The TA provided to the supervisors of the TCSPs is expected to generate further TA requests and, more importantly, result in the development of harmonized regional approaches to identification, control and supervision of ML/FT risk in the sector.

43. **Close cooperation with GAFISUD and CFATF is expected to continue, especially with regards to identification of priorities at a multi-country level.** A diagnostic exercise is currently underway by the GAFISUD Secretariat. Going forward, other areas that have been identified for TA in the near term are the casino and internet gaming industries and capacity building of criminal justice officials to effectively implement their laws. In coordination with CFATF, plans are already underway to organize a joint regional Caribbean and Central American training workshop for regulators of casinos as well as joint training for FIUs in the region. The expansion of the donor community to include countries in the region that are leaders on AML/CFT will be an important element of future TA initiatives.

## Box 7. List of FSRBs and Other Regional Bodies by Region

### **FSRBs**

#### **Africa**

**ESAAMLG:** Botswana, Kenya, Lesotho, Malawi, Mozambique, Mauritius, Namibia, Seychelles, South Africa, Swaziland, Tanzania, Uganda, Zambia, and Zimbabwe.

#### **Asia Pacific Region**

**APG:** Australia, Bangladesh, Brunei Darussalam, Cambodia, Chinese Taipei, Cook Islands, Fiji Islands, Hong Kong, China; India, Indonesia, Japan, Republic of Korea (South Korea), Macau, China; Malaysia, The Marshall Islands, Mongolia, Nepal, New Zealand, Niue, Pakistan, Palau. The Philippines, Samoa, Singapore, Sri Lanka, Thailand, Tonga, United States of America, Vanuatu.

#### **Middle East**

**MENAFATF:** Algeria, Bahrain, Egypt, Jordan, Kuwait, Lebanon, Morocco, Oman, Qatar, Saudi Arabia, Syria, Tunisia, the United Arab Emirates, and Yemen.

**EAG (includes countries in Europe and Asia/Pacific):** Kyrgyzstan, Kazakhstan, and Tajikistan are the MCD countries in the EAG. Non-MCD members are Russia, China, and Belarus.

#### **Europe**

**MONEYVAL(includes countries in Caucasus:** Albania, Andorra, Armenia, Azerbaijan, Bosnia and Herzegovina, Bulgaria, Croatia, Cyprus, Czech Republic, Estonia, Georgia, Hungary, Latvia, Liechtenstein, Lithuania, Moldova, Malta, Monaco, Poland, Romania, Russia, San Marino, Serbia and Montenegro, Slovakia, Slovenia, The former Yugoslav Republic of Macedonia, and Ukraine.

#### **Latin America and Caribbean**

**CFATF:** Anguilla, Antigua and Barbuda, Aruba, Bahamas, Barbados, Belize, Bermuda, British Virgin Islands, Cayman Islands, Costa Rica, Dominica, Dominican Republic, El Salvador, Grenada, Guatemala, Guyana, Haiti, Honduras, Jamaica, Montserrat, Netherlands Antilles, Nicaragua, Panama, St Kitts and Nevis, St. Lucia, St Vincent and the Grenadines, Suriname, Trinidad and Tobago, Turks and Caicos Islands, and Venezuela.

**GAFISUD:** Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Paraguay, Peru, and Uruguay.

#### **Other Regional Bodies**

**GIABA:** Benin, Burkina Faso, Cape Verde, Cote d'Ivoire, Gambia, Ghana, Guinea Bissau, Guinea, Liberia, Mali, Niger, Nigeria, Senegal, Sierra Leone, and Togo.

**GABAC:** Cameroon, Congo Rep. of, Gabon, Equatorial Guinea, Central African Republic, and Chad.

**OGBS:** Aruba, Bahamas, Barbados, Bermuda, Cayman islands, Cyprus, Gibraltar, Guernsey, Hong Kong, China; Isle of Man, Jersey, Labuan, Macao SAR, China; Mauritius, Netherlands Antilles, Panama, Singapore, and Vanuatu.

### III. IMPLEMENTING THE REVISED AML/CFT STANDARDS: DNFBBs

44. **This section discusses the conceptual and implementation challenges posed by the extension of AML/CFT obligations to designated non-financial businesses and professions (DNFBPs)**<sup>5</sup> under the revised FATF 40 Recommendations and the adoption of the Special Recommendations on Terrorist Finance.

45. **The extension of AML/CFT obligations to DNFBBs was one of the key changes in the revised FATF 40.** This change had been under discussion for some time and was based on a significant body of case-studies and analytical work.<sup>6</sup> The European Union (EU) anticipated this change by placing DNFBBs under the Second Money Laundering Directive of 2001.

46. **There are significant implementation challenges facing the DNFBBs.** First, the scope and organization of DNFBBs differ greatly from those of the supervised financial institutions on which AML/CFT work has been focused to date. Secondly, few of these professions have much experience with AML/CFT obligations and some—lawyers in particular—have concerns about the compatibility of these requirements with their professional obligations. Finally, general supervisory regimes in these sectors, where they exist at all, differ greatly from those for financial institutions.

#### A. Characteristics and Practices

47. **The challenges in applying the FATF requirements to DNFBBs are most clearly evidenced by the wide range of activities permitted for DNFBBs across different countries.** For example, because of legal restrictions or conventional practice, in a number of countries it is unusual for lawyers to carry out financial transactions for or on behalf of clients. In other countries, lawyers are actively involved in a very broad range of financial activity. Similarly, in several countries notaries are a highly specialized and strictly governed private profession; in other countries they are public servants; in still other countries there is no such distinct profession. Likewise, the scope and responsibilities of auditors and accountants, and the extent of their regulation, varies considerably from country to country. In many countries, there is no distinct profession of trust and company service providers, but the constituent activities may be carried out by lawyers, auditors, accountants, notaries or other practitioners. Casino operations differ substantially across countries: some are authorized to provide a range of financial services (foreign exchange, credit, and payments transfers); some are not permitted to provide any financial services; and some countries do

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<sup>5</sup> Lawyers, notaries, and other independent legal professionals; accountants; real estate agents, trust and company service providers, dealers in precious metals and stones, and casinos. The FATF Recommendations that apply to them are R 12, R 16, R 24, and R 25, many of which are incorporated by reference to the parallel customer identification, suspicious transaction reporting, record-keeping, training, and supervision requirements already applied to financial institutions in R 5, R 6, R 8, R 9, R 10, R 11, R 13, R 15, and R 21.

<sup>6</sup> FATF conducts such analytical and case-studies work under its “Typologies” process.

not permit casinos at all. Real estate agents may be informally organized, very lightly regulated, and offer a range of related financial services, or they may be licensed only for a narrow brokerage function with collateral financial services provided by other professions or financial institutions.

48. **The variety of business practices for DNFBPs is mirrored in a wide range of existing regulatory regimes.** In some countries, the covered professions are subject to demanding qualifications and strict licensing. In others, entry into the professions is more flexible and subject to light regulation. Lawyers are typically governed by some form of self-regulation; auditors and accountants may or may not be subject to any regulation. In general, there is little organized regulation or oversight of real estate agents and even less of dealers in precious metals and stones. Where casinos are legal, they are always closely regulated and some are starting to apply AML/CFT requirements.

### **B. Implementing AML/CFT Obligations**

49. Since the AML/CFT obligations were only relatively recently extended to DNFBPs, many countries are just beginning to introduce the necessary legal and regulatory framework. Staff found in the benchmarking work that even within the European Union, several countries have had difficulty in designing and implementing provisions that fit their circumstances and the requirements of the second EU directive.

50. **Countries assessed to date performed poorly on preventive measures for DNFBPs.** The analysis of DNFBPs is based on the preliminary findings of the first series of AML/CFT assessments that have been conducted using the 2004 Methodology with a view to identifying: (a) issues that have arisen in implementing the new regime for DNFBPs and, (b) issues encountered in carrying out assessments using the methodology. Specifically, the ratings for the DNFBPs as reflected in Recommendations 12, 16, and 24 point to clear weaknesses. For Recommendation 12, on extending customer due diligence procedures to DNFBPs, no country was rated either fully or largely compliant; 56 percent achieved a partially compliant rating, and 44 percent were non-compliant (see Section I). The situation was similar for Recommendation 16, suspicious activity reporting, where no countries were compliant, 11 percent were largely compliant, 44 percent partially compliant and 50 percent non-compliant. In the same fashion, the ratings regarding Recommendation 24, on general AML/CFT supervision of DNFBPs, show no compliant countries, 11 percent largely compliant, 28 percent partially, and 61 percent non-compliant.

51. **The strikingly diverse profiles of the different businesses and professions leads to a variety of specific issues in each sector.** Staff made more detailed observations on the basis of an in-depth examination of the preliminary drafts of a sub-set of nine country assessments, of which six were carried out by the IMF (Bahrain, Belarus, Greece, Hungary, Italy, and Panama); two were carried out by FATF (Belgium and Norway) and one by MONEYVAL (Slovenia). It should be noted that this sample is small and not very representative of a cross section of countries; most are high- to middle-income countries, except for Belarus. It is generally well established that such countries are better aware of the AML/CFT requirements and have taken more measures compared to low-income countries. In addition, as a prelude to formal assessments, during the summer of 2004, Fund Staff

visited five major countries (United States, United Kingdom, Germany, Netherlands, and Switzerland) to benchmark progress in implementing the new FATF requirements. The results of that benchmarking exercise were very much in line with findings reported here.

## **Lawyers**

**52. Extending AML/CFT obligations to lawyers has been controversial in many countries.** The requirement to report suspicious transactions, in particular, is viewed as encroaching on the tradition of lawyer-client privilege. In a few countries, law associations have been able to stall introduction of new regulations or have challenged them in court. It must be noted that FATF does recognize that exemptions to suspicious transaction reporting are applicable to lawyers, notaries, other independent legal professionals, and accountants when they are acting as independent legal professions, and “if the information was obtained in circumstances where they are subject to professional secrecy or legal professional privilege.” Thus, under FATF, the obligation to report is confined to circumstances in which the professionals are acting “on behalf of or for a client, and engaging in a financial transaction in relation to” defined financial activities. Such activities may include buying and selling of real estate; managing of client money, securities or other assets; management of bank, savings or securities accounts; organization of contributions for the creation, operation or management of companies; creation, operation or management of legal persons; and arrangements, and buying and selling of business entities. The findings show that from country to country there is considerable variation in the recognition of the scope of legal professional privilege as well as wide differences in the understanding of “engaging in financial transaction on behalf or for a client.” Generally, legal professional privilege covers information received from or obtained through a client: (a) in the course of ascertaining the legal position of their client; or (b) in the course of representing a client in judicial, administrative, arbitration or mediation proceedings.

**53. Of the nine countries reviewed, four have not yet extended AML/CFT preventive measures to lawyers.** Of the five that have introduced such requirements, three have followed the FATF approach of limiting the requirement to those circumstances in which the lawyers provide some form of financial services. The two other countries have included a much wider range of legal services within the scope of the obligation of lawyers, subject always to exemption for legal privilege.

**54. Most countries have not yet fully implemented effect compliance monitoring programs for lawyers.** Self regulation of lawyers by their professional associations is the norm in almost all countries. Binding codes of conduct are typical but these frequently do not cover AML/CFT, and relatively few law associations have a tradition of pro-active examination of members for compliance. In two jurisdictions, the FIU has been given authority to supervise lawyers for AML/CFT compliance but, to date, these powers have not been exercised. It is frequently unclear whether the law association or another agency has enforcement authority for non-compliance with preventive requirements. Only one country has provided guidance tailored to the specific circumstances of lawyers, while another considers that the lawyers’ code of conduct is the relevant compliance guide. Countries have few to no reporting of suspicious transactions by lawyers. While the regime applicable to lawyers is relatively new, assessors generally reported that limited STR reporting is probably

the result of uncertain obligations, insufficient training and awareness, and weak compliance monitoring and enforcement.

## **Notaries**

55. **Among countries reviewed, four have extended AML/CFT obligations to notaries**, three have not, and two do not consider notaries to be a distinct profession. In European countries where notaries are a distinct profession, they are typically considered to perform a public or quasi-public function and are subject to strict professional qualification requirements. In these countries, notaries typically do not engage in financial transactions for or on behalf of clients. Also, arrangements for oversight and enforcement of professional standards are usually spelled out in law, regulation or professional codes, and are actively supervised either by an SRO or by the courts. While notaries are not always covered by AML/CFT obligations, many of the CDD, record keeping, and compliance requirements established in AML/CFT legislation are central to the day-to-day responsibilities of notaries. In the assessments to date, few issues have been encountered regarding AML/CFT compliance by notaries. Even so, relatively few STR reports have been filed by notaries.

## **Auditors and Accountants**

56. **Of the nine countries reviewed, five have imposed AML/CFT obligation on auditors and accountants** and four have not. In two of the countries that do not cover auditors and accountants, the authorities assert that accountants and auditors do not normally engage in financial transactions for or on behalf of clients. In the other countries, about half have some restrictions on commercial/financial activities of auditors and accountants, the other half does not. In general, independent auditors who have the authority to certify financial statements are subject to more demanding professional qualifications and are subject to stricter regulation than are accountants. However, the necessary qualifications, the scope of responsibilities, and the form of regulation of accountants, in particular, vary considerably among countries. Auditors and accountants generally belong to separate SROs or professional organizations. Oversight of AML/CFT obligations of auditors and accountants is poorly developed in the five countries that have imposed preventive requirements. In three countries, oversight responsibility has been assigned to either the FIU or a government ministry, but no compliance monitoring has been initiated. In the two other countries, compliance monitoring has been assigned to SROs which have not yet organized themselves to take up this responsibility. Across all the countries assessed only a few STRs have been reported by auditors and accountants.

## **Trust and Company Service Providers**

57. **Of the countries reviewed only one has a distinct profession of trust and company service (TCS) provider.** No countries assessed have extended AML/CFT obligations to TCS providers. Some countries state that such services are provided by lawyers, accountants (which are covered by AML/CFT obligations where they have been introduced) or by other business service providers (who fall outside the DNFBP regime). Several countries do not recognize trust arrangements and consequently it appears that relatively little attention has been paid to the difficult CDD issues posed by such arrangements. The assessments undertaken to date have not delved deeply into issues related to TCS providers.

## **Real Estate Agents**

58. **Of the countries reviewed, six have extended AML/CFT obligations to real estate agents.** While real estate agents are frequently registered or licensed, they generally do not have a tradition of professional regulation. Consequently there are no pre-existing bodies that could assume responsibility for oversight of compliance with AML/CFT obligations. Three countries have assigned formal oversight responsibility to either a ministry or to the FIU, but none have yet initiated active oversight for real estate agents. Assessments generally found that awareness of, and compliance with, AML/CFT obligations are relatively low among real estate agents and, across all countries, relatively few suspicious transactions have been filed by real estate agents.

## **Dealers in Precious Metals and Stones**

59. **Of the countries reviewed, three have imposed AML/CFT obligations on dealers in high value goods,** four have imposed such obligations on a limited class of dealers in precious metals and stones (e.g., bullion, auction dealers, jewelers), and two have not yet addressed the topic. In several countries, AML/CFT obligations only apply for cash (or all) transactions above a minimum value, as allowed under the FATF recommendations. In some countries, authorities believe they satisfy FATF Recommendations by prohibiting cash payments in excess of certain amounts or have cash transaction reporting requirements above certain thresholds. Monitoring compliance with the AML/CFT requirements for high value goods dealers has proven to be a problem for all countries. In general, there are no pre-existing regulatory organizations with a capacity to take on AML/CFT oversight of these businesses. Some governments have assigned compliance monitoring to their FIU. While there is some spot checking, no countries have developed a systematic regime for overseeing compliance by dealers in high value goods.

## **Casinos**

60. **Casino operations are authorized in seven of the nine countries reviewed.** AML/CFT requirements have been imposed in five of those countries. The scope of casino activity varies from country to country. Some countries have capped the number of authorized casinos; and/or limit activities to a few games; and/or restrict casino's scope for offering financial services (foreign exchange, credit, balance transfers), while others allow a

wide range of games and financial services. Casinos are generally subject to oversight by a gaming commission and are subject to close regulation for tax or public policy purposes. Oversight generally addresses customer identification, record keeping and internal control requirements, even when these are not specifically required for AML/CFT purposes. AML/CFT compliance by casinos is actively supervised. However, suspicious transactions reporting by casinos is frequently based on reporting of winnings above a certain threshold and it is unclear whether casino controls adequately detect transactions that are truly suspicious.

### **C. Experiences with Assessments**

61. **There has been a significant expansion of the number of distinct sectors requiring detailed assessment;** at least ten non-financial professions, business or activities in addition to the three prudentially regulated financial sectors (banking, securities, and insurance). In every country, each of the new areas has a distinct legal framework, regulatory environment and business practices. While the categories of preventive measures that are required (customer due diligence, record keeping, compliance programs, and suspicious transactions reporting) are the same as those for the prudentially regulated financial sectors, evaluating their effective implementation requires case by case review of arrangements in each sector. To illustrate, appropriate customer due diligence practices for lawyers, accountants, casinos, or dealers in high value goods can be considerably different based on the type of business conducted and whether the relationship with the client is ongoing or one-off. Similarly, the internal controls necessary for compliance with AML/CFT measures differ from sector to sector.

62. **A consensus on best practice for preventive AML/CFT measures has not yet emerged among the DNFBS themselves or their respective supervisors.** Over the last decade, core principles of supervision have been carefully developed for each of the major prudentially regulated sectors. These principles provide clear benchmarks for evaluating whether institutions and supervisors are carrying out their responsibilities with respect to regulated activities, including for implementing AML/CFT requirements. There is no similar reference point for evaluating AML/CFT implementation by DNFBS. Consequently, assessors must make independent judgments about the reasonableness and effectiveness of arrangements in each area reviewed, adding a greater degree of subjectivity to their findings.

63. **There is inconsistency among assessors when rating compliance because of the wide variety of regulatory frameworks and oversight mechanisms found in each of the different DNFBS areas.** Typically, each area is subject to its own unique regulatory regime; or it may be only superficially regulated. In most countries, regulation does not include the detailed operational rules and guidelines that are common in the prudentially regulated financial sectors and which are a feature of most AML/CFT regulations. Functional supervisors in these areas also do not have a tradition of close oversight and examination practices, in addition to having differing oversight and enforcement capacity from area to area within individual countries and across countries.

64. **In some reviewed countries, responsibilities for regulating, compliance monitoring, and sanctioning are dispersed.** It is not unusual for AML/CFT compliance

monitoring to be exercised by an agency other than the functional regulator and for sanctioning authority to be assigned to a third body. Even where the compliance monitoring responsibility is clearly spelled out, in many countries the assigned supervisors do not have sufficient resources and/or adequate enforcement authority to ensure effective compliance with AML/CFT requirements.

65. **Assessors also need to have additional expertise and familiarity with the business practices and regulatory environment of DNFBPs.** The assessment experience indicates that some assessors are unfamiliar with the operational practices of casinos, the regulatory requirements of the relevant tax authorities, the self regulatory practices of lawyers, auditors, accountants and notaries, as well as their business practices. Thus, in several instances some areas have been lightly covered.

#### IV. IMPLEMENTING THE REVISED AML/CFT STANDARD: REMITTANCES

66. **This section discusses particular challenges of implementing AML/CFT obligations that apply to Remittance Service Providers (RSPs) and describes Fund/Bank work on remittances systems.** This work has focused on improving data and knowledge on remittance flows; reducing remittance costs; improving developmental impact; and regulating and supervising remittance systems.

67. **RSPs are not a separate category under the FATF revised Recommendations.** In many countries, the transfer of money or value is one of the functions performed by financial institutions and, therefore, the full range of AML/CFT obligations already apply to them. In some countries, RSPs also include any person or entity conducting this function as a business or a part of a business, and may be subject to specific regulations. However, for AML/CFT purposes FATF requires that such businesses be subject to Special Recommendation VI (SR VI). SR VI specifies that RSPs must be either registered or licensed and be subject to effective systems for monitoring and ensuring compliance. This calls for RSPs to be subject to customer identification, record keeping, suspicious transactions reporting, and ML/FT prevention policies.

68. **One of the main difficulties a country may face when introducing specific AML/CFT requirements for RSPs, is how to encourage informal funds transfer agents to be part of the regulatory framework.** RSPs that are not part of the regulatory framework may pose a particular risk of misuse for ML/FT; this risk differs from country-to-country. A majority of the clients of RSPs are migrant workers remitting funds back to their country of origin. Accordingly, effective regulation involves finding the appropriate balance for preventive measures that do not impede the flows of remittances nor drive remittance systems underground. These measures should also not limit competition among RSPs nor represent obstacles to deepening financial services for both senders and beneficiaries of such flows.

69. **Bank/Fund staff work has noted that come countries have a tendency to over-regulate.** Some country's regulations may also unintentionally favor certain RSPs. It is generally recommended that countries consult with RSPs before introducing regulations and conduct specific risk-based analysis on the potential for ML/FT abuse.

## A. Characteristics and Practices

70. **Remittance flows are an important source of funds for many developing countries.** Officially recorded remittance flows to developing countries are estimated to have reached \$126 billion in 2004, registering an increase of 49 percent since 2001.<sup>7</sup> Much of this increase occurred in low-income countries, where remittances rose by 82 percent during the period from 2001 to 2004. Most of the \$41 billion increase in remittances to developing countries from 2001 to 2004 was concentrated in South Asia (\$17 billion), Latin America and the Caribbean (\$13 billion), and, to a lesser extent, East Asia and the Pacific (\$7 billion).<sup>8</sup>

71. **The increase in remittance flows have been particularly strong in China, India, Mexico, Pakistan, and the Philippines.** Even though most top recipient countries are large, remittances in many small developing countries (e.g., Lebanon, Lesotho, Tajikistan, and Tonga) are significant as a share of GDP or in per capita terms. In some cases, the increase in recorded flows may be explained, in part, by the implementation of more accurate recording mechanisms after the events of September 2001.<sup>9</sup>

72. **Workers' remittances have been recognized as a significant source of external funding for developing countries.** They are deemed to have counter cyclical effects in stabilizing household incomes during periods of economic distress.<sup>10</sup> Therefore, since remittances have tended to be more stable than private capital flows, by strengthening financial-sector infrastructure and facilitating international migration, countries could increase the development impact of remittance flows.<sup>11</sup> Studies in this area address questions like the effects of remittances on poverty, on financial development and, at a macro level, the impact of remittances on recipient countries.

## B. Implementing AML/CFT Obligations

73. **Overall compliance with SR IV concerning remittance systems from assessments were mixed.** 35 percent of countries were assessed as compliant with another 24 percent

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<sup>7</sup> This estimate is based on the official recording of remittance flows for balance-of- payments statistics. Flows through unofficial channels, such as informal funds transfer systems, are likely to be under recorded.

<sup>8</sup> World Bank, Global Development Finance Report 2005.

<sup>9</sup> Central banks in Mexico and Guatemala have improved the recording of remittance flows in recent years coinciding with implementation of new AML/CFT legislation.

<sup>10</sup> IMF Staff Papers. Vol. 52, No.1, 2005. The authors confirmed the countercyclical effect of remittance flows based on aggregate data on remittances, but imply that remittances do not act like a source of capital for economic development.

<sup>11</sup> Dilip Ratha. 2003. "Workers' Remittances: An Important and Stable Source of External Development Finance." *Global Development Finance, Chapter 7.*

found largely compliant, while 29 percent were partially compliant, and 12 percent were non-compliant. Among the Special Recommendations for CFT, the compliance with SR VI turned out the best. As in Section III a more detailed analysis of the same nine countries (see paragraph 51) was made which allowed the additional specific observations below.

74. **Of the nine countries reviewed, all have extended their AML/CFT regime to cover RSPs.** Where RSPs are affiliated with banks, AML compliance tends to track that of the parent organization. In three countries where independent RSPs are allowed to operate, compliance with AML requirements is not closely supervised. Post offices, which commonly provide remittance services, are generally subject to the AML/CFT requirements, but their compliance has not been closely evaluated in most assessments. This is in part attributed to the fact that the postal agency may be government owned and subject to supervision by a designated official body.

75. **As far as informal providers are concerned, all nine countries have a strict licensing regime in place that prohibits any money transfer activity outside the regulated framework.** Most of these countries believed that the presence of informal, unlicensed remittance businesses was not significant. However, only a few countries have made systematic efforts to verify that this is in fact the case.<sup>12</sup>

76. **Remittance sending and recipient countries have different approaches when introducing AML/CFT regulations for RSPs.** Sending countries are particularly concerned with risks associated with the financing of terrorism. Recipient countries, in many instances, are more concerned with maximizing the developmental impact of these flows, and thus the rationale behind regulating remittances (including AML/CFT preventive measures) for them is closely related to this factor.

### C. Ongoing and Completed Work

77. **Protecting the integrity of remittance flows and maximizing their development impact has been identified as the main priorities of Bank/Fund work.** Staff have contributed to increasing the understanding of factors behind these flows, the main channels used in key remittance corridors, the role of the private sector in promoting remittance systems, the potential for abuse of the systems, and the AML/CFT framework needed to protect and monitor remittance systems. The work to date, in cooperation with other organizations and institutions, has focused on the reduction of the price of transfers, improvements in the efficiency of payment systems infrastructure; the study and development of regulations to protect the integrity of these flows; the analysis of their development impact; and the improvement of data collection.

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<sup>12</sup> During the course of the DNFBP benchmarking exercise, Staff was also able to gather information on remittance issues, identify good practices for a supervisory framework and look into the effects of the regulations on the accessibility of migrants and other unbanked segments of society. The various countries visited have implemented either a registration or a licensing regime, consistent with FATF recommendations. The choice of regime usually reflects the characteristics of national financial systems as well as national approaches to financial regulation.

## Improving Data and Knowledge

78. **Bank staff have developed and tested methodologies to better understand and monitor the size and nature of bilateral flows**, the factors that influence flows, and the mechanisms through which flows move. The information gathered serves to better inform and guide policies to lower remittance transaction costs, enhance the developmental impact in the recipient countries, and minimize opportunities for abuse. Bilateral Remittance Corridor Analyses (BRCA) have already been conducted in seven remittance corridors. In some cases, the BRCA was done in partnership with donors and national government agencies. There are plans to provide TA to countries on how to conduct their own BRCA.<sup>13</sup>

79. **Bank/Fund work on statistical issues is part of broader initiatives to improve, over the longer term, the world-wide recording of remittances within the balance-of-payments framework.** Following calls from users for improvements in remittances statistics, including from the G8 Heads of State, G7 Finance Ministers requested the formation of an international working group to recommend measures to improve remittances statistics. The work on reviewing international concepts was assigned to a United Nations-led group of technical experts, which includes Fund and Bank staff. In consultation with an even wider cross-section of statistical compilers, this group developed recommendations on improved concepts and definitions.<sup>14</sup> These recommendations will be reflected in revised versions of the IMF Balance of Payments Manual, fifth edition and the 1993 System of National Accounts.

80. **Bank's Global Economic Prospects 2006 (GEP 2006) will focus on International Remittances and Migration.** The GEP 2006 will review key questions surrounding the size of remittances for developing countries. In addition to the size, channels, and major corridors of remittance flows, it will discuss their macroeconomic effects and government policy responses in the recipient countries.

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<sup>13</sup> The Netherlands has expressed interest in conducting research on its remittances corridor with Surinam using the Bank's methodology.

<sup>14</sup> Papers of this group are available at its website <http://unstats.un.org/unsd/tradeserv/reldocs.asp>.

## Box 8. Bank's Activities on Remittances

The large remittance flows (estimated more than \$150 billion in 2005) and its significant development impact present challenges to policy makers. Increasing remittances flows and demands for access to financial services among senders and receivers have created new transfer mechanisms and financial products for large volume of smaller transactions. Studies at the Bank aim to improve knowledge on these flows with a view to offer policy guidance to client countries.

### **Bank/CPSS Task Force for General Principles on International Remittance Systems**

The Bank co-chaired with the Bank for International Settlements' Committee for Payment and Settlement Systems (CPSS) a Task Force to address the needs of international policy coordination for remittance payment systems. Main topics of their work include market environment, consumer protection and transparency, Market infrastructure, and public policy. The output from this Task Force will form a basis for the development and oversight of payment systems for remittances.

### **Remittances Corridors Analysis**

The nature of the remittance senders and their incentives to use Formal Fund Transfer (FFT) systems shape remittance corridors between sender and recipient countries. Analysis of these corridors in different regions confirms that reliability, access to formal remittance mechanisms and cultural familiarity are key to promoting the use of FFT systems, while linking remittance transfers to financial products, which range from saving accounts to mortgages.\* Also studies in Mexico, the Philippines, Guatemala, Pakistan, Ghana, Albania, have confirmed the positive effect that remittances have on poverty reduction. The Bank is also collaborating with the ADB Bank on a study of hindrances to the use of ATMs to lower costs of remitting in Central Asia, the Caucasus and Moldova.

### **International Working Group to improve remittance statistics**

The Bank is chairing a multilateral effort, which includes the Fund and the UN statistics division, aimed at improving the reporting of remittance statistics, particularly in the framework of the Balance of Payments.

### **Surveys**

Surveys covering all remittance stakeholders have been conducted. Central banks have been asked about the challenges they face to collect data on remittances. Characteristics of remittance senders and recipients among different migrant communities have been identified by household surveys. And finally, the private sector has responded to surveys on their business models, geographical coverage, size of flows, and costs.

### **CGAP work on remittances**

In addressing AML/CFT compliance by service providers catering to low-income customer, CGAP undertook joint research with the Bank. CGAP has also conducted studies to estimate remittance flows, domestically and between South Africa and neighboring countries, and to characterize the nature of demand for money transfer services among poor migrants and recipients. Other studies include household and focus group surveys of domestic migrants from rural to urban areas, and financial service providers in both labor-importing and -exporting provinces in China and India. These studies identified the need for gradual implementation of new measures, adoption of risk-based approach to regulate and the use of exemptions for low-risk categories of transactions.

### **2006 Global Economic Prospects**

Remittances size, determinants, development impact, and steps to reduce transactions costs will be drawn from Bank's work listed above and captured in the *Global Economic Prospects (GEP)*. The GEP will outline measures to reduce remittance fees and strengthen the financial infrastructure by encouraging competition among RSPs, avoiding over-regulation, introducing new technologies, harmonizing payment systems and extending financial services for both remittance senders and recipients.

\* Countries involved in this analysis are Canada, Germany, Guatemala, Indonesia, Italy, Mexico, Morocco, Nepal, Netherlands, Nigeria, Qatar, Saudi Arabia, Serbia, Surinam, United Kingdom, United States, and Vietnam.

Source: World Bank

81. **The Bank's work on Global Economic Prospects 2006 (GEP 2006) will focus on International Remittances and Migration.** The GEP 2006 will review key questions surrounding the size of remittances for developing countries. In addition to the size, channels, and major corridors of remittance flows, it will discuss their macroeconomic effects and government policy responses in the recipient countries.

### **Improving Developmental Impact**

82. **Preliminary lessons from staff work indicate differing levels of impact on development depending upon whether flows come through formal or informal channels.** Two main categories have been identified: 1) "Mature" corridors where the use of formal mechanisms are already in place, and 2) "Nascent" corridors where initial market conditions need to be fostered and cultivated for formal remittance mechanisms to thrive.

83. **Those corridors with a higher degree of maturity have experienced reduction in transfer cost,** improvement in the recording of remittance flows and better awareness of the potential to link remittance senders and recipients to other financial products. Greater use of formal channels is believed to reduce the risk of abuse of remittance systems for ML/FT. In both remittance-sending and remittance-receiving countries, improving access to financial services has been associated with a shift from informal to regulated systems, especially among lower income groups. Encouraging senders to channel a growing proportion of remittances through regulated RSPs has greater potential for increasing the access of both senders and recipients to other financial services, providing both additional income-earning opportunities and enhanced capacity to manage financial risks. However, this requires an increasing awareness on the part of senders and recipients to available formal options and the benefits of using them in order to maximize the developmental impact of remittances.

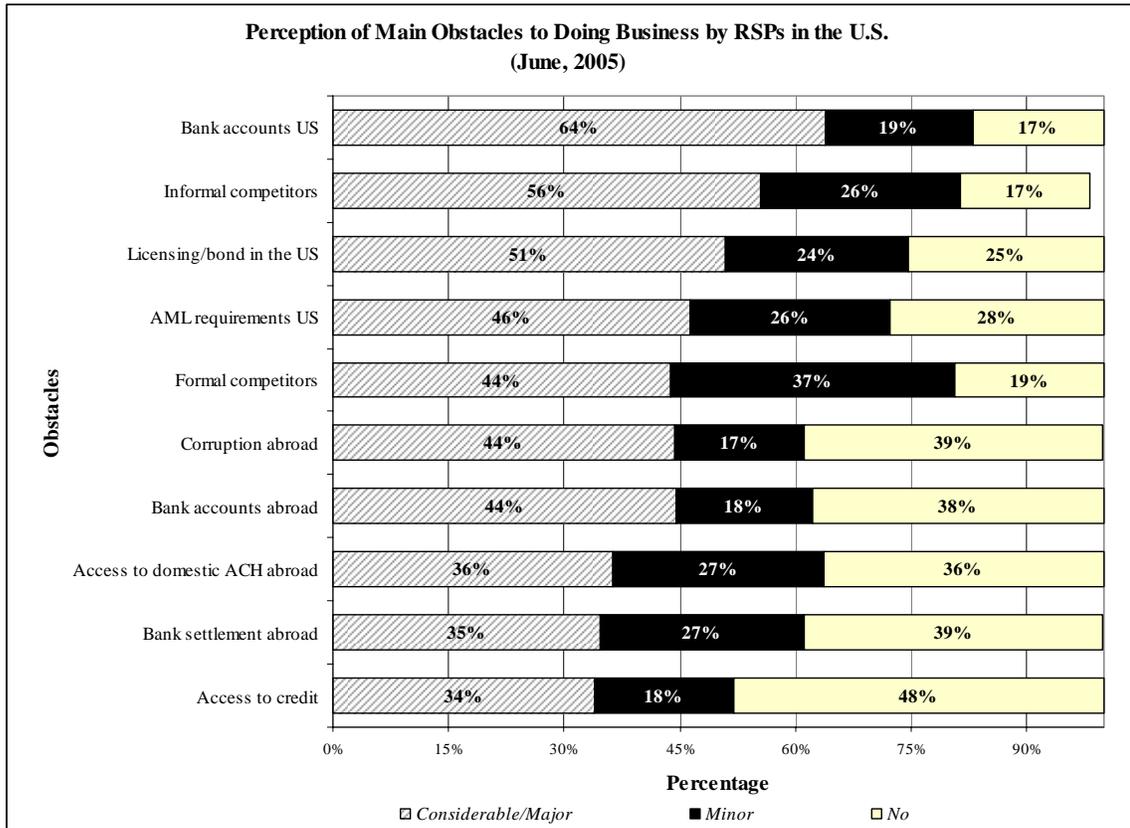
### **Reducing Remittance Cost**

84. **A key factor in reducing remittance costs in bilateral corridors is generating market competition among RSPs.** There is evidence that the entry of diverse RSPs, such as banks, credit unions, money transfer operators and others into the remittance market often stimulates the discovery of more cost-effective ways of doing business and this ultimately drives down prices for the consumer. In the U.S.-Mexico corridor, for example, the steady decline in prices and reduction of business costs followed the increase in the variety of market competitors. The implementation of technology and efficient payment systems are also important factors in reducing cost.

85. **Providing basic financial infrastructure and allowing access to RSPs are important pre-requisites** for regulated providers to attract remitters away from informal systems. Access by non-bank RSPs to the payments systems infrastructure including sharing the benefits of real-time settlements could facilitate better liquidity management while contributing to lowering cost of remittances through formal channels.

### Box 9. Study of Remittance Service Providers in the United States

The Bank conducted a survey on remittance service providers (RSPs) in selected parts of the U.S. Findings from the survey describe how business environment is perceived by these RSPs. The following figure represents some of the obstacles to doing business listed by the surveyed RSPs. The four largest obstacles are related to their regulatory regime, either directly or indirectly.



Source: World Bank. Andreassen, Ole. (forthcoming). "Remittance service providers in the United States."

86. **Cooperation on payment systems is common in order to ensure the safety, efficiency, and transparency of the way payments are processed** and of the circuits which support remittance transactions. The leading international forum for policy development in this area is the Bank for International Settlements' Committee for Payment and Settlement Systems (CPSS). At the end of 2004, the World Bank and the CPSS convened a Task Force, with IMF involvement, to address the needs of international policy coordination for remittance systems, which is expected to issue *General Principles for International Remittance Systems* during the first half of 2006.<sup>15</sup> The output from this Task Force will form a basis for the development and oversight of remittance payment systems in the future and

<sup>15</sup> The Task Force includes central banks from sending and receiving countries, international financial institutions, and development banks.

will address market environment, consumer protection and transparency, market infrastructure, and public policy for remittance systems.

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### **Regulating Remittance Systems**

88. **In March 2005, Fund staff issued a paper presenting some lessons for implementing a regulatory framework for both the formal and informal remittance sectors** based on the experience of a sample of countries that have issued specific regulations to implement the FATF recommendations. The main points highlighted in the paper are that:

- Countries should consult the private sector before imposing a regulatory regime;
- Application procedures should be clear and simple, whether a country chooses registration or licensing;
- Owners and managers of a remittance provider should be identified and subject to the minimum requirement of a background check by the authorities;
- Remittance providers must have programs to guard against money laundering and terrorist financing;
- There should be onsite and offsite monitoring to ensure compliance; and
- Authorities should be able to impose sanctions.

In addition to these supervisory requirements, providers should also be required to comply with specific AML/CFT requirements, consisting of minimum customer identification, tailored record keeping and reporting of suspicious activity.

89. **Ensuring the integrity of flows is important both to enhance the income effect on growth and the safety of financial sectors.** It is possible that the introduction of new or intensified AML/CFT regulations could have the unintentional and undesirable consequence of reducing the access of the low-income group to formal financial services. Bank staff studies with CGAP recommends that this outcome could be minimized or avoided through

gradual implementation of new measures; the adoption of a risk-based approach to regulation; and the use of exemptions for low-risk categories of transactions.

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91. **The Bank/Fund continue to provide support to increase awareness of remittances.** The Fund co-organized the Hawala Conference with the Central Bank of the U.A.E., and published the book “Regulatory Frameworks for Hawala and Other Remittance Systems.” The Bank continued its support of the APEC Remittance Systems Initiative and organized a Second Policy Dialogue in Bangkok, Thailand in May 2005.

92. **Staff have been cooperating with the FATF, IFIs, and national agencies** through participation in working groups, outreach and technical assistance to address issues for strengthening the regulatory and supervisory aspects of remittance systems including AML/CFT issues. This work aims to raise the overall awareness of remittance systems and to protect the integrity of remittances flows for countries and providers from the risk of money laundering and terrorist financing and for consumers with respect to transparency of transfer costs. The technical assistance of the Fund concentrates on reviewing information on the size and major operational details of remittance providers and the vulnerabilities for misuse by criminals for money laundering and terrorist financing purposes.

## V. IMPLEMENTING THE REVISED AML/CFT STANDARD: NON-PROFIT ORGANIZATIONS

93. **This section discusses the conceptual and implementation challenges faced by the extension of AML/CFT obligations to non-profit organizations (NPOs)** under the revised FATF 40 Recommendations and the Special Recommendations on Terrorist Finance. Unlike the AML/CFT issues surrounding DNFBPs and remittance systems, the challenges for NPOs are of a different order of magnitude. Special Recommendation VIII (SR VIII), adopted in October 2001, requires countries to address the risk of terrorist financing through NPOs. Specifically, it calls for a review of the adequacy of existing legislation and for countries to ensure that NPOs cannot be abused. There is no explicit link to money-laundering in either the Recommendation or the assessment criteria, nor does the Recommendation specify what measures should be taken.<sup>16</sup>

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<sup>16</sup> While there is no explicit AML component, it would appear in practice that many specific mechanisms for implementing CFT protections would also protect against ML.

94. **FATF had little prior experience with the NPO sector**, and there have not been many case-studies nor analytical work predating the introduction of SR VIII.<sup>17</sup> FATF has not yet issued an Interpretative Note providing official guidance for assessors and authorities, but published a Best Practices Paper in October 2002.<sup>18</sup> The discussion of the NPO sector in this section is based on a review of assessments undertaken thus far and as in Section III (see paragraph 51), a more detailed analysis of the same nine countries was made contributing to additional specific observations in this section. Further, staff is undertaking broader studies of the NPO sector which includes a general survey and analysis of issues in the sector. The results of this staff study on NPOs will be the subject of a separate paper to be submitted to the Board at a later date which will examine the economic significance of NPOs worldwide and summarize global practice in NPO supervision.

#### A. Characteristics and Practices

95. **By any definition, the NPO sector worldwide is vast**, encompassing millions of entities with annual expenditures of over \$1.3 trillion.<sup>19</sup> The structures that countries have put in place to oversee NPOs also vary widely. Depending on the country, NPOs may come under the scrutiny of specialized supervisors, tax authorities, public prosecutors, courts of registry, social welfare ministries, religious authorities or any combination of these or other bodies.

96. **Drawing on the analysis of other supervisory regimes, various institutional structures can be differentiated** on the basis of the kinds of registration that NPOs are subject to and the kind of licenses (broadly defined) that are granted.<sup>20</sup> This analysis can also provide the basis for understanding what elements need to be added to different kinds of existing regimes to strengthen their CFT components.

97. **The practice of registering NPOs is far from universal and the scope of registration varies.** In some countries, NPOs are considered to be a specialized form of legal person, subject to a variation on the registration requirements for a business entity. In others, registration is entirely voluntary. Even in the former cases, it is usually possible to form

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<sup>17</sup> The first typologies conference that addressed NPOs was in October, 2003; although, a few case studies were presented in the 2002 Best Practices Paper.

<sup>18</sup> In FATF practice, an Interpretative Note (IN) is an integral part of the standard and can be used to develop essential assessment criteria for rating a country. A Best Practices Paper (BPP) cannot be used as a basis for essential, only additional (voluntary) criteria. The BPP for non-profits, however, does provide some fairly detailed suggestions about how jurisdictions could approach the problem.

<sup>19</sup> Salamon, Lester; Solkolowski, S. Wojciech; *et al*, *Global Civil Society: Dimensions of the Nonprofit Sector*, (Kumarian Press: Bloomfield, CT, 2004), vol. 2, pp. 15–16. This study, sponsored by Johns Hopkins University, only covers 36 countries, so the real size of the global sector is larger.

<sup>20</sup> Registration involves authorities collecting and maintaining informational records about an entity. Licensing is granting an entity permission to perform an activity or receive a benefit and usually implies some level of government approbation.

small associations without legal personality. Countries with established religions may register houses of worship, but others do not. In most registration regimes, some classes of NPOs are exempted a priori. The information that is included in registration files can also vary a great deal from country to country. Some require NPOs to present founding documents or charters which set out the purpose of the organization. Others require some form of financial statement. Still others only require basic name and address information. Of the countries reviewed, several have voluntary registration, a few countries require mandatory registration involving extensive financial and documentary information, and others report some form of universal registration with more limited information being provided.<sup>21</sup>

98. **The terminology of licensing is not customarily applied to government oversight of NPOs**, but the concept can be usefully applied to provide an analytical framework. There are generally two classes of rights that the state can grant to NPOs, both having to do with their financial operations. The first is the right to receive money directly or indirectly from the state. The second is the right to raise money from the citizens of the state. In return for one or another of these “licenses,” the government can require more information from the entity, impose a fit-and-proper tests for its leadership, exercise some influence over program choices, and/or apply sanctions for abuses. However, such licenses tend to be voluntary and therefore license-based regimes can be evaded. An NPO that does not care for tax-exempt status does not have to seek it and many private foundations do not have to solicit funds from the public. However, they may still pose a risk for FT purposes.

99. **The most common form of public financing “license” is the granting of tax privileges.** Countries can, and the majority do, offer various forms of tax exemption to certain classes of NPOs and/or to their donors. In exchange for forgoing expected revenue, the tax authorities usually require information on the financial activity of the organization and can be granted a quasi-supervisory role vis-à-vis the NPO. Several assessed countries reported some form of tax privilege for some of their NPOs (although other countries did not convey any information about this aspect of NPO oversight). Another form of “license” is the right to receive grants or contracts from the state, which will often carry a higher level of scrutiny, especially in highly developed government procurement systems. Finally, some jurisdictions have set up quasi-governmental charities which perform social services and can use government channels for receiving donations.<sup>22</sup>

100. **A distinct form of “license” is the right to solicit donations from the public.** In return for this privilege, the authorities can impose anti-fraud (donor-protection) regimes. The most extensive of these require proof that donations are going for the purposes of specified activities. The authorities can also examine the NPO’s books and replace

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<sup>21</sup> Due to lack of consistency in the assessment process on this Recommendation, not all the reports convey clear information about country NPO regimes. These breakdowns are therefore tentative.

<sup>22</sup> The most prevalent type of such organizations is the government “Zakat” organization in certain jurisdictions where Islam is the established religion. However, variations on this model can be found elsewhere as well.

management where they are performing unsatisfactorily. The regime can involve all the traditional tools of supervision such as on-site and off-site inspections. Such licenses can be granted, and the attendant supervision imposed at either the national or the sub-national level. However, very few countries assessed reported controls over the solicitation of funds, some countries even stated explicitly that controls were absent, while the rest were silent on this issue.

101. **In a number of countries, the NPO sector has some form of self-regulatory organizations (SRO)** which evaluate individual NPOs and bestow ratings (in some cases membership in an umbrella organization or a “seal of approval” is required). While SROs are not government agencies, the ratings or seals given serve to address the same anti-fraud, donor protection issues—often demanding a much higher level of transparency than does the applicable government regulatory body.

### **B. Implementing CFT Obligations**

102. **Countering terrorism or the financing of terrorism was not a central part of any of the NPO oversight regimes prior to the adoption of SR VIII by FATF.** NPOs, like other natural and legal persons, are explicitly prohibited from supporting terrorism. In those countries which had anti-“extremism” legislation, NPOs could not be formed to support causes that were otherwise prohibited. However, these are not issues that attract the attention of most officials involved in NPO supervision and oversight. Rather, traditionally the focus has been on preventing the misuse of tax privileges or the defrauding of donors.

103. **Legal and regulatory frameworks do not appear to have changed significantly since 2001.** While awareness of terrorist-related risks among NPOs has been raised (particularly by high-profile asset-freezing actions in certain countries), few authorities have adopted new measures to address these issues.<sup>23</sup> Nonetheless, compliance with SR VIII was rated more favorably than for many other CFT special recommendations. 17 percent of countries were rated compliant, 17 percent largely compliant, 28 percent partially compliant and 39 percent non-compliant. With respect to the nine countries on which staff focused, only two had conducted the FATF-required review of the CFT vulnerabilities of their NPO regimes, and none had introduced any new or special measures to modify their existing regimes. However, while the Recommendation does not require the introduction of specific measures, many existing protections for NPOs focus on detecting fraud by founders or managers and on ensuring greater transparency of financial records and flows. These would

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<sup>23</sup> In one country, the authorities have published a set of “voluntary best practices” and the tax authorities are preparing guidance for overseas grant-makers. These efforts have come under a great deal of criticism from the country’s NPO sector. In addition, the country’s bilateral donor agency has tightened the due diligence procedures it demands from its grantees and contractors to minimize the possibility of their funds ending up in the hands of terrorists. In another country, the NPO regulatory authority has, without having to issue new regulations, focused its considerable powers over domestically-based charities on the fight against FT. One new possibility that has been raised by FATF is whether NPO-specific indicators of suspicion could be developed and disseminated to guide financial institutions in their dealings with NPOs.

provide a measure of protection against diversion of funds to support FT, which some assessors may have considered as a factor in their ratings.

### **C. Experiences with Assessments**

104. **The absence of any concrete specific preventative measures for NPOs is the major challenge for assessors.** Conscientious assessors may have to examine a wide range of oversight practices to see if the overall environment achieves the objectives set in the standard. The extension of AML/CFT preventive measures to NPOs remains tentative, the regulatory framework weak or uncertain, and there have been few incidences or no filing of suspicious transactions reports.

## **VI. LIST OF BANK/FUND AML/CFT PUBLICATIONS**

### **Joint Publications**

Paul Allan Schott, World Bank and International Monetary Fund, Second Edition 2004, *Reference Guide to Anti-Money Laundering and Combating the Financing of Terrorism* (Washington, DC: World Bank).

International Monetary Fund and The World Bank Group, 2004, *Financial Intelligence Unit: An Overview* (Washington, DC: International Monetary Fund).

World Bank and International Monetary Fund, 2004, *Combating Financial Abuse, Regional Videoconference: Middle East and North Africa Region—Egypt, Iran, Jordan, Lebanon, and Yemen*, Global Dialogue Series (Washington, DC: World Bank and International Monetary Fund).

### **IMF**

International Monetary Fund, 2005, *Regulatory Frameworks for Hawala and Other Remittance Systems* (Washington, DC: International Monetary Fund).

International Monetary Fund, 2005, “Approaches to a Regulatory Framework for Formal and Informal Remittance Systems: Experiences and Lessons,” (International Monetary Fund) [www.imf.org/external/np/pp/eng/2005/021705.htm](http://www.imf.org/external/np/pp/eng/2005/021705.htm).

International Monetary Fund (forthcoming 2006), “Working Together – Regulatory Cooperation and Information Exchange” (Washington DC: International Monetary Fund)

Johnston, Barry and John Abbott, 2005 “Deterring the Abuse of the Financial System—Elements of an Emerging International Standard” (Policy Discussion Paper No—PDP 05/03 <http://www.imf.org/external/pubs/ft/pdp/2005/pdp03.pdf> ).

Johnston, Barry and Oana Nedelescu 2005, “The Impact of Terrorism on Financial Markets” (Working Paper WP 05/60 - <http://www.imf.org/external/pubs/ft/wp/2005/wp0560.pdf>).

Thony, Jean-François, 2005, *Money Laundering and Terrorism Financing: An Overview* - Current Developments in Monetary and Financial Law, Vol. 3, pp. 241–264 (Washington, DC: International Monetary Fund).

Kyriakos-Saad, Nadim, 2005, *The Methodology for Assessing Compliance with Anti-Money Laundering and Combating the Financing of Terrorism Standards*, - Current Developments in Monetary and Financial Law, Vol. 3, pp. 265–278 (Washington, DC: International Monetary Fund).

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### **World Bank**

World Bank and International Monetary Fund, 2004, *Effective Regimes to Combat Money Laundering and the Financing of Terrorism: Strengthening the Collaborative Process, Lessons Learned*, Global Dialogue Series (Washington, DC: World Bank).

Hernandez-Coss, Raul, World Bank, 2005, *The U.S.-Mexico Remittance Corridor: Lessons on Shifting from Informal to Formal Transfer Systems*, World Bank Working Paper No. 47 (Washington, DC: World Bank).

Hernandez-Coss, Raul, World Bank, 2005, *The Canada-Vietnam Remittance Corridor: Lessons on Shifting from Informal to Formal Transfer Systems*, World Bank Working Paper No. 48 (Washington, DC: World Bank).

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World Bank, 2005, *The Second APEC Policy Dialogue: The Role of the Private Sector in Shifting from Informal to Formal Remittance Systems*, (World Bank) [www.remittance-initiative.org](http://www.remittance-initiative.org).

World Bank, 2005, *APEC Symposium on Alternative Remittance Systems: Shaping the Remittances Market by Shifting to Formal Systems*, CD-ROM (Washington, DC: World Bank).

World Bank, 2005, *AML/CFT Regulation: Implications for Financial Service Providers that Serve Low-Income People* (Washington, DC: World Bank) [http://www.cgap.org/docs/FocusNote\\_29.pdf](http://www.cgap.org/docs/FocusNote_29.pdf) .