

INTERNATIONAL MONETARY FUND

**Revisions to the Financial Action Task Force (FATF) Standard—Information Note to
the Executive Board**

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ACRONYMS

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| AML/CFT | Anti-money Laundering and Combating the Financing of Terrorism |
| CDD | Customer Due Diligence |
| DNFBP | Designated Nonfinancial Businesses and Professions |
| FATF | Financial Action Task Force |
| FAD | Fiscal Affairs Department of the IMF |
| FSRB | FATF-Style Regional Body |
| LEG | Legal Department of the IMF |
| PEP | Politically-Exposed Person |
| R | Recommendation |
| SR | Special Recommendation |
| UN | United Nations |
| UNCAC | United Nations Convention against Corruption |
| UNSCR | United Nations Security Council Resolution |
| WMD | Weapons of Mass Destruction |

EXECUTIVE SUMMARY

The purpose of this note is to inform the Executive Board of the amendments made to the standard on anti-money laundering and combating the financing of terrorism (AML/CFT). The Financial Action Task Force (FATF)—the standard setter for AML/CFT—adopted on February 16, 2012 a revised standard, now entitled the “*International Standards on Combating Money Laundering and the Financing of Terrorism and Proliferation: the FATF Recommendations.*”¹

In June 2011, during the discussion of the effectiveness of the Fund’s AML/CFT program,² Executive Directors noted that over the past decade, the Fund has contributed significantly to international efforts against money laundering and terrorist financing. As part of its work in this area, the Fund, together with the Bank, the FATF and the FATF-style Regional Bodies (FSRBs) assesses countries’ level of compliance with the AML/CFT standard pursuant to a common assessment methodology. Directors recognized that these assessments have contributed importantly to the Report on the Observance of Standards and Codes (ROSC) program and to the Financial Sector Assessment Program (FSAP) and rely on close cooperation and coordination with other key players, notably the FATF and the Bank.³

Consistent with past practice, the revised FATF standard and accompanying assessment methodology will be submitted to the Board with a request for their endorsement in mid 2013, i.e., after the assessment methodology (which is currently being discussed) has been finalized. As indicated below, the methodology—which will spell out the requirements of the standard in some detail—is an important tool for the conduct of AML/CFT assessments. This approach will enable the Board to be fully informed of what the revised standard entails when it considers its endorsement. This submission will also report on the outcome of the FATF discussions on the staff’s proposed shift towards more targeted, risk-based assessments together with an analysis of the associated resource implication that was requested by Directors in June 2011.⁴

The FATF initiated a review of its recommendations against money laundering and terrorist financing in 2009 and brought it to a close in February 2012 with the formal adoption of a single set of revised recommendations and new interpretive notes. The FATF intended the review to be a limited, focused exercise. It was aimed at clarifying the

¹ <http://www.fatf-gafi.org/topics/fatfrecommendations/documents/fatfrecommendations2012.html>

² Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT)—Report on the Review of the Effectiveness of the Program - <http://www.imf.org/external/pp/longres.aspx?id=4571>.

³ See Public Information Notice (PIN) No. 11/74, Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT)—Report on the Review of the Effectiveness of the Program.

⁴ See PIN No. 11/74.

standard and ensuring its continued relevance. Most of the changes made are technical in nature; the high-level principles previously expressed in the recommendations remain for the most part unchanged. Others, however, are more substantive and introduce new elements.

The following changes are of particular interest to the Fund:⁵

- **Risk-based approach:** There is a new recommendation providing that countries should identify, assess, and understand the money laundering and terrorist financing risks they face and take appropriate measures to mitigate those risks.
- **Tax crimes:** The list of designated predicate offenses, the underlying crimes that give rise to money laundering, has been expanded to include tax crimes.
- **Financing of proliferation:** There is a new recommendation providing that countries should apply UN targeted financial sanctions to persons and entities that finance the proliferation of weapons of mass destruction. Another recommendation calls on countries to ensure national cooperation and coordination among their competent authorities, *inter alia*, in the prevention of the financing of proliferation.
- **Anti-corruption:** Following calls from the G20, the revised recommendations place a greater emphasis on action against corruption.

Additional changes were also introduced in the revised standard and are briefly described in Section II.B below.

An assessment methodology is indispensable for the conduct of assessments of countries' compliance with the standard and to ensure their consistency. The FATF is currently working with its members and observers—with Fund staff taking an active part—on the development of a new assessment methodology for the revised standard. This work includes bringing the assessment methodology in line with the new standard, discussing (in continued cooperation with the Bank) with the FATF and the FSRBs options for adopting a more targeted, risk-based approach to assessments, establishing how best to assess the effectiveness of AML/CFT frameworks, as well as designing a new detailed assessment questionnaire and a template for future assessment reports. The FATF plans to complete these tasks by February 2013 and to conduct the first on-site assessment visits using the revised methodology in October 2013. Assessments by the other assessor bodies (i.e., the FSRBs, the Fund, and the World Bank) are expected to start concomitantly or soon thereafter.

⁵ With the exception of the recommendations on the financing of proliferation which are reproduced in Box 3, the recommendations associated with these changes are included in Annex 1.

INTRODUCTION

1. **The FATF Recommendations are the international standard for AML/CFT.**⁶

They aim at strengthening global safeguards and further protecting the integrity of the financial system by providing governments with stronger tools to take action against financial crime.

2. **The original FATF Forty Recommendations were developed in 1990 as an initiative to combat the misuse of financial systems by persons laundering drug money.** In 1996, the recommendations were revised to reflect evolving money laundering trends and techniques, and to broaden their scope beyond drug-money laundering. In October 2001, the FATF expanded its mandate to address the funding of terrorism and issued eight Special Recommendations on terrorist financing. The FATF Recommendations were revised a second time in 2003. The main changes introduced in 2003 included: (i) the adoption of stronger standard for money laundering predicate offenses; (ii) the extension of the customer due-diligence (CDD) process for financial institutions and enhanced customer identification measures for higher-risk customers and transactions; (iii) the extension of AML/CFT measures to designated nonfinancial businesses and professions (DNFBPs); (iv) the inclusion of key institutional measures in AML systems; and (v) the improvement of transparency of legal persons and arrangements. A ninth Special Recommendation was added in October 2004.

3. **In 2002, the Fund's Executive Board endorsed the addition of the FATF Recommendations to the list of areas and associated standards and codes useful to the operational work of the Fund.**⁷ As noted above, AML/CFT assessments are an important part of the joint Bank/Fund ROSC and FSAP programs. Since 2004, the Fund has conducted AML/CFT assessments of more than 35 countries. These assessments were conducted using a comprehensive methodology that is applied by all AML/CFT assessor bodies. They resulted in detailed assessment reports and ROSCs (most of which have been published) and, together with the assessments conducted by the Bank, the FATF and the FSRBs, provide a comprehensive baseline of public information on AML/CFT regimes worldwide. In addition, the FSAP policy requires that every full FSAP and FSAP update incorporate a full AML/CFT assessment. The 2011 Board Paper on the review of the effectiveness of the

⁶ The FATF is an inter-governmental body whose purpose is the development and promotion of national and international policies to combat money laundering, the financing of terrorism and, more recently, the financing of the proliferation of weapons of mass destruction. It was established by the G7 in 1989 in response to mounting concern over money laundering. Its membership has grown from 16 members at its inception to 36 at present (34 jurisdictions and two regional organizations). The FATF is complemented by nine FATF-style regional bodies (FSRBs); together, the FATF and the FSRBs comprise over 180 member jurisdictions. The Fund is an observer at the FATF and the FSRBs.

⁷ The history of the Board's endorsements of the AML/CFT standard is summarized in Box 1.

AML/CFT program described in some detail the AML/CFT work of the Fund, and the ensuing Board discussion⁸ provided clear directions on the way forward.

4. **To date, over 180 countries have endorsed the FATF Recommendations** through their membership in either the FATF or one of the nine FSRBs. Most of these countries have now undergone at least one assessment (conducted by the FATF, an FSRB, the Fund, or the Bank) of their level of compliance with the FATF standard.

5. **In 2009, the FATF started the process of reviewing and updating its recommendations** in view of the conclusion of the third round of mutual evaluations of its members and in preparation for the next round of evaluations. A set of issues for discussion was agreed in October 2009 and the review work was spread out over two years. The revision was conducted in close cooperation with the FSRBs and observer organizations such as the Fund and the Bank whose staff participated actively in the process.

6. **The 2009 review was intended to be a limited and focused exercise.** It was aimed primarily at addressing deficiencies and loopholes that were highlighted during the third round of evaluations and in the implementation of the standard. Thus, the initiative was particularly focused on areas where the standard was outdated or difficult to implement or assess (e.g., customer due-diligence requirements, transparency of legal persons and arrangements, and international cooperation).

7. **The formal adoption of the revised standard took place during the FATF February 15–17, 2012 plenary meeting.** Discussions are proceeding within the FATF on the nature and scope of the next round of assessments as well as on a new assessment methodology which is expected to be completed by February 2013. Fund and Bank staff and the FSRBs are actively involved in the discussions.

⁸ See PIN No. 11/74.

Box 1. Previous endorsements of the AML/CFT standard by the Board

In July 2002, Directors “endorsed adding AML/CFT to the list of 11 areas where standards and codes are useful to the operational work of the Fund and for which assessments are undertaken, and to adopt the FATF 40+8 Recommendations as the associated standard” (Summing up by the Acting Chair, Executive Board Meeting 02/80, July 26, 2002), provided that certain conditions were met. Amongst these conditions was the finalization of the assessment methodology by the FATF.

On November 18, 2002, Executive Directors took note that “the conditions [were] met and added the FATF 40+8 Recommendations to the list of areas and associated standards and codes useful to the operational work of the Fund for which assessments will be undertaken and reports on the Observance of Standards and Codes (ROSCs) will be prepared.” Executive Directors at the same time endorsed “the comprehensive and integrated methodology that was endorsed at the FATF October 2002 Plenary” (Decision No. 12884-(02/114)).

In March 2004, on the occasion of the “Joint Report on Review of the Twelve-Month Pilot Program of Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) Assessments,” staff recommended that Fund (and Bank) Executive Directors “endorse the revised standard and the assessment methodology for our operational work” (paragraph 42). As noted in the Acting Chair’s Summing up, “the Executive Board endorsed the revised FATF standard that expands the scope of activities, and the revised assessment methodology for the Fund’s operational work, in view of the international acceptance that the revised FATF 40+8 is the relevant standard for the preparation of the AML/CFT ROSCs” (The Acting Chair’s Summing Up, Executive Board Meeting 04/29, March 24, 2004).

I. CONTENT

8. **The revisions clarify and strengthen the previous elements of the standard and address new and emerging threats**, while maintaining the necessary stability and rigor in the recommendations. The FATF also took this opportunity to restructure the recommendations, notably by merging those dealing with money laundering with those dealing with the financing of terrorism.

A. Main changes from the Fund’s perspective

9. **The following four components of the revised standard are of particular importance to the Fund:** (i) the increased prominence of the so-called “risk-based approach” to AML/CFT and the related move towards assessing countries’ effectiveness in mitigating their ML/FT risks; (ii) the inclusion of tax crimes in the list of designated predicate offenses⁹ to money laundering; (iii) the expansion of the standard to cover targeted

⁹ 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 revised 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;

(continued...)

financial sanctions pursuant to the United Nations Security Council Resolutions (UNSCRs) on the prevention, suppression, and disruption of proliferation of weapons of mass destruction (WMD); and (iv) the strengthened emphasis on action against corruption.

i) Risk-based approach to AML/CFT

10. The revised standard contains a new recommendation (Recommendation 1) providing that countries should identify, assess, and understand the money laundering and terrorist financing risks that they face and apply a risk-based approach to mitigate those risks. Recommendation 1 represents the culmination of work conducted over the past two years to integrate more comprehensively the concept of money laundering and terrorist financing risk into the FATF standard. Fund staff has actively contributed to this work.

11. This increased emphasis on risk will also be relevant in establishing the manner in which the FATF and other assessor bodies, such as the Fund, will assess compliance with the new standard. In June 2011, Executive Directors saw merit in exploring ways to strengthen AML/CFT assessments, including the possibility of conducting targeted, risk-based assessments. While Directors acknowledged the potential benefits of a risk-based approach, many Directors preferred to keep options open pending FATF discussions of these issues. Directors agreed that staff, in continued close cooperation with the World Bank, should raise these issues with FATF and report to the Board within two years.¹⁰ As requested by Directors, staff will report on the outcome of these discussions to the Board in mid-2013.

ii) Inclusion of tax crimes in the list of designated predicate offenses to money laundering

12. The revised standard includes “tax crimes” in the list of designated categories of predicate offenses to money laundering.¹¹ While the revised FATF standard does not

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.

¹⁰ Directors also agreed that, if such an approach was adopted, under a framework for risk-based assessments, the first AML/CFT assessment for a member would be comprehensive while subsequent assessments would focus on those areas that present the greatest risk of money laundering and/or terrorist financing taking place without being detected or sanctioned. This approach would produce better targeted and more focused assessments. Directors agreed that a shift to targeted and risk-based AML/CFT ROSCs would need to be agreed with the standard setter and other stakeholders. In particular, the methodology for conducting such assessments and criteria for the selection of issues to be assessed with respect to specific countries need to be developed in cooperation with the FATF and the FATF-style regional bodies along with other stakeholders. (See PIN No. 11/74.)

¹¹ Box 2 provides some background on the considerations that led to the inclusion by FATF of tax crimes as predicate offenses to money laundering.

contain a definition of “tax crimes,” it requires that countries apply the crime of money laundering to all serious offenses.¹² It will henceforth be a requirement under the revised FATF standard for countries to provide in their domestic law that serious tax crimes are predicate offenses to money laundering.

13. **The AML framework may prove particularly useful in complementing and supporting the efforts of revenue administrations against tax crimes.** Tax crimes generate a large amount of proceeds, and many jurisdictions around the world already provide that they constitute predicate offenses to money laundering. A number of countries’ laws and institutions are also designed to promote collaboration among tax administrations, financial regulators, financial intelligence units, investigators, prosecutors, and other relevant institutions. An effective use of the AML framework should enhance compliance with tax laws by increasing the probability of detection of tax evaders and by imposing deterring sanctions and increasing revenues.

14. **In future assessments against the new standard, assessors will need to consider whether countries have ensured that a sufficiently broad set of tax-related offenses constitute predicate offenses to money laundering.** These assessments will clarify the normative scope of “tax crimes” which, in turn, will determine how significant the revised recommendation is in terms of facilitating action against tax crimes and related money laundering.

15. **This development has implications for the Fund’s surveillance, program work, and technical assistance.** Tax crimes and related money laundering will continue to be discussed in the context of bilateral surveillance when they may undermine the stability of a member’s domestic financial system or external stability. In certain countries, tax crimes may be critical in the context of adjustment programs. In these cases, AML-related conditions can be used to support anti-tax evasion strategies when they are macro-critical to the achievement of a program’s goals or to monitor program implementation. Such measures have already been included in adjustment programs. In addition, TA programs will be developed to assist members in leveraging the AML tools in their domestic fiscal framework.

¹² The General Glossary to the FATF Recommendations notes that, when deciding on the range of offenses to be covered as predicate offenses under each category, countries may decide, in accordance with their domestic law, how they will define these offenses and the nature of any particular elements of those offenses that make them serious offenses.

Box 2. Inclusion of tax crimes as predicate offenses to money laundering—Background

The inclusion of tax offenses in the FATF list of crimes that should be predicates to money laundering was already considered in the context of the 2003 revision of the standard. At that time, “smuggling” was included because it was recognized that smuggling of goods and the consequential evasion of customs and excise taxes was a serious offense that generated significant criminal proceeds. No consensus was reached at the time on a more comprehensive inclusion of tax crimes.

During the most recent revision, the FATF first considered the merits, obstacles, and implications of specifically including tax crimes as a designated category of predicate offense and looked at different technical definitions of tax crimes. This initial discussion was based on a survey of national legislations in OECD countries, as well as on FATF members’ experience in using their AML framework to tackle tax crimes. The FATF also examined to what extent the standard already covered (albeit under a different heading) tax-related offenses.

The FATF considered fiscal offenses in relation to three different types of taxes: (a) customs and excise duties and taxes, (b) indirect taxes, and (c) direct taxes. FATF delegations agreed that these were the types of tax crimes that would need to be covered under the designated categories of offenses (contained in the General Glossary to the FATF Recommendations). While, as noted above, crimes concerning customs and excise taxes or duties were already part of the predicate offenses to money laundering under former Recommendation 1, the other two types of tax crimes were not covered. Therefore, language was drafted to cover all three types of tax crimes. More specifically, the following underlined wording was added to the existing list of categories of offenses that should be predicate offenses to money laundering:

- smuggling (including in relation to customs and excise duties and taxes);
- tax crimes (related to direct taxes and indirect taxes).

iii) Expansion of the standard to cover targeted financial sanctions pursuant to United Nations Security Council Resolutions (UNSCRs) on the prevention, suppression, and disruption of proliferation of weapons of mass destruction (WMD)

16. **The revised standard contains a new Recommendation 7 which provides that countries should implement targeted financial sanctions pursuant to the UNSCRs on the proliferation of weapons of mass destruction.** These UNSCRs notably require countries to freeze without delay the funds or other assets of, and ensure that no funds and other assets are made available to, persons or entities designated by the United Nations Security Council as being involved in illicit proliferation of WMD. The new recommendation contains provisions similar to those laid out in the context of freezing of terrorist assets (which have already been endorsed by the Fund),¹³ in line with the relevant

¹³ Previously FATF Special Recommendation (SR) III, now Recommendation 6.

UNSCRs.¹⁴ A detailed interpretive note provides directions on the implementation of this new recommendation.¹⁵ In addition, Recommendation 2 provides that countries should ensure national cooperation and coordination among their competent authorities in the prevention of the financing of proliferation of WMD. The text of these two recommendations is provided in the box below.

Box 3. FATF Recommendations on the financing of proliferation

Recommendation 2: National cooperation and coordination

Countries should have national AML/CFT policies, informed by the risks identified, which should be regularly reviewed, and should designate an authority or have a coordination or other mechanism that is responsible for such policies.

Countries should ensure that policy-makers, the financial intelligence unit (FIU), law enforcement authorities, supervisors and other relevant competent authorities, at the policy-making and operational levels, have effective mechanisms in place which enable them to cooperate, and, where appropriate, coordinate domestically with each other concerning the development and implementation of policies and activities to combat money laundering, terrorist financing and the financing of proliferation of weapons of mass destruction.

Recommendation 7: Targeted financial sanctions related to proliferation

Countries should implement targeted financial sanctions to comply with United Nations Security Council resolutions relating to the prevention, suppression and disruption of proliferation of weapons of mass destruction and its financing. These resolutions require countries to freeze without delay the funds or other assets of, and to ensure that no funds and other assets are made available, directly or indirectly, to or for the benefit of, any person or entity designated by, or under the authority of, the United Nations Security Council under Chapter VII of the Charter of the United Nations.

17. **The scope of the recommendations on proliferation financing (Recommendations 2 and 7) is narrower than both the UNSCRs to which they refer and the treatment of terrorism financing under the standard.** With regard to the UNSCRs, while relevant UNSCRs include a broad range of requirements (such as travel bans, activity-based financial prohibitions), Recommendation 7 focuses on a subset of the provisions contained in these resolutions, essentially those dealing with the implementation of the financial provisions. Specifically, Recommendation 7 focuses on ensuring compliance with the obligations related to the freezing of funds and other assets of specific persons and entities, as set forth in specific UNSCRs or designated by the Security Council and its committees in annexes to the relevant resolutions. Moreover, the scope of the financing of

¹⁴ These are: Resolutions 1718 (2006); 1737 (2006); 1747 (2007); 1803 (2008); and 1929 (2010).

¹⁵ Particularly with respect to the designation of persons or entities (to be made by the UN Security Council or the Security Council Committees set up pursuant to the relevant UNSCRs), national procedures, freezing and prohibition of dealing in funds or other assets of designated persons or entities, de-listing, unfreezing and access to frozen funds/assets.

proliferation recommendations is narrower than the scope of the recommendations relating to terrorism financing. Recommendations 7 and 2 concentrate on targeted financial sanctions and domestic cooperation respectively, whereas the recommendations in the terrorist financing context also cover other areas such as the criminalization of terrorist financing, the reporting of suspicious transactions, preventive measures, investigative powers and international cooperation.

iv) Strengthened emphasis on action against corruption

18. **In response to the G20 calls to step up efforts against corruption,¹⁶ the FATF introduced two important changes to the standard in this area.** First, it included the United Nations Convention against Corruption (UNCAC)¹⁷ among the treaties that countries will have to ratify and fully implement as part of their AML/CFT efforts. Second, the revised standard provides that financial institutions and designated nonfinancial businesses and professions should apply enhanced due diligence not only to individuals who are or have been entrusted with prominent public functions by a foreign country—the so-called “Politically-Exposed Persons,” or PEPs—(as was the case previously), but also, on a risk basis, to domestic PEPs and individuals who are or have been entrusted with those functions by an international organization.¹⁸ In the case of international organizations, this refers to “members of senior management, i.e. directors, deputy directors and members of the board or equivalent functions.”¹⁹ This is likely to result in financial institutions, in certain cases, requesting the concerned individuals to fill in a questionnaire on their source of wealth and funds, obtaining senior management approval for the establishment or continuation of a business relationship, and undertaking ongoing monitoring of the business relationship. The potential practical implications of this revised recommendation for the Fund are discussed in greater detail in Annex 2.

Box 4. PEPs in other relevant international documents

For many countries, the extension of enhanced due diligence to domestic PEPs is not entirely new. Article 52, paragraph 1, of the UNCAC already calls for enhanced due diligence with respect to PEPs, without making a distinction between foreign and domestic PEPs. The Legislative Guide to UNCAC clearly states that the “measures [contained in the Convention] apply both to public officials in the State where the scrutiny occurs and to public officials in other jurisdictions. This is essential not only

¹⁶ See, for instance, paragraphs 85–89 of the Cannes Summit Final Declaration, and the priorities and discussion paper of the Mexican Presidency of the G20 (<http://www.g20.org/en/mexican-presidency-of-the-g20/mexican-presidency-of-the-g20>).

¹⁷ Only 14 countries around the world have not yet ratified the United Nations Convention against Corruption.

¹⁸ Box 4 describes briefly the treatment of PEPs by the United Nations in UNCAC and by the Wolfsberg Group.

¹⁹ See the definition of PEPs in the General Glossary to the FATF Recommendations which specifically excludes middle ranking or more junior individuals from its scope.

for the purposes of prevention and transparency, but also for the facilitation of investigations, asset identification and return that may take place in the future.”²⁰

The Wolfsberg Group²¹ notes that financial institutions should consider a range of factors when determining whether a particular holder of a public function has the requisite seniority, prominence or importance to be categorized as a PEP. Relevant factors include examining the official responsibilities of the individual’s function, the nature of the title, the level of authority the individual has over government’s activities and other officials, and whether the function affords the individual access to significant government assets and funds or the ability to direct the awards of government contracts or tenders. The Wofsborg Group also indicates that heads of international organizations may fall within the definition of PEPs.²²

B. Other changes

19. Some of the other main changes to the standard include:

- **Title of the standard:** In light of the extended scope of the standard, the title has been amended to include a specific reference to the financing of proliferation.
- **Structure of the Recommendations:** The 9 Special Recommendations on terrorist financing were merged with the 40 Recommendations on money laundering; a separate section on terrorist financing and on financing of proliferation was created; the number of recommendations was brought from 49 down to 40; and the remaining recommendations were rearranged in a more logical order. The recommendations have been structured as follows: (a) AML/CFT policies and coordination; (b) Money laundering and confiscation; (c) Terrorist financing and financing of proliferation; (d) Preventive measures; (e) Transparency and beneficial ownership of legal persons and arrangements; (f) Powers and responsibilities of competent authorities and other institutional measures; and (g) International cooperation.
- **Interpretive Notes (INs):** The INs were considerably expanded in order to facilitate the implementation of the recommendations. The new INs are more numerous and more detailed than under the previous standard. As a result, most of the changes appear in the INs rather than in the recommendations.

²⁰ See paragraph 692 of the Legislative guide for the implementation of the United Nations Convention against Corruption.

²¹ The Wolfsberg Group is an association of eleven global banks, which aims to develop financial services industry standards, and related products, for Know Your Customer, Anti-Money Laundering, and Counter Terrorist Financing policies.

²² See the Wolfsberg Group Frequently Asked Questions on PEPs ([http://www.wolfsberg-principles.com/pdf/Wolfsberg_PEP_FAQs_\(2008\).pdf](http://www.wolfsberg-principles.com/pdf/Wolfsberg_PEP_FAQs_(2008).pdf)).

- **Customer due-diligence (CDD) measures:** Greater specificity was added to the measures to be taken to establish the beneficial ownership and control of legal persons and arrangements, specific measures were defined in relation to beneficiaries of life insurance policies and trusts; and the risk-based approach to CDD was clarified.
- **Transparency of legal persons and arrangements:** Provisions relating to beneficial ownership and control of legal persons and arrangements were strengthened by requiring that there be reliable information available about the beneficial ownership and control of companies, trusts, and other legal persons or legal arrangements. The interpretive notes to the recommendations dealing with these obligations now expand on the type of information to be collected and maintained and on options to make the information available to competent authorities.
- **Investigative powers:** The types of special investigative techniques that countries should use were expanded.
- **International cooperation:** A new requirement on countries to respond to requests made pursuant to non-conviction based confiscation proceedings and related provisional measures (unless this is inconsistent with fundamental principles of their domestic law) was added. Provisions were included to strengthen cooperation between competent authorities (i.e., outside the mutual legal assistance framework).

II. NEXT STEPS

20. **Staff expects to submit the new FATF standard and a revised assessment methodology to the Board with a request for their endorsement in mid 2013.** This submission will be included in the staff report to the Board on the outcome of the FATF discussions on the nature and scope of the next round of assessments and staff's proposed shift towards more targeted, risk-based assessments together with an analysis of the associated resource implications that was requested by Directors in June 2011.

ANNEX 1. SELECTED FATF RECOMMENDATIONS

The FATF Recommendations introducing changes that are of particular interest to the Fund are reproduced below:²³

I. Risk-based approach

²³ The text of the recommendations on the financing of proliferation is reproduced in Box 3.

Recommendation 1: Assessing risks and applying a risk-based approach

Countries should identify, assess, and understand the money laundering and terrorist financing risks for the country, and should take action, including designating an authority or mechanism to coordinate actions to assess risks, and apply resources, aimed at ensuring the risks are mitigated effectively. Based on that assessment, countries should apply a risk-based approach (RBA) to ensure that measures to prevent or mitigate money laundering and terrorist financing are commensurate with the risks identified. This approach should be an essential foundation to efficient allocation of resources across the anti-money laundering and countering the financing of terrorism (AML/CFT) regime and the implementation of risk-based measures throughout the FATF Recommendations. Where countries identify higher risks, they should ensure that their AML/CFT regime adequately addresses such risks. Where countries identify lower risks, they may decide to allow simplified measures for some of the FATF Recommendations under certain conditions.

Countries should require financial institutions and designated non-financial businesses and professions (DNFBPs) to identify, assess and take effective action to mitigate their money laundering and terrorist financing risks.

II. Tax crimes

Recommendation 3: Money laundering offence

Countries should criminalise money laundering on the basis of the Vienna Convention and the Palermo Convention. Countries should apply the crime of money laundering to all serious offences, with a view to including the widest range of predicate offences.

Designated categories of offences means:

- participation in an organised 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.

When deciding on the range of offences to be covered as predicate offences under each of the categories listed above, each country may decide, in accordance with its domestic law, how it will define those offences and the nature of any particular elements of those offences that make them serious offences.

III. Anti-corruption

Recommendation 12: Politically-exposed persons

Financial institutions should be required, in relation to foreign politically exposed persons (PEPs) (whether as customer or beneficial owner), in addition to performing normal customer due diligence measures, to:

- (a) have appropriate risk-management systems to determine whether the customer or the beneficial owner is a politically exposed person;
- (b) obtain senior management approval for establishing (or continuing, for existing customers) such business relationships;
- (c) take reasonable measures to establish the source of wealth and source of funds; and
- (d) conduct enhanced ongoing monitoring of the business relationship.

Financial institutions should be required to take reasonable measures to determine whether a customer or beneficial owner is a domestic PEP or a person who is or has been entrusted with a prominent function by an international organisation. In cases of a higher risk business relationship with such persons, financial institutions should be required to apply the measures referred to in paragraphs (b), (c) and (d).

The requirements for all types of PEP should also apply to family members or close associates of such PEPs.

Recommendation 36: International instruments

Countries should take immediate steps to become party to and implement fully the Vienna Convention, 1988; the Palermo Convention, 2000; the United Nations Convention against Corruption, 2003; and the Terrorist Financing Convention, 1999. Where applicable, countries are also encouraged to ratify and implement other relevant international conventions, such as the Council of Europe Convention on Cybercrime, 2001; the Inter-American Convention against Terrorism, 2002; and the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime and on the Financing of Terrorism, 2005.

**ANNEX 2. POLITICALLY-EXPOSED PERSONS (PEPs) OF INTERNATIONAL ORGANIZATIONS:
THE REVISED FINANCIAL ACTION TASK FORCE (FATF) RECOMMENDATION 12 AND ITS
IMPLICATIONS FOR THE FUND**

EXECUTIVE SUMMARY

The Financial Action Task Force (FATF) adopted the revised anti-money laundering and combating the financing of terrorism (AML/CFT) standard in February 2012. Among the main changes, the revised standard extends the application of enhanced due diligence by financial institutions to individuals who are or have been entrusted with a prominent function by an international organization, including the Fund, in cases where a determination is made of a higher-risk business relationship with such individuals. The General Glossary to the FATF standard defines “persons who are or have been entrusted with a prominent function by an international organization” as “members of senior management, i.e., directors, deputy directors and members of the board or equivalent functions.”

The language used by the FATF standard is rather generic and is not meant to reflect the governance structure of any particular international organization. Moreover, the implementation of the standard is a matter of national law, regulation, and practice and thus its interpretation may vary from country to country, and among different financial institutions operating within a given country. It is therefore still unclear how particular countries and financial institutions will apply the revised standard. The revised methodology, which is expected to be finalized by February 2013, will help clarify the basis on which countries’ compliance with this recommendation will be assessed.

INTRODUCTION

The FATF—the standard setter for AML/CFT—adopted on February 16, 2012 a revised standard, now renamed the “International Standards on Combating Money Laundering and the Financing of Terrorism and Proliferation: the FATF Recommendations.”²⁴

The previous version of the AML/CFT standard provided the application of enhanced due diligence²⁵ by financial institutions to individuals who are or have been entrusted with prominent public functions by a foreign country (so called “foreign PEPs”).²⁶ The revised standard (in Recommendation 12)²⁷ extends the application of enhanced due diligence by financial institutions²⁸ also to individuals who are or have been entrusted with those functions domestically²⁹ or in the context of an international organization,³⁰ including

²⁴ In 2002, the Fund’s Executive Board endorsed the addition of the FATF Recommendations to the list of areas and associated standards and codes useful to the operational work of the Fund. As indicated in the information note, once the assessment methodology for the revised standard is finalized, both the revised standard and the methodology will be submitted to the Board with a request for their endorsement.

²⁵ Customer due diligence measures include identifying the customer and verifying that customer’s identity, identifying and verifying the identity of the beneficial owner, understanding and obtaining information on the purpose and intended nature of the business relationship, and conducting ongoing due diligence on the business relationship and scrutiny of transactions undertaken throughout the course of that relationship. Enhanced CDD measures include, but are not limited to, obtaining information on the source of funds or source of wealth of the customer, obtaining the approval of senior management to commence or continue the business relationship, conducting enhanced monitoring of the business relationship, by increasing the number and timing of controls applied, and selecting patterns of transactions that need further examination.

²⁶ The General Glossary to the revised FATF standard defines foreign PEPs as “individuals who are or have been entrusted with prominent public functions by 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.”

²⁷ See Annex 1 for the text of Recommendation 12.

²⁸ Note that FATF Recommendation 22 extends the application of the customer due-diligence requirements contained in Recommendation 12 to the so-called designated nonfinancial businesses and professions (DNFBPs), i.e., casinos, real estate agents, dealers in precious metals and stones, lawyers, notaries, other independent legal professionals and accountants, and trust and company service providers. Therefore, the references in this note to financial institutions apply, *mutatis mutandis*, to DNFBPs.

²⁹ For many countries, the extension of this requirement to domestic PEPs is not entirely new: Article 52, paragraph 1, of the United Nations Convention against Corruption (UNCAC) already contains a similar provision and makes no distinction among the various types of PEPs. Only 14 countries around the world have not yet ratified it.

³⁰ The General Glossary to the revised FATF standard defines international organizations as follows: “International organizations are entities established by formal political agreements between their member States that have the status of international treaties; their existence is recognized by law in their member countries; and they are not treated as resident institutional units of the countries in which they are located. Examples of international organizations include the United Nations and affiliated international organizations such as the

(continued...)

the Fund.³¹ Accordingly, the mere fact of holding such a function in an international organization would qualify such individuals as PEPs and, as a result and depending upon the application of relevant national law and regulation, may subject them to enhanced due diligence by financial institutions in cases where a determination is made of a higher risk business relationship with them.³²

This note describes the extension of enhanced due diligence provisions to PEPs of international organizations and the possible implications for the Fund and its senior management.³³

I. The FATF standard

The FATF standard is not legally binding under international law, nor is it directly applicable to the Fund. However, in practice, it is followed and implemented by all FATF member countries and, through the network of FATF-Style Regional Bodies (FSRBs), by some 180 countries around the world. A process of mutual evaluations by the FATF and FSRBs, and assessments by the Fund and the Bank is in place to assess compliance with and the effective implementation of the FATF standard at a national level.

As the revised standard is already in force, it is up to each country and to financial institutions to determine when and how these requirements will be transposed into and implemented under their domestic system. The implementation of the revised standard may vary from country to country. Financial institutions may also decide to impose on their customers stricter requirements than what is expected in the domestic legal framework (e.g., pursuant to group policies), as permitted under domestic law. Following the revision of the standard and its implementation, existing or prospective customers could be asked questions by financial institutions in order to determine whether they are PEPs of international organizations and, in cases where an assessment is made of a higher-risk business relationship, enhanced due diligence could be applied. These questions may include, but are not limited to, the source of wealth³⁴ or funds,³⁵ or completing a financial disclosure

International Maritime Organization; regional international organizations such as the Council of Europe, institutions of the European Union, the Organization for Security and Cooperation in Europe and the Organization of American States; military international organizations such as the North Atlantic Treaty Organization, and economic organizations such as the World Trade Organization or the Association of Southeast Asian Nations, etc.”

³¹ This is part of the greater emphasis placed by the FATF on anti-corruption, following G20 calls.

³² While with regard to foreign PEPs, financial institutions have no choice but to apply enhanced due-diligence measures, as regards PEPs of international organizations, enhanced due diligence will only be applied if the financial institution determines that they pose a higher risk.

³³ The FATF is currently preparing a Best Practice paper which, once finalized, may help further clarify some of the issues contained in this note.

³⁴ This refers to the origin of the PEP’s entire body of wealth (i.e., total assets).

of assets at the beginning of the relationship to generate a baseline of information to be used by an institution's compliance officer in connection with ongoing relationship monitoring.

II. FATF Recommendation 12 and the possible practical implications for the Fund

As noted above, revised FATF Recommendation 12 has extended existing enhanced due diligence for foreign PEPs, among others, to a person who is or has been entrusted with a prominent function by an international organization in cases of a higher-risk business relationship with such persons. The definition of PEPs of international organizations contained in the General Glossary to the revised FATF Recommendations states that these individuals include directors, deputy directors and members of the board or equivalent functions, including family members³⁶ or close associates³⁷ of such PEPs. The language used by the FATF standard is rather generic and is not meant to reflect the governance structure of any particular international organization. The definition of PEP (and the related enhanced due diligence) however clearly does not encompass middle-ranking or more junior individuals. The enhanced due-diligence provisions also apply where the beneficial owner³⁸ (e.g., of the funds/assets or transactions) is a PEP (for example, if the customer is only acting in representation of a third party, who is a PEP).³⁹

In practice, the revision of the standard implies that a financial institution—from the outset of establishing the business relationship or in the course of an already established

³⁵ This refers to the origin of the particular funds or other assets which are the subject of the business relationship between the PEP and the financial institution (e.g., the amounts being invested, deposited, or wired as part of the business relationship).

³⁶ The Wolfsberg Frequently Asked Questions on PEPs defines “close family” to encompass a PEP’s direct family members, including spouses, children, parents and siblings.

³⁷ The Wolfsberg Frequently Asked Questions on PEPs defines “close associate” to encompass a PEP’s widely and publicly known close business colleagues and/or personal advisors to the PEP, in particular personal financial advisors or persons acting in a financial fiduciary capacity. The notion of “close associates” includes persons who are closely connected to a PEP, either socially or professionally.

³⁸ In the FATF terminology, “*beneficial owner*” refers to the natural person(s) who ultimately owns or controls a customer and/or the natural person on whose behalf a transaction is being conducted. It also includes those persons who exercise ultimate effective control over a legal person or arrangement. The expressions “ultimately owns or controls” and “ultimate effective control” refer to situations in which ownership/control is exercised through a chain of ownership or by means of control other than direct control.

³⁹ Family members and close associates of PEPs (who are to be treated as PEPs themselves), also have family members and close associates who may abuse this relationship (or be abused by it) for illicit purposes. Recommendation 12 does not require that this second layer of persons be treated as PEPs, unless they are PEPs in their own right. Nevertheless, financial institutions will consider the risk of doing business with such persons and, in some cases; those risks may be higher than with other types of customers.

business relationship—will have to take reasonable measures⁴⁰ to determine (in most cases, based on guidance by competent national authorities) whether the business relationship with the prospective/existing customer who is/has been entrusted with a prominent function by an international organization poses a “higher risk.” In the affirmative, financial institutions will be required to apply certain measures, such as obtaining senior management approval for establishing (or continuing, for existing customers) such business relationships; taking reasonable measures to establish the source of wealth and funds and conducting enhanced ongoing monitoring of the business relationship.

In conclusion, as a result of the implementation of revised FATF Recommendation 12, PEPs of international organizations, including the Fund, may become subject, in case of a determination of a higher-risk business relationship, to enhanced due diligence by financial institutions in the United States or elsewhere. The revised methodology for the assessment of countries’ compliance with the standard will help clarify the basis on which these issues will be assessed.

⁴⁰ The General Glossary of the FATF Recommendations defines “reasonable measures” to mean appropriate measures which are commensurate with the money laundering or terrorist financing risks.