



## ANTI -MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM INCLUSION IN SURVEILLANCE AND FINANCIAL STABILITY ASSESSMENTS—GUIDANCE NOTE

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### **EXECUTIVE SUMMARY**

*This note provides guidance on the inclusion of AML/CFT issues in surveillance and financial stability assessments (FSAs). Specifically, it provides a framework for the treatment of cases where money laundering or terrorist financing (ML/TF) and related underlying crimes (i.e., “predicate crimes” or “predicate offenses”) are so serious as to threaten domestic stability, balance of payments stability, the effective operation of the International Monetary System—IMS—(in the case of Article IV surveillance), or the stability of the domestic financial system (in the case of FSAs).*

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## ACRONYMS

<b>AML/CFT</b>	Anti-Money Laundering and Combating the Financing of Terrorism
<b>FATF</b>	Financial Action Task Force
<b>FSA</b>	Financial Stability Assessment under the FSAP
<b>FSAP</b>	Financial Sector Assessment Program
<b>FSSA</b>	Financial System Stability Assessment
<b>ICRG</b>	International Cooperation Review Group
<b>IMS</b>	International Monetary System
<b>ISD</b>	Integrated Surveillance Decision
<b>ML</b>	Money Laundering
<b>RAM</b>	Risk Assessment Matrix
<b>TF</b>	Terrorism Financing

## INTRODUCTION

**1. This guidance follows a Board discussion on the AML/CFT program in June 2011 and subsequent exchanges between staff and management to operationalize the Board’s directives.** Following the discussion of staff’s report on the AML/CFT program, the Board endorsed the approach and considerations outlined by staff in the paper for the coverage of AML/CFT and related predicate crimes<sup>1</sup> issues in the context of FSAs and bilateral surveillance.<sup>2</sup> This guidance also reflects the approach outlined in the Integrated Surveillance Decision (ISD) adopted by the Board on July 18, 2012.<sup>3</sup> In particular, this guidance identifies circumstances in which ML/TF-related issues should be covered in the context of Article IV missions on a mandatory basis. However, it is not expected that these issues would have to be covered routinely.

**2. Money laundering refers to activities intended to conceal or disguise the origins of the proceeds of crime (i.e., “predicate crimes” or “predicate offenses”) through processes that transform illegal inputs into apparently legitimate outputs.** Proceeds generated by crimes such as fraud, theft, and drug trafficking are made to look as if they were the fruits of honest activities—transformed, for instance, into legitimate-looking bank accounts, real estate, or luxury goods. Terrorism financing involves the raising and processing of funds to supply terrorists with resources to carry out their attacks. While the phenomena differ in key ways, they often exploit the same vulnerabilities in financial systems that allow for an inappropriate level of anonymity and nontransparency in the execution of financial transactions.

**3. The close relationship between the criminal act that gives rise to proceeds and the laundering of these proceeds makes it very difficult to separate the act of money laundering from the underlying crime.** Similarly, there is often a very close nexus between operations to finance a terrorist act and the terrorist act itself. If there were no fraud, no tax crime, no insider

<sup>1</sup> Predicate crimes are the underlying crimes that give rise to money laundering. Traditionally, the most important of these crimes was considered to be narcotics trafficking. As the 1990s progressed, however, the increasing recognition of the significance of the proceeds generated by non-drug-related crimes led to the designation of such crimes as predicates to money laundering. The FATF standard designates the following categories of offenses as predicate offenses to money laundering: participation in an organized criminal group and racketeering; terrorism, including terrorist financing; trafficking in human beings and migrant smuggling; sexual exploitation, including sexual exploitation of children; illicit trafficking in narcotic drugs and psychotropic substances; illicit arms trafficking; illicit trafficking in stolen and other goods; corruption and bribery; fraud; counterfeiting currency; counterfeiting and piracy of products; environmental crime; murder, grievous bodily injury; kidnapping, illegal restraint and hostage-taking; robbery or theft; smuggling; (including in relation to customs and excise duties and taxes); tax crimes (related to direct taxes and indirect taxes); extortion; forgery; piracy; and insider trading and market manipulation.

<sup>2</sup> See *AML/CFT—Report on the Review of the Effectiveness of the Program*, IMF Policy Paper, May 11, 2011, <http://www.imf.org/external/np/pp/eng/2011/051111.pdf> and Public Information Notice, No. 11/74, June 27, 2011, [www.imf.org/external/np/sec/pn/2011/pn1174.htm](http://www.imf.org/external/np/sec/pn/2011/pn1174.htm).

<sup>3</sup> The ISD will apply to all Article IV consultations that are completed by the Executive Board on or after January 18, 2013. Until this date, the approach outlined in this Guidance Note should be applied, with regard to Article IV consultations, within the framework outlined in the 2007 Surveillance Decision.

trading, no drug trafficking, no corruption, or indeed no proceeds-generating crime at all, there would be no money laundering. Money laundering is an essential component of any profit-generating crime, because without the laundering, crime would not pay. Accordingly, it is widely acknowledged that AML/CFT strategies and controls play an important role in mitigating risks arising from predicate crimes.

**4. Money laundering, terrorist financing and the related predicate crimes can undermine the stability of a country’s financial system or its broader economy in a number of ways and may have adverse spillover effects on global stability.** Threats to financial stability and macroeconomic performance can be directly attributable to money laundering and terrorist financing in certain cases, resulting, for example, in loss of access to global financial markets and destabilizing inflows and outflows. In many instances, however, threats arise from the predicate crimes themselves, often in combination with money laundering or terrorist financing. Box 1 provides a few illustrations of the impact of criminal behaviors on the economy in Fund member countries.

#### **Box 1: The impact of criminal behaviors on the economy—Illustrations**

In **Afghanistan**, over \$900 million—or more than 5 percent of the country’s GDP and 50 percent of the government’s budget—were diverted from Kabul Bank through interest-free loans to bank insiders and politically-connected parties, and subsequently invested in foreign real estate. In August 2010, when the Afghan government intervened to replace the management of the bank, depositors withdrew more than \$200 million in deposits in a bank run that threatened the country’s precarious financial and political stability. To date, Afghanistan’s central bank has spent \$825 million to bail out the banking sector, a considerable cost for a country so poor.

**Antigua and Barbuda** was chosen by U.S. fraudster Allen Stanford as the base for a massive Ponzi scheme, which marketed “high-yield” certificates of deposit on his Antigua-based bank (the Bank of Antigua) to credulous investors. As in any Ponzi scheme, the income from later investors went into paying returns to the earlier ones. When the scheme came tumbling down in 2009, it took with it Stanford’s bank—and a large part of the Antiguan economy, which was enmeshed in the growth of what had become the island’s biggest private employer. That year, Antigua’s GDP shrank by 10.7 percent and the Bank of Antigua came under the control of the regional central bank (the Eastern Caribbean Central Bank). The Bank of Antigua was ultimately resolved in a purchase and assumption operation in which the Government of Antigua and Barbuda had to inject resources amounting to 3 percent of the country’s GDP. The massive decline in the economy and the already high level of indebtedness of the government led it to request a \$118 million Fund-supported program in 2010. In March 2012, Stanford was convicted in the United States of defrauding 30,000 investors in 113 countries.

In the **Dominican Republic**, insiders at Banco Intercontinental, the second-largest private bank in the country, set up an elaborate scheme to loot the bank’s assets. They loaned money to themselves and secured loans from third parties with bank funds while concealing these nonperforming assets in a parallel set of books. Every day for 14 years, an automated accounting program “balanced” the bank’s books by transferring real assets and liabilities between the two systems to make the “above-ground” bank look solvent. When the fraud finally came to light in 2003, “BANINTER” (as the bank was known) and two related commercial banks were bailed out by the government at a cost of 21 percent of the country’s GDP. The social and economic costs exceeded the direct cost of the bailouts; a rapid depreciation of the peso by

approximately 65 percent led to very high inflation and a serious erosion of real incomes. Some 1.5 million Dominicans (about 16 percent of the population) fell below the poverty line in the aftermath of the banking crisis, 670,000 of whom fell into extreme poverty.

In **Greece**, tax administration has been a longstanding weakness. Tax evasion, a criminal offense in the country, is so widespread that it has been considered as one of the determinants of the crisis. According to estimates, unreported income for 2009 for the self-employed alone (e.g., doctors, accountants, lawyers) stood at a lower bound of €28 billion.<sup>4</sup> This is to be compared with a GDP for 2009 of €235 billion and a tax base of €98 billion. At the tax rate of 40 percent, the foregone tax revenues would have accounted for 31 percent of the budget deficit shortfall in 2009. Improvement in tax collection and administration are crucial in Greece's efforts to support fiscal consolidation.

<sup>1</sup>Artavanis, Morse, Tsoutsouras (2012) "Tax evasion across industries: soft credit evidence from Greece", Fama-Miller Center for Research in Finance, Chicago Booth Paper No. 12-25.

**5. Left unchecked, ML, TF, and predicate crimes enable criminals to amass wealth, power, and influence**, which in turn undermine the rule of law and have a corrosive, corrupting effect on society and the economic system as a whole. AML/CFT controls, when effectively implemented, mitigate the adverse effects of criminal economic activity and promote integrity and stability in financial markets. Strong AML/CFT regimes enhance financial sector integrity and macroeconomic stability both on a national and international level.

**6. Staff should address the effects of ML, TF, or related predicate crimes in Article IV reports** when they (i) in the context of bilateral surveillance, undermine the relevant member's domestic or balance of payments stability, or (ii) in the context of multilateral surveillance, give rise to spillovers which may significantly influence the effective operation of the IMS, including by undermining global economic and financial stability ("global stability").<sup>4</sup> In such cases, staff will provide the authorities with policy advice on the measures that should be taken to address threats presented by ML, TF, or different types of predicate crimes. In some instances, these threats can also be addressed by other Fund policies (e.g., the 1997 Guidance Note on the Role of the Fund in Governance Issues), or other standards and codes (e.g., the Code of Good Practices on Fiscal Transparency or the Basel Core Principles).

**7. Evenhandedness, focus, and selectivity should be exercised when considering the inclusion of ML/TF issues in surveillance**, and this note provides guidance to staff to determine when the problem has reached a sufficient threshold and what to do where it does. As noted in the Guidance Note for Article IV Consultations,<sup>5</sup> it is a general principle that surveillance should be evenhanded while also paying due regard to countries' specific circumstances. In addition,

<sup>4</sup> Box 2 outlines the legal basis for the mandatory inclusion of ML/TF-related issues in surveillance.

<sup>5</sup> See Guidance Note for Article IV Consultations, IMF Policy Paper, June 13, 2012, <http://www.imf.org/external/np/pp/eng/2012/061312.pdf>.

surveillance should focus on those policies of members that can significantly influence present or prospective domestic or balance of payments stability and the spillovers that can undermine global stability, and staff should use judgment in selecting the specific issues to cover, and for this purpose will take a risk-based approach. The following section provides guidance on the circumstances in which ML/TF, or related predicate crimes issues may undermine domestic or balance of payments stability or global stability.

### **Box 2: The legal basis for the mandatory inclusion of ML/TF-related issues in surveillance**

**The legal and policy framework for the conduct of surveillance is set out in Article IV and the Integrated Surveillance Decision (ISD).** In its bilateral surveillance, the Fund assesses whether members are in compliance with the obligations of Article IV, Section 1 governing the conduct of members' exchange rate and domestic economic and financial policies and, in particular, the obligation to collaborate with the Fund and other members to assure orderly exchange arrangements and to promote a stable system of exchange rates ("systemic stability"). The ISD confirms that systemic stability is most effectively achieved by each member adopting policies that promote its own balance of payments stability and domestic stability. The concept of "balance of payments stability" refers to "a balance of payments position that does not and is not likely to give rise to disruptive exchange rate movements."

**The ISD requires the Fund, in its bilateral surveillance, to assess whether a member's exchange rate policies are promoting balance of payments stability and whether its domestic economic and financial policies are promoting domestic stability.** The ISD requires bilateral surveillance to focus on those policies of members that can significantly influence present or prospective balance of payments and domestic stability. In particular, it provides that exchange rate policies and monetary, fiscal, and financial sector policies (both their macroeconomic aspects and macroeconomically relevant structural aspects) will always be the subject of the Fund's bilateral surveillance with respect to each member.

**A member's AML/CFT framework encompasses both domestic and external policies that fall within the scope of members' obligations under Article IV, Section 1.** Some features of such frameworks are domestic in nature—for example, controls on domestic operations within the country's banking system (e.g., the transfer of balances between resident account holders in two domestic banks). Others involve external policies—for example, rules governing the making of payments and transfers to financial institutions abroad—that have cross-country or potentially global effects.

**In its multilateral surveillance, the Fund focuses on issues that may affect the effective operation of the international monetary system (IMS),** including the spillovers arising from policies of individual members that may significantly influence the effective operation of the IMS, including by undermining global economic and financial stability.

**Under the ISD, an Article IV consultation is a vehicle for both bilateral and multilateral surveillance.** In an Article IV consultation, staff should, in particular, discuss outward spillovers arising from a member's policies where the member is not promoting its own domestic or balance of payments stability, or where the spillovers may undermine global stability.

## RELEVANCE OF ML, TF, AND RELATED PREDICATE CRIMES FOR DOMESTIC OR BALANCE OF PAYMENTS STABILITY, OR GLOBAL STABILITY

**8. ML, TF, and the various forms of financial abuse may undermine domestic or balance of payments stability by adversely affecting the stability of a country's domestic financial system or the broader economy.** Domestic or balance of payments stability may be undermined by the act of ML or TF itself or by related predicate crimes in at least three different ways: i) by destabilizing the member's financial system; ii) through important inward or outward spillover effects; and iii) through an adverse effect on the broader economy (e.g., illegal transactions are not recorded in official statistics and are so large as to undermine the ability of economic policymakers to gain a true picture of the state of the economy and to formulate economic policy accordingly).

**9. Moreover, ML, TF, and financial abuse can give rise to outward spillovers that, in particular, can undermine global stability.** As noted in the guidance note for Article IV consultations, examples of such spillovers potentially include policies implemented by countries that are systemically important, but also policies of countries that suffer from large vulnerabilities, which could trigger a systemic crisis in certain broader circumstances, either directly through trade and financial linkages with other countries or indirectly through market contagion.<sup>6</sup>

**10. For the purposes of analyzing the potential impact of these phenomena on domestic or balance of payments stability or global stability, it is sometimes difficult to separate the act of ML or TF from the related predicate crime.** As noted above, there is often a very close relationship between the criminal act that gives rise to proceeds and the laundering of these proceeds. Similarly, there is often a very close nexus between operations to finance a terrorist act and the terrorist act itself.

### A. Impact of ML and TF on Domestic or Balance of Payments Stability

**11.** There are circumstances in which ML or TF itself can undermine the stability of a country's financial system or its broader economy. More specifically:

- **Impeded or lost access to global financial markets:** The actual or perceived failure of a member to deal effectively with ML or TF may result in a loss of access of its financial system to global financial

<sup>6</sup> See Guidance Note for Article IV Consultations, IMF Policy Paper, June 13, 2012, para. 15, <http://www.imf.org/external/np/pp/eng/2012/061312.pdf>.



markets, with potentially negative consequences for financial stability and the economy as a whole. It has become a more frequent practice for national supervisors to prohibit their banks from dealing with financial institutions from countries with weak AML/CFT frameworks, or at least, to subject transactions with institutions from such countries to stricter conditions. The application of these measures towards financial institutions from such countries is expressly contemplated in the FATF standard and, in some cases, has been specifically called for by a number of fora, including the G20 and the FATF's International Cooperation Review Group (ICRG). Even in the absence of specific guidance from the relevant national authorities, financial institutions in some countries may be reluctant to deal with banks from jurisdictions where ML or TF is a major concern.

### Box 3: The FATF standard and the ICRG process

**The FATF's 40 Recommendations constitute the international standard for AML/CFT.** They are recognized by the IMF and the World Bank as part of the Standards and Codes initiative. The FATF standards encompass a broad range of issues, including the regulation of services provided by financial institutions and certain nonfinancial businesses and professions, cross-border movements of currency, the transparency of legal entities, substantive and procedural criminal law, institutional capacity, sanctions, and domestic and international cooperation.

**The FATF pioneered the practice of requiring its members to undergo periodic mutual evaluations—**or peer reviews—respecting their implementation of its standard, the results of which are published and followed up by regular discussions on the progress made in addressing deficiencies.

**The FATF has established the International Cooperation Review Group (ICRG) process to identify and engage with jurisdictions considered to pose a significant risk to the international financial system.** This initiative applies to FATF members and nonmembers alike, and is intended to encourage countries to strengthen their AML/CFT regimes. As part of this process, the FATF has issued public statements expressing concern about significant deficiencies in the AML/CFT regimes of a number of jurisdictions. Based on the ICRG process, the FATF can ultimately call on countries to apply counter-measures with regard to jurisdictions it deems to have strategic AML/CFT deficiencies.

**In June 2011, Directors expressed their continued support to the Fund's collaboration with the FATF, including its ICRG process towards noncooperative jurisdictions.** In this regard, Directors agreed that staff should continue to participate in the ICRG, play a "good offices" role, and provide relevant information on member countries under review with the consent of the relevant member, while refraining from those aspects of the process that are coercive in nature.

- **Destabilizing inflows and outflows:** ML or TF activities may give rise to significant levels of criminal proceeds or "hot money" flowing into and out of individual financial institutions in ways that are destabilizing for these institutions. Such inflows or outflows can be either cross-border or domestic and, where transactions in illegal markets or criminal proceeds are significant in relation to the size of the

country's formal sector, these flows can affect the entire financial system and have cross-country or potentially global effects.

## B. Impact of Predicate Crimes on Domestic or Balance of Payments Stability

12. There are a number of ways in which the predicate crimes to ML or TF can undermine the stability of a country's financial system or its broader economy. The examples provided below are intended to be illustrative rather than exhaustive.

- **Financial sector fraud:** ML may be associated with broader problems of financial sector fraud. The potentially adverse effects on financial stability that may arise from large scale "Ponzi schemes" in the financial sector have been well-publicized. Financial fraud may undermine a country's financial system in many different ways—through large-scale bank insolvencies that ensue when banks' balance sheets are not properly valued, by large outflows of capital from the banking system as the scale of the fraud becomes known, or by the loss of access of a financial sector to international financial markets arising from the deterioration in the jurisdiction's reputation.
- **Compromised financial sector supervision:** ML and TF may be the symptoms of deeper problems concerning the integrity of a country's framework for financial sector supervision. Where important financial institutions within a country are owned or controlled by criminal elements, the authorities may encounter difficulties in supervising these institutions or in identifying and addressing problems before domestic financial stability is undermined.
- **Corruption:** Corruption generates a significant amount of proceeds which need to be laundered. Bribery, corruption, and associated governance issues can have direct and indirect impacts on financial stability. The proceeds of corruption are a key component of illicit financial flows that can create reputational risk for recipient financial institutions, wherever they are located, pose particular threats for offshore financial centers with smaller financial sectors, and result in potentially destabilizing outflows for the source country.
- **Tax crimes:** ML may be associated with tax fraud that can undermine financial or macroeconomic activity in important ways. Significant levels of tax crimes may affect the government's revenue stream to a point where its fiscal balance is severely undermined.

## C. Transmission Mechanisms

13. **The negative effects of ML, TF, or related predicate offenses will typically be transmitted through a country's financial system, as indicated in the examples below.**

- **“Hot money” flows:** Criminal proceeds will generally have to be placed within a country’s financial system and may either remain there or may be transferred abroad to the financial systems of other countries. The injection of large amounts of “hot money” arising from corruption, tax evasion, or drug trafficking may subject a country’s banking system to volatile inflows and outflows that can threaten its stability.
- **Impact of terrorism and terrorist financing:** Negative effects associated with terrorism could also be channeled through the financial system. Incidents of terrorism and terrorist financing may undermine the stability of a country’s financial system—either because of a history of terrorist incidents or through the effect of a single but significant event. These circumstances may make key sectors of the economy vulnerable to declines in economic activity to the point where the stability of individual banks may be threatened (e.g., sectors such as tourism or transportation).

**14. However, there are circumstances in which ML, TF, or related predicate crimes will have an adverse effect on the stability of the broader economy without necessarily directly involving the financial system.** This will be the case particularly in countries with only rudimentary banking systems where illegal transactions are conducted in cash and the proceeds of crime are never introduced into the banking system. This phenomenon, itself, may impede the development of the country’s banking system (i.e., funds are not being used for formal intermediation purposes through the banking system), which in turn impedes economic growth. Beyond their effect on the banking system, however, these cases may undermine broader macroeconomic stability in at least two important ways:

- **Problems with economic policymaking:** Where the illegal sector forms a significant part of the economy and criminal proceeds remain in cash (i.e., without introduction to the banking system), official data on employment, consumption, and foreign exchange transactions may not fully reflect the underlying economic realities. Economic policymakers will have great difficulty in gaining a real understanding of the state of the economy and in formulating sound economic policies.
- **Adverse effects on growth:** Corruption, especially grand corruption at the national level and in the revenue administration, has a demonstrated negative effect on fiscal balances, foreign direct investment, and growth. Production and trafficking in illegal narcotics divert resources from legal and productive investments and activity. Illegal logging and other environmental crimes despoil natural resource wealth in ways that are incompatible with sustainable growth and development. More generally, large illegal sectors can represent deadweights on formal economies resulting in sub-optimal growth. In extreme cases, unchecked criminal activity can rise to the level of threatening state functions and the rule of law, with associated adverse economic effects.

**15. Money laundering, terrorist financing, and related predicate crimes may undermine the stability of the country in which they originate but may also have adverse spillover effects on the stability of other countries.** For example, extensive criminal activities in one country may lead to illicit transfers from and large short-term capital flows to another country with potentially destabilizing effects on that country's economy. The availability of ML services in one jurisdiction may encourage and facilitate tax evasion in neighboring countries with adverse effects on their fiscal positions. Spillovers can also be transmitted through non-balance of payments channels, such as market contagion (e.g., financial fraud in a domestic bank triggers transmission when it defaults on interbank liabilities). Such spillovers may be of such nature and magnitude as to significantly affect global stability.

## CASES FOR INCLUSION OF ML/TF-RELATED ISSUES IN ARTICLE IV SURVEILLANCE

### A. Inclusion in Article IV Surveillance

**16. Whenever ML, TF, or related predicate crimes may significantly influence a member's present or prospective domestic or balance of payments stability, or may give rise to external spillovers that undermine global stability, they should be addressed in the Article IV consultation with that member.** While it is not expected that these issues will be discussed routinely, they should be raised by staff, when they are sufficiently serious to warrant discussion under bilateral or multilateral surveillance. In particular, the spillovers arising from such policies should be raised where the member is not promoting its own domestic or balance of payments stability.

**17. Criteria are set forth below to guide mission teams. They are not intended to be exhaustive and staff should exercise judgment and flexibility in their application.** The following questions can help staff identify and prioritize ML/TF-related concerns with regard to, in turn, (i) their impact on the stability of a country's financial system; (ii) the threats to financial sector stability arising from predicate crimes; (iii) the adverse effect of ML/TF-related issues—that do not necessarily involve the financial system directly—on the stability of the broader economy; and (iv) their adverse spillover effects and, the impact on global stability:

#### Impact of the act of ML/TF on financial sector stability

- *Is the country's access to global financial markets vulnerable to AML/CFT-related sanctions and blacklisting?* The main source of information in this regard is the FATF website<sup>7</sup>, which can be

<sup>7</sup> See: [www.fatf-gafi.org/icrg](http://www.fatf-gafi.org/icrg).

complemented by information from FATF-style regional bodies, as well as recent AML/CFT assessment reports.

- *What amount of proceeds of crime can be estimated to be laundered in the country's financial sector? Is this amount large relative to the overall size of the financial sector? Are any systemic financial institutions at risk of abuse as instrumentalities for ML or TF?* The estimate of the proceeds of crime potentially laundered in a country derives from an analysis of the situation regarding domestic crime, as well as the potential for laundering of foreign proceeds of crime.<sup>8</sup> Staff should consider whether some financial products or institutions might be more at risk than others (e.g. share of non-resident deposits, financial relations with countries known for generating high levels of proceeds of crime evidenced by the existence of subsidiaries and branches in these countries, or by relevant information on cross-border financial flows).
- Are the ML/TF-related weaknesses identified in the financial sector a potential source or amplifier of domestic or balance of payments instability? Do they have the potential to significantly affect global stability? The analysis of real-financial linkages should focus on considerations similar to the ones mentioned in the Guidance Note for Article IV Consultations.<sup>9</sup>

### **Impact of predicate crimes on financial sector stability**

- Are there indications that criminal elements might own, control, or hold a significant proportion of financial sector assets, or a significant equity interest in key financial institutions? This information can be gathered from news reports; discussions with supervisory authorities, or descriptions of vulnerabilities identified in AML/CFT assessment reports, particularly in relation to fit-and-proper requirements for financial institutions' managers and beneficial owners.
- Are there indicia pointing to possible regulatory capture by criminal elements or weaknesses in the regulatory and criminal justice systems which could hamper effective supervision of the financial sector? This information can be gathered from news reports; reports from international organizations, or NGOs on corruption and governance; and AML/CFT assessment reports, particularly, in relation to the sections covering the structural elements necessary for an effective AML/CFT regime and the effectiveness of the supervisory framework.

<sup>8</sup> A discussion of LEG's ongoing work in estimating proceeds of crime, as of June 2011, is included in Annex III, sections C and D, *AML/CFT—Report on the Review of the Effectiveness of the Program*, IMF Policy Paper, May 11, 2011, <http://www.imf.org/external/np/pp/eng/2011/051111.pdf>.

<sup>9</sup> See Guidance Note for Article IV Consultations, IMF Policy Paper, June 13, 2012, para. 20, <http://www.imf.org/external/np/pp/eng/2012/061312.pdf>.

- Does a recent terrorist attack or the threat of one undermine the stability of key sectors (e.g., banking, tourism, transportation, foreign investment) or does the level and nature of terrorist incidents otherwise threaten domestic financial stability? Information on the level of the terrorist threat can be gathered from domestic and international threats assessments. This information should be analyzed in light of the specificities of a given jurisdiction (e.g., size of the tourism sector and exposure of the financial system or individual financial institutions to this sector).
- Are there risks of financial sector fraud of a magnitude susceptible of undermining the stability of the domestic financial system? Risks in this regard can be estimated from an analysis of possible Ponzi-scheme indicators (e.g., unduly high interest rates on deposits, or returns on investments that appear to be unaffected by fluctuations in the market environment).
- Are these elements a potential source or amplifier of domestic or balance of payments instability? Do they have the potential to significantly affect global stability? The analysis of real-financial linkages should focus on considerations similar to those mentioned in the Guidance Note for Article IV Consultations.<sup>10</sup>
- Are there elements indicating that tax crimes may significantly affect the government's revenue stream, or subject the financial system to volatile flows related to large amounts of "hot money"? Risks in this regard can be estimated from the size of the informal economy and relevant statistical information, and may be triggered by changes in the legal framework (either of the country of origin of tax evaders or in countries of destination of proceeds of tax evasion), or the identification of a country as a non-cooperative jurisdiction (e.g., by the OECD's Global Forum).

**Adverse effect of ML, TF, or related predicate crimes not necessarily involving the financial system directly or the stability of the broader economy**

- What is the significance of corruption (perceived, suspected, or established) by government or elected officials relative to the size of the economy or the government budget? Information on the level of corruption can be gathered from reports issued by international organizations, NGOs, and the media. An analysis of the state and local budgets could also reveal indicators of corruption, both on the expenditure side (e.g., suspicions of slush funds, major contracts awarded under unusual conditions, doubtful operations of state owned enterprises), or revenue side (e.g., compromised tax administration, questionable changes to the tax code in relation to the taxation of natural resources).

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<sup>10</sup> See Guidance Note for Article IV Consultations, IMF Policy Paper, June 13, 2012, para. 20, <http://www.imf.org/external/np/pp/eng/2012/061312.pdf>.

- Are there indications that macroeconomic policy formulation is impaired by the existence of unaccounted for economic transactions generated in the informal or illegal sectors? Relevant indicators can be the size of the informal sector, the use of cash relative to GDP, the contribution of drug production and trafficking to GDP or exports. This information can be gathered from reports from other international organizations, the media, papers from academics, and the analysis of statistical and law enforcement information.

### **Adverse effects of developments and policy actions in other countries (inward spillovers)**

- Are there indications that criminal activities in other countries might have an impact on a member's own domestic or balance of payments stability? Examples of relevant developments could be a major banking fraud affecting another jurisdiction financially interconnected with the member, or changes in the level of proceeds stemming from drug production in a country interconnected with the member, affecting the member's financial system or real estate sector.
- Are there indications that ML/TF weaknesses or changes in other countries' legal framework might have an impact on a member's own domestic or balance of payments stability? Examples include international sanctions against a member's major trade partner which could have an impact on bilateral trade flows, or the amendment of the legal framework of an offshore financial center making it more attractive for the proceeds of tax evasion of a member.

### **Spillover effects on the stability of other countries (outward spillovers)**

- Does the actual or potential level of abuse of financial institutions as instrumentalities for ML or TF pose important risks of outward spillovers of such a nature and magnitude as to give rise to disruptive exchange rate movements or to significantly affect global stability? An estimate of the possible impact on the domestic or balance of payments stability of other countries can be gathered through i) an analysis of the vulnerabilities of the jurisdiction under Article IV review (e.g., latest AML/CFT assessments, media reports), ii) an analysis of the financial flows in and out of the jurisdiction (e.g., cross-border payments, balance of payment disaggregated by foreign counterpart), and iii) an assessment of the exposure of jurisdictions with an important level of proceeds of crime to these flows. On this basis, staff will assess the impact of these spillovers, including their effect on global stability.
- Is there a significant risk of fraud or other crimes (e.g., financial sector fraud, tax evasion, currency smuggling) of such a nature and magnitude as to give rise to disruptive exchange rate movements or to significantly affect global stability through external transfers? Analysis should determine if criminal behaviors identified in the jurisdiction under Article IV review could be a potential source or amplifier of domestic or balance of payments instability in other countries. Risks in this regard can be estimated from i)

an analysis of possible fraud indicators (e.g., Ponzi-scheme indicators, estimates of tax evasion, estimates of exports of illicit goods), and ii) an analysis of the direction of the financial and trade flows or of the balance of payments disaggregated by foreign counterpart.

## B. Operational Issues

**18. Whenever issues arising from ML, TF, or related predicate crimes may significantly influence the domestic or balance of payments stability of a member, or undermine global stability, they should be discussed during the Article IV consultation with the member and covered in the related staff report.** In addition, even where domestic or balance of payments stability or global stability is not at risk, it is possible for staff and the member to agree to discuss these issues on a voluntary basis in the Article IV consultation (see Box 4). In any case, however, the country team should examine the extent to which risks related to ML/TF and predicate crimes appear to exist in the country. In order to support the work of the country team, LEG is monitoring on an ongoing basis member countries' conditions in light of the factors outlined above.

### Box 4: Voluntary discussion of AML/CFT-related issues as part of policy advice

While the ISD specifies the circumstances in which issues are required to be discussed (i.e., on a mandatory basis) in an Article IV consultation, the Fund's legal framework also permits the Fund to discuss other issues in an Article IV consultation even where they fall outside of the mandatory scope of Article IV. The discussion of such issues, however, is contingent upon the member's agreement. It constitutes a form of "policy advice" under Article V, Section 2(b) of the Fund's Articles and has formed the basis for the discussion of AML/CFT issues in many Article IV consultations with members over the years.

Coverage of AML/CFT-related issues on a voluntary basis will not be systematic as consultations should be focused and resources are limited. Staff may discuss AML/CFT-related issues, however, as part of policy advice when this could assist the member in addressing emerging ML/TF-related concerns and the member agrees to such a discussion. A typical example would be the situation where a country is identified by the FATF as a jurisdiction with strategic AML/CFT deficiencies. While ML/TF-related concerns in such cases may not always be of a magnitude such as to justify treatment in an Article IV consultation on a mandatory basis, a discussion could assist the member in addressing them, at an early stage.

**19. LEG is dedicating desk-based resources to analyze member countries' economic developments from a financial integrity perspective on an ongoing basis. When significant risks for domestic or balance of payments stability or global stability are identified or when there is scope for the coverage of AML/CFT-related issues on a voluntary basis, LEG will provide the Article IV team with a background note to assist in the preparation of the Policy Note.**<sup>11</sup> This note will include recommendations to the country team concerning the significance of

<sup>11</sup> For countries where major ML/TF-related concerns are identified, LEG will provide regular updates to country teams.



the member country's ML, TF, or related predicate crimes threats and vulnerabilities, and their potential impact on domestic, balance of payments, or global stability. LEG's diagnostic tools include an analysis of ML/TF-related threats and vulnerabilities, based on the most recent AML/CFT assessment, TA reports, information received from the country team, statistics on predicate crimes, press and literature reviews, research, as well as cross-country comparisons. LEG staff will provide comments on Policy Notes and participate in Policy Consultation Meetings, when appropriate.

**20. During the mission, the country team will discuss AML/CFT-related issues with the authorities, as appropriate.** If necessary, LEG staff will prepare an issues note, talking points, and other supporting material for the Article IV team to use in their interactions with the authorities on AML/CFT issues. LEG staff will stand ready to provide HQ-based support to the country team during its mission. Should the AML/CFT-related issues be particularly complex or require specialized knowledge in a given consultation, LEG staff would normally join the Article IV on-site mission.

**Table 1: Examples of policy advice addressing criminal behaviors in Article IV**

Type of predicate crime	AML/CFT-related policy advice	Other Fund policies	Outside Fund's policy advice
Corruption	Implement measures to detect politically-exposed persons (FATF R.12)	Put in place an anti-corruption agency (1997 Guidance Note on the Role of the Fund in Governance Issues)	Reduce military spending <sup>1</sup>
Tax evasion	Ensure that financial institutions report suspicions of tax evasion to the authorities (FATF R.20)	Implement relevant tax policy and revenue administration measures (see BUFF/10/55) <sup>2</sup>	Increase the number of criminal convictions for tax evasion
International drug trafficking	Enhance mutual legal assistance in cases of drug trafficking (FATF R.37)	N/A	Eradicate drug cultivation
Corporate fraud	Ensure entity transparency (FATF R.24 and R.25)	Disclose capital structures and arrangements (OECD Principles on Corporate Governance)	Encourage settlements with fraudsters in order to recover assets
Insider abuse in financial institutions	Prevent criminals or their associates from being the beneficial owners of a financial institution (FATF R.26)	Promote effective systems of internal management and risk control (Basel Core Principles)	Encourage change of shareholders in a specific financial institution

<sup>1</sup> Concluding Remarks by the Acting Chairman—Military Expenditure and the Role of the Fund Executive Board Meeting 91/138, October 2, 1991, <http://www.imf.org/external/pubs/ft/sd/index.asp?decision=EBM/91/138>.

<sup>2</sup> The Acting Chair's Concluding Remarks, From Stimulus to Consolidation—Revenue and Expenditure Policies in Advanced and Emerging Economies Executive Board Seminar 10/1, May 5, 2010, <http://www.imf.org/external/np/sec/pn/2010/pn1059.htm>.

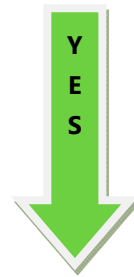
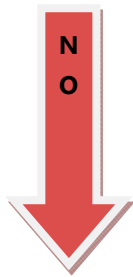
**21. Following the mission, when AML/CFT-related issues were discussed on a mandatory or voluntary basis, the staff report should include a discussion of the member's ML/TF risks and of the actions being considered by the authorities to mitigate those risks, as appropriate.**

These elements should be included both in the policy discussion and in the staff appraisal.

Ultimately, staff will provide advice on measures that need to be taken to enhance the member's AML/CFT regime in light of the existing threats. In general, AML/CFT issues will be discussed under financial sector issues. However, there may be instances where these issues will be more relevant with regard to fiscal issues (e.g., in relation to tax evasion) or structural reforms (e.g., in relation to corruption). LEG will assist country teams in formulating AML/CFT policy recommendations for the staff report, as necessary. In preparation of the Board meeting, LEG staff stands ready to assist the Article IV team in relation to Board members' questions on AML/CFT-related issues. LEG staff could attend the Board meeting to assist with AML/CFT-related issues, as appropriate.

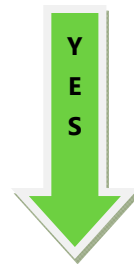
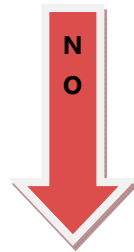
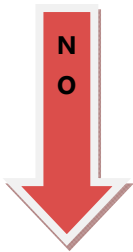
**INCLUSION OF ML/TF-RELATED ISSUES IN ARTICLE IV SURVEILLANCE  
DECISION TREE**

Are ML/TF or predicate crimes significant in relation to domestic or balance of payments stability or global stability?



Is Fund member interested in voluntarily discussing ML/TF or predicate crimes issues raised by staff?

Are ML/TF or predicate crimes particularly complex?



No inclusion of ML/TF-related issues in the AIV consultation

Inclusion and LEG staff to support the country team as appropriate from HQ

Inclusion and LEG staff to join the Article IV mission

## INCLUSION OF ML/TF-RELATED ISSUES IN FINANCIAL STABILITY ASSESSMENTS

**22. Under the revised FSAP policy, a financial stability assessment is designed to assess near-term vulnerabilities for the stability of the domestic financial system.**<sup>12</sup> Financial stability assessments must include the following three components:

- An evaluation of the source, probability, and potential impact of the main risks to macro-financial stability in the near term;
- An assessment of the country's financial stability policy framework; and
- An assessment of the authorities' capacity to manage and resolve a financial crisis, should the risks materialize.

**23.** All three elements are expected to be covered in all FSSAs. Stability assessments in individual cases may cover additional areas, if needed, and may also be accompanied by detailed assessments of compliance with standards and codes.

### A. Inclusion on a Voluntary Basis Only

**24. There is no requirement that a modular financial stability assessment, either mandatory or voluntary, include an examination of AML/CFT-related issues.** A voluntary assessment is conducted as a form of technical assistance at the request of the member. A mandatory assessment is conducted in the context of bilateral surveillance under Article IV.<sup>13</sup>

**25. However, in either case, it is possible for the Fund and the member to agree to discuss, on a voluntary basis, AML/CFT-related issues as part of the assessment.** The modalities for addressing these issues may range from a comprehensive reassessment (in extreme cases), to a targeted assessment, a technical note, or a few paragraphs in the FSSA.

**26. The final decision to examine AML/CFT-related issues in a stability assessment would be based on an overall assessment of the member's circumstances** and the extent to which ML, TF, or related predicate crimes may undermine the stability of the member's domestic financial system. Accordingly, much of the analysis discussed above in the context of surveillance will be relevant for this purpose. In particular, staff should examine the relative importance of AML/CFT

<sup>12</sup> See Financial Sector Assessment Program – Procedures Manual, p. 5 <http://www-intranet.imf.org/departments/SPR/OGR/Documents/ProceduresGuide.pdf>.

<sup>13</sup> Of course, where issues arising from ML/TF or related predicate crimes may undermine domestic, balance of payments, or global stability, they will be discussed in the related Article IV consultation.

issues with regard to other financial stability issues that may need to be covered, and will be guided by the following considerations:

- A country's access to global financial markets is vulnerable to AML/CFT-related sanctions and blacklisting;
- The actual or potential level of abuse of financial institutions as instrumentalities for ML or TF is large relative to the country's financial sector or GDP;
- The estimated level of proceeds of crime generated in the country is large relative to the country's formal sector (official) GDP;
- Transactions in specific illegal markets (e.g., drug production and trafficking) are large relative to the country's formal sector (official) GDP;
- Criminal elements own, control, or hold a significant proportion of financial sector assets, or a significant equity interest in key financial institutions;
- Regulatory capture by criminal elements or weaknesses in the regulatory and criminal justice systems hamper effective supervision of the financial sector;
- There is a significant risk of financial sector fraud of a magnitude that could undermine the stability of the domestic financial system;
- Corruption by government or elected officials is significant relative to the size of the economy or the government budget; and
- A recent terrorist attack or the threat of one makes key sectors vulnerable (e.g., banking, tourism, transportation, foreign investment), or the level and nature of terrorist incidents otherwise threaten domestic financial stability.

## B. Operational Issues

**27. Following a country's request for an FSA, staff will determine whether it should be proposed to the member to include ML/TF-related issues in the exercise.** Upon confirmation of a country's participation in an FSA, staff will assess whether ML/TF-related issues may have an impact on financial stability using the diagnostic tools identified in section II.B, and being guided by the questions identified in section III.A. In the affirmative, staff will assess the most appropriate form of inclusion of ML/TF-related issues in the FSA (full reassessment, targeted assessment, technical note, or incorporation of a few key issues into the FSSA). These assessments will be conducted by MCM and LEG staff on the basis of available information. The strength of the case made by staff for

voluntary discussions would benefit from the availability of estimates on the prevalence and magnitude of ML/TF or predicate crimes-related issues in academic papers or from reliable public sources.

**28. Where staff believes that AML/CFT issues should be discussed, the FSAP mission chief will propose to the authorities that the relevant issues be included in the scope of the FSA.** To assist the mission chief in discussions with the authorities, LEG staff will prepare a background note and talking points.

**29. When appropriate, staff will raise the possible inclusion of ML/TF-related issues in the FSA during the scoping discussion with the authorities.** In cases where ML/TF or predicate crimes are considered particularly complex to deal with in the context of a given FSA, LEG staff will participate in the scoping discussions with the authorities. To the extent staff has concerns that ML/TF-related issues pose risks to financial stability, and the authorities refuse to include an AML/CFT component in the FSA, the FSSA would identify these risks and indicate that they have not been covered. While this approach might be a source of friction with the authorities, the process should ensure the comprehensiveness and credibility of the FSA in the few instances where ML/TF-related issues are deemed critical for financial stability.

**30. If it is decided to include ML/TF-related issues in the FSA, staff will include them in the FSA's Risk Assessment Matrix (RAM), and in stress tests, as appropriate.** When ML/TF-related issues are identified as a major source of risk, they should be included in the RAM, alongside with the possible triggers (e.g., financial sanctions against the country, variation in the price of drugs), and transmission mechanisms, with the assessment of regulatory, supervisory, and crisis management frameworks and the results of stress tests to arrive at qualitative assessments of (i) the probability of risk triggers being activated (low, medium, high); and (ii) the potential impact on financial stability and on the broader economy should those events materialize.<sup>14</sup>

**31. The staffing of the AML/CFT component of the mission will depend on the inclusion modality of ML/TF-related issues in an FSA.** In case of a full reassessment or a targeted assessment, LEG staff will join the FSA mission. For a technical note or a discussion of key issues, LEG staff will prepare tailored questions for the pre-mission questionnaire and talking points for the FSA mission, and join the mission only when the AML/CFT-related issues are particularly complex. Following the mission, LEG staff will, depending on the circumstances, produce a full or a targeted AML/CFT assessment, a technical note, or a few paragraphs in the FSSA. In preparation of the Board meeting, LEG staff stands ready to assist the FSA team in relation to Board members' questions on AML/CFT-related issues.

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<sup>14</sup> For more information on the RAM and stress tests, see The Financial Sector Program after Ten Years: Experience and Reforms for the Next Decade, IMF Policy Paper, August 28, 2009, <http://www.imf.org/external/np/pp/eng/2009/082809b.pdf>.

**INCLUSION OF ML/TF-RELATED ISSUES IN FSAs**  
**DECISION TREE**

