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The international community has pushed hard in recent years for the identification, development and monitoring of international standards and codes relating to economic, financial, and regulatory good practices, including, supervision and regulation of banking, insurance and securities, and most recently anti-money laundering and combating the financing of terrorism (AML/CFT). In July 2002, AML/CFT was added to the list of areas where standards and codes are useful to the operational work of the IMF and the World Bank and the FATF 40+8 Recommendations were endorsed as the associated standard. This endorsement was the culmination of steadily increasing involvement by the IMF and the World Bank in global AML/CFT efforts. The major effort up to this point centered on a recognition of the need for world-wide assessments of countries' AML/CFT efforts and for a common approach to such assessments.

The IMF and the World Bank took a leading role in the development of the Methodology for Assessing Compliance with AML/CFT standards and its subsequent endorsement by the Financial Action Task Force (FATF) and a number of FATF-style regional bodies, ensuring that the methodology would be used by a variety of international bodies conducting complementary work in this area.

### **Background**

At its September 2000 meeting, the International Monetary and Financial Committee (IMFC)<sup>1</sup> requested the IMF to prepare a joint paper with the World Bank on their respective roles in combating money laundering and financial crime and in protecting the international financial system. The two institutions were asked to explore incorporating work

on financial system abuse, particularly with respect to international efforts to combat money laundering, into their various activities, as relevant and appropriate.

In early 2001, staff produced two Board papers focusing on anti-money laundering (AML) issues<sup>2</sup> and on the IMF involvement in this area.<sup>3</sup> On April 13, 2001, the Boards of both the IMF and the World Bank discussed money laundering and how the two institutions could enhance their contributions to global AML efforts. Executive Directors recognized that money laundering was a problem of global concern affecting major financial markets as well as smaller ones, and that to address it, international cooperation had to be stepped up. The Fund's Executive Directors agreed that the IMF had an important role to play in protecting the integrity of the international financial system, including through efforts to combat money laundering. Executive Directors agreed that the IMF should take a number of steps to enhance international efforts to counter money laundering. These steps included (1) the intensification of the IMF's focus on AML elements in all relevant supervisory principles including through the development of a methodology on AML supervisory principles; (2) working more closely with major international AML groups, in particular with the Financial Action Task Force; (3) including AML concerns in its surveillance and other operational activities when macroeconomically relevant.<sup>4</sup>

It was generally agreed that the FATF 40 Recommendations would be recognized as the appropriate standard for combating money laundering and that work should go forward to determine how the Recommendations could be adapted and made operational for the IMF's work. The Board emphasized, however, that the IMF's involvement in this area should be strictly confined to its core areas of competence and that the IMF should not get involved in law enforcement activities.<sup>5</sup> What is meant by the expressions "core areas of competence" and "law enforcement activities" has never been clearly defined. Nevertheless, this statement has constituted the guiding—albeit shifting—principle of the IMF's involvement in the area of AML.

### **The Development of the Methodology**

Staff began working on the development of a methodology. On July 26, 2001, staff met with a number of representatives from the FATF. The discussions focused on the process of adapting and making operational the FATF 40 Recommendations for the IMF and World Bank's work in order to formally incorporate the standard into the Reports on the Observance of Standards and Codes (ROSC)<sup>6</sup> framework and on the preparation of the methodology to be used by IMF and World Bank assessors when reviewing AML elements as part of assessments of observance of financial sector standards.

Two themes dominated this meeting that were going to accompany and shape, in one way or another, the major debates that took place in the course of developing the methodology. The first theme was the extent of the IMF and World Bank's involvement in the area of AML. Echoing the Executive Directors' position at the Executive Board meeting of April 13, 2001, staff asserted that given that the two institutions' mandate was primarily related to financial system supervision, the assessment of countries' compliance with the totality of the FATF 40 Recommendations was problematic because a number of the Recommendations were concerned with law enforcement and/or extended well beyond regulated financial institutions.<sup>7</sup> Staff also noted that the FATF's non-cooperative countries and territories (NCCT) initiative, which is involuntary, uses a different assessment methodology than the one used by the FATF for its members in the context of mutual evaluations—based on a “name and shame” approach—did not conform with the ROSC principles of voluntariness, uniformity, and cooperativeness. As a result, the recognition of an AML ROSC would be problematic as long as the FATF pursued its NCCT initiative. Staff noted, however, that if the issues related to the adaptation of the FATF 40 Recommendations and the NCCT initiative to the ROSC principles were resolved, a ROSC based on the entire FATF 40 Recommendations could be assessed by the FATF or the FATF-style regional bodies (FSRBs) using, among other sources, material from IMF and World Bank assessments of compliance with those supervisory standards relevant to AML, with the agreement of the jurisdictions concerned. Participants at the meeting agreed to pursue their discussions in the months ahead on the ROSC process and the methodology.

The draft methodology was annexed to the August 15, 2001 report to the Executive Board entitled *Anti-Money Laundering—Enhanced Contribution by the Fund (SM/01/258)*. The draft methodology focused on AML practices in the prudentially regulated financial sectors and drew extensively on the existing principles of prudential supervision in the areas of banking, securities, and insurance together with the criteria developed in the standard setters own methodology papers.<sup>8</sup> These sources were augmented by drawing on additional subsequent papers by the supervisory standard setters relevant to AML work and on the FATF 40 Recommendations. The draft methodology included criteria to assess the AML elements present within the financial sector supervisory and regulatory framework to ensure that adequate controls and procedures are in place to prevent abuse of the financial system by criminals. These elements, which covered requirements for due diligence reviews on those who control or use regulated financial intermediaries, including fitness tests for owners/managers and know-your-customer rules, overlapped with about 19 of the FATF 40 Recommendations.

The draft methodology did not include any criterion for assessing the AML legal and institutional framework or international cooperation in this area. While this exclusion may have been consistent with the Executive Board's instructions concerning the IMF involvement in this area and in law enforcement activities, it reflected an excessively narrow understanding of the phenomenon of money laundering and of the area that the IMF and World Bank staff could usefully cover in their assessments of jurisdictions compliance with AML principles. This approach would be short lived—staff used this draft methodology in four Financial Sector Assessment Program (FSAP) undertakings conducted in member countries.

In the wake of the events of September 11, 2001, a task force composed of the Legal, Monetary and Exchange Affairs, and Policy Development and Review Departments of the IMF completed on November 5, 2001 a Board paper entitled, "Intensified Fund Involvement in Anti-Money Laundering Work and Combating the Financing of Terrorism."<sup>9</sup> In the paper, the IMF's task force noted that the events of September 11 had demonstrated all too clearly that terrorism can, not only imperil the peace of nations, but also have far-reaching negative consequences for global economic growth and financial stability. The paper stated that these events

and their aftermath have therefore prompted a re-examination, at national and international levels, of mechanisms for the promotion and enforcement of laws against both money laundering and financing of terrorism. The Board paper included a set of measures for consideration by the IMF Board. One of the measures proposed that the methodology would be amplified and expanded by including relevant parts of the FATF Eight Special Recommendations on Terrorist Financing issued on October 31, 2001 as well as legal and institutional issues related to the effectiveness of financial sector policies in the AML area. Added to the prudential supervisory aspects of AML would be relevant legal and institutional issues such as the extension of Know-Your-Customer and other AML principles applicable to the unsupervised sector, the existence of a suitable legal framework including criminal and civil statutes, institutions for effective implementation (including FIUs), resources and training needs of supervisors, and bilateral or multilateral arrangements for the exchange of information.

The task force also proposed that the expanded methodology would be applied in all FSAP and Offshore Financial Center (OFC) assessments. The AML assessment would be presented in detail as part of FSAP reports to the authorities, and would be included as a substantive chapter in the related Financial Sector Stability Assessment (FSSA) reports, that are circulated to the Board. In addition, countries would be encouraged to approve the distribution of the detailed assessments in this area (either as separate documents or as part of larger technical assistance reports) to the Board and relevant bodies, such as the FATF. Thus, the range of countries to which the AML Methodology Document would apply would be expanded, and the results could be made more widely available.

On November 12, 2001, the IMF's Executive Directors supported expanding the IMF's involvement beyond anti-money laundering to efforts aimed at countering terrorism financing and expanding the methodology to include aspects relating to combating the financing of terrorism. In addition, having noted that effective implementation of financial supervisory principles depends on a sound legal framework and on other institutional structures, most Directors considered it appropriate to expand coverage to legal and institutional issues in the methodology. Some Directors considered that the methodology should eventually cover all the FATF Recommendations, both the original 40 (as revised) and the

additional 8 on terrorist financing. However, several Directors supported an evolutionary approach whereby the staff would work on expanding coverage of the assessment methodology to these issues while experience in the implementation of the existing methodology accumulated. At this meeting, Executive Directors also supported applying the expanded methodology in OFC assessments as well as onshore assessments in the context of the FSAP, though they stressed that these assessments should be done on a voluntary basis. These decisions constituted a radical departure from the narrow approach that had previously characterized the IMF's involvement in the area of AML.

On November 17, 2001, the IMFC endorsed the IMF's action plan for enhancing "collaboration with the FATF on developing a global standard covering the FATF recommendations, and working to apply the standard on a uniform, cooperative, and voluntary basis."<sup>10</sup>

In April 2002, the papers "Intensified Work on Anti-Money Laundering and Combating the Financing of Terrorism"<sup>11</sup> and "Fund and Bank Methodology for Assessing Legal, Institutional, and Supervisory/Regulatory Aspects of Anti-Money Laundering and Combating the Financing of Terrorism: Update and Next Steps"<sup>12</sup> were distributed to the Boards of the IMF and the World Bank. The second paper focused on the progress toward a comprehensive methodology and the next steps toward developing an AML/CFT ROSC. Two annexes were attached to this paper: Annex I, prepared by Fund and Bank staff, which consisted of a revised draft of the methodology, and Annex II, prepared by the FATF ROSC Working Group, which consisted of criteria needed to cover assessment of those aspects of the FATF 40+8 not covered in Annex I (primarily related to the institutional capacity and effectiveness of the criminal justice system).

The second paper was discussed at an IMF Board seminar on April 8, 2002 and at a World Bank Board technical briefing on May 7, 2002. During the seminar, the IMF Board discussed both Annex I and Annex II. Executive Directors supported the extension of the methodology to cover the legal and institutional framework, while calling for caution not to overstep the boundaries of the IMF's expertise by moving into law enforcement. At the World Bank technical briefing, similar concerns were

expressed about the scope of the Bank's possible work in law enforcement.

On April 20, 2002, the IMFC called on the IMF to complete "the comprehensive AML/CFT methodology, based on a global standard covering the Financial Action Task Force Recommendations, and the development of assessment procedures compatible with the uniform, voluntary, and cooperative nature of the ROSC process."<sup>13</sup> On April 21, 2002, the Development Committee welcomed the action plans agreed to by the IMF and the World Bank and enhanced collaboration with other institutions. The Development Committee encouraged the World Bank and the IMF "to continue to integrate [AML/CFT] issues into their diagnostic work in line with their respective mandates, and urged that capacity building assistance be increased so that countries could better address these issues."<sup>14</sup>

On June 12, 2002, Annex I (Fund and Bank Methodology for Assessing Legal, Institutional and Supervisory/Regulatory Aspects of Anti-Money Laundering and Combating the Financing of Terrorism), and Annex II (Assessment of Implementation of Legal and Institutional Elements Outside of the Supervisory or Regulatory Framework) were circulated to the Executive Board. Both annexes were largely unchanged from those provided to the Executive Directors in April 2002. For Annex I, the changes reflected the technical comments of Executive Directors, standard setters (Basel Committee, IAIS, and IOSCO) as well as from the FATF ROSC Working Group, FATF Members, the Egmont Group, and AML/CFT experts. For Annex II, changes reflected comments from FATF members and the Egmont Group. The same month, the FATF Plenary instructed the FATF Secretariat to merge the two Annexes to constitute a draft comprehensive methodology for assessing compliance with the FATF 40+8 Recommendations.

On July 26, 2002, the Executive Board discussed the paper prepared by the staff of the IMF and the World Bank on "Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT), Proposals to Assess a Global Standard and to Prepare ROSCs."<sup>15</sup> The paper proposed two different methods for preparing comprehensive AML/CFT assessments and associated ROSC modules that would be based on the use of a single comprehensive methodology thereby providing for a con-

sistent assessment approach and avoiding duplication of assessments. Method 1 contemplated Financial Action Task Force (FATF) and FATF-Style Regional Bodies (FSRBs)-led assessments and associated ROSCs, which would be undertaken in the context of FATF/FSRB mutual evaluations and would not include IMF/World Bank staff. Under Method 2, IMF/World Bank staff-led assessments and associated ROSCs would be undertaken by both IMF/World Bank staff (including experts under staff supervision), who would assess and take responsibility for part of each assessment and associated ROSC, and other experts not affiliated with IMF/World Bank staff who would assess and take responsibility for the rest of the assessment and associated ROSC.

The two methods were developed to recognize that a comprehensive treatment of AML/CFT, including those areas that Directors had expressed concerns that neither the IMF nor the World Bank staff (or experts under their supervision) should assess. These areas, referred to as “areas not within Fund/Bank assessment responsibility,” include implementation of criminal laws and the activities of those parts of the non-prudentially supervised sector that are not macro-relevant but that pose a money laundering risk.

In addition, the paper proposed that the Boards of the IMF and the World Bank could agree to add AML/CFT to the list of 11 areas where standards and codes are useful to the operational work of the IMF and the World Bank and to adopt the FATF 40+8 Recommendations as the associated standard provided that four conditions were satisfactorily met by FATF at its plenary meetings on October 9–11, 2002:

1. The FATF Secretariat, in consultation with Fund/Bank staff, completes the draft of the comprehensive and integrated assessment methodology by the Annual Meetings for consideration at the October Plenary;
2. The FATF endorses the comprehensive methodology and its use in undertaking FATF/FSRB mutual evaluations and Fund/Bank staff-led assessments;
3. The FATF agrees to undertake its mutual evaluations consistent with the ROSC process; and



4. The FATF does not undertake a further round of the NCCT process, at least during the period of a 12 month pilot project.

At the meeting of July 26, 2002, Executive Directors agreed to conditionally add the FATF 40 Recommendations and the 8 Special Recommendations on terrorism financing to the list of areas and associated standards and codes useful to the operational work of the IMF and to endorse a 12-month pilot program of AML/CFT assessments and accompanying ROSCs that would involve participation of the IMF and the World Bank, the FATF, and FATF-Style Regional Bodies (FSRBs). The Executive Board of the World Bank took a similar decision in August.

The FATF Secretariat, in close collaboration with Fund and Bank staff and standard setters produced the draft comprehensive and integrated methodology by merging Annexes I and II of the draft methodologies of June 12, 2002, streamlining some of the criteria and reordering some sections. The substance of the methodology, however, was largely unchanged. Those elements formerly included within Annex II (i.e., the elements not to be assessed by the IMF and the World Bank) were italicized. On September 4, 2002, the draft of the comprehensive and integrated AML/CFT methodology was circulated to the IMF Executive Board for information and comments according to the timetable for the completion of a comprehensive methodology by the time of the Annual Meetings of the IMF and the World Bank and to receive endorsement from the FATF at the plenary for October 9–11, 2002.

At its October plenary, the FATF endorsed the comprehensive and integrated methodology and agreed to participate in the 12-month pilot program of assessments together with the IMF and the World Bank. The FATF agreed that the new methodology would be used for its future mutual evaluations. The FATF also agreed not to undertake a further round of the NCCT process during the 12-month pilot program.

On November 15, 2002, Executive Directors added the FATF 40+8 Recommendations to the list of areas and associated standards and codes useful to the operational work of the IMF for which assessments would be undertaken and ROSCs would be prepared, and they endorsed the comprehensive and integrated AML/CFT methodology.

### **The Structure of the AML/CFT Assessment Methodology**

Throughout the period leading to the endorsement of the AML/CFT methodology, the successive drafts were circulated to the various standard setters, member bodies, and organizations, and their comments were taken into consideration in refining the methodology. The drafts were also used in FSAP and OFC assessments and benefited from the experience acquired in conducting the assessments.

The AML/CFT Methodology is designed to guide the assessment of a jurisdiction's compliance with AML/CFT standards. While it is based primarily on the FATF 40 and the FATF Eight Special Recommendations on Terrorist Financing, it also includes relevant elements from United Nations Security Council Resolutions and international conventions and from supervisory/regulatory standards for the banking, insurance, and securities sectors as well as from the Egmont Group. It has also been strengthened by the assessment experience of the FATF (from its mutual evaluations), of the IMF and World Bank (in the FSAP and by the IMF in the OFC program). Accordingly, in many respects, the AML/CFT Methodology went beyond the FATF 40 Recommendations as they stood prior to the revision of June 2003.

The AML/CFT Methodology lists 120 criteria assessing the legal and institutional framework as well as the supervisory mechanisms in place in all relevant sectors, including the banking, insurance and securities sectors where applicable. It recognizes that an effective AML/CFT system requires an adequate legal and institutional framework, which should include: (1) laws that create AML/CFT offences and other penal measures, and that impose the required obligations on financial institutions; (2) an appropriate institutional or administrative framework; and (3) laws that provide competent authorities with the necessary duties, powers and sanctions, including the ability to co-operate internationally.

Following an introductory section that presents briefly its background, the methodology is divided into three sections. Section 2.1 deals with criminal justice measures, FIUs, and international co-operation, and section 2.2 covers preventive measures for financial institutions. Section 2.3 seeks information on any measures that a jurisdiction may have

adopted regarding monitoring or reporting of large currency or cross-border transactions.

Section 2.1 entitled Criminal Justice Measures and International Cooperation is drawn mainly from the FATF 40+8, but also relies on relevant international conventions, UN Security Council Resolutions, and the work of the Egmont Group. The assessment criteria are set out in five subsections, covering criminalization of money laundering and financing of terrorism (subsection I), confiscation of proceeds of crime or property used to finance terrorism (subsection II), the FIU and processes for receiving, analyzing, and disseminating financial information and other intelligence at the domestic and international levels (subsection III), law enforcement and prosecution authorities, powers, and duties (subsection IV), and international co-operation (subsection V).

Section 2.2 entitled Preventive Measures for Financial Institutions applies to the banking, insurance, and securities sectors as well as other financial sectors that are vulnerable to money laundering and financing of terrorism. These other categories of financial institutions should include all financial institutions as covered by the FATF 40+8, including in particular, bureaux de change (foreign exchange offices) and money remittance or transfer companies. The assessment criteria are set out in nine subsections, covering general framework (subsection I), customer identification (subsection II), ongoing monitoring of accounts and transactions (subsection III), record keeping (subsection IV), suspicious transactions reporting (subsection V), internal controls, compliance and audit (subsection VI), integrity standards (subsection VII), enforcement powers and sanctions (subsection VIII), and co-operation between supervisors and other competent authorities (subsection IX).

Section 2.2.1 contains the criteria for assessing the legal and institutional elements that are required for all financial institutions. For each of these criteria, it is also necessary to assess whether those measures have been effectively implemented. Sections 2.2.2, 2.2.3 and 2.2.4 contain additional sector-specific criteria for the banking, insurance, and securities sectors, which have been provided by the relevant standard setters (the Basel Committee, IAIS, and IOSCO) and which are based on standards they have issued.

Finally, section 2.3 entitled Monitoring or Reporting of Large Currency or Cross-border Transactions is based on FATF Recommendations 22 and 23, which, although discretionary Recommendations, form an integral part of the AML/CFT systems in a number of jurisdictions. This section seeks information from each jurisdiction on any measures that it may have taken concerning the monitoring or reporting of large currency or cross-border transactions, and the use of cash.

The AML/CFT methodology has been complemented by a set of documents, including a criterion-by-criterion worksheet and a detailed assessment template to facilitate the production of the ROSC. In addition, a set of guidelines has been developed to help assessors in the conduct of their assessments.

### **A Significant Development in AML/CFT Assessment Practices**

The development of the AML/CFT methodology constituted an unprecedented move towards the harmonization of AML/CFT assessment practices and the globalization and enhancement of AML/CFT efforts. Following the endorsements of the FATF and the IMF, the pilot program of assessments by the IMF/World Bank and the FATF under the two methods began. Shortly thereafter, most FSRBs endorsed the methodology and started using it in the mutual evaluations of their members.

The development of the AML/CFT methodology also accompanied a significantly increased involvement by the IMF and the World Bank in the international efforts to combat money laundering and the financing of terrorism. The AML/CFT methodology went beyond the FATF 40 Recommendations on a number of issues that were either not specifically covered in the Recommendations or were not sufficiently clear. While this forward looking approach created some tensions between the FATF 40 Recommendations and the methodology for the assessment of compliance with which it had been developed, most of the innovations were integrated in the FATF 40 Recommendations when these were revised in June 2003.

The benefits of the AML/CFT methodology and the two method approach are numerous. They contributed to the appeasement of the controversies that had accompanied the NCCT exercise and instilled a new spirit in the conduct of assessments. They provided a framework for a global, unified, and methodic approach to assessments. They created the conditions for increased uniformity and objectivity of assessments. Finally, the AML/CFT methodology and the two method approach should ensure a significant saving of resources and contribute toward avoiding the duplication of efforts in the area of AML/CFT assessments.

Following the revision of the FATF 40 Recommendations in June 2003, efforts are under way to revise the AML/CFT methodology to reflect the changes introduced to the Recommendations. Building on the experience acquired during the period of ever closer cooperation, there is little doubt that the international financial organizations, the FATF, and the FSRBs will further improve this rather unique instrument.

## Notes

<sup>1</sup> The IMFC has the responsibility of advising, and reporting to, the Board of Governors on matters relating to the Board of Governors' functions in supervising the management and adaptation of the international monetary and financial system, including the continuing operation of the adjustment process, and in this connection reviewing developments in global liquidity and the transfer of resources to developing countries; considering proposals by the Executive Board to amend the Articles of Agreement; and dealing with disturbances that might threaten the system.

<sup>2</sup> *Financial System Abuse, Financial Crime and Money Laundering—Background Paper*, February 12, 2001.

<sup>3</sup> See IMF Board paper *Enhancing Contributions to Combating Money Laundering (SM/01/103)*.

<sup>4</sup> The World Bank Board agreed on a similar set of steps.

<sup>5</sup> The IMF Board's conclusions are set out in BUFF/01/54 of April 29, 2001.

<sup>6</sup> A ROSC summarizes the extent to which countries observe certain internationally recognized standards in a number of areas that the IMF and Bank Boards have recognized to be useful for their operational work. On each of these standards, a summary report is produced on the basis of an assessment conducted in the country. Once approved, these reports are examined within the context of IMF Article IV consultations and are available to Board members when the IMF reviews the economic and financial situation of each member country as part of its surveillance role. ROSCs are also used by the World Bank to fulfill its functions. To produce a ROSC, a detailed assessment of the country's compliance with the relevant standard is carried out, either as a stand alone assessment, or within the framework of an existing assessment program, such as the Financial Sector Assessment Program (FSAP), which assesses the vulnerability of the country's financial sector, or the Offshore Financial Centers Program (OFC). In all cases, a ROSC is produced on the basis of a voluntary, uniform and cooperative process.

<sup>7</sup> The validity of this assertion is not discussed in this contribution.

<sup>8</sup> The Basel Committee on Banking Supervision (Basel Committee), the International Association of Insurance Supervisors (IAIS), and the International Organization of Securities Commissions (IOSCO).

<sup>9</sup> See BUFF 01/076 (November 12, 2001).

<sup>10</sup> Press Release No 01/47 (November 17, 2001).

<sup>11</sup> SM 02/97 (March 27, 2002).

<sup>12</sup> SM/02/102, (April 2, 2002).

<sup>13</sup> Press Release 02/22 (April 20, 2002).

<sup>14</sup> Development Committee Communiqué, April 21, 2002.

<sup>15</sup> SM/02/227, July 17, 2002.