Chapter 8

Assessing Financial System Integrity—Anti-Money Laundering and Combating the Financing of Terrorism

Both the World Bank and IMF have long been involved in international efforts to strengthen financial sector supervision and to promote good governance, which, among other things, both contribute to reducing financial crime and enhance the integrity of the international financial system. Since 2001, the Bank-Fund involvement in those issues has been intensified, with a sharper focus on both anti-money-laundering (AML) measures and efforts aimed at combating the financing of terrorism (CFT). Both the Bank and the Fund have worked closely with the Financial Action Task Force on Money Laundering (FATF), the standard setting body in this area, to develop a methodology for assessing the observance of international standards on the legal, institutional, and operational framework for AML–CFT.[1] The Bank and the Fund conduct assessments of AML–CFT regimes as part of the FSAP assessments and, in the case of the Fund, as part of OFC assessments. Assessments are also conducted as part of the mutual evaluations for FATF members, which are done by FATF or FATF-style regional bodies (FSRB).[2]

The FATF standards draw on and complement a wide range of United Nations (UN) conventions and resolutions that promote international cooperation in preventing and containing drug trafficking, organized crime, corruption, and efforts to finance terrorism. In addition, all financial supervisory standards have core principles to enhance know-your-customer (KYC) rules, suspicious transactions reporting, and other due diligence requirements that help to support AML–CFT regimes. Box 8.1 contains an overview of key UN conventions and resolutions that complement FATF standards, and box 8.2 highlights key aspects of financial sector supervisory standards that support an effective AML–CFT regime.

Money laundering is "transferring illegally obtained money or investments through an outside party to conceal the true source."[3] The number and variety of transactions used

Box 8.1 United Nations Conventions and Security Council Resolutions in Support of AML-CFT Regimes

The 2004 Methodology (FATF 2004a) identifies three United Nations (UN) conventions and several UN Security Council Resolutions that are incorporated into the requirements of the FATF standards on AML–CFT regimes. UN conventions have the effect of law in a country once that country has signed, ratified, and implemented the convention, depending on the country's constitution and legal structure. Under certain circumstances, the Security Council of the United Nations has the authority to bind all member countries, regardless of other action or inaction on the part of an individual country. This box summarizes the relevant provisions of these United Nations instruments.

- *United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (1988; the Vienna Convention)*—The Vienna Convention, as it is commonly known, deals primarily with the illicit drug trade and related law enforcement issues. It is the first UN convention to define the concept of "money laundering," even though it does not use that term, and it calls on countries to criminalize the activity. This convention is limited, however, to drug-trafficking offenses and does not address the preventative aspects of the crime.
- *The International Convention against Transnational Organized Crime (2000; the Palermo Convention)*—This convention contains a broad range of provisions to fight organized crime. With respect to money laundering, it requires countries to
  - Criminalize money laundering and include all serious crimes as predicate offenses of money laundering (not just drug-related offenses), plus permit the required criminal knowledge or intent to be inferred from objective facts, not proven individually.
  - Establish regulatory regimes to deter and detect all form of money laundering.
  - Authorize domestic and international cooperation and exchanges of information among administrative, regulatory, law enforcement, and other types of authorities.
  - Promote the establishment of governmental units to centrally collect, analyze, and disseminate information.
- *International Convention for the Suppression of the Financing of Terrorism (1999)*—This convention requires countries to criminalize terrorism, terrorist organizations, and terrorist acts. Under this convention, it is unlawful for any person to provide or collect funds with the intent or knowledge that the funds will be used to carry out any defined acts of terrorism.
- *Security Council Resolution 1373*—This resolution obligates all countries to criminalize actions to finance terrorism. This resolution also obligates countries to deny all forms of support to terrorist groups and to freeze assets of those involved in terrorist acts. It also encourages cooperation among countries for criminal investigations and for sharing information about planned terrorist acts.
- *Security Council Resolution 1267 and Its Successors*—Security Council Resolution 1267 required all countries to freeze the assets of the Taliban and entities owned or controlled by them, as determined by the "Sanctions Committee." Later, Resolution 1333 added the assets of Osama bin Laden and al-Qaeda to the freezing list. Subsequent resolutions established monitoring arrangements (Resolution 1363), merged earlier lists (Resolution 1390), provided some exclusions (Resolution 1452), and improved implementation measures (Resolution 1455). Together, the various lists for freezing assets are maintained and updated by the "1267 Committee" and are published on the UN's Web site.

The UN documents noted above are available at the Web homepages of the United Nations and the United Nations Office of Drugs and Crime: UN conventions are accessible at http://www.undoc.org/undoc/index.html; and the security council resolutions at http://www.un.org/documents/scres.htm.

to launder money has become increasingly complex, often involving numerous financial institutions from many jurisdictions, and increasingly using nonbank financial institutions (e.g., bureaux de change, wire remittance services, cash couriers, insurers, brokers, traders), as well as nonfinancial businesses and professions (e.g., lawyers, accountants, and trust and company service providers). Money-laundering methods are diverse and

Box 8.2 Core Principles and Guidelines of Financial Sector Supervision in Support of AML–CFT Regimes

The Basel Committee on Banking Supervision (Basel Committee), International Association of Insurance Supervisors (IAIS), and International Organization of Securities Commissioners (IOSCO) have each issued broad supervisory standards and guidelines on a wide range of supervisory issues, including money laundering as it relates to banking, insurance, and securities. FATF incorporates those standards and guidelines in its 40 recommendations.

The Basel Committee

The Basel Committee has issued three documents covering money-laundering issues:

- *Statement on Prevention of Criminal Use of the Banking System for the Purpose of Money Laundering*—This statement contains essentially four principles that should be used by banking institutions:
  - Proper customer identification
  - High ethical standards and compliance with laws and regulations
  - Cooperation with law enforcement authorities
  - Policies and procedures to be used to adhere to the statement
- *Core Principles for Effective Banking Supervision*—These principles set out a comprehensive blueprint for supervisory issues, which cover a wide range of topics. Core Principle 15 deals with money laundering by stipulating that bank supervisors must determine that banks have adequate policies and procedures in place, including strict know-your-customer (KYC) rules.
- *Customer Due Diligence for Banks*—This paper provides extensive guidance on appropriate standards for banks to use in identifying their customers. The paper was issued in response to a number of deficiencies noted on a global basis with regard to the KYC procedures noted above. In addition, the standards go beyond the fight against money laundering and are intended to help protect banks in terms of safety and soundness.

IAIS

This association has issued its Guidance Paper 5, "Anti-Money-Laundering Guidance Notes for Insurance Supervisors and Insurance Entities," which parallels the Basel Committee's statement on prevention. It contains four principles that should be embraced by insurance entities:

- Comply with anti-money-laundering laws.
- Have know-your-customer procedures in place.
- Cooperate with all law enforcement authorities.
- Have internal anti-money-laundering policies, procedures, and training programs for employees.

IOSCO

This organization passed its "Resolution on Money Laundering" to be implemented by securities regulators in individual countries. It consists of seven specific areas for securities regulators to consider in establishing requirements for firms under their jurisdiction:

- The extent of customer identifying information with a view toward enhancing the ability of authorities to identify and prosecute money launderers
- The adequacy of record-keeping requirements to reconstruct financial transactions
- Whether an appropriate manner is used to address the reporting of suspicious transactions
- What procedures are in place to prevent criminals from obtaining control of securities businesses and to share information with foreign counterparts
- Whether means are appropriate for monitoring compliance procedures designed to deter and detect money laundering
- The use of cash and cash equivalents in securities transactions, including documentation to reconstruct transactions
- Whether means are appropriate to share information to combat money laundering

are constantly evolving. Money launderers may also operate outside financial systems, for example, through alternative remittance systems.

Terrorist acts and terrorists who commit or assist in such acts are defined in various UN conventions and resolutions. Various UN resolutions seek actions to freeze or confiscate funds to designated terrorists. Although the origin of the funds used in support of

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terrorism may be either legal or illegal, often, the methods used to channel funds for terrorist purposes are the same as those used by money launderers.

This section explains and motivates the main elements of FATF standards for AML–CFT regimes, provides an overview of the underlying assessment methodology, and highlights the main lessons of recent assessment experience. Some special topics that frequently arise in AML–CFT assessments are highlighted in light of their importance for effective AML–CFT regimes. Some of the key elements of AML–CFT regimes are already covered as part of the assessments of financial supervision standards. AML–CFT standards go beyond financial supervision aspects and cover legal, institutional, and law enforcement aspects that go beyond the financial sector and that include certain other businesses and professions.

8.1 AML–CFT Standards—Links to Stability and Institutional Development

Money laundering can have potentially negative consequences for a country's macroeconomic performance, can impose welfare losses, and may also have negative cross-border externalities. For example, it could compromise bank soundness with potentially large fiscal liabilities, could lessen the ability to attract foreign investment, and could increase the volatility of international capital flows and exchange rates. In the era of high capital mobility, abuse of the global financial system makes national tax collection and law enforcement more difficult. Money laundering may also distort the allocation of resources and the distribution of wealth and can be costly to detect and eradicate. Economic damage can arise not only from direct financial system abuse but also from allegations that affect the reputation of a country or from one country's actions against perceived financial system abuse in another economy. Those types of allegations or actions can, through reputational effects, affect the willingness of economic agents—particularly those outside the country in question—to conduct business (e.g., inward investment, banking correspondent relationships) in that country, which can lead to adverse consequences.

Money laundering and terrorist financing may compromise the reputations of financial institutions and jurisdictions, undermine investors' trust in those institutions and jurisdictions, and, therefore, weaken the financial system. Trust underpins the existence and development of financial markets. The effective functioning of financial markets relies heavily on the expectation that high professional, legal, and ethical standards will be observed and enforced. A reputation for integrity—soundness, honesty, adherence to standards and codes—is one of the most valued assets by investors, financial institutions, and jurisdictions.

8.2 AML–CFT Standards—Scope and Coverage

In 1990, the FATF issued a report containing a set of 40 recommendations, which provided a comprehensive plan of action needed to fight against money laundering. Since then, the recommendations have been revised twice, most recently in October 2004 (FATF

2004b) and have been recognized widely as an international standard in this area. The recommendations cover (a) all the measures that national AML regimes should have in place within their legal, criminal justice, and regulatory systems; (b) the preventive measures to be taken by financial institutions and certain other businesses and professions; and (c) international cooperation. The FATF recommendations now apply not only to money laundering but also to terrorist financing. The eight "Special Recommendations on Terrorist Financing" (FATF 2004c), which were adopted in 2001 and most recently updated in October 2004, address ratification and implementation of UN resolutions, criminalization of the financing of terrorism, efforts to freeze and confiscate terrorist assets, reports of suspicious transactions, international cooperation, alternative remittances, wire transfers, nonprofit organizations, and cash couriers. Taken together, the 40 recommendations and the 9 special recommendations provide a comprehensive framework of measures for combating money laundering and terrorist financing.

An effective AML–CFT system requires an adequate legal and institutional framework and law enforcement mechanisms, as outlined in the FATF recommendations. The AML–CFT system should include (a) laws that create money laundering and terrorist financing offenses and that provide for freezing, seizing, and confiscating the proceeds of crime and terrorist funding; (b) laws, regulations, or, in certain circumstances, other enforceable means that impose the required obligations on financial institutions and on designated nonfinancial businesses and professions; (c) an appropriate institutional or administrative framework and effective laws that provide competent authorities with the necessary duties, powers, and sanctions; and (d) laws and other measures that give a country the ability to provide the widest range of international cooperation. It is also essential that the competent authorities ensure that the whole system is effectively implemented. Specific FATF recommendations spelling out the above framework in greater detail are listed in Annex 8.A.

8.3 Preconditions for Effective Implementation of AML–CFT Standards

An effective AML–CFT system also requires that certain structural elements and a general policy framework, not covered by the AML–CFT assessment criteria, be in place. The lack of those elements, or significant weaknesses or shortcomings in the general framework, may significantly impair the implementation of an effective AML–CFT framework. The structural elements include in particular

- Sound and sustainable financial sector policies and a well-developed public sector infrastructure
- The respect for principles such as transparency and good governance
- A proper culture of AML–CFT compliance that is shared and reinforced by government, financial institutions, designated nonfinancial businesses and professions, industry trade groups, and self-regulatory organizations (SROs)
- Appropriate measures to combat corruption
- A reasonably efficient court system that ensures that judicial decisions are properly enforced

- High ethical and professional requirements for police officers, prosecutors, judges, and so forth, as well as measures and mechanisms to ensure that those requirements are observed
- A system for ensuring the ethical and professional behavior on the part of professionals such as accountants, auditors, and lawyers that may include the existence of codes of conduct and good practices, as well as methods to ensure compliance such as registration, licensing, and supervision or oversight

Many of those issues are likely to be covered as part of the assessments of preconditions for other supervisory standards, and information from the other assessments can help inform AML–CFT assessments.

8.4 Assessment Methodology and Assessment Experience

The 40 recommendations and eight special recommendations on terrorist financing have been endorsed by the Executive Boards of the IMF and the World Bank as the AML–CFT standard for which Reports on Observance of Standards and Codes (ROSCs) are prepared (see IMF and World Bank 2002). Coverage of the AML–CFT standard in Fund-Bank work has progressively widened and now encompasses the full scope of the FATF recommendations. Key dates in this evolution are outlined in the following list:

- In April 2001, the Executive Board directed that AML elements in the relevant supervisory standards for the prudentially regulated financial sector be given particular emphasis. Law enforcement aspects and the broader legal institutional framework for AML policies were excluded.
- In November 2001, the Fund developed an action plan that extended IMF work not only to include terrorist financing elements but also to include, for any jurisdiction, the overall legal and institutional arrangements for AML–CFT. The plan also extended beyond such arrangements to support financial supervision per se, but it excluded involvement in law enforcement issues.
- In July 2002, the Bank, the Fund, and the FATF agreed to an AML–CFT assessment methodology for evaluating compliance with AML–CFT standards, and this agreement was endorsed by the Fund's and the Bank's Executive Boards. The methodology delineated those legal, institutional, and supervisory elements of the AML–CFT standard for which the Fund and the Bank would take accountability, as well as those law enforcement and nonfinancial sector elements that should be left to others. A pilot program of assessments that had been based on 2002 methodology was initiated.
- In March 2004, the Fund's and the Bank's Executive Boards reviewed the pilot program and determined that Bank-Fund staff members could take accountability for the full scope of the AML–CFT standard, including effective implementation of criminal justice elements and application of the regime beyond the regulated financial sector.[4]

Box 8.3 Weaknesses in AML/CFT Regimes: Results of Pilot Program Assessments

The assessments undertaken during the pilot program using the 2002 Methodology identified numerous shortcomings in national AML–CFT regimes. This box lists specific types of shortcomings that led to ratings of "materially noncompliant" or "noncompliant" in a fairly high percentage of countries assessed. The shortcomings identified were encountered across a wide range of countries and appeared with varying frequency. Some shortcomings are concentrated in a few countries where compliance is generally weak. Others represent exceptions in regimes where compliance is otherwise strong.

The list below provides an indication of some of the types of deficiencies that needed to be corrected to achieve compliance with the earlier FATF standard; it does not cover topics such as the financial intelligence function and enhanced due diligence that were not yet included in the FATF standard at the time of the pilot program.

Main Weaknesses Identified in AML–CFT Assessments

- Poor assistance provided to other countries' investigations into financing terrorism
- Poor attention given to transactions with higher risk countries
- Poor detection and analysis of unusual large or otherwise suspicious transactions
- No criminalization of the financing of terrorism and of terrorist organizations
- Inadequate systems to report suspicious transactions linked to terrorism
- Inadequate AML programs in supervised banks, financial institutions, or intermediaries and inadequate authority to cooperate with judicial and law enforcement
- Inadequate guidelines for detecting suspicious transactions
- Inadequate measures to freeze and confiscate terrorist assets
- No obligation to take reasonable measures to obtain information about customer identity
- Lack of procedures for mutual assistance (for the production of records, the search of persons, and the seizure and obtaining of evidence for money-laundering investigations and prosecution) in criminal matters
- Inadequate internal policies, procedures, controls, audit, and training programs
- No requirement to report promptly to the Financial Intelligence Units if institutions suspect that funds stem from a criminal activity
- Poor international exchange of information relating to suspicious transactions as well as to persons or corporations involved

The scope of the weaknesses listed above are further explained in the following list:

- General Legal Framework (FTAF 1–3)—In most cases, secrecy laws hindered the effective investigation and prosecution of money-laundering offenses by imposing restrictions on access to customer information or its exchange, whether domestically or internationally.
- Customer identification and record keeping (FATF 10–13)—Deficiencies include not prohibiting anonymous or fictitious accounts, unclear or vague regulations on official documents to be used for identifications, exemptions from identification requirements, and insufficient coverage of recordkeeping requirements.
- Increased diligence of financial institutions (FATF 14–19)—Deficiencies ranged from an absence of clear laws requiring the reporting of suspicious transactions to overly restrictive thresholds for determining suspicion; in some cases, procedures and channels for reporting suspicious transactions were unclear.
- Implementation and role of regulatory and other administrative authorities (FATF 26–29)—In many countries (in the pilot), supervisors and regulators cannot effectively cooperate with each other domestically because of legal impediments to share relevant information or absence of legal gateways; also, authorities have not established adequate guidelines to assist financial institutions in detecting suspicious patterns of behavior by customers, partly reflecting deficiencies in the role of financial intelligence units.
- Criminalization of the financing of terrorism and associated money-laundering(SRII)—In almost a third of the countries, the financing of terrorism was not criminalized in any manner or, even if criminalized, was not made a predicate offense for money laundering.

Source: IMF and World Bank (2004, annex II).

8.4.1 AML–CFT Assessment Methodology

Starting in 2002 and as agreed, AML–CFT assessments can be conducted using one of two approaches: either (a) Fund-Bank assessments or (b) FATF or FATF-style regional body (FSRB) mutual evaluations. Under both approaches, assessors will need to use the revised common methodology endorsed by the Fund-Bank Boards and by the FATF in February–March 2004.[5]

The 2004 methodology (revised slightly in February 2005) was developed to reflect (a) the revised FATF 40 recommendations that were adopted by the FATF in 2003 and revised in 2004, (b) the originally eight (now nine) special recommendations to combat terrorist financing adopted in 2001 and revised in 2004, and (c) a number of FATF interpretative notes. The following are key features of the 2004 methodology:

- Although the 2002 methodology was structured both topically and sectorally, the 2004 methodology follows the structure of the revised FATF 40 recommendations. This revision will help in the determination of whether the FATF recommendations have been fully and properly implemented and whether the AML–CFT system is effective.[6] Consistent with the FATF recommendations, all financial institutions are now assessed against the same criteria, thus eliminating the overlap and duplication in criteria in the 2002 methodology, which included specific criteria for different financial sectors.
- The criteria relating to the eight special recommendations on terrorist financing are kept separate from the AML criteria, though, where applicable, they cross-reference the relevant AML criteria.
- The 2004 methodology distinguishes between the mandatory elements (i.e., the essential criteria) and the nonmandatory elements (i.e., the additional elements). The latter are formulated as questions and are based on best practice or guidance issued by the FATF or other international standard setters. The additional elements are not to be taken into account when determining a compliance rating for a recommendation but may be referenced when describing the overall robustness of the system.
- The 2004 methodology further distinguishes between basic requirements that need to be implemented through laws and regulations and through more detailed requirements that may alternatively be implemented through other enforceable means, such as enforceable guidelines issued by competent authorities.
- There is a four-level compliance rating: compliant, largely compliant, partially compliant, and noncompliant. The overall structure and rating system are comparable to assessment methodologies for other standards and codes.
- The 2004 methodology contains more than 200 essential criteria, 20 subcriteria, and 35 additional criteria. In addition, the methodology contains examples and note boxes to help provide guidance to the assessors in their work.
- The 2004 methodology contains a fairly detailed and comprehensive set of assessment criteria, particularly with respect to criminal justice and regulatory systems, preventive measures for financial sector, powers of competent authorities, and international cooperation. The following selected examples illustrate the level of detail in the methodology. The methodology contains, for example, detailed criteria concerning the conduct of customer due diligence (CDD) with respect to the circumstances under which CDD is to be conducted, timing of verification,

measures to be taken with respect to existing customers, conditions under which simplified CDD may be allowed, conditions under which a financial institution can rely on third parties and introduced business, and additional CDD measures in certain circumstances such as correspondent banking. The methodology specifies preventive measures that should apply to a designated set of nonfinancial businesses and professions where they prepare for, or carry out, certain types of transactions.[7] Countries are also required to review the effectiveness of their AML–CFT systems on a regular basis and to maintain comprehensive statistics for this purpose.

8.4.2 Assessment Experience

To date, experience in conducting AML–CFT assessments has been gained using an earlier 2002 methodology during a 12-month pilot program that ended in October 2003. During the pilot program, the Fund, the Bank, the FATF, and the FSRBs collaborated to undertake AML–CFT assessments of 41 jurisdictions.[8] Some general observations from the pilot program included the following:

- Overall compliance with the FATF recommendations is uneven across jurisdictions. Many jurisdictions show a high level of compliance with the original FATF 40 recommendations. The most prevalent deficiency is weaker compliance with the eight special recommendations on terrorist financing.
- For many countries, the essential legal elements of an AML–CFT regime are in place; however, important gaps in implementation remain because of insufficient resources and training.
- Poor coordination among government agencies has weakened AML–CFT regimes. In a number of cases, effective working relationships had not been established among the financial supervisors, the financial intelligence unit, the financial investigators, the police, the public prosecutors, and the courts.
- Ineffective law enforcement was observed in several instances. Police, prosecutors, or the courts lacked the skills, training, or resources to investigate, prosecute, or adjudicate money-laundering cases. In addition, law enforcement agencies frequently focused on predicate offenses and neglected the law enforcement strategies that were available under proceeds of crime legislation.
- Weak financial supervision has affected the enforcement of know-your-customer rules, suspicious transactions reporting, and international cooperation and information exchange. In some cases, understaffed and undertrained financial supervisors lacked the skills or capacity to monitor and to enforce compliance with formal AML–CFT requirements. (See box 8.3 for a summary of the results of pilot program of assessments.)

8.5 Special Topics in AML–CFT Assessments

While AML–CFT assessments cover a wide range of issues, certain institutional arrangements play a critical role in the effectiveness of the overall AML–CFT regime and, hence, are analyzed closely in most assessments. These assessments include customer due diligence arrangements and the role of financial intelligence units.

8.5.1 Assessing Preventive Measures: The Example of Customer Due Diligence

FATF Recommendation 5 calls for financial institutions to undertake customer identification measures in a variety of circumstances: when establishing business relations, when carrying out certain occasional transactions, when there is a suspicion of money laundering or terrorist financing, and when the financial institution has doubts about previously obtained identification data.

Recommendation 5 also addresses the types of customer identification measures to be undertaken in various circumstances: using reliable, independent source documents, data, or information; identifying beneficial owners, including the owners and controllers of legal persons and arrangements; obtaining information on the purpose and intended nature of a business relationship; and monitoring transactions on an ongoing basis for consistency with the business relationship, including the source of funds. Recommendation 5 provides that the extent of customer identification measures may be adjusted on a risk-sensitive basis, depending on the type of customer, business relationship, or transaction, with enhanced due diligence required for higher risk transactions.

The corresponding criteria in the methodology state that financial institutions should be required to undertake customer identification in the various circumstances and should use the various measures called for in Recommendation 5. Assessors evaluate compliance at two levels. They confirm that financial institutions (or other covered parties) are subject to binding customer identification obligations—in the form of law, regulation, or other enforceable means—for each of the requirements identified in the methodology. In addition, they verify that supervisory arrangements are in place to monitor and enforce compliance with the formal customer identification requirements. This action requires the assessor to evaluate supervisory procedures for offsite monitoring and onsite examination of financial institutions' customer identification policies and procedures. Typically, assessors also visit with financial institutions to verify that customer identification requirements are being followed and that supervisory oversight is effective.

Assessments undertaken during the 12-month pilot program identified a variety of banks' weaknesses in compliance with FATF's recommendations with respect to customer identification. In some cases, the obligation for banks to undertake customer identification was advisory rather than mandatory. In a number of cases, customer identification obligations were vague and did not address a number of issues covered in the recommendations. In several cases, supervisors did not have an effective program for monitoring and enforcing compliance with customer identification requirements. Failure to monitor compliance frequently occurred because of inadequate supervisor resources.

8.5.2 Financial Intelligence Units

Financial Intelligence Units (FIU) constitute a key element in policies to counter financial crime and money laundering. FIU is a national agency that receives, analyzes, and disseminates to competent authorities the particular financial information and intelligence concerning suspected proceeds of crime or other disclosures required by national laws and regulation.[i] With some variation among jurisdictions, FIUs are statutorily empowered to receive a wide variety of financial information from diverse sources. These sources may include reports by financial institutions of suspicious or unusual transactions—as determined by financial institutions—of some or even all offshore wire transactions or of large cash transactions. FIUs also typically have access to information not only from other domestic governmental sources, including those administering customs, tax, pension, and criminal laws but also from foreign FIUs. A key task of FIUs is to analyze this information (along with information publicly available) to uncover leads on possible financial crime for use in investigations or inquiries conducted by domestic (and often foreign) law enforcement and financial institution regulatory agencies.

Establishment of an FIU is one of the key standards of the FATF, a prerequisite for an effective regime that reports suspicious transactions and for the detection and prevention of money laundering and terrorist financing. Intelligence gathered and disclosed to law enforcement's and financial institutions' regulatory agencies can also assist in investigations on or inquiries into potential predicate crimes, including financial crimes. Because FIUs provide a central gathering point for analyzing a broad range of domestic and foreign financial information, they may be particularly effective at uncovering patterns among large numbers of complex financial transactions that point to a possible financial crime. For example, reports of many FATF member countries conclude that a majority of the financial information received and analyzed by their FIUs does not point to possible money laundering but, rather, to fraud against the financial institutions themselves, including wire and check fraud, credit card fraud, loan fraud, and embezzlement.

FIUs have far greater access than do individual financial institutions to relevant data. For example, FIUs can track suspicious transaction reports from all financial institutions that are required to make such reports and can seek additional information from governmental and other sources with respect to those transactions. In addition, FIUs often develop special expertise to identify patterns among transactions (e.g., offshore wire transfers) that suggest possible laundering or terrorist financing. Combinations of information gleaned in those ways can sometimes uncover complex schemes. If the transactions involve multiple jurisdictions, the ability to share information internationally among FIUs also becomes more important.

Annex 8.A FATF 40+8 Recommendations for AML–CFT

Forty Recommendations

Legal Systems (in line with UN conventions)

1. Legal systems should specify a broad scope of money-laundering offenses by criminalizing money laundering related to all serious offenses and capturing, at a minimum, the designated range of offenses.

2. Legal systems should establish standards to prove the offense of money laundering and to clarify that criminal, civil, and administrative liability will apply to legal persons (corporations).
3. A country should have authority to confiscate illegal funds and to apply provisional measures, such as freezing or seizing to deal with money-laundering offenses.

Preventive Measures (to be taken by financial institutions and nonfinancial businesses)

4. Secrecy laws should not prevent implementation of the recommendations.
5. Financial institutions and nonfinancial businesses should have an obligation to carry out customer due diligence, including identifying and verifying customer identity.
6. Financial institutions and nonfinancial businesses should have special measures in place for politically exposed persons.
7. Financial institutions and nonfinancial businesses should have special measures in place for correspondent banking.
8. Financial institutions and nonfinancial businesses should have measures in place to address money-laundering threats from new technologies and from business that is not conducted face to face.
9. Financial institutions and nonfinancial businesses should rely on third parties for customer identification and for introduced business.
10. Financial institutions and nonfinancial businesses should adhere to a five-year record-keeping requirement.
11. Financial institutions and nonfinancial businesses should pay special attention to complex, unusual large transactions and to all unusual patterns of transactions.
12. Customer identification should be applied to designated nonfinancial businesses and professions (DNFBPs).
13. Financial institutions and nonfinancial businesses should have an obligation to report suspicious transactions to financial intelligence units.
14. Legal protection should be granted for persons reporting their suspicions in good faith, and prohibitions against tipping off should be established.
15. Financial institutions and nonfinancial businesses should have measures in place for internal controls, compliance, and audit.
16. Requirements for reporting and monitoring suspicious activity should be applied to DNFBPs.
17. A country should have effective, proportionate, and dissuasive sanctions for money-laundering offenses.
18. A country should not allow the establishment of shell banks.
19. Financial institutions and nonfinancial businesses should consider monitoring of cross-border cash transportation and should develop a system for reporting currency transactions above a fixed amount.
20. Financial institutions and nonfinancial businesses should consider applying FATF requirements to other businesses beyond DNFBPs.
21. Special attention should be given to higher-risk countries.

22. AML requirements should be applied to foreign branches and subsidiaries.
23. Financial institutions should be subject to adequate regulation, supervision, and monitoring.
24. DNFBPs need to be subject to regulation, supervision, and monitoring.
25. Competent authority should provide guidelines on reporting, along with feedback on effectiveness.

Institutional and Other Measures

26. A country should have established a financial intelligence unit.
27. A country should have a designated law enforcement authority for money-laundering and financing-terrorism offenses.
28. Law enforcement authority should have adequate legal powers for investigation.
29. Regulators should have adequate legal powers to monitor and ensure compliance with AML–CFT requirements.
30. Competent authorities should have adequate resources, integrity, and training for AML–CFT efforts.
31. Effective mechanisms need to be developed domestically for cooperation.
32. Institutions should maintain statistics on reporting, investigations, prosecutions, and mutual legal assistance.
33. Institutions should establish measures to deter unlawful use of corporations and timely information on beneficial ownership and control.
34. Institutions should establish measures to prevent unlawful use of legal arrangements (e.g., trusts), and ensure timely information on settlor, trustee, and beneficiaries.

International Cooperation

35. Each country should adopt Vienna, Palermo, suppression of financing of terrorism, and other international conventions.
36. Each country should rapidly provide mutual legal assistance.
37. Each country should render assistance notwithstanding the absence of dual criminality.
38. Each country should have expeditious powers to identify, freeze, seize, and confiscate property laundered from money laundering and financing terrorism.
39. Each country should recognize money laundering as an extraditable offence.
40. Each country should provide a wide range of other possible international cooperation.

Special Recommendations for Combating the Financing of Terrorism

SRI Ratify and implement relevant UN conventions and resolutions.
SRII Criminalize terrorist financing.
SRIII Implement measures to freeze and confiscate terrorist assets.

SRIV Have a suspicious transaction reporting requirement that applies to suspicion of terrorist financing.
SRV Provide cooperation on proceedings related to financing of terrorism.
SRVI Implement measures to deter improper use of money- and value-transfer services.
SRVII Call for countries to require adequate originator information in fund transfers and related messages.
SRVIII Call for countries to review adequacy of laws and regulations related to nonprofit organizations to prevent misuse for terrorism purposes.
SR IX Have measures to detect physical cross-border transportation of currency and bearer negotiable instruments.

Notes

1. The FATF is an intergovernmental body whose purpose is the development and promotion of policies to combat money laundering and terrorist financing. It was established by the G-7 Summit in 1989. See http://www1.oecd.org/fatf/.
2. These are regional anti-money-laundering, task-force-like organizations that have been created in the Caribbean, Asia, Europe, and Southern Africa. Similar regional groupings are planned for Western Africa and Latin America.
3. Definitions of money laundering have been adopted in common vocabulary (see *Oxford English Dictionary*, 1989, 702). FATF defines money laundering as the processing of criminal proceeds to disguise their illegal origin, and the International Organization of Securities Commissions (IOSCO) defines it as a wide range of activities and processes intended to obscure the source of illegally obtained money and to create the appearance that it has originated from a legitimate source.
4. See IMF and World Bank (2004).
5. See FATF (2004a). In time, the FATF-style regional bodies (FSRBs) are expected also to endorse the revised methodology.
6. The 2002 AML–CFT methodology was organized topically with the legal and institutional framework and effectiveness for criminal justice measures in one part, core preventive measures for all financial institutions in a second part, and sector-specific preventive measures for banking, insurance, and securities in a third part. The organization of the 2002 AML–CFT methodology reflected the evolving nature of its development, beginning with the focus on supervisory measures for prudentially regulated financial institutions, the addition of the legal and institutional framework and CFT, and, finally, the implementation of the criminal justice measures.
7. The designated nonfinancial business and professions are casinos; real estate agents; dealers in precious metals and stones; lawyers, notaries, and other independent legal professions; accountants; and trust and company service providers.
8. Assessments were conducted on the basis of a 2002 assessment methodology. This section is based on the Fund-Bank report titled *Twelve-Month Pilot Program of Anti-Money-Laundering and Combating the Financing of Terrorism (AML–CFT) Assessments* (IMF and World Bank 2004).

9. The definition of FIU has been developed by Egmont Group of Financial Intelligence Units, an international body of government disclosure receiving agencies set up in 1995 so it could enhance cooperation and information exchange to detect and combat money laundering. Egmont Group has issued guidance on information exchange and processing by FIUs.

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