

CHAPTER**16****Recent Developments in International Monetary Fund Involvement in Anti-Money Laundering and Combating the Financing of Terrorism Matters**

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The systematic involvement of the International Monetary Fund (IMF) in anti-money laundering (AML) and (later) combating the financing of terrorism (CFT) matters was initiated through the establishment of the Offshore Financial Center (OFC) Program in July 2000. The purpose of the program was to offer a voluntary assessment of compliance by OFC with various international standards on banking, insurance, and other relevant sectors. It was also aimed at assessing vulnerabilities and threats to financial stability and the potential for contagion of offshore risks to relevant onshore economies.¹

The OFC Program was established in the context of a call by the Group of Seven (G-7) governments to take action against the abuse of the global financial system with the view to ensuring that “its credibility and integrity are not undermined by crime, poor regulatory standards and harmful tax competition” by “offshore havens which undermine international standards of financial regulation.”² In particular, the G-7 governments called upon the international financial institutions “to strengthen governance and anti-money laundering measures in programs with member countries.” In establishing the OFC Program, the Executive Directors of the IMF also stressed that “effective anti-money laundering measures are important for the integrity of the financial system, as well as for fighting financial crime.”³

On April 13, 2001, the Executive Board of the IMF decided to enhance its contribution to the fight against money laundering, specifically through recognizing the Financial Action Task Force 40 Recommendations on Money Laundering (FATF 40 Recommendations) as the appropriate AML standard; endorsing the creation of a

methodology for assessing compliance with the standard; and incorporating AML concerns in the IMF's surveillance and other operational activities where macroeconomically relevant.⁴ The Executive Board also recognized that more vigorous national and international efforts to counter money laundering were needed, including through the promotion of sound financial systems and good governance, the design and implementation of judicial and legal reform and other related capacity-building programs, and effective law enforcement. It was stressed however that the IMF's involvement should be strictly confined to its core areas of competence.

Principal Developments

The events of September 11, 2001, reinforced the determination of the IMF. On November 12, 2001, the Executive Board stressed that the IMF has a key role to play in combating money laundering and terrorism financing as part of international efforts to prevent the abuse of financial systems and to protect and enhance the integrity of the international financial system.⁵ The Executive Board agreed on a number of measures to intensify the IMF's work in this area and extend it to combating the financing of terrorism. The main decisions taken included expanding the joint IMF–World Bank AML Methodology Document⁶ and IMF technical assistance to include aspects relating to anti-terrorism financing and to legal and institutional issues; applying the expanded methodology in OFC assessments (the pace of which would be speeded up), as well as onshore assessments in the context of Financial Sector Assessment Programs (FSAPs); introducing AML/CFT issues in the context of Article IV consultations on the basis of a voluntary questionnaire; enhancing the IMF's collaboration with the FATF, including by working closely and rapidly with the FATF on a suitable assessment process that is compatible with the uniform, voluntary, and cooperative nature of the Report on the Observance of Standards and Codes (ROSC) exercise, and by contributing to the revision of the FATF 40 Recommendations; increasing relevant IMF technical assistance to correct deficiencies in countries' anti-money laundering and anti-terrorism financing regimes identified in the course of FSAPs and OFC assessments; and, finally, to develop an IMF role in the coordination of such technical assistance.

In considering how the IMF could extend its activities to limit the use of financial systems for terrorism financing and to make its AML

work more effective, the Executive Directors stressed that the IMF's involvement in these areas should be consistent with its mandate and core areas of expertise. Recognizing that no single agency can resolve the problems independently, they also emphasized that the Fund should adopt a disciplined and collaborative approach that respects the expertise, scope, and mandate of other relevant institutions, and that the roles of the various institutions involved should be clarified.

Pilot Program and Comprehensive Methodology

The year 2002 marked a deepening of the IMF's work in the area of AML/CFT. On July 26, 2002, the Executive Board conditionally added the FATF 40 Recommendations and FATF Special Recommendations on Terrorist Financing (together FATF 40+8 Recommendations) to the list of areas and associated standards and codes for the operational work of the IMF, and endorsed a 12-month pilot program of AML/CFT assessments and accompanying ROSCs that would involve participation of the IMF, the World Bank, the FATF, and the FATF-Style Regional Bodies (FSRBs).⁷

The Executive Board decided that assessments would be conducted in accordance with the comprehensive and integrated methodology based on the FATF 40+8 Recommendations and the assessment procedure should be compatible with the uniform, voluntary, and co-operative nature of the ROSC process. The methodology was endorsed by the FATF for its mutual evaluations in October 2002 and by the Executive Board of the IMF in November 2002.⁸

As part of the pilot program, which took place between October 2002 and 2003, a total of 33 assessments were carried out by the IMF and/or World Bank within the framework of the IMF's OFC assessments and the Bank/IMF FSAP,⁹ and 8 mutual evaluations were carried out by the FATF and the FSRBs. Of the 33 Bank/IMF assessments, 18 were FSAP assessments, 13 were OFC assessments, and 2 were stand-alone assessments. Three of the mutual evaluations were carried out by the FATF and five by the FSRBs.

Revision of the FATF 40 Recommendations and the Comprehensive Methodology

After completing an extensive review that included the participation of the private sector, the IMF/Bank, the FSRBs, and other interested organizations, the XIV Plenary Meeting of the FATF (June 16–20, 2003) issued a revised version of the FATF 40 Recommendations. Significant changes to the revised FATF 40 Recommendations included

- specifying a minimum list of designated categories of predicate crimes for money laundering;
- extending various AML requirements to financing of terrorism, including suspicious transaction reporting requirements;
- introducing risk-based application of customer due diligence (CDD), including enhanced measures for higher risk customers and transactions, correspondent banking, politically exposed persons, and business and transactions where third parties are relied upon for completing CDD;
- extending AML/CFT requirements, particularly CDD, record keeping, and STR requirements, to certain designated nonfinancial businesses and professions consisting of casinos, real estate agents, dealers in precious metals and stones, lawyers, notaries, other legal professionals, and accounting, trust, and company service providers; and
- prohibiting shell banks and improving transparency of legal persons and arrangements.

The revised FATF 40 Recommendations came into effect immediately, and a revised methodology was adopted by the FATF in February 2004. The revised FATF recommendations and the revised methodology were adopted by the IMF in April 2004.¹⁰ The revised methodology differs significantly from the 2002 methodology: it reflects the significant changes included in the revised FATF recommendations and was informed by the experience the various assessor bodies and organizations gained in the course of their respective assessments, including, in particular, under the 2002 methodology.

The revised methodology, in contrast to the 2002 methodology, is structured along the lines of the revised FATF 40 Recommendations and the 9 Special Recommendations. The criteria relating to the Special Recommendations on Terrorist Financing are separate from the AML criteria, though, where applicable, they cross-reference the relevant AML criteria. While the new structure facilitates the determination by assessors of whether the FATF recommendations have been fully and properly implemented, the reports based on the assessments must be organized along the following four areas reflecting an effective AML/CFT system with an adequate legal and institutional framework: (1) laws that create money laundering (ML) and terrorist financing (FT) offenses and provide for the freezing, seizing, and confiscation of the proceeds of crime and terrorist funding; (2) laws, regulations, or, in certain circumstances, other enforceable means that impose the required obligations on financial institutions and designated nonfinancial businesses and professions; (3) an appropriate institutional or administrative framework, and laws that provide competent authorities with the necessary duties, powers, and sanctions; and (4) laws and other measures that give a country the ability to provide the widest range of international cooperation. In addition, an effective AML/CFT system requires the existence of certain structural elements—not covered in the FATF recommendations—whose absence may significantly impair the system itself. Such elements include, but are not limited to, (1) the respect of principles such as transparency and good governance; (2) a proper culture of AML/CFT compliance shared and reinforced by government, financial institutions, designated nonfinancial businesses and professions, industry trade groups, and self-regulatory organizations; (3) appropriate measures to combat corruption; and (4) a reasonably efficient court system that ensures that judicial decisions are properly enforced. Although the revised methodology does not include criteria for assessments of these areas, major weaknesses or shortcomings in these elements should be noted in assessment reports because of the overall debilitating impact they can have on an AML/CFT system.

Reflecting the expanded scope and detail of the revised recommendations, the revised methodology includes some 200 essential criteria, 20 subcriteria, and 35 additional elements. The essential criteria cover the elements that should be present in order to establish full compliance with the mandatory elements of each of the recommenda-

tions. In some cases, elaborations in the form of subcriteria are provided to assist in identifying important aspects of the assessment of the criteria. In addition, examples intended to assist assessors are included for a number of criteria. The additional elements are derived from nonmandatory elements in the FATF recommendations or from Best Practice and other guidance issued by the FATF, or by international standard-setters such as the Basel Committee on Banking Supervision; they are options that can further strengthen the AML/CFT system and may be desirable. Although they form part of the overall assessment, they are not mandatory and are not assessed for compliance purposes.

The four-level compliance rating system has been maintained under the revised methodology but is now more delineated. The four possible ratings of compliance are compliant, largely compliant, partially compliant, and noncompliant. In exceptional circumstances, a recommendation may be rated as not applicable. The ratings are defined as follows:

Compliant. The Recommendation is fully observed with respect to all essential criteria.

Largely compliant. There are only minor shortcomings, with a large majority of the essential criteria being fully met.

Partially compliant. The country has taken some substantive action and complies with some of the essential criteria.

Noncompliant. There are major shortcomings, with a large majority of the essential criteria not being met.

Not applicable. A requirement or part of a requirement does not apply, due to the structural, legal, or institutional features of a country—for example, a particular type of financial institution does not exist in that country.

The New Role of the IMF

At the end of the pilot program, and following the revision of the standard and the assessment methodology, the Executive Board clarified and reiterated the commitment of the IMF to the global efforts

against money laundering and financing of terrorism in March 2004. Notably, the Executive Board endorsed the FATF 40+8 Recommendations as the standard for AML/CFT assessments and the application of the revised methodology for the IMF's work (including the preparation of AML/CFT ROSCs as part of the list of standards and codes for which ROSCs are prepared).

The Board also decided that AML/CFT assessments, whether prepared by the IMF or the World Bank (or the FATF or FSRBs), should continue to be included in all FSAP and OFC assessments. In addition, the Board emphasized that delivery of technical assistance is a key element of raising global compliance with the FATF Recommendations and welcomed the increased contribution of the IMF in its delivery of technical assistance in collaboration with other bilateral and multilateral providers of technical assistance.

What this means in operational terms is that the IMF will continue to contribute to the global developments in AML/CFT, principally by conducting country assessments and providing technical assistance, within the scope of its mandate and expertise. In this regard, the Executive Board agreed in March 2004 that assessing whether countries have the capacity to implement AML/CFT laws effectively is part of the core mandate of the IMF.

In practice, the workload for the AML/CFT assessments is shared between the FATF (and the FSRBs), the IMF, and the World Bank, and the results of the assessments (or mutual evaluations as in the case of FATF and the FSRBs) are incorporated in the ROSCs (which include results of other assessments, such as those for banking and insurance supervision) that are produced as part of the assessment process under an FSAP or OFC assessment. The ROSCs are circulated to the Executive Board of the IMF (and the Executive Boards of the World Bank and the IMF for an FSAP assessment). The emphasis for the AML/CFT assessments, as with the other assessments, is that they should be uniform, voluntary, and cooperative.

Technical Assistance

IMF/Bank technical assistance (TA) has increased substantially as the two organizations intensified their provision of assistance, focusing principally on drafting of laws and regulations, implementation of

preventive measures and training, and the establishment and operations of financial intelligence units (FIUs). Between January 2002 and December 2003, there have been 85 country-specific TA projects benefiting 63 countries, and 32 regional TA projects benefiting more than 130 countries. Since the IMF Executive Board decision in March 2004, the IMF and the World Bank have delivered about 200 new projects and trained more than 1,000 officials around the world on the various aspects of AML/CFT.

Publication and outreach have also been an important part of the IMF/Bank TA efforts. Between January 2002 and December 2003, some of the principal AML/CFT publications include *Reference Guide to Anti-Money Laundering and Combating the Financing of Terrorism*, published by the World Bank in April 2003; *Suppressing the Financing of Terrorism: A Handbook for Legislative Drafting*, published by the IMF in July 2003; and *Informal Funds Transfer Systems: An Analysis of the Informal Hawala*, published by the IMF and the World Bank in September 2003. In June 2004, the IMF published *Financial Intelligence Units: An Overview*.

Conclusion

The involvement of the IMF in AML/CFT efforts introduced paradigmatic changes to the work of the international community in this area. It is generally agreed that the IMF's efforts contributed to bringing a new dimension, dynamism, and universality to AML/CFT work. However, a number of elements of the new architecture are subject to considerable tension and warrant monitoring in the period ahead. Some of the basic assumptions on which the overall AML/CFT strategy is built are being questioned. Generally, some analysts have argued that considerable efforts are being exerted at disproportionate costs on the basis of a flawed strategy with few results, if any. An analysis of the efforts and a qualitative assessment of the strategy will have to be effected at regular intervals in the not-so-distant future and corrections introduced, if necessary.

On another level, the IMF continues to be seen by many as a reluctant participant in AML/CFT efforts. While there are no doubts about the legendary dedication of its staff, the IMF as an institution is sometimes believed to be having second thoughts about the wisdom and the appropriateness of its involvement in this area. These interro-

gations are being raised in the context of a more comprehensive soul-searching exercise by the institution as to its strategy in the medium term. While a number of analysts consider that the IMF, in order to remain relevant in the era of globalization, should resolutely embrace its role in AML/CFT issues, the IMF itself continues to be unsure as to how it should adapt in these changing times. This is also taking place in the context of calls for streamlining the IMF's activities and a zero-growth budget that appear to be at odds with the tasking of the institution with additional missions and apprehensions that these new tasks will be insufficiently funded.

There are a number of specific issues that will continue to constitute stimulating challenges in the period ahead. One such issue is the political will of states in addressing AML/CFT issues and the optimal use and coordination of technical assistance resources. Another issue that will need to be addressed derives from the architecture that was designed to conduct AML/CFT assessments. As mentioned above, AML/CFT assessments are now conducted under a unified methodology by a number of vastly different organizations and bodies. How these bodies will conduct their assessments in order for their outputs to be of similar quality is an open question. Initial analysis of a number of reports conducted under the first AML/CFT methodology has shown that these reports have not yet attained satisfactory uniformity with regard to quality and consistency. Significant efforts will have to be made in the period ahead to ensure that the approaches by the different bodies and organizations to measure states' compliance with AML/CFT standards are reasonably uniform and produce highly consistent reports of satisfactory quality.

Notes

¹ IMF, *Offshore Financial Centers—The Role of the IMF* (June 23, 2000). *See also* Financial Stability Forum, *Report of the Working Group on Offshore Centers* (2000).

² Communiqué of the G-7 Finance Ministers and Central Bank Governors, Tokyo, January 22, 2000.

³ IMF, “IMF Board Reviews Issues Surrounding Work on Offshore Financial Centers,” Public Information Notice No. 00/62 (July 26, 2000).

⁴ IMF, “IMF Executive Board Discusses Money Laundering,” Public Information Notice No. 01/41 (April 29, 2001).

⁵ IMF, “IMF Board Discusses the IMF’s Intensified Involvement in Anti-Money Laundering and Combating the Financing of Terrorism,” Public Information Notice No. 01/120 (November 16, 2001).

⁶ See IMF and World Bank, “Twelve-Month Pilot Program of Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) Assessments—Joint Report on the Methodology for Assessing Compliance with the FATF 40 Recommendations and the FATF 8 Special Recommendations Supplementary Information” (March 2004), <http://www.imf.org/external/np/aml/eng/2004/031604.pdf>, which includes as an Annex, “Methodology for Assessing Compliance with AML/CFT Standards,” [hereinafter “the methodology”].

⁷ IMF, “IMF Advances Efforts to Combat Money Laundering and Terrorist Finance,” Public Information Notice No. 02/87 (August 8, 2002).

⁸ On the development of the methodology, see Nadim Kyriakos-Saad, “The Methodology for Assessing Compliance with Anti-Money Laundering and Combating the Financing of Terrorism Standards,” in IMF, *Current Developments in Monetary and Financial Law*, Vol. 3 (Washington: IMF, 2005), at 265.

⁹ The FSAP is a program developed pursuant to the Asian financial crisis of the late 1990s to identify strengths, risks, and vulnerabilities of member countries’ financial systems and assess observance of financial sector standards, codes, and good practices.

¹⁰ IMF, “IMF and World Bank Enhance Efforts at Combating Money Laundering and Terrorist Financing,” Press Release No. 04/70 (April 2, 2004).