

INTERNATIONAL MONETARY FUND AND THE WORLD BANK

Twelve-Month Pilot Program of Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) Assessments

Joint Report on the Review of the Pilot Program

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ACRONYMS

AML	Anti-Money Laundering
APG	Asia-Pacific Group on Money Laundering
CAS	Country Assistance Strategy
CDD	Customer due diligence
CFATF	Caribbean Financial Action Task Force
CFT	Combating the Financing of Terrorism
ESAAMLG	Eastern and Southern Africa Anti-Money Laundering Group
FIRST	Financial Sector Reform and Strengthening Initiative
FATF	Financial Action Task Force
FIU	Financial Intelligence Units
FSA	Financial Sector Assessment
FSAP	Financial Sector Assessment Program
FSSA	Financial System Stability Assessment
FSRB	FATF–Style Regional Bodies
GAFISUD	South American Financial Action Task Force
IAE	Independent AML Expert
IMF	International Monetary Fund
IMFC	International Monetary and Financial Committee
NBFI	Non-bank financial institution
NCCT	Non-Cooperative Countries and Territories
OFC	Offshore Financial Center
Moneyval	Council of Europe Group on Money Laundering
ROSC	Report on Standards and Codes
TA	Technical Assistance
UN	United Nations
UN-CTC	United Nations Counter Terrorism Committee
UN-ODC	United Nations Office on Drugs and Crime

EXECUTIVE SUMMARY

In July and August 2002, respectively, the IMF and World Bank Boards endorsed a 12-month pilot program of *anti-money laundering and combating the financing of terrorism* (AML/CFT) assessments using the methodology adopted by the Financial Action Task Force (FATF) and endorsed by the Fund/Bank Boards. They requested a comprehensive review at the end of the pilot program.

- Over the course of the pilot program, AML/CFT assessments have been conducted in 41 jurisdictions. The Fund conducted 20 assessments, the Bank conducted 6 assessments, and 7 assessments were conducted jointly by the Fund and the Bank. The FATF and the FATF-style regional bodies (FSRBs) conducted 8 assessments. The delivery of technical assistance by the Fund/Bank was greatly increased. Over the last two years, there have been 85 country-specific assistance projects benefiting 63 countries and 32 regional projects reaching more than 130 countries.
- Key elements of the program have worked well, including a considerable deepening of international attention to AML/CFT issues and good collaboration with the FATF and FSRBs and other international and regional organizations. Some elements of the program could be improved, including the sharing of the burden of assessments between the Fund/Bank and the FATF/FSRBs and the quality and integration of the work now carried out by IAEs into assessment reports.
- As part of its review of the pilot program, the FATF concluded that close collaboration with the Fund/Bank has led to significant progress in globalizing the fight against money laundering and terrorist financing. The FATF has proposed that the Fund/Bank expand their program by adopting a more comprehensive and integrated approach to conducting assessments.
- Decisions by both the IMF and the World Bank Boards are required on the modalities of AML/CFT work in FSAPs and OFC assessments, including in particular, on whether to:
 - Continue to collaborate with the FATF in view of the confirmation that it has no plans at present to undertake a further round of the Non-Cooperative Countries and Territories' (NCCT) exercise.
 - Endorse the revised FATF Recommendations as the new standard for which Reports on the Observance of Standards and Codes (ROSCs) are prepared and the revised methodology to assess that standard; assessments under the revised recommendations, which have been expanded, will be significantly more resource intensive than the original FATF Recommendations.
 - Maintain or modify the current Board policy, which limits Fund/Bank involvement in AML/CFT assessments. Current policy precludes Fund/Bank

staff from becoming involved in the assessment of implementation of criminal justice measures and from the assessment of implementation in sectors that are not macroeconomically relevant. These areas, which are not currently covered by the Fund/Bank, are assessed by independent AML/CFT experts (IAEs) that are neither supervised nor financed by the Fund/Bank.

- For the Fund, provide additional funding for AML/CFT assessments and related technical assistance in view of the expansion of the coverage of the methodology, and for the Bank, the budgetary implications for the Bank will be discussed in the context of the medium-term strategy framework (MTSF) and the FY05 budget paper.

In response to the FATF proposals and staffs' findings regarding the quality and integration of the work carried out by the IAEs, the paper outlines three possible options on how to take forward the Fund and Bank's work in AML/CFT assessments and technical assistance.

Option 1 would maintain current policy limitations on Fund/Bank involvement and responsibility in AML/CFT assessments and technical assistance. Options 2 and 3 would modify current policy limitations and make the Fund/Bank fully accountable for comprehensive assessments of the standard, with the key difference between the second and third options relating to financing arrangements.

- Option 1: Maintain the status quo regarding responsibilities for assessments as under the pilot program, but seek commitment for more external resources to finance the IAEs through the creation of a trust fund that would facilitate their availability for Fund/Bank missions and enhance quality control. The budgetary implications of Option 1 to the Fund/Bank would be small; its feasibility depends on the willingness and ability of FATF/FSRB members to provide and supervise IAEs for Fund/Bank-led missions.
- Option 2: The Fund/Bank would take responsibility for assessing the full standard and would employ and supervise external experts to do the work now carried out by IAEs. The costs of the external experts would be financed through an externally funded account. Integration of the work now carried out by IAEs would be greater than under Option 1. This option would also involve an increase in budgetary costs to the Fund/Bank over Option 1 to acquire the requisite new skills to supervise the experts, and the feasibility of this option is contingent on the availability of external resources.
- Option 3: The Fund/Bank would take responsibility for the assessment of the full standard and the costs would be borne by the Fund/Bank. Quality, consistency, and integration of the work now carried out by IAEs would be the same as under Option 2. However, for a pace of 20 Fund/Bank assessments per year the required budgetary costs would be significantly larger than under Option 2, and in the context of a constrained budget environment would require re-allocation of resources from other areas of Fund/Bank activity. Alternatively, if the current envelope of resources already determined for AML/CFT assessments and related technical assistance is not

increased, there could be fewer AML/CFT assessments or less AML/CFT technical assistance.

Options 2 and 3 would constitute a significant expansion in the involvement of the Fund and Bank in the AML/CFT area. If the Boards decided to proceed with either one of these options, it would be advisable to acknowledge the exceptional character of the AML/CFT work, and it may be necessary to review carefully in the near future the organizational arrangements for this work in the Bank and the Fund. Guidance from the Boards on this matter is requested.

There are a number of issues and uncertainties associated with each of the above options.

- As the new AML/CFT methodology has not yet been implemented, and extends coverage into several new areas, there is considerable uncertainty about the true cost of the different options, and the current cost estimates are likely to be on the low side. Developing more precise cost estimates of assessments will require practical experience with implementation of the new standard.
- There is uncertainty as to whether sufficient external funding and outside experts can be secured for either Option 1 or 2.
- All of the options assume the FATF/FSRBs will take on at least an equitable share of the burden of carrying out assessments.

Over the course of the next 12–24 months, there will be a clearer understanding of the resource implications of the new standard, and the feasibility of the FATF/FSRBs meeting their commitment to provide quality assessments in a timely manner. Based on this experience, the staffs would plan to prepare a report for information to the Boards of the Fund and the Bank in 12–18 months' time on the quality and consistency of the FATF/FSRB assessments, and to conduct a comprehensive review of the overall effectiveness of the Fund/Bank program after three years.

I. INTRODUCTION

1. At the Fund Board meeting on July 26, 2002 and the Bank Board meeting on August 6, 2002, Executive Directors conditionally endorsed the FATF Recommendations as the *anti-money laundering and combating the financing of terrorism (AML/CFT)* standard for the operational work of the Fund and the Bank.¹ They also endorsed a 12-month pilot program of AML/CFT assessments using two approaches to assessments: (1) assessments led by the Fund and Bank staffs; and (2) those conducted by the FATF and FSRBs. Reports on the Observance of Standards and Codes (ROSCs) are prepared under either approach. The Boards requested a comprehensive review at the end of the pilot program focusing on the various lessons learned and the consistency and quality of assessments.

2. The Fund and Bank Boards have followed an evolutionary approach to the two institutions' involvement in AML/CFT.

- In November 2001, the IMF Board agreed to intensify its contribution to the international efforts against money laundering and terrorist financing. Directors stressed that the Fund's involvement should be consistent with its mandate and core areas of expertise. Directors confirmed, in particular, that it would be inappropriate for the Fund to be involved in law enforcement issues.²
- In January 2002, the Bank Board welcomed the work on AML/CFT as part of the Bank's development mandate in the financial sector as it relates to and reinforces the Bank's complementary and parallel work on governance and legal framework issues. As noted in the Bank's Action Plan, "consistent with its core expertise, the Bank will address issues related to the adequacy of financial supervisory regimes, legal and judicial framework for fighting financial abuse and capacity building to deal with these concerns. The Bank will not be involved in law enforcement matters."³

¹ Fund/Bank endorsement considered four conditions which were subsequently met: (i) the FATF at its October 2002 Plenary finalize the current AML/CFT methodology; (ii) the FATF endorse the methodology for use in FATF/FSRB and Bank/Fund assessments; (iii) that FATF mutual evaluations be consistent with ROSC process; and (iv) that the FATF not undertake a further round of its non-cooperative countries and territories (NCCT) initiative, at least during the period of the pilot project. (BUFF/02/122, July 31, 2002; Bank R2002-0146, July 18, 2002.) The FATF 40+8 Recommendations were formally added as a standard for the Fund/Bank operational work on November 15, 2002, with the decision DEC No.12884-(02/114).

² BUFF/01/176, November 14, 2001.

³ Bank SecM2002-0006, January 7, 2002, page 8.

- In July 2002, Bank and Fund Executive Directors emphasized that four key principles should guide the Bank and Fund roles in AML/CFT assessments and accompanying ROSCs:⁴
 - Staff involvement in assessing non-prudentially-regulated financial sector activities should be confined to those that are macroeconomically relevant and pose a significant risk of money laundering/terrorist financing;
 - All assessment procedures should be transparent and compatible with the uniform, voluntary, and cooperative nature of the ROSC exercise;
 - The assessments would be conducted in accordance with the comprehensive and integrated methodology; and
 - The assessments should be followed up with appropriate technical assistance at the request of the countries assessed in order to build their institutional capacity and develop their financial sectors.
3. This paper reviews the experience with the pilot program and offers alternative modalities for taking forward the AML/CFT work. The paper is outlined as follows: Section II discusses the background and progress with the pilot program; the findings from the assessments; and progress in intensifying AML/CFT technical assistance. Section III discusses the lessons learned. Section IV discusses issues going forward, including the resource implications of the different options. Section V provides issues for discussion.

II. THE AML/CFT PILOT PROGRAM AND TECHNICAL ASSISTANCE

A. Key Elements of the Pilot Program of Assessments

4. **As endorsed by the Fund and Bank Boards, there are two approaches to assessments using the common methodology and leading to the preparation of ROSCs:**
- **Fund/Bank staff-led assessments.** Fund/Bank staff (and experts under staff supervision) assess compliance with all criteria except those relating to the implementation of criminal justice measures and to sectors that, while vulnerable to money laundering or financing of terrorism, are not macroeconomically relevant. One or more independent AML/CFT experts (IAEs) assess the remaining criteria. The substantive work of the IAE is not supervised by Fund/Bank staff, and their participation is not financed by the Fund/Bank.

⁴ *BUFF/02/122, July 31, 2002; Bank R2002-0146, July 18, 2002.*

- **FATF/FSRB assessments.** Representatives from FATF/FSRB member jurisdictions and staff from the FATF/FSRB Secretariats conduct the entire assessment according to the common methodology without Fund/Bank staff participation.

5. **Current policy for Fund/Bank-led assessments establishes a clear line between work done by the IAE and work done by Fund/Bank staff.** Consistent with Board guidance that staff would not be involved in assessing implementation of criminal laws and the activities of those parts of the non-prudentially-regulated financial sector that are not macro-relevant, the staffs have relied on IAEs to assess (i) the implementation of criminal laws; and (ii) the implementation of preventive measures for non-prudentially regulated financial sectors that are not macroeconomically relevant.

6. **In order to implement the procedures for Fund/Bank led assessments, national authorities that are members of the FATF and some FSRBs agreed to provide and finance the IAEs for the Fund/Bank-led missions, and also to provide reviewers for the work of the IAEs.** A roster of IAEs was created to include the names of experts nominated by participating countries, and IAEs were identified for individual missions either through contact with national authorities or through the secretariats of the FATF and FSRBs. A protocol was agreed with the FATF/FSRBs for the IAE's involvement in Fund/Bank led missions, for the sharing of reports with the IAE reviewers, and for the review of the IAE's work.⁵ Annex I discusses the participation of individual FSRBs in the pilot.

7. **Consistency with the ROSC process.** In addition to agreement to use the common assessment methodology, Fund/Bank and the FATF/FSRB assessors use a core set of report templates structured similarly to those used in other standards and codes assessments by the Fund/Bank. Under the ROSC process, the authorities have the right of reply, and the reports include sections to provide the authorities an opportunity to present their views.

8. **AML/CFT ROSCs prepared under both methods are subject to Fund/Bank staff review.** In the case of FATF/FSRB reports, the review involves a *pro forma case-by-case review for consistency with the ROSC format*. The *pro forma* review includes a consistency check between the detailed assessment and the ROSC, but it does not make a judgment on the substance of conclusions to the assessments.

9. **Avoidance of duplication.** Duplication is avoided through coordination of assessment schedules between the Fund/Bank and the FATF/FSRBs. At the outset, coordination of schedules was achieved primarily at the FATF/FSRB plenary meetings and

⁵ For the pilot, the USA provided IAEs for five assessments, Ireland for three, Barbados for two, Belgium for two, France for two, Netherlands for two, and Aruba, Australia, the Bahamas, Germany, Hong Kong SAR, Italy, Japan, Liechtenstein, New Zealand, Norway, Spain, South Africa, Sweden, and United Kingdom for one each. IAEs were also provided by the CFATF Secretariat (one assessment) and OAS/CICAD (two assessments).

through ad hoc working groups. In cases where the FATF/FSRB conduct an assessment using the common methodology of one of its members, and the member is also undergoing an FSAP, Fund/Bank staff agreed that they would not undertake a separate assessment and would reflect the results of the FATF/FSRB-led assessment when available in the FSAP and FSSA/FSA.⁶ Staff urged a reciprocal approach by the FATF/FSRBs to use a Fund/Bank-led assessment in lieu of a mutual evaluation, and to date, two FSRBs (APG and CFATF) have accepted this. Some other FSRBs (Moneyval, GAFISUD, and CFATF) have emphasized their preference to conduct the assessments of their own members and their willingness to adjust their mutual evaluation schedules to prepare the assessments in the context of the FSAPs.

B. Assessments Included in the Pilot Program

10. **There have been 33 Fund/Bank-led assessments during the pilot** (Table 1). As of February 13, 2004, 19 assessments have been finalized, including the preparation of ROSCs, with an additional 14 assessments in final stages of completion. In addition, the **FATF and FSRBs have completed 8 assessments** of their own members, although for many of these the ROSC summaries remain incomplete (Table 2). The FATF and FSRBs also commenced an additional 12 assessments during the pilot period; however, results were not available for the review.

11. In preparing this paper, the staff included in its review those 41 assessments where detailed reports were available (Annex II provides a detailed review of the findings, including compliance with the FATF Recommendations). Staff have observed an increased awareness among jurisdictions of the need for strong legislative and institutional frameworks together with strong implementation features in the AML/CFT area.

12. Some general observations were:

- Overall compliance with the FATF 40+8 Recommendations is uneven across jurisdictions. Many jurisdictions show a high level of compliance with the original FATF 40 Recommendations.⁷ **The most prevalent deficiency among all**

⁶ ROSCs produced by the FATF/FSRB are issued for information of the IMF Executive Board separately from the FSSA documents. Summary information from the FATF/FSRB assessments is included in the FSSA documents forwarded to the Fund Board to the extent that it is available. However, in most instances to date, the FATF/FSRB assessments have come later than the FSAP and OFC missions.

⁷ As measured by the number of Recommendations rated compliant or largely compliant, at least 70 percent of the jurisdictions have received ratings of compliant or largely compliant for the majority of the original 40 recommendations (21 out of 26). Only 26 out of the original 40 FATF Recommendations were of a nature that could be rated.

assessments is weaker compliance with the Eight Special Recommendations on terrorist financing. Updated legislation is needed to deal effectively with the specific requirements of these recommendations.

- There is generally a higher level of compliance in high and middle income countries than in low income countries. **Higher income countries** typically have well developed AML/CFT regimes but with specific gaps, especially concerning the Eight Special Recommendations on terrorist financing. **For middle income countries**, the legal frameworks for AML/CFT are in place, but further work remains to be done to fully implement the regimes.
- Results for **lower income countries** are mixed. Many have put in place the essential legal elements of an AML/CFT regime. However, there are some important gaps, and implementation remains a challenge due to insufficient resources and training. A few lower income countries, particularly those with unsophisticated financial systems, have only rudimentary AML/CFT arrangements.

13. Inadequate implementation limits the overall effectiveness of several AML/CFT regimes. Identified weaknesses include:

- **Poor coordination among government agencies.** In a number of cases, effective working relationships had not been established among financial supervisors, the FIU, financial investigators, the police, public prosecutors, and the courts.
- **Ineffective law enforcement.** 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 offences and neglected the law enforcement strategies available under proceeds of crime legislation.
- **Weak supervision.** In some cases, understaffed and under-trained financial supervisors lacked the skills or capacity to monitor and enforce compliance with formal AML/CFT requirements.
- **Inadequate systems and controls among financial firms.** In a significant number of cases financial firms did not have systems in place to ensure that customer due diligence was undertaken, to ensure that suspicious activity was identified and reported, or to ensure that adequate records were being maintained.
- **Shortcomings in international cooperation.** In a number of cases, the ability of the authorities to provide information to international counterparts was slowed or prevented by (i) strong secrecy provisions; (ii) restrictions placed on counterpart's use of information (e.g., supervisors could share the information only with other supervisors); and (iii) an inability to share information unless a criminal investigation was already underway or a formal agreement was in place.

14. **Most jurisdictions have responded positively to the assessments.** Mission recommendations have received broad acceptance; authorities have developed action plans to correct the shortcomings identified; and in many cases they have already started taking steps to remedy the deficiencies. The Fund/Bank and other agencies have intensified the delivery of technical assistance for legislative drafting and for the training of financial sector supervisors in response to the assessments. Most progress is being made in developing up-to-date legal and institutional frameworks. Making implementation effective through measures such as staffing and training of supervisory and law enforcement agencies is a longer-term process, requiring assignment of additional resources in the countries and is progressing more slowly.

Table 1. AML/CFT Assessments by the IMF and World Bank as Part of the Pilot

(as of February 27, 2004)

Context for Assessment:	Completed	Draft Reports in Final Stages of Completion
FSAP	<p>Assessed jointly by Fund and Bank Staff/Experts Bangladesh Honduras Malta Mauritius</p> <p>Assessed by Fund Staff/Experts Hong Kong SAR United Kingdom</p> <p>Assessed by Bank Staff/Experts FYR Macedonia Mozambique Romania Tanzania</p>	<p>Jordan Oman</p> <p>Austria Japan Kuwait Singapore</p> <p>Algeria Kenya</p>
OFCS	<p>Assessed by Fund Staff/Experts Anguilla British Virgin Islands Guernsey Isle of Man Jersey Liechtenstein Montserrat</p>	<p>Bahamas Belize Bermuda Cayman Islands Labuan, Malaysia Turks & Caicos</p>
Stand Alone	<p>Assessed jointly by Fund and Bank Staff/Experts Czech Republic</p> <p>Assessed by Fund Staff/Experts Israel</p>	
	Completed	Draft Reports in Final Stages of Completion
Fund/Bank	5	2
Fund only	10	10
Bank only	4	2
Total	19	14

Table 2. AML/CFT Assessments by the FATF and FSRBs as Part of the Pilot

(as of February 27, 2004)

Assessor Organization	Completed ^{1/}	Other Assessments Commenced During the Pilot ^{2/}
FATF	South Africa Russia Germany	Argentina Brazil Mexico Saudi Arabia
APG		New Zealand ^{3/}
CFATF		Dominica Grenada St Kitts & Nevis St Lucia St Vincent & Grenadines
ESAAMLG	Swaziland	
GAFISUD	Bolivia Ecuador ^{4/} Chile	
Moneyval	Azerbaijan	Armenia Serbia
Total reports	8	12

1/ For the table, FATF and FSRB assessments are complete when the detailed assessment report is finalized, not when the ROSC is final. To date, one ROSC is final and six ROSCs are near completion.

2/ Draft reports were not available for inclusion in the review of the pilot.

3/ New Zealand was jointly assessed by the APG and FATF.

4/ Detailed Assessment is in draft, and completion is planned for early March.

C. Preliminary Findings regarding the Quality and Consistency of Assessments

15. **In view of the fact that there have been only five FSRB assessments (done by ESAAMLG, GAFISUD, and Moneyval; see Table 2), a full review of the quality and consistency of these assessments will need to be deferred.** Staff had considered (SM/02/227 and R2002-0146) that, in order to conduct an adequate review of the quality and consistency of the assessments and ROSCs, the FATF and each FSRB would need to conduct

at least three mutual evaluations. Among the assessor organizations only the FATF and GAFISUD have completed the requisite three assessments, although only one ROSC summary is complete. MONEYVAL and ESAAMLG have completed one each. While CFATF has undertaken five assessments, none of the assessment reports have been received by the Fund/Bank staff. The APG has undertaken one assessment jointly with the FATF, but it remains incomplete. Until a substantive review is completed, staff proposes that arrangements under the pilot program would continue.⁸ Fund and Bank staffs would continue to work closely with some of the FSRBs, in particular through the provision of training to their assessors, to strengthen their capacity to carry out assessments.

16. **The reports that have been received to date are generally of good quality.** The use of a common methodology and templates provided a basis for the preparation of consistent and uniform assessments by the Fund/Bank and the FATF and those FSRBs that have provided reports. There was some variation in the way topics were treated from report to report but few clear outliers or patterns of inconsistencies among the different assessors. Over the course of the pilot as the templates were refined and with the development of a cadre of experienced assessors, greater uniformity and consistency was established.

17. **All assessments require a degree of subjectivity and were influenced by the skill mix of the assessment teams** (whether Fund/Bank staff, IAEs, or experts on the FATF/FSRB assessment teams). Thus, some assessments emphasized the presence or absence of adequate laws and regulations, while others emphasized effective implementation of those laws and regulations. Internal review helped to address these differences. In particular, it was important to be able to refer to knowledgeable reviewers with practical experience in implementing AML/CFT systems under different legal and regulatory systems.

D. AML/CFT Technical Assistance

18. **Fund/Bank technical assistance has increased substantially in the last two years as staff intensified assistance to countries and regional organizations to strengthen their AML/CFT regimes.** AML/CFT technical assistance provided by Fund and Bank staff has focused on drafting of laws and regulations, implementation of preventive measures in the financial system, and training of evaluators. Staff have also advised on the establishment of FIUs and the implementation of AML/CFT measures in the financial system.

19. **During the time period January 2002–December 2003, the Fund/Bank has delivered 117 TA projects including 85 direct TA to 63 countries and 32 regional projects reaching more than 130 countries** (Table 3). The upward trend in monthly TA projects is reflected in Figure 1. Assessments under the new methodology are increasingly

⁸ Under these arrangements, FATF/FSRB assessments would result in ROSCs subject to pro forma Fund/Bank reviews, and the ROSC principles that the assessments are uniform, voluntary, and cooperative continue to be observed.

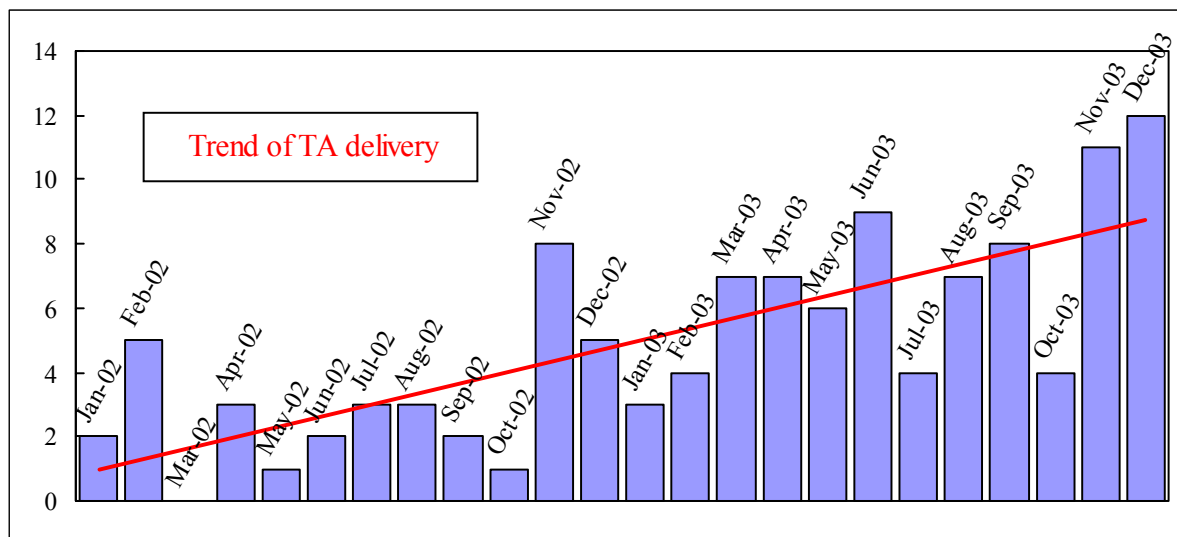
used as a diagnostic tool to identify TA needs: 19 percent of TA requests were related to Fund/Bank assessments under the FSAP and OFC programs, and a small but growing number of TA requests were linked to FSRBs mutual evaluations. As a result of the TA, many countries have been able to upgrade their legal and regulatory frameworks to better comply with international standards.

Table 3. Fund/Bank AML/CFT Technical Assistance
Number of Projects during Six-Month Periods

	Jan 02 – June 02	July 02 – Dec 02	Jan 03 – Jun 03	July 03 – Dec 03	Total Jan 02 – Dec 03
Country specific	10	18	28	29	85
Regional	3	4	8	17	32
Total	13	22	36	46	117

Source: Fund/Bank

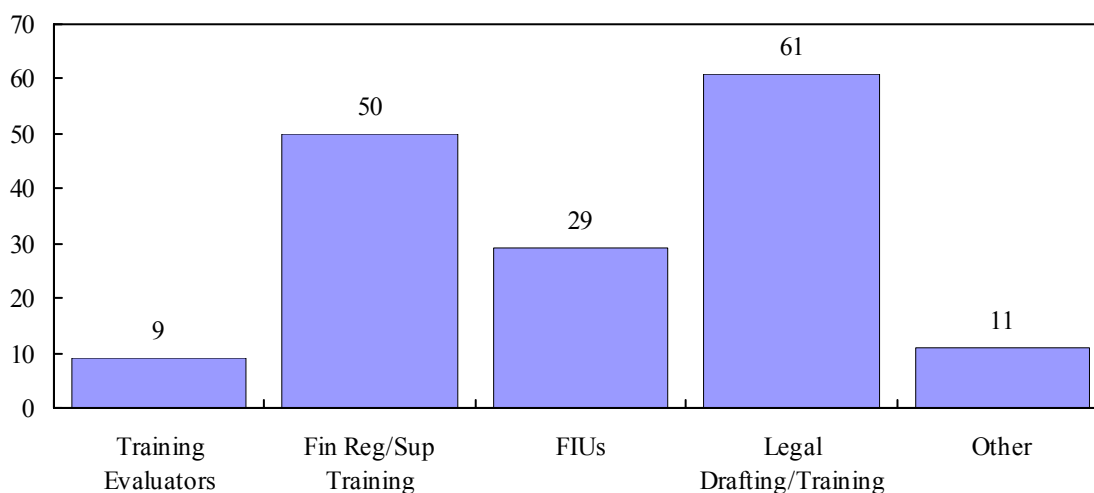
Figure 1. Monthly TA Projects, January 2002–December 2003



20. **Technical assistance projects have to date emphasized legal drafting and developing supervisory systems** (Figure 2). As the countries' preventive systems mature, TA delivery is evolving from assisting countries in the establishment of the basic legal and institutional framework to enhancing the effectiveness of implementation. Most TA projects have a combination of AML and CFT elements, reflecting the natural linkages between these two areas. Of the 85 country-specific TA projects, 52 (61 percent) required one or several on-site missions, while 33 projects (39 percent) were achieved by direct advice to countries from headquarters.

21. **TA delivery appears to be reasonably well distributed across regions.** The countries of Africa and Eastern Europe have been the main recipients of individual TA projects (23 and 24 percent, respectively) and the Asian, Pacific, Western Hemisphere, and Middle East countries accounted for 12, 17, 17, and 7 percent, respectively. The number of regional TA projects is rising. A total of 32 training and capacity building regional projects have been completed since January 2002 including 8 training workshops for FSRB evaluators in 2003,⁹ regional capacity building projects for financial sector regulators and supervisors, and training of legislative drafters. Training is expected to constitute an important element of the Fund/Bank's work.

Figure 2. Type of assistance, January 2002–December 2003



Summary

- **Legal Drafting:** assistance on adapting legal systems to international AML/CFT standards.
- **Financial Regulation and Supervisory Training:** strengthening of the AML/CFT aspects of financial regulations and supervisory practices.
- **FIU Advise** on creation and strengthening of FIUs.
- **Other:** (e.g., provision of long-term experts to a country, creation of new FSRBs).

Note: One single TA project may involve several types of assistance. Therefore, the total count of types of assistance (160) is greater than the total number of projects (117).

⁹ The training for evaluators helped facilitate 8 mutual evaluations by CFATF, GAFISUD, and ESAAMLG, and allowed these organizations to have an ambitious plan of completing approximately 24 mutual evaluations in 2004. FIRST has assisted with the funding of a few of the regional projects.

22. **Publications and outreach have been an important part of the Fund/Bank technical assistance efforts.** The Bank's interactive "Global Dialogue Series" have connected Fund/Bank staff and experts with policymakers from over 63 countries. In April 2003, the Bank produced a handbook for AML/CFT officials entitled "Reference Guide to Anti-Money Laundering and Combating the Financing of Terrorism". The report entitled "Informal Funds Transfer Systems in the APEC Region: Initial Findings and a Framework for Further Analysis" was completed in September 2003. The Fund published "Suppressing the Financing of Terrorism: A Handbook for Legislative Drafting"; and the Fund and the Bank published a study on "Informal Fund Transfer Systems: An Analysis of the Hawala System." Further work under the APEC initiative is ongoing with the Bank developing four country case studies to identify lessons on informal funds transfer systems. In addition, Fund staff has collaborated with the Global Organization of Parliamentarians against Corruption (GOPAC) to bring the message of AML/CFT to parliamentarians.

23. **The Bank and the Fund increasingly have integrated AML/CFT considerations into their operational work by incorporating AML/CFT concerns into country programs through Country Assistance Strategies (CASs) for the Bank, and through Article IV surveillance for the Fund.** For the Bank, AML/CFT concerns were reflected in 34 CASs since FY 2002. For the Fund, in addition to FSSA reports to the Executive Board, results from the AML/CFT questionnaire were incorporated in 76 Article IV discussions since January 2002. For the Bank, AML/CFT TA components totaling \$2.2 million have been included in lending programs for 4 countries—Bangladesh, Guatemala, Honduras, and Pakistan. In addition, for Serbia/Montenegro AML/CFT is an area to be covered in the adjustment loan.

24. **TA coordination with external partners continues to be a key objective of Fund/Bank efforts.** The Fund/Bank meet regularly to discuss ongoing and new TA projects and to coordinate activities. In addition, TA coordination meetings are held with other donor organizations including through informal contact with strategic partners (e.g., the UN-CTC and UN-ODC). The Bank's global TA database provides a mechanism for bringing together in one location information on TA requests and donor responses. In August 2003, the Bank also launched an external website (www.amlcft.org) which hosts information on the Bank's AML/CFT program, upcoming capacity building activities, and resource information on best practices, publications, relevant links, news, and current events.

III. LESSONS LEARNED

25. **The 12-month pilot program has provided a practical vehicle to learn lessons about the assessment methodology, the two assessment approaches, and more generally about the Fund/Bank's role in AML/CFT.** This section discusses the lessons learned from the pilot program with a focus on those elements that worked well and those elements which could be improved.

A. What has Worked Well

26. **First, the adoption of AML/CFT as one of the standards for which ROSCs are prepared, and the inclusion of assessments as part of FSAPs and OFC assessments, has significantly deepened the international attention to the standard.** This attention has been reflected, for example, in the increasing demand for technical assistance focused on AML/CFT as discussed in Section II. The assessments conducted during the pilot have proved to be a useful diagnostic tool for determining strengths and weaknesses in country AML/CFT regimes, and technical assistance needs. Most countries have initiated actions to implement the recommendations that were made as part of the assessments.

27. **Second, the pilot has demonstrated that the arrangement by which FATF/FSRBs can be relied upon to conduct assessments and prepare ROSCs that can be linked to FSAPs works reasonably well.** While a full assessment of the quality and consistency of the ROSCs has yet to be prepared, the initial finding is that there is no significant difference between the quality of Fund/Bank assessments and those of the FATF and the FSRBs that have provided reports. **The use of a common methodology, common templates, and evaluator training has helped to achieve this consistency.** Further coordination with FATF/FSRBs is, nevertheless, needed to ensure timely receipt of their reports to incorporate the findings into the FSAPs.

28. **Third, the pilot has significantly deepened collaboration between the Fund/Bank and the FATF and FSRBs.** In the area of assessments, the Fund, the Bank, the FATF, and the FSRBs began over 50 AML/CFT assessments during the pilot, and were able to avoid significant duplication in conducting assessments. While several of the assessment reports still need to be finalized, the 41 assessment that were completed over 12 months compares very favorably to other standards initiatives.¹⁰ In the area of technical assistance, the FSRBs served as an important focal point to identify technical assistance needs and to coordinate delivery. The Fund/Bank's training of evaluators has also helped to strengthen and deepen the knowledge and skills in the member countries of the FSRBs.

29. **Fourth, collaboration of the Fund/Bank with other organizations on AML/CFT has also been strengthened.** The Fund/Bank and the UN-CTC have been collaborating in identifying weaknesses and technical assistance needs in CFT. The Fund/Bank have collaborated with the UN-ODC, the Commonwealth Secretariat, regional supervisory bodies, and regional training institutes in delivering AML/CFT technical assistance. Staff has also been working with bilateral donors and the Egmont Group¹¹ to coordinate technical

¹⁰ The experience with the Basel Core Principles is that 60 assessments were conducted in the first three years: 12 assessments in 1999 and before, and 24 assessments each for years 2000 and 2001. (SM/02/310, October 04, 2002).

¹¹ The Egmont Group is an association of financial intelligence units (FIUs) established to facilitate cooperation in the exchange of financial intelligence by its members in the interest

(continued)

assistance delivery. The delivery of technical assistance has benefited from significant voluntary contributions by Japan, as well as contributions by the Netherlands and Italy, and is increasingly relying on support from the FIRST initiative.¹²

B. Areas where there is Need for Improvement

Burden sharing

30. **The Fund/Bank conducted the great majority of AML/CFT assessments during the pilot**, largely reflecting the late start of the FATF and FSRBs, whose participation did not really get going until the second half of the pilot. The Fund conducted 20 assessments alone; the Bank conducted 6 assessments alone; and 7 assessments were conducted jointly. The Fund's more intensive participation reflected the concurrent Fund Board direction to significantly intensify OFC assessments, in which the Bank was not involved. In addition, the Bank is not involved in the AML/CFT assessments of industrialized countries.

31. **Close coordination between the Fund/Bank and the FATF/FSRBs on the timing of assessments will be critical** for the purposes of preparing for the assessments, staffing the missions, minimizing the assessment burden on countries, and ensuring that the results from FATF/FSRB assessments are available for the FSAPs. The FATF and some FSRBs have indicated their willingness to adjust their mutual evaluation schedules to accommodate the Fund/Bank FSAP/OFC assessment schedules, which should produce more equitable burden sharing in the future.

Assessment methodology and templates

32. Over the course of the 12-month pilot program, assessment procedures and reporting templates were revised three months into the pilot to deal with issues that arose in the early assessments.

33. Most often assessors noted difficulties using the assessment methodology. A frequent criticism was the considerable repetition among sections, as well as the lack of clarity in the relationship between sector-specific criteria and the other prevention measures in the FATF Recommendations. These concerns were given close scrutiny and dealt with by Fund/Bank staff, which participated together with FATF and FSRBs in the revision of the comprehensive methodology completed in February 2004.

of combating money laundering and terrorist financing and to actively encourage the development of FIUs.

¹² The Financial Sector Reform and Strengthening (FIRST) Initiative is a \$53 million multi-donor trust fund that provides technical assistance grants for capacity building and policy development projects in the financial sectors of developing countries.

Supervision and integration of AML/CFT work

34. **Coordination and integration of AML/CFT work has been a challenge in view of the multidisciplinary composition of the missions.** AML/CFT assessments (and technical assistance) require teams made up of legal, financial sector, and law enforcement professionals.¹³ In the initial period of the assessments, the need arose to reach a consensus between the legal and financial sector experts on how countries could implement requirements under the methodology. Differences were eventually resolved through reference to the standard setter.

35. **The Fund/Bank AML/CFT assessments are also unique in that they used independent outside experts (IAEs) not under the supervision of staff, which has led to a mixed experience under the pilot.** In a number of cases, their work dovetailed smoothly with that of the other parts of the assessment. Problems encountered in other cases included (i) difficulties in recruiting IAEs for some assessments (especially for the assessment of low income countries); (ii) variable quality of the work produced by IAEs; and (iii) lack of integration and consistency of the IAE's work.

36. **Funding and expertise were particular issues with the IAEs.** It was often difficult to ensure the availability of IAEs for the full period of Fund/Bank-led missions, reflecting expertise and funding constraints, and difficulties in freeing up people because of operational requirements among national authorities that are carrying the cost of providing IAEs. In addition, IAEs often were identified late in the process, which did not always allow sufficient time to prepare in advance of missions. These difficulties have also resulted in not always having the most appropriately qualified IAE for the task or in the IAE conducting the assessment at a different time than the main mission. In some instances, the nonmacroeconomically relevant sectors were not assessed by IAEs, owing to the difficulty of identifying IAEs with the requisite background to assess both the law enforcement and the sector-specific measures.

37. **The depth of the review of IAE work done by independent reviewers from the FATF and FSRBs also was varied** and tended to focus only on the IAE's adherence to the AML/CFT methodology. In only a few cases did the reviewer address whether the IAE properly considered all of the information provided by national authorities. Reviewers also had limited contact with IAEs and given time constraints were not able to always ensure consistency with other parts of the assessment report, or to check for consistency with other AML/CFT assessments. In some cases, finalization of reports was delayed by difficulties in finding reviewers for the IAE's work. For three assessments of developing countries, despite broad consultation and research, reviewers could not be identified.

¹³ In the Fund and Bank's context, the staffing and supervision is provided out of four units: MFD and LEG in the Fund and the Financial Sector Vice-Presidency and Legal Department in the Bank.

38. **There is scope to introduce measures to improve the availability of qualified IAEs for Fund/Bank-led missions, to better integrate their work into the rest of the assessment and to improve quality control.** Box 1 provides specific proposals on how the collaboration with IAEs could be strengthened. However, most critical is the assignment of adequate resources to support the activities of IAEs (Section IV).

Box 1. Proposals to Strengthen Quality and Integration of IAE Work on Fund/Bank-led Missions

IAE training: As with other evaluators, IAEs should be provided with training in conducting AML/CFT assessments. Such training could be offered globally or regionally, preferably in collaboration with the FATF/FSRBs and financed with resources from voluntary contributions. The training program would be designed to allow IAEs to become acquainted with the relevant international AML/CFT standards, the AML/CFT assessment methodology, and Fund/Bank assessment policies and procedures. Fund/Bank policy in the future could require staffs to work only with IAEs who have received training prior to participating in AML/CFT assessments.

Terms of reference: IAEs should receive a standardized terms of reference prior to their mission defining their areas of responsibility regarding law enforcement issues and for non-prudentially regulated sectors that are not macro-relevant. The standardized terms of reference would be developed in collaboration with the FATF/FSRBs.

Clearer definition of IAE profile: The areas to be covered by IAEs are quite diverse and require a range of expertise covering: (1) police, prosecution and FIU work, international cooperation; (2) nonmacroeconomically relevant financial sectors that pose an ML/FT risk (e.g., informal fund transfer systems, exchange bureaus); and (3) under the revised FATF 40 Recommendations, non-prudentially regulated professions (casinos, real estate agents, dealers in precious metals and stones, lawyer, notaries, other independent legal professions and accountants). The precise expertise of the IAEs needs to be more clearly defined, the roster of experts developed accordingly, and the selection process for IAEs targeted to the specific needs in the assessments.

Better integration of IAEs into assessment teams would be achieved by ensuring that the IAE is available to participate as a full member of the Fund/Bank led team:

- Have an opportunity to comment on the mission's terms of reference and agree on the mission's division of labor;
- Visiting the jurisdiction at the same time as Fund/Bank staff and experts and attending all relevant meetings together with the other members of the team;
- Get briefing from mission head before and during assessment visits on the mission's objectives, methods, and debriefing on its preliminary conclusions before exit; and
- IAE would be involved in the report writing and review in a more coordinated and systematic manner.

Creation of a panel of outside experts to review the work of IAEs. Under the current Board policy (which would be maintained in Option 1), a panel of independent experts would review the work of IAEs and help ensure quality and integration of the IAE's work into Fund/Bank-led assessments and ROSCs. The review panel would also arbitrate substantial differences of interpretation in assessing the work of the IAE parts of the assessments.

Editing of documents by staff. The staff could take editorial responsibility for IAE portions at least in ROSCs so that language used in the text is consistent and reads well. This editing process would not involve substantial alterations of the IAE's opinions.

IV. GOING FORWARD

39. **Based on the generally successful experience with the pilot program, the staff recommends that AML/CFT work continues to be a regular part of the work of the Fund/Bank.** Nevertheless, in taking forward this work, there are a number of policy, budget, and procedural issues that need to be addressed. This section sets out the issues and possible approaches going forward.

A. Revised FATF Recommendations and AML/CFT Assessment Methodology

40. **The FATF finalized its new FATF 40 Recommendations in June 2003, and the assessment methodology covering both the revised FATF 40 Recommendations and the eight Special Recommendations on Terrorist Financing was subsequently revised and adopted by the FATF in February 2004.**¹⁴ The most significant changes were to expand the range of financial institutions and non-prudentially regulated professions and nonprofit organizations covered under the assessments.

41. **The revised AML/CFT assessment methodology was prepared by a FATF working group that included FATF members, FSRBs, and Fund and Bank staff.** An earlier draft of the methodology was circulated to the IMF's Board on December 18, 2003 (SM/03/400) and to the Bank's Board on February 4, 2004 (SecM2004-0020) for information and comments. Several members provided comments that were forwarded to the FATF Working Group. The final methodology, endorsed by the FATF Plenary in February 2004, will be circulated to Executive Directors as a supplement to this paper in advance of the Fund and the Bank Board meetings. The supplement will include an explanatory note on the evolution between the 2002 and the revised methodologies. The Fund and Bank staffs expect that the FSRBs will, in turn, endorse the new methodology for their own use. Further technical work remains in the preparation of a common set of report templates and assessment procedures.

42. **The staffs recommend that Fund and Bank Executive Directors endorse the revised standard and the assessment methodology for our operational work.** There is international acceptance that the revised FATF 40+8 is the relevant standard for the preparation of the ROSCs. Before the Bank and the Fund could begin using the revised standard in their assessments, however, the following policy, budget and logistical concerns need to be addressed.

B. Scope of Fund/Bank Involvement in AML/CFT Assessments

43. **The revision to the FATF Recommendations and methodology will increase the assessment workload, in particular with regard to the work undertaken by the IAE**

¹⁴ The eight Special Recommendations, adopted in October 2001, were not revised as part of the revision to the FATF 40 Recommendations.

under the current policy. The ability to conduct comprehensive assessments at a sustained pace will depend on the availability of greater resources to cover the assessment of (i) the implementation of criminal laws; and (ii) the implementation of preventive measures for nonmacroeconomically relevant activities.

44. **The FATF President has written to Fund and Bank Management to propose that the Fund and the Bank adopt a comprehensive and integrated approach to AML/CFT assessments** (Annexes III and IV). The FATF in its review of Fund/Bank procedures concluded that a more comprehensive assessment approach was needed, as it would be simpler, more effective, and produce reports that are integrated and consistent. The FATF proposes that the Fund/Bank adopt a more comprehensive and integrated approach to assessments going forward, noting that this approach would be consistent with the assessments of other standards conducted by the Fund and the Bank.

45. **Fund/Bank staff agree that there is a need for improvement in the quality and integration of the work of the IAEs with the objective of achieving consistent and high quality assessment reports.** As the AML/CFT work has expanded, it has become increasingly difficult to ensure the availability of qualified IAEs. To address this problem, there needs to be a more systematic approach to identifying, training, and paying for IAEs to facilitate their integration into Fund/Bank AML/CFT missions. Different approaches could help achieve this objective. In addition to the measures outlined in Box 1, it will be critical to assign adequate resources for the IAEs and their supervision.

46. **Three options could be considered to improve the availability of adequate IAE resources and the integration of their work in AML/CFT assessments** (the different options are summarized in Box 2):

- **The first option would maintain the current policy limiting Fund/Bank involvement.** It envisages the possibility that an outside body would establish an external financing mechanism and outside review panels that would enhance the overall quality of the work done by the IAEs, and to a certain extent, their integration into the Fund/Bank work product. Its feasibility depends on the continued willingness and ability of FATF/FSRB members to provide IAEs, and to finance and manage their activities. This would require additional discussion with FATF and FSRBs.
- **The second and third option would require a change to the Fund/Bank's policy to make the staffs accountable for the assessment of implementation of the criminal justice systems and AML/CFT preventive measures in the nonmacroeconomically relevant sectors.** Under these options, the Fund/Bank would employ and supervise experts and be fully accountable for the assessment of the complete AML/CFT standard and ensure the preparation of integrated and consistent reports. The Fund and Bank would need to recruit additional expertise, and there would be a cost to the Fund/Bank budgets to supervise/undertake this work.

- **The key difference between the second and third option relates to financing arrangements.** Under the second option, most of the additional resources would be financed from a Fund/Bank-administered account or other similar arrangements funded by members. Similar to Option 1, the feasibility of Option 2 depends on external financing. Option 3 envisages that the budgets of the Fund and the Bank would be used to finance all aspects of AML/CFT work. In a constrained budgetary environment, this would require reallocation of resources away from other areas of work or a reduction in the number of AML/CFT assessments or technical assistance.
- **Under options 2 and 3, a policy determination would also be needed as to whether the Fund/Bank would provide technical assistance in those areas formerly covered by the IAEs.** For other financial sector standards, the Fund/Bank stand ready to provide technical assistance to members in all areas covered by the assessments. This policy determination would have significant additional cost implications. To limit the budgetary implications for the Bank and Fund, this work could be funded through contributions to an administered account as in Option 2. However, the Bank and the Fund would need to supervise and review this assistance.
- In addition, under options 2 and 3, the Bank/Fund would deliver training to the FSRBs on the new elements of the methodology with the view that the training would help to support more equitable burden sharing of assessments in the future.

Box 2. Options for Going Forward

Option 1: *Maintain status quo regarding responsibilities for assessments as under the pilot, but commit more external resources to the IAEs (including through establishing a trust fund) to ensure their availability for Fund/Bank missions and quality control.*

- Fund/Bank staff would not require any new expertise.
- Better integration and quality control over IAE work would be achieved through measures outlined in Box 1 and by establishing an externally financed and managed trust fund to ensure availability of IAEs and to finance the creation of a permanent review panel to be accountable for quality and integration of IAE work.
- Budget consequences would be minimal to Fund/Bank.

Option 2: *Fund/Bank become accountable for the full standard, and would employ and supervise external experts to do the work of the IAEs, who would be financed through an externally funded account.*

- Fund/Bank would need additional resources/expertise for supervision of experts.
- Enhancement and integration of the expert's work would be achieved through Fund/Bank staff supervision of the work of the experts, and measures outlined in Box 1.
- Budget consequences for Fund/Bank would be modest.
- For the Fund, extends staff involvement beyond core areas of expertise.

Option 3: *Fund/Bank become accountable for the full standard, and the costs would be borne on the Fund/Bank budgets*

- Fund/Bank would need additional resources/expertise for supervision of experts and to conduct assessments.
- Enhancement and integration of the expert's work would be achieved as in Option 2.
- Budget consequences for Fund/Bank would be substantial.
- For the Fund, extends staff involvement beyond core areas of expertise.

47. **Under the second and third options, the Fund/Bank would become accountable for the assessment of a much expanded range of activities**, leading to both quantitative and qualitative changes in Fund/Bank work (Table 4). Options 2 and 3 would extend the Fund and Bank's operations into two new areas, previously the sole responsibility of the IAEs:

- **Assessing the Implementation of Criminal Laws.** Staff would become accountable for the assessment of the implementation of AML/CFT-related criminal laws (and potentially the provision of related technical assistance). This work would include, inter alia: (i) review of the adequacy of an authority's capacity to implement the legal framework by financial intelligence units and law enforcement agencies (police), including the existence of structures with adequate resources and means; (ii) assessment of the existence and—in some cases—the implication of the statistics relating to prosecution, investigations, and FIUs; (iii) assessment of the existence of arrangements to improve cooperation with foreign countries, including the existence of mutual legal assistance mechanisms. Box 3 provides a more detailed description of what the assessment of these elements implies. Annex V provides an abstract of the sections drafted by the IAE in a recent published ROSC using the October 2002 Methodology.
- **Nonmacroeconomically relevant sectors.** The Fund and the Bank would become accountable for assessing AML/CFT procedures in place in a wide range of financial sector and non financial business and professional activities that may not be macroeconomically relevant in a number of cases. The new methodology includes specific AML/CFT requirements for lawyers, casinos, real estate brokers, precious metal dealers, dealers in precious stones, accountants, charities, money remittance systems, trust and company service providers, and all entities covered under the FATF definition of financial institutions, which goes extensively beyond banks, insurance companies and security firms.

48. **Taking on these new areas would constitute a significant expansion in the involvement of the Fund and the Bank in the AML/CFT area, and it would be advisable to acknowledge the exceptional character of this extension (see Box 4) and seek ways to demarcate it from other Fund and Bank's activities.** Delineation to a particular area of work may be difficult to maintain in practice, because of the dynamic nature of ML/TF activities.¹⁵ It would also be important to contain unrealistic expectations regarding the outcome of the expanded program, by giving it specific, monitorable objectives and explicitly recognizing that these assessments, however extensive, cannot be expected to identify all weaknesses in jurisdictions' AML/CFT regimes but only to assist member countries to preserve the integrity of their financial systems.

¹⁵ The FATF 40 Recommendations have been revised twice in thirteen years. Any further change to the AML/CFT standard would require further discussion at the Boards.

Table 4. Scope of Fund/Bank AML/CFT Accountability/Assessment Work under the Three Options

Topic	Option 1 (Status Quo) Coverage and Scope	Options 2 and 3 (Full accountability, including new elements under revised FATF standard) Coverage and Scope
Legal and Institutional Arrangements	Criminalization, confiscation, FIU, law enforcement and prosecution, cooperation <i>Evaluation of laws as written</i>	(i) FIUs; (ii) the statistics for prosecution, investigations, and FIUs; (iii) capacity to implement the legal framework for FIUs and law enforcement agencies (police, judiciary); and (iv) the existence of arrangements to cooperate with foreign countries, including the existence of mutual legal assistance mechanisms and for extradition. <i>Full scope assessment, including evaluation of laws, and capacity and effectiveness of criminal justice system</i>
Preventive Measures, by sector¹		
Financial institutions	Banking, securities, and insurance (if macro relevant) <i>Full scope assessment (i.e., examination of legal framework, institutional capacity, and effectiveness of regime)</i>	Banking, securities, insurance <i>Full scope assessment</i> Credit Unions, savings banks, bureaux de change, hedge funds, other companies engaged in financial leasing, consumer credit, mortgage credit, commercial finance, credit/debit card, and transfer of money or value (including informal remittance agents) <i>Full scope assessment with exception of sectors for which AML/CFT requirements are not applied due to low risk</i>
Designated nonfinancial businesses and professions (DNFBP)	Case-by-case, if macro relevant or ML/FT vulnerable <i>Qualitative evaluation of ability of sector to control ML/FT risk</i>	Casinos (including internet casinos), lawyers, notaries, other legal professionals and accountants, real estate agents, dealers in precious metals or precious stone, trust and company service providers, company registrars <i>Full scope assessment; requirements vary from sector to sector</i>
Miscellaneous Activities		Nonprofit organizations <i>Qualitative assessments, subject to a few mandatory requirements or recommended practice</i>

¹ Preventive measures include: customer identification, monitoring of accounts and transactions, record keeping, suspicious transaction reporting, internal controls, integrity standards, enforcement powers and sanctions, and cooperation among competent authorities.

Box. 3. Assessment Criteria Relating to the Implementation of Criminal Justice Measures in the FATF Recommendations

Criteria 26.2, 26.3 and 26.5 to 26.10 cover the operational aspects of FIUs, the independence and autonomy of such units, and the protection and dissemination of information held by FIUs.

Criteria 27.2 to 27.6 assess whether special investigative techniques are permitted by law and used in the conduct of ML/FT investigations (e.g., controlled deliveries of the proceeds of crime or funds intended for use in terrorism, undercover operations, etc.), the use of financial investigators, the use of cooperative investigations with appropriate competent authorities in other countries, and the review of ML and FT methods, techniques and trends by countries' competent authorities.

Criteria 30.1 to 30.4 assess whether FIUs, law enforcement and prosecution agencies, but also financial supervisors and other competent authorities involved in combating money laundering and terrorist financing are adequately structured (including the need for operational independence), funded, staffed and provided with sufficient training and resources to fully and effectively perform their functions. Examples of the type of training that will be assessed include techniques for the tracing and seizure of property. In terms of resources, the methodology emphasizes the importance of adequate information technology.

Criteria 31.1 and 31.2 relate to the existence of mechanisms of cooperation and coordination among policy makers, the FIU, law enforcement, supervisors and other competent authorities with regard to the development and implementation of policies and activities to combat money laundering and terrorist financing.

Criteria 32.1 to 32.4 assess whether countries have mechanisms in place to review the effectiveness of AML/CFT systems, such as comprehensive statistics on suspicious transaction reports, ML and FT investigations, prosecutions, and convictions, property frozen, seized and confiscated, mutual legal assistance, and other forms of international requests for cooperation as well as other action relating to on-site examinations conducted by supervisors.

Criteria 38.3 to 38.6 assess whether countries have arrangements in place to coordinate seizure and confiscation with other jurisdictions, and to share confiscated assets or use the product of confiscations for law enforcement, health, education or other purposes.

Criterion 39.4 and 39.5 relates to the existence of procedures for allowing extradition requests relating to ML to be handled without undue delay.

Box 4. Taking on the IAE Criteria and Assessing Nonmacroeconomically Relevant Sectors: Issues for the Bank and Fund

Bank: The IAE mechanism in the pilot program responded to concerns raised by Executive Directors that Bank assessment of AML/CFT law enforcement could lead to involvement in individual cases or become tantamount to enforcing the country's laws.

The AML/CFT Methodology elements related to law enforcement focus on a technical, non-political assessment of implementation capacity of relevant institutions, enforcement statistics, and cooperation arrangements with other countries. These are all types of assessment that have parallels in other Bank work, such as legal and judicial reform, anti-corruption, insolvency and accounting reform. Moreover, the Bank's actual experience with the work of the IAEs in the pilot program has shown that there are no examinations of individual cases and no activities that involve the Bank in "street policing" in any of the law enforcement components of the methodology.

Based on the experience gained in the pilot program, it now seems unlikely that through this AML/CFT assessment work, the Bank will be called upon to take actions that interfere in domestic politics or enforce local laws. Therefore, the Executive Directors could, consistent with the Bank's Articles, approve the Bank's taking full responsibility for the elements currently covered by the IAEs. However, to maintain the appropriate distance from the enforcement of individual cases, any law enforcement-related technical assistance that may be provided by the Bank should focus on capacity building.

Fund: Assessing the implementation of a criminal law or the capacity of a given authority to implement does not contravene the prohibition against the Fund to exercise law enforcement powers. However, such an expansion would draw the Fund away from its strategic vision—a streamlined institution focused on its core areas of expertise and competencies. On this basis, in its previous discussions, the Fund's Board sought to maintain certain consistency between the Fund's involvement with AML/CFT assessments and the institution's core areas of expertise. To this end, the Board established a "bright line" that limits staff's involvement to assessing those areas that are macro-economically relevant, and decided that staff would not be involved in assessing the implementation of criminal laws. Moreover, as more effective regulation will prompt illegal financing to move to less regulated sectors and new modalities, coverage of the AML/CFT standard would need to expand with a risk of further extending expertise and competencies.

The assessment of the implementation of criminal laws related to the AML/CFT standard, as well as non macro economically relevant sectors would extend Fund work further than for other standards and codes. The standards and codes initiative has been focused on informing national authorities and helping market participants price risk and allocate investments appropriately. At present, there is no area of work where Fund staff systematically attempts to assess members' capacity to implement criminal laws. This has been the case even in areas that are much closer to the Fund's core expertise than AML/CFT (such as, for instance, tax administration). However, the Fund has been involved in a few occasions in the implementation of criminal laws in the area of corruption, although this involvement was limited to situations where effective implementation was considered an important component of a Fund-supported program. To date, the Fund has not been involved systematically in either the assessment or provision of technical assistance to non-macroeconomically relevant sectors. Furthermore, the assessment of the implementation of criminal justice measures and non-macroeconomically relevant sectors could result in the proliferation of Fund assessments of these areas in other governance standards.

The experience of the pilot has confirmed that assessments did not require staff getting involved in individual cases. The new methodology does not require the Fund to exercise law enforcement powers or get involved in actual investigations or in individual cases in the countries assessed, although it would extend Fund work into a new dimension.

49. Recognition of the exceptional character, as well as the need for demarcation of the Fund and Bank involvement in AML/CFT under either the second or third option, could be provided for through organizational changes. Organizational changes could help achieve a number of objectives:

- improve the efficiency and accountability in the delivery of AML/CFT assessments and technical assistance by better integrating the expertise and supervision on AML/CFT that is now spread across four departments (MFD and LEG in the Fund and the Financial Sector Vice-presidency and Legal Department in the Bank). The need to consider AML/CFT issues comprehensively require substantial time in coordinating the work of different units;
- increase the flexibility to recruit and develop the necessary expertise outside the existing Fund/Bank career streams; and
- more clearly delineate the resources that the Fund/Bank would commit to AML/CFT work, so as to avoid open ended commitments, while providing a framework for garnering external financing for AML/CFT, for example through the establishment of a dedicated trust fund for AML/CFT technical assistance.

50. **There would be a number of possible ways to organize AML/CFT work of the Fund and the Bank that could help to achieve the above objectives.** Different reporting mechanism, funding arrangements and human resource management practices could be considered drawing on past experience with alternative organizational structures in the Bank and the Fund. Capacity to maintain the “value added” of explicit Fund/Bank engagement would be critical. An evolutionary approach to organizational changes might be desirable as experience is gained with the implementation of the full AML/CFT standard.

51. **Should the Boards decide to proceed with either the second or third options, it may be necessary to review the organizational arrangements for AML/CFT work in the Fund and Bank,** in particular, given that at least 70 person budget years could be employed in this pursuit in the Fund and the Bank combined. Consideration could be given to creating a joint “unit” that would be focused on and be responsible for AML/CFT work.¹⁶

C. Resource Costs Estimates of the Options

52. **There is considerable uncertainty about the costs of assessments under the new FATF standard and methodology because it has not been implemented.** Table 5 provides a summary of the preliminary estimates for the additional direct costs of conducting the assessments and providing technical assistance, respectively, under the different options.

¹⁶ Present commitments for AML/CFT work include 26 person budget years in the Fund (combined MFD/LEG), and which under Option 3 would be expected to double.

These estimates do not include the associated overhead costs of facilities, recruitment of experts, information technology, and other services. Under Options 2 or 3, the latter costs would be significant; for the Fund, as a rule of thumb, they could double the cost to the institution as a whole. For the Bank, these estimates should be understood as preliminary and specific budget implications as well as possible overruns or efficiencies will be addressed in the context of the medium-term strategy framework, (MTSF) and the FY 2005 budget paper.

53. In the context of current FSAP/OFC plans, the staff anticipates that there will be a total of about 30 AML/CFT assessments annually. Of these 30, the Fund and Bank would each conduct about 10 assessments as either part of an FSAP, FSAP update, or OFC assessment and the FATF/FSRBs would undertake a further 10 assessments. For the latter, the 10 FATF/FSRB assessments would be linked to the FSAP/OFC program. In addition, the FATF/FSRBs are expected to undertake up to 10 more assessments annually as part of the regular schedule of assessments of their own members that would be outside of the FSAP/OFC program.

Table 5. Estimates of Direct Costs for Assessments and Technical Assistance under Three Options
(In millions of U.S. dollars)

	Option 1		Option 2 ¹		Option 3 ¹	
	Assess- ments	With TA	Assess- ments	With TA	Assess- ments	With TA
Fund costs ²	0.0	0.0	1.0	2.0	1.9	4.4
Bank costs ³	0.0	0.0	0.7	1.5	1.5	3.0
Total	0.0	0.0	1.7	3.5	3.4	7.4
External funding (trust fund or external account) ⁴	2.2	0.0	1.7	3.9	0.0	0.0
Total Fund/Bank costs and external funding	2.2	0.0	3.4	7.4	3.4	7.4

Source: staff estimates

1/ Direct costs assume combined 20 assessments by the Bank and Fund with 2-3 IAEs/experts per assessment. The size of assessment teams will vary depending on complexity. The estimate for the Fund reflects that on average it will have larger assessment teams because of its responsibility for AML/CFT assessments in high-income countries.

2/ See Table 6 for Fund estimates and assumptions. Estimates for options 2 and 3 do not include additional overhead costs of \$1 million for MFD and LEG; as well as other excluded overheads for facilities, IT, etc.

3/ See Table 7 for World Bank TA estimates and assumptions.

4/ See Tables 8 and 9 for assumptions regarding use of the trust fund/external account for assessments and TA.

54. **For the cost estimates, staff considered its experience under the pilot program, with the most significant adjustment for staffing related to the expanded coverage of the nonmacroeconomically relevant sectors covered under the new methodology.** During the pilot, Fund/Bank assessment missions typically included three people—one financial sector expert, one legal expert, and one IAE. With the new methodology, the mission team size is projected to increase by 1–2 team members. Depending on the individual option, there will be a significant effect on the Fund and Bank’s operating budgets.

55. Under **Option 1**, there would be only a slight increase in direct and indirect costs from assessments for the Fund and Bank. As there would be no modification to current policy, there in turn would not be a need to provide additional technical assistance in those areas outside of the current limitations. The impact on the Bank and Fund budgets under Option 1 would be readily dealt with through a reallocation of current departmental budgets.

56. Under Option 1, the IAEs would be financed from the trust fund. Staff projects a need for between two and three IAEs per mission, which is up from typically one IAE using the earlier methodology. The estimated annual cost to the trust fund to finance IAEs for the 20 Fund/Bank-led missions and the review panel is estimated at \$2.2 million.¹⁷

57. For **Options 2 and 3**, the assessment and technical assistance work would be delivered through a combination of both permanent headquarters-based staff and short-term experts. Under both options, the number of staff positions needed by the Fund and the Bank is projected to be the same (see Table 6 for Fund estimates and Table 7 for Bank estimates). Generally, the difference between the two options concerns only the funding of the experts: under Option 2 the experts would be externally funded, whereas for Option 3, the experts would be funded through the Bank and Fund's own budget.

58. Under both options, the Fund and Bank would need to recruit the new headquarters based staff that would be involved in both assessment and TA missions, and would oversee the work of the short-term experts. Under both options, new expertise would be needed from outside the Fund and Bank, as this specialized knowledge is not available within the Fund and Bank currently.

59. For the Fund to conduct assessments and deliver technical assistance (see Table 6), the Monetary Financial Systems Department (MFD) under Options 2 and 3, would need an estimated 6 new staff positions with specialized knowledge and 4 additional positions for supervision and support at a combined cost estimate of \$1.8 million. For the Fund's Legal Department (LEG), there would be a need for an estimated 4 new staff with specialized knowledge and 2 support staff at a projected cost of \$1 million. The travel costs for the two departments for the additional staff only is projected at \$0.2 million (see Table 6 for assumptions on travel cost).

60. Under Option 3, MFD would need an estimated 8 person years of short-term expert time that combined with the specialized and other staff under Option 2 would have an estimated cost of \$3.1 million. In IMF LEG, there would be a need for an estimated 4 person years of short-term expert time that combined with the specialized and support staff under Option 2 would have a projected cost of \$1.7 million. The travel cost for the two departments

¹⁷ The trust fund estimate assumes 20 assessments, 2.5 persons per assessment mission and 30 days per person (see Table 8).

for staff and experts is estimated at \$0.5 million. Total dollar costs for experts, specialized and other staff and travel costs would be projected to be \$5.4million.¹⁸

61. For the Bank, under Option 2, the additional costs are estimated at \$0.7 million for the organization, supervision, and review of the ten assessment missions and \$0.3 million for the delivery of technical assistance, and \$0.5 million for training of FSRB assessors on the new elements of the methodology. Under Option 3, the additional cost compared to Option 2 would include ten assessment missions estimated at \$0.8 million, as well as ten immediate follow up technical assistance mission estimated at \$0.7 million. The estimate of TA would include \$0.7 million for TA follow up to assessments, \$0.5 million for training to FSRB assessors, and \$0.3 million for management and supervision.

62. **Opportunity Costs.** With highly constrained Fund and Bank administrative budgets, Options 2 and 3 would entail cuts in other areas. To take the activity fully onto the Fund and Bank's budgets the following are some illustrations of the opportunity costs from Option 3.

- For MFD's budget the additional staffing and support for 10 AML/CFT assessments using the new methodology and the delivery of associated technical assistance would be equivalent to (i) all financial sector ROSCs contained in 6 FSAPs, or (ii) 16 percent of MFD's Fund-financed technical assistance budget. For IMF LEG, the cost of additional staffing and support for 10 AML/CFT assessments using the new methodology under option 3 would correspond approximately to 50 percent of LEG's current AML/CFT technical assistance budget.
- Alternatively, without additional resources or reallocation of resources, the Fund and the Bank could carry out a combined number of 10 AML/CFT assessments. There would still be a need to rebalance the mix of skills.

63. In the above illustrations, the additional resource requirements are absorbed by MFD and IMF LEG. However, given the effect on the departments of the Fund and the Bank that are in charge of AML/CFT work, there may be a need to consider whether the additional resources should be obtained from a wider redeployment of resources from other lower priority activities. For the Fund, the precise resource implications and budgetary consequences will depend on the organizational structures adopted for the work. Paragraphs 54–62, however, indicate the broad magnitude of the resource consequences. Following guidance from the Fund's Board, staff will put forward a specific proposal for the structure, staffing, and funding for the new AML/CFT work.

¹⁸ The total amount differs from Table 5 because the \$5.4 million includes \$1 million for supervision and support staff that are not directly involved in assessments or delivery of technical assistance.

64. **Timing of implementation of the new methodology would depend on the assignment of resources/expertise, implementation of organizational changes, development of supporting questionnaires and templates, and training of evaluators to conduct assessments.** The FATF does not intend to begin a new round of assessments of its own members using the new methodology starting before the second half of 2004. Realistically, the Fund/Bank are unlikely to be able to begin assessments with the new methodology before the third or fourth quarter of 2004. Nevertheless, it is very likely that there will be a strong demand for technical assistance from members to implement the new standard. Under these assumptions, at least half of the total resource requirement for the eventual steady-state could arise for the Fund in FY2005.¹⁹ Because the Bank's fiscal year starts in July, which would be nearer to the time that assessment missions would begin using the revised methodology, the entire additional resource requirement would be needed in FY2005.

65. **There are considerable uncertainties under the three options.**

- **The first concerns the availability of funding.** The success of Options 1 and 2 is subject to obtaining requisite external financing either for a trust fund or to create a Fund/Bank administered account. As set out above, absorbing the additional costs under Options 2 and 3 in a constrained budgetary environment would require a reallocation of staff positions, and reductions in technical assistance, and/or other actions.
- **The second uncertainty is the actual cost of conducting assessments under the new methodology,** which has not yet been implemented. For the Fund/Bank, the cost estimates are based on the pilot program experience.

66. While staff believes the pilot program achieved the initial objectives agreed to by the Boards at the start of the program, the nature of money laundering and terrorist financing is constantly adapting, including in response to governmental actions to control it. To avoid the Fund and Bank making an open-ended commitment, with the risk that their expertise and competencies would need to be further extended down the road with additional resource implications, staffs recommend that there be a further comprehensive review of the overall scope and effectiveness of the Fund/Bank program after three years. The staff would also report in advance of the Annual Meetings with proposals for organizational arrangements for AML/CFT, and in 12–18 months' time on the quality and consistency of the FATF/FSRB assessments.

¹⁹ For FY2005, the Fund would seek the budgetary authorization for the creation of 16 new positions to be filled during the course of the year.

D. AML/CFT Assessments in the FSAP and OFC Program

67. **It would seem appropriate to continue to link the AML/CFT assessments to the FSAP and OFC program**, which assumes that AML/CFT assessments would be included in the context of all new FSAPs and OFC assessments. These assessments could be either Fund/Bank or FATF/FSRB led, based on the agreed assessment methodology. The results of the FATF/FSRB assessments should be available to be incorporated in the FSSAs and OFC reports. In some cases, this will mean that the FATF/FSRBs will need to share preliminary results with the FSAP or OFC mission.

68. The FSAP program is evolving and it is expected that in the coming years the program will contain a larger number of FSAP re-assessment and updates. Where the FSAP updates are for countries that have not previously had AML/CFT assessments using the methodology, there would be a general expectation that FSAP updates would include AML/CFT assessments. As above, these assessments could be either Fund/Bank or FATF/FSRB led. For countries that have been assessed using the methodology, updates of the AML/CFT assessments could be appropriate about every five years. This cycle is consistent with the FATF/FSRB mutual evaluation schedules and the planned updates for OFCs assessments.

69. On an exception basis, outside the FSAP/OFC program, staff could respond to requests for **stand-alone AML/CFT assessments** from countries. The exception would be (i) those countries that have received an earlier FSAP or OFC assessment that did not include an AML/CFT assessment;²⁰ and (ii) countries that are not members of the FATF/FSRBs and are not otherwise scheduled for full FSAPs/OFC assessments in the near future.

E. The Non-Cooperative Countries and Territories (NCCT) Initiative

70. The Fund and Bank Boards conditioned their endorsement and use of the FATF Recommendations for Fund and Bank operational work on the agreement that the FATF not undertake a further round of the non-cooperative countries and territories (NCCT) exercise, at least during the period of the 12-month pilot program. The FATF has not initiated a further round of the NCCT exercise.

71. In a letter of February 11, 2004, (Annexes III and IV) the President of the FATF has confirmed that the FATF has no plans, at present, to undertake a further round of the NCCT exercise. The letter also notes that members do retain the right to take measures to protect the financial sector, notably against individual countries that do not or insufficiently apply the FATF Recommendations. This is a reference to a longstanding FATF Recommendation that requires members to take appropriate safeguard measures in those circumstances.

²⁰ The circumstances of when this would occur would be in those instances when the FSAP or OFC assessment was prior to the AML/CFT pilot program, and therefore, did not include a full AML/CFT assessment according to the agreed methodology.

V. ISSUES FOR DISCUSSION AND RECOMMENDATIONS

Recommendations for Fund and Bank Executive Directors

- Continue the existing collaboration with the FATF in view of its indication that it has no plans at present to conduct a further round of NCCT exercises;
- Continue to make AML/CFT assessments a regular part of the Fund-Bank work in the context of all FSAPs and the Fund work in the context of OFC assessments; and
- Endorse the revised FATF 40+8 special recommendations as the new standard for preparing ROSCs, and endorse the revised methodology.

Issues for Fund and Bank Executive Directors

- Which of the three options to adopt for organizing the assessment and technical assistance work going forward, including their budgetary implications.
- If the Boards were to decide upon either the second or third options, whether there should be a review of organizational arrangements for AML/CFT by the Fund and the Bank.

Table 6. Estimate of Additional Resources for Assessments and Technical Assistance to the Fund Budget

	Assessments	Technical Assistance	Division-Department Resources 1/	Total
Option 2				
Staff years:				
MFD	3	3	4	10
LEG	2	2	2	6
Total 5/	5	5	6	16
Expert years:				
MFD	0	0	N/A	0
LEG	0	0	N/A	0
Total 5/	0	0	N/A	0
Dollar costs to Fund (includes cost of staff, experts, and travel in millions)				
MFD	0.5	0.5	0.7	1.8
LEG	0.3	0.3	0.3	1.0
Travel cost 2/	0.1	0.1	0.0	0.2
Total 5/	1.0	1.0	1.0	3.1
	Assessments	Technical Assistance	Division-Department Resources \1	Total
Option 3				
Staff years:				
MFD	3	3	4	10
LEG	2	2	2	6
Total 5/	5	5	6	16
Expert years:				
MFD	3	5	N/A	8
LEG	2	2	N/A	4
Total 5/	5	7	N/A	12
Dollar costs to Fund (includes cost of staff, experts, and travel in millions)				
MFD	1.0	1.4	0.7	3.1
LEG	0.7	0.7	0.3	1.7
Travel cost 3/,4/	0.2	0.3	0.0	0.5
Total 5/	1.9	2.4	1.0	5.4

Source: staff estimates

1/ Staff to provide divisional and departmental support (assistants, RAs, Supervisor, resource management staff).

2/ Travel expense calculated as under option 3, adjusted to number of positions.

3/ Travel expense for assessments is 10 missions, 2.5 additional persons per mission, \$8000 per person.

4/ Travel expense for TA missions (16 missions 2.5 persons per mission, \$8000 per person) and outreach/training visits (\$24,000).

5/ Totals may not add due to rounding.

Table 7. Estimate of Additional Resources for Assessments and Technical Assistance to the Bank Budget

(In millions of U.S. dollars)

		Option 2	Option 3 ¹
Assessments ²	Supervision	0.7	0.7 ²
	Missions	-	0.8
TA	Management/Supervision	0.3	0.3
	Training	0.5	0.5
	Rapid TA Missions		0.7
Total Assessments and TA		1.5	3.0

¹ The assessment costs reflect the cost of 10 assessments (\$0.8 million) as well as internal capacity to develop expertise on these new areas (\$0.7 million), and the TA costs reflect immediate TA follow up to assessments (\$0.7 million), training to FSRB assessors on the new elements of the assistance (\$0.3 million). There is no allowance for capacity building.

² The estimated additional cost for assessment missions is based on the assumption that 2 additional experts would be required in each of the 10 AML/CFT assessments scheduled for FY2005, at an average cost of \$40,000 per assessor per mission.

Table 8. Required Additional Resources for Assessments
under Revised Methodology

Resources for Assessments	Actual FY 2004	Option 1	Option 2	Option 3
Fund: (person years)				
MFD	6	0	3	6
LEG	5	0	2	4
Total resources for assessments (person years)	11	0	5	10
Dollar costs to Fund		0.0	1.0	1.9
Dollar costs to the Bank		0.0	0.7	1.5
Estimated Combined Fund/Bank Dollar Costs		0.0	1.7	3.4
Trust Fund/External Funding Resources for Assessments 1/				
<i>(Dollar Cost in millions of US\$)</i>		Option 1	Option 2	Option 3
Administrative Costs		0.3	0.0	0.0
Review Panel:				
Salary		0.4	0.2	0.0
Travel plus per diem		0.1	0.1	0.0
Assessments:				
Salary		1.0	1.0	0.0
Travel plus per diem		0.4	0.4	0.0
Total Trust Fund/External Funding		2.2	1.7	0.0

Source: staff estimates

1/ To support 20 assessments by Fund/Bank (assumes 2.5 people per mission, and 30 days per mission to cover elements assessed by IAEs).

Table 9. Required Additional Resources for Technical Assistance
under Revised Methodology

Resources for Technical Assistance	Actual FY 2004	Option 1	Option 2	Option 3
Fund: (person years)				
MFD	9	0	3	8
LEG	6	0	2	4
Total resources for TA (person years)	15	0	5	12
Dollar Cost to the Fund		0.0	1.0	2.4
Dollar costs to the Bank		0.0	0.8	1.5
Total Dollar Costs for Fund and Bank		0.0	1.8	3.9
Trust Fund/External Funding Resources for Technical Assistance 1/				
<i>(Dollar Cost in millions of US\$)</i>		Option 1	Option 2	Option 3
Salary		0.0	1.6	0.0
Travel plus per diem		0.0	0.6	0.0
Total		0.0	2.2	0.0

Source: staff estimates

1/ Trust Fund calculations comprised 32 direct TA missions and 4 training/outreach missions.

Recent Developments of the FSRBs

72. Below is a discussion of the specific situation vis-à-vis the endorsement and use of the common assessment methodology for mutual evaluations and participation by the FSRBs in preparing assessments and ROSCs for purposes of FSAPs and OFC assessments.

73. **Asia Pacific Group on Money Laundering (APG).**²¹ The APG endorsed the methodology for its use at their Annual Meeting in September 2003 and began to use it during the assessments of New Zealand (which was joint assessment with the FATF).²²

74. The APG carried out an assessment of the Philippines using the new methodology in November 2003, and is planning to carry out AML/CFT assessments of Pakistan as part of the FSAP as well as for Niue and Marshall Islands in the first half of 2004. As noted above, the APG has agreed to accept the results of Fund/Bank-led assessment for their own purposes. In this regard, APG accepted the results of the Fund/Bank assessment of Bangladesh, which was conducted in the context of an FSAP.

75. The Fund/Bank provided a training workshop to the APG evaluators on December 10–12, 2003 in Kuala Lumpur. Around 40 evaluators attended the workshop and learned from the use of methodology and preparation of the detailed assessment report and ROSC.

76. **Caribbean Financial Action Task Force (CFATF).**²³ At its plenary/ministerial meeting held in October 2003, the CFATF Ministers have agreed to use the methodology in assessments with the concurrence of the countries that are assessed.²⁴ As part of the pilot

²¹ Australia, Bangladesh, Cook Islands, Fiji, Hong Kong SAR, India, Indonesia, Japan, Macao SAR, Malaysia, Marshall Islands, Nepal, New Zealand, Niue, Pakistan, Republic of Korea, Palau, Philippines, Samoa, Singapore, Sri Lanka, Taiwan Province of China, Thailand, United States, and Vanuatu.

²² The APG had earlier planned its annual meetings for May 2003, but subsequently needed to postpone them to October 2003.

²³ Anguilla, Antigua and Barbuda, Aruba, Bahamas, Barbados, Belize, Bermuda, British Virgin Islands, Cayman Islands, Costa Rica, Dominica, Dominican Republic, Grenada, Guatemala, Guyana, Haiti, Honduras, Jamaica, Montserrat, Netherlands Antilles, Nicaragua, Panama, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Suriname, Trinidad and Tobago, Turks and Caicos Islands, and Venezuela.

²⁴ At its Plenary and Council of Ministers Meeting held in Antigua and Barbuda on October 23, 2003, the Ministers, inter alia, "Endorsed the principle of the use of a common and mutually agreed Methodology in the assessment of AML/CFT regimes globally" and
(continued)

program, the CFATF conducted mutual evaluations of five of its members using the methodology. The results of the five assessments will be included within the context of the Fund/Bank FSAP for the Eastern Caribbean Currency Union. The CFATF ministers have also agreed to use the results of assessments conducted by the IMF/Bank for its purposes with the agreement of the assessed jurisdictions.

77. CFATF Ministers further agreed to consider the revised FATF Recommendations for the next round of mutual evaluations starting 2005. In addition, several CFATF members have actively participated in the revision of the AML/CFT methodology through the FATF working group.

78. CFATF plans to undertake 13 mutual evaluations in 2004 using the October version of the methodology, and the Fund/Bank will organize one training workshop in March 2004 for CFATF's eight Spanish-speaking member countries. Previous TA regional projects in the Caribbean also included training for CFATF English-speaking mutual evaluators and development of post-assessment (OFC) action plans for six Eastern Caribbean Currency Union countries.

79. **Grupo de Acción Financiera de Sudamérica (GAFISUD).**²⁵ At its December 2002 plenary meeting, GAFISUD endorsed the use of the methodology. GAFISUD, in 2003, converted its mutual evaluations of Bolivia, Chile, and Ecuador using the new methodology, including the preparation of ROSCs. Subsequently, the three mutual evaluations and ROSCs were used in the context of the Fund/Bank FSAP initiative. To date, there has not been a need for the Fund/Bank to conduct AML/CFT assessments among GAFISUD members.

80. As noted above, GAFISUD also participated with the FATF in the joint mutual evaluations of Argentina and Brazil that commenced during the pilot period. In 2004, GAFISUD is planning to carry out assessments of Colombia and Paraguay in conjunction with the Fund/Bank's FSAP initiative. GAFISUD currently intends that its assessors will use the revised FATF Recommendations and the assessment methodology.

81. In September 2003, the Fund/Bank provided practical training on the use of the methodology to 30 mutual evaluators from the 9 countries of GAFISUD, and a new training workshop will be taught in mid-2004, after which GAFISUD plans to evaluate at least two countries in 2004 and 7 countries in 2005. Also during the Pilot Program, the Fund/Bank held a multi-disciplinary workshop on coordination and cooperation strategies among AML/CFT authorities of 9 countries of the region.

"Agreed to continue to use the current Methodology—October 2002 version—for the completion of the second round of Mutual Evaluations where the countries to be evaluated so agree."

²⁵Argentina, Bolivia, Brasil, Chile, Colombia, Ecuador, Paraguay, Peru, and Uruguay.

82. **Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG).**²⁶ ESAAMLG formally endorsed the AML/CFT methodology at its ministerial council meeting in August 2003. As part of the pilot program, ESAAMLG completed a mutual evaluation for Swaziland. In addition, ESAAMLG representatives participated as observers in the FATF mutual evaluation of South Africa using the AML/CFT methodology.

83. In 2004, ESAAMLG intends to carry out mutual evaluations using the methodology for Namibia, Mozambique, Lesotho, and Malawi.

84. In January and May 2003, the Fund and the Bank provided practical training on conducting mutual evaluations using the methodology to about 30 assessors from ESAAMLG's 14 member countries. ESAAMLG has since undertaken two mutual evaluations, i.e., Swaziland and South Africa (the last one jointly with the FATF). For 2004, mutual evaluations using the methodology are scheduled for Namibia, Mozambique, Lesotho, Mauritius, and Malawi after a follow-up training workshop taught by the Fund/Bank on January.

85. **Moneyval.**²⁷ In December 2002, Moneyval endorsed the AML/CFT methodology for new members. Moneyval completed a mutual evaluation of Azerbaijan during the period of the pilot program using the assessment methodology. In addition, the results of the mutual evaluation were used for purposes of the Fund/Bank FSAP that began in the fourth quarter 2003. Mutual evaluations of Serbia and Montenegro, Bosnia and Herzegovina, and Albania are underway with additional evaluations planned for Slovenia, Cyprus, Czech Republic, and Slovak Republic in 2004. The results of the Slovenia mutual evaluation will be used for the upcoming FSAP.

86. Training initiatives in the region have included supporting the development of a Council of Europe action plan for four countries and a workshop on AML/CFT for the authorities of 25 European countries in 2003. The Fund/Bank will also assist MONEYVAL in its mutual evaluator training in April 2004.

²⁶ ESAAMLG members are: Botswana, Kenya, Lesotho, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, Tanzania, Uganda, Zambia, and Zimbabwe. Progress has been made in the formation of an FSRB for West Africa—Groupe Intergovernmental d'Action Contre le Blanchiment d'Argent en Afrique de l'Ouest (GIABA).

²⁷ Moneyval was formerly known as the Select Committee of Experts on the Evaluation of Anti-Money Laundering Measures (PC-R-EV); its members are Albania, Andorra, Armenia, Azerbaijan, Bosnia-Herzegovina, Bulgaria, Croatia, Cyprus, Czech Republic, Estonia, Georgia, Hungary, Latvia, Liechtenstein, Lithuania, Malta, Moldova, Poland, Romania, Russia, San Marino, Serbia and Montenegro, Slovakia, Slovenia, FYR Macedonia, and Ukraine.

87. **Other FSRBs:** The Fund/Bank has also provided technical support for the creation and development of new FSRBs in Africa and the Middle East. In West Africa, Fund/Bank staff have worked closely with organizers in the creation and development of the Groupe Intergouvernemental d'Action Contre le Blanchiment d'Argent en Afrique de l'Ouest (GIABA), including guidance and training provided through the GIABA Secretariat on the assessment methodology and assessments. To a lesser extent, there has been modest progress in the creation of the Groupe d'Action Contre le Blanchiment en Afrique Centrale (GABAC). In January 2004, the staffs facilitated a meeting of representatives from Middle East countries towards the formation of a new FSRB in this region. The staffs collaborated closely with the Gulf Cooperating Council, host governments, and the FATF in this effort.

Findings from the AML/CFT Assessments

Introduction

88. This annex provides an analysis of the substantive findings of the 41 AML/CFT assessments carried out under the pilot program. The first section provides a statistical analysis of the degree of compliance with each of the FATF Recommendations that were rated in the assessments, and how this performance varied between developed and developing countries. The second section details the types of shortcomings that were observed with respect to observance of the FATF Recommendations. This section also summarizes findings in the assessments with respect to AML/CFT topics in the methodology that extend beyond the formal requirements of the FATF Recommendations.

Statistical Analysis

89. The 41 AML/CFT assessments in the pilot program each included compliance ratings for 27 of the FATF 40 Recommendations and for 7 of the 8 Special Recommendations. Some recommendations were not rated because, by their nature they were not explicitly assessable, or because they had not yet fully come into force. As called for in the methodology, a four grade rating system was used: compliant (C); largely compliant (LC), materially non-compliant (MNC), and non-compliant (NC).

90. The FATF Recommendations cover a variety of topics, which, taken together, address most of the elements considered essential for a robust AML/CFT regime. Tables 10 and 11 list the topics covered by each of the rated recommendations. Some recommendations, such as number 40 dealing with ML as an extraditable offence, are quite specific so that an evaluation of compliance or non-compliance is relatively straightforward. Other recommendations, however, such as number 26 which calls for adequate AML programs in supervised banks, etc., are much broader in scope and an evaluation of compliance requires a more comprehensive and qualitative review of laws, regulations and institutional arrangements. Thus, the rankings in this section of recommendations by degree of compliance, or the rankings of countries by number of recommendations satisfied, are only rough indicators of successful AML/CFT regimes or the seriousness of shortcomings.

91. Table 10 presents a Profile of Overall Compliance with FATF Recommendations. The table shows the percentage of cases that were rated compliant, largely compliant, materially non-compliant, and non-compliant. Figures 3, 4, and 5 provide separate bar charts of this data for high income jurisdictions, medium income jurisdictions, and low income jurisdictions.²⁸ Table 12 provides a classification of the recommendations ordered to show those that most frequently were rated materially non-compliant or non-compliant.

²⁸ Higher income economies (GNI per capita of \$9,076 or more), include: Austria, The Bahamas, Bermuda, British Virgin Islands, Cayman Islands, Germany, Guernsey, Hong Kong SAR, Isle of Man, Israel, Japan, Jersey, Kuwait, Liechtenstein, Malta, Singapore,
(continued)

Table 10. Profile of Overall Compliance with FATF Recommendations

FATF Recommendations	Compliant (in percent)	Largely Compliant (in percent)	Materially Noncompliant (in percent)	Noncompliant (in percent)	Assessed Jurisdictions (number)
The Forty Recommendations					
1 – Ratification and implementation of the Vienna Convention	82	8	10	0	39
2 – Secrecy laws consistent with the 40 Recommendations	63	18	15	5	40
3 – Multilateral cooperation and mutual legal assistance in combating ML	45	30	20	5	40
4 – ML a criminal offense (Vienna Convention) based on drug ML and other serious offenses	68	23	5	5	40
5 – Knowing ML activity a criminal offense (Vienna Convention)	73	15	2	10	41
7 – Legal and administrative conditions for provisional measures, such as freezing, seizing, and confiscation (Vienna Convention)	40	45	10	5	40
8 – FATF Recommendations 10 to 29 applied to non-bank financial institutions (e.g. foreign exchange houses)	7	50	29	14	14
10 – Prohibition of anonymous accounts and implementation of customer identification policies	20	55	23	3	40
11 – Obligation to take reasonable measures to obtain information about customer identity	22	44	27	7	41
12 – Comprehensive record keeping for five years of transactions, accounts, correspondence, and customer identification documents	40	38	23	0	40
14 – Detection and analysis of unusual large or otherwise suspicious transactions	28	30	28	15	40
15 – If financial institutions suspect that funds stem from a criminal activity, they should be required to report promptly their suspicions to the FIU	39	29	22	10	41
16 – Legal protection for financial institutions, their directors and staff if they report their suspicions in good faith to the FIU	78	10	3	10	40
17 – Directors, officers and employees, should not warn customers when information relating to them is reported to the FIU	58	28	8	8	40
18 – Compliance with instructions for suspicious transactions reporting	63	13	8	18	40
19 – Internal policies, procedures, controls, audit, and training programs	33	35	30	3	40
20 – AML rules and procedures applied to branches and subsidiaries located abroad	38	22	22	19	32
21 – Special attention given to transactions with higher risk countries	37	20	20	24	41
26 – Adequate AML programs in supervised banks, financial institutions or intermediaries; authority to cooperate with judicial and law enforcement	38	23	33	8	40
28 – Guidelines for suspicious transactions' detection	37	24	32	7	41
29 – Preventing control of, or significant participation in financial institutions by criminals	45	30	18	8	40
32 – International exchange of information relating to suspicious transactions, and to persons or corporations involved	46	22	15	17	41
33 – Bilateral or multilateral agreement on information exchange when legal standards are different should not affect willingness to provide mutual assistance	51	32	11	5	37
34 – Bilateral and multilateral agreements and arrangements for widest possible range of mutual assistance	53	25	20	3	40
37 – Existence of procedures for mutual assistance in criminal matters for production of records, search of persons and premises, seizure and obtaining of evidence for ML investigations and prosecution	44	22	32	2	41
38 – Authority to take expeditious actions in response to foreign countries' requests to identify, freeze, seize and confiscate proceeds or other property	33	45	18	5	40
40 – ML an extraditable offense	61	17	7	15	41
Eight Special Recommendations on Terrorist Financing					
SR I – Take steps to ratify and implement relevant United Nations instruments	37	32	18	13	38
SR II – Criminalize the FT and terrorist organizations	43	15	10	33	40
SR III – Freeze and confiscate terrorist assets	40	25	15	20	40
SR IV – Report suspicious transactions linked to terrorism	41	18	13	28	39
SR V – Provide assistance to other countries' FT investigations	43	10	25	23	40
SR VI – Impose AML requirements on alternative remittance systems	18	18	18	45	11
SR VII – Strengthen customer identification measures for wire transfers	9	30	27	33	33
SR VIII - Ensure that entities, in particular nonprofit organizations, cannot be misused to finance terrorism	33	0	33	33	3

Sources: Assessment reports.

Turks and Caicos, and United Kingdom; medium income economies (GNI per capita of \$736 – \$9,075), include: Algeria, Anguilla, Belize, Bolivia, Chile, Czech Republic, Ecuador, Honduras, Jordan, Labuan (Malaysia), FYR Macedonia, Mauritius, Montserrat, Oman, Romania, Russia, South Africa, and Swaziland; lower income economies (GNI per capita of \$735 or less), include: Azerbaijan, Bangladesh, Kenya, Mozambique, and Tanzania.

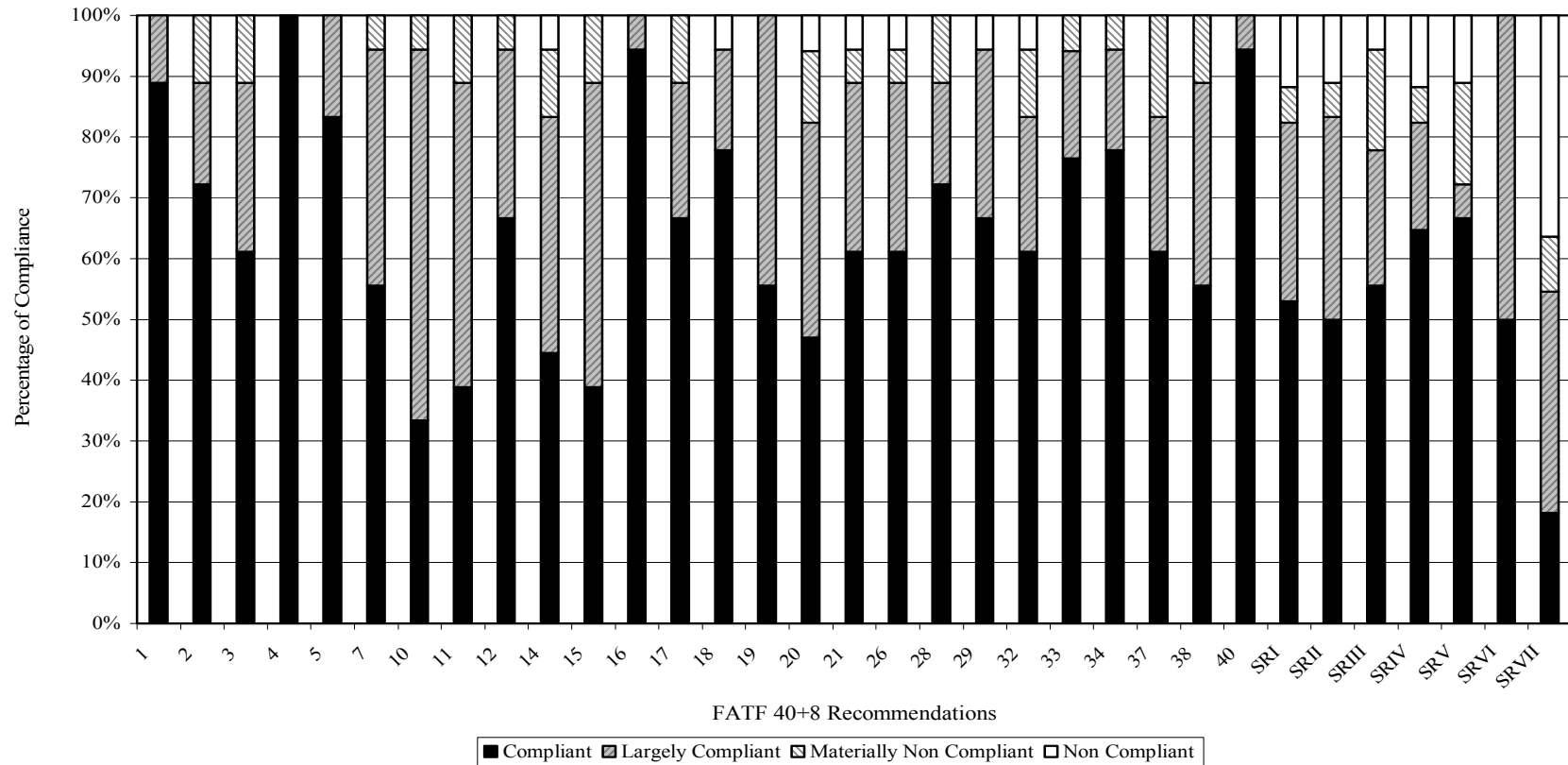
Table 11. FATF Recommendations Rated Materially Noncompliant or Noncompliant

Proportion of jurisdictions ^{1/}	Eight Special Recommendations	Proportion of jurisdictions ^{1/}	Eight Special Recommendations
20/33	SR VII – Strengthen customer identification measures for wire transfers	14/40	SR III – Freeze and confiscate terrorist assets
19/40	SR V – Provide assistance to other countries’ FT investigations	12/38	SR I – Take steps to ratify and implement relevant United Nations instruments
17/40	SR II – Criminalize the FT and terrorist organizations	7/11	SR VI – Impose AML requirements on alternative remittance systems
16/39	SR IV – Report suspicious transactions linked to terrorism	2/3	SR VIII – Ensure that entities, in particular nonprofit organizations, cannot be misused to finance terrorism
	<u>FATF Recommendation</u>		<u>FATF Recommendation</u>
18/41	21 – Special attention given to transactions with higher risk countries	9/40	12 – Comprehensive record keeping for five years of transactions, accounts, correspondence, and customer identification documents
17/40	14 – Detection and analysis of unusual large or otherwise suspicious transactions	9/40	34 – Bilateral and multilateral agreements and arrangements for widest possible range of mutual assistance
16/40	26 – Adequate AML programs in supervised banks, financial institutions or intermediaries; authority to cooperate with judicial and law enforcement	9/40	38 – Authority to take expeditious actions in response to foreign countries’ requests to identify, freeze, seize and confiscate proceeds or other property
16/41	28 – Guidelines for suspicious transactions’ detection	9/41	40 – ML an extraditable offense
14/41	11 – Obligation to take reasonable measures to obtain information about customer identity	8/40	2 – Secrecy laws consistent with the 40 Recommendations
14/41	37 – Existence of procedures for mutual assistance in criminal matters for production of records, search of persons and premises, seizure and obtaining of evidence for ML investigations and prosecution	6/40	7 – Legal and administrative conditions for provisional measures, such as freezing, seizing, and confiscation (Vienna Convention)
13/41	should be required to report promptly their suspicions to the FIU	6/14	8 – FATF Recommendations 10 to 29 applied to non-bank financial institutions; (e.g., foreign exchange houses)
13/40	19 – Internal policies, procedures, controls, audit, and training programs	6/40	17 – Directors, officers and employees, should not warn customers when information relating to them is reported to the FIU
13/32	20 – AML rules and procedures applied to branches and subsidiaries located abroad	6/37	33 – Bilateral or multilateral agreement on information exchange when legal standards are different should not affect willingness to provide mutual assistance
13/41	32 – International exchange of information relating to suspicious transactions, and to persons or corporations involved	5/41	5 – Knowing ML activity a criminal offense (Vienna Convention)
10/40	3 – Multilateral cooperation and mutual legal assistance in combating ML	5/40	16 – Legal protection for financial institutions, their directors and staff if they report their suspicions in good faith to the FIU
10/40	10 – Prohibition of anonymous accounts and implementation of customer identification policies	4/39	1 - Ratification and implementation of the Vienna Convention
10/40	18 – Compliance with instructions for suspicious transactions reporting	4/40	4 – ML a criminal offense (Vienna Convention) based on drug ML and other serious offenses.
10/40	29 – Preventing control of, or significant participation in financial institutions by criminals		

Sources: Assessment reports.

^{1/} Ratings were not recorded for all recommendations in some assessments. Proportion represents the number of jurisdictions adversely rated out of total jurisdictions assessed for each recommendation.

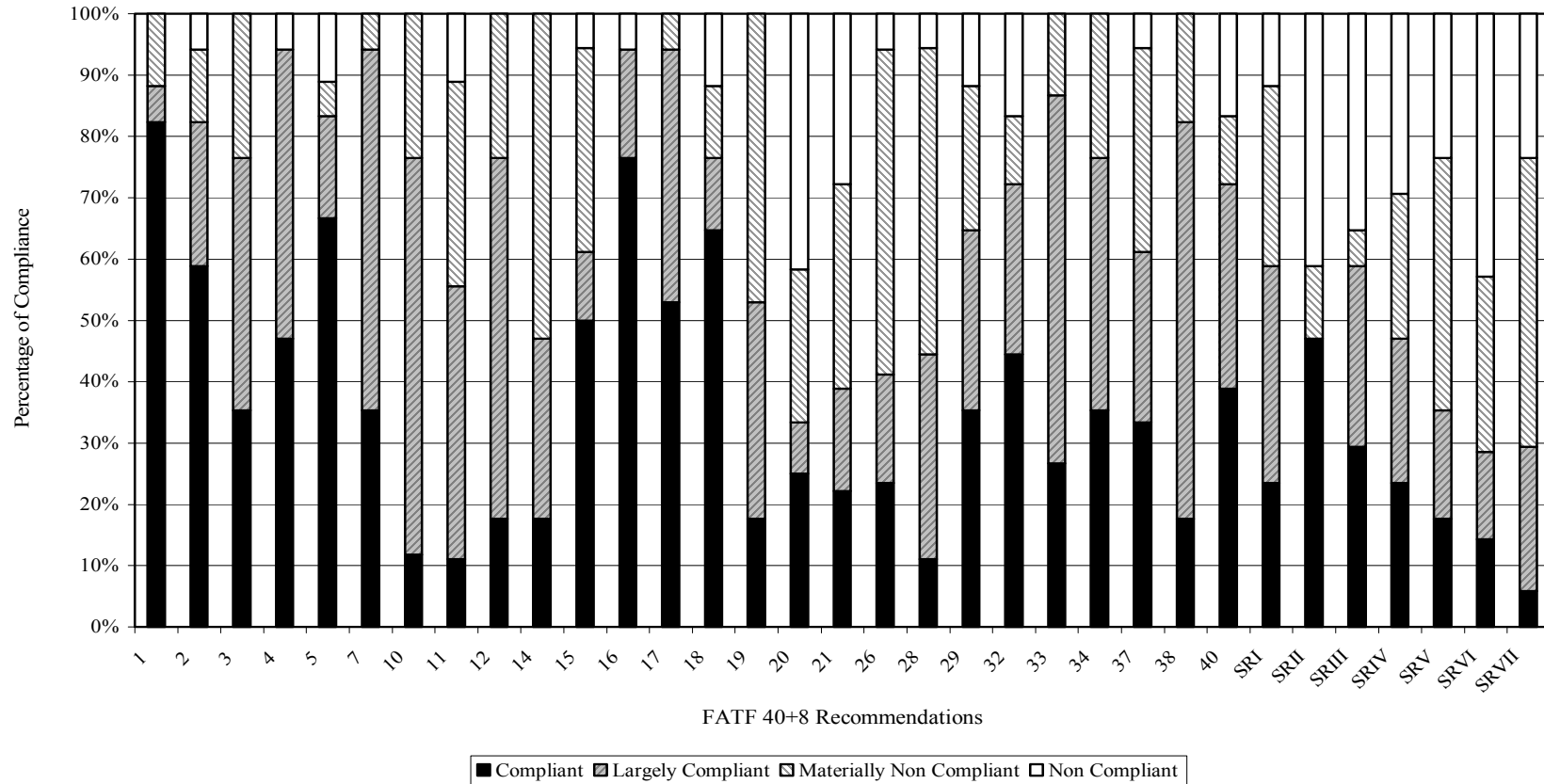
Figure 3. Compliance with AML/CFT: Higher Income Economies ^{1/}



Source: Assessment reports, staff calculations.

^{1/} Higher income economies, which have a GNI per capita (World Bank Atlas method) of \$9,076 or more, include Austria, Bahamas, The, Bermuda, British Virgin Islands, Cayman Islands, Germany, Guernsey, Hong Kong SAR, Isle of Man, Israel, Japan, Jersey, Kuwait, Liechtenstein, Malta, Singapore, Turks and Caicos, and United Kingdom.

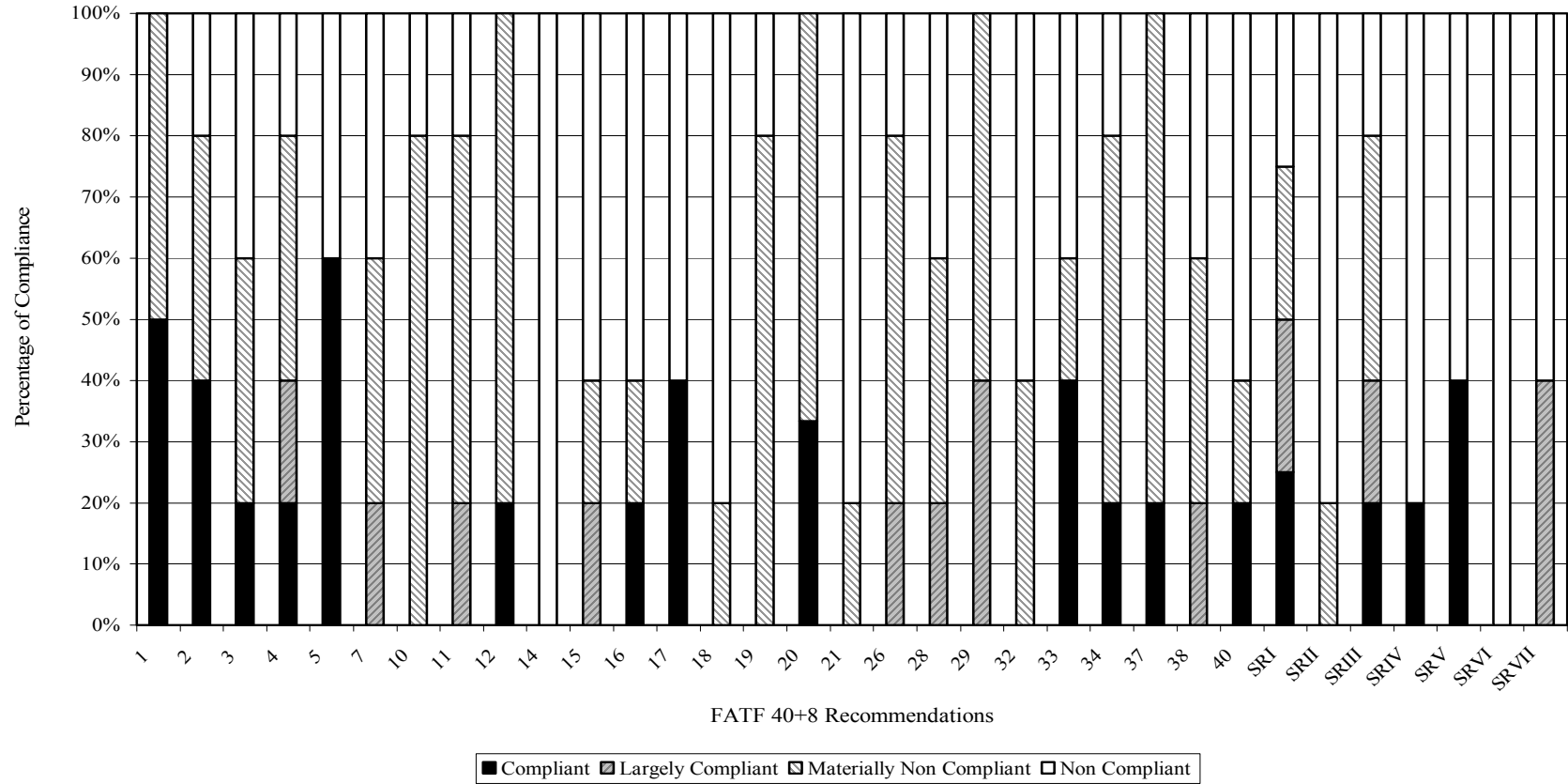
Figure 4. Compliance with AML/CFT: Medium Income Economies ^{1/}



Source: Assessment reports.

^{1/} Medium income economies, which have a GNI per capita (World Bank Atlas method) of \$736 – \$9,075, include: Algeria, Anguilla, Belize, Bolivia, Chile, Czech Republic, Ecuador, Honduras, Jordan, Labuan, FYR Macedonia, Mauritius, Montserrat, Oman, Romania, Russia, South Africa, and Swaziland.

Figure 5. Compliance with AML/CFT: Lower Income Economies ^{1/}



Source: Assessment reports.

^{1/} Lower income economies, which have a GNI per capita (World Bank Atlas GNI) of \$735 or less, include: Azerbaijan, Bangladesh, Kenya, Mozambique, and Tanzania.

92. Based on the data, supplemented by information developed in the next section, the following observations can be made:

- The original FATF 40 Recommendations were rated as compliant or largely compliant in about 70 percent of all of the assessments. Compliance with the Special Eight Recommendations related to the financing of terrorism, on the other hand, was lower. This reflects the fact that the Special Eight have only been adopted recently (i.e., in October 2001) and many countries, particularly lower income countries, have not yet adopted the specific laws or regulations that are necessary to achieve legal compliance.
- Recommendations related to criminalizing money laundering, secrecy laws, record keeping, training, and international cooperation were among those where good compliance was generally observed. On the other hand, weaknesses were encountered more frequently with respect to those recommendations dealing with preventive measures.
- Compliance with the recommendations is strongest among higher income jurisdictions (Figure 3) where almost all recommendations were rated either compliant or largely compliant in almost 90 percent of the cases. Among this group of countries deficiencies generally related to isolated gaps in legislation or in the standards applied for preventive measures, such as customer identification. While the higher income grouping includes a few members of FATF that might be expected to be relatively compliant with the FATF standards, it also includes a number of wealthier off-shore jurisdictions where compliance was also strong. It is also noteworthy that the higher income countries are relatively farther along in satisfying the requirements of the Special Recommendations.
- The middle income jurisdictions also show a good level of compliance with the recommendations Figure 4. Within this group, the performance of the transition economies reflects, in part, the fact that the countries assessed have recently undergone significant financial sector reforms and modernization and this has extended to their anti-money laundering regimes. In contrast to the higher income countries, the ratings for the middle income jurisdictions more frequently fell into the largely compliant, rather than fully compliant, category. This difference reflects the fact that in a number of cases laws or regulations do not fully cover all of the criteria laid out in the methodology or implementation of laws and regulations has not yet been made fully effective.
- Among lower income jurisdictions compliance is generally weak (Figure 5). A number of these countries have adopted measures that address only some of the elements necessary for a fully functioning AML/CFT regime and even in these cases legislation frequently needs to be updated. In addition, the poorer countries frequently have weak and under resourced supervisory regimes so that poor implementation of

AML/CFT preventive measures is itself a symptom of more deep-seated institutional weaknesses, especially with respect to the ability to cooperate internationally.

Shortcomings with Respect to FATF Recommendations

93. This section catalogs qualitatively some of the specific types of shortcomings that were identified during the assessments and which led to ratings of materially non-compliant or non-compliant. Table 12 ranks the main area of weakness. The material that follows Table 12 is presented under topical headings and summarizes the findings for clusters of recommendations that address related issues.

94. The shortcomings identified below were encountered across a wide range of countries and appeared with varying frequency. Some are concentrated in a few countries where compliance is generally weak. Others represent exceptions in regimes where compliance is otherwise strong. The narrative provides an indication of how frequently a particular deficiency was encountered and some indication of the significance of the shortcoming. This tabulation rounds out the analysis of the findings presented in the statistical section above and provides an indication of some of the types of deficiencies that need to be corrected to achieve compliance with the FATF standard.

95. The AML/CFT methodology addresses some topics, such as the financial intelligence function and enhanced due diligence, that go beyond the formal standards set in the FATF 40+8 Recommendations. Findings with respect to these other areas are briefly summarized at the end of this section.

Table 12. Main Weaknesses Identified in AML/CFT Assessments

Weakness Identified	Total Countries Found Materially Noncompliant or Noncompliant	Total Countries Assessed	MNC or NC to Total Assessed (in percent)
1. Poor assistance provided to other countries' FT investigations	19	40	48
2. Poor attention given to transactions with higher risk countries	18	41	44
3. Poor detection and analysis of unusual large or otherwise suspicious transactions	17	40	43
4. No criminalization of the FT and terrorist organizations	17	40	43
5. Inadequate systems to report suspicious transactions linked to terrorism	16	39	41
6. Inadequate AML programs in supervised banks, financial institutions or intermediaries; authority to cooperate with judicial and law enforcement	16	40	40
7. Inadequate guidelines for suspicious transactions' detection	16	41	39
8. Inadequate measures to freeze and confiscate terrorist assets	14	40	35
9. No requirement to take reasonable measures to obtain information about customer identity	14	41	34
10. Inadequate procedures for mutual assistance in criminal matters for production of records, search of persons and premises, seizure and obtaining of evidence for ML investigations and prosecution	14	41	34
11. Inadequate internal policies, procedures, controls, audit, and training programs	13	40	33
12. No requirement to report promptly to the FIU if financial institutions suspect that funds stem from a criminal activity	13	41	32
13. Poor international exchange of information relating to suspicious transactions, and to persons or corporations involved	13	41	32

Sources: Assessment reports.

Experience with FATF Recommendations

General Framework (FATF 1-3)

96. Fourteen jurisdictions were rated non-compliant or materially non-compliant for one or more of these FATF Recommendations. The ratification and implementation of the Vienna Convention (FATF 1) was the best observed FATF Recommendation in this group with only two instances where compliance was rated materially non-compliant. Compliance with FATF 2 was less robust: eight jurisdictions were materially non-compliant and two non-compliant. In most cases, the reason for non compliance was that secrecy laws hindered the effective investigation and prosecution of ML offenses by imposing restrictions on access to customer information or its exchange, whether domestically or internationally. Compliance with FATF 3 was the weakest with ten of the assessed jurisdictions showing material or full non compliance with the requirements of mutual legal assistance. The obstacles to mutual assistance range from a general lack of laws and treaties enabling international cooperation to specific shortcomings, such as the inability to provide access to financial records in money laundering cases prior to the laying of a charge.

Scope of Criminal Offense of Money Laundering (FATF 4-6)

97. The vast majority of jurisdictions reviewed were found fully compliant with FATF Recommendations 4 and 5, while Recommendation 6 (corporate criminal liability) was not rated given its optional nature. Only four jurisdictions were assessed as materially non-compliant or noncompliant with FATF 4 (scope of ML crime). In a minority of cases (seven)] the jurisdictions exhibited minor shortcomings in criminalizing ML, for example by not extending the ML offense to all serious offenses that were relevant in the local context (e.g., tax fraud), which resulted in largely compliant ratings. Compliance with FATF 5 (knowledge standard) was generally strong: four jurisdictions were found non compliant and another two materially non-compliant. Where weaknesses were cited, legislation was imprecise or too narrowly drafted.

Provisional Measures and Confiscation (FATF 7)

98. Given the complexity of FATF 7 (confiscation), only 17 of the jurisdictions reviewed achieved full compliance, with another 17 exhibiting minor deficiencies. Eight jurisdictions had significant deficiencies. Among the latter, two were rated non-compliant and four materially non-compliant. Four jurisdictions found materially non-compliant had shortcomings related to the limited scope of their confiscation regime in that it did not deal with the confiscation of laundered property, of instrumentalities used in or intended to be used for ML or, in another case the regime was limited to the proceeds of drug trafficking.

General Role of Financial System in Combating ML (FATF 8-9)

99. For FATF 8 refer to experience with FATF 10-28. FATF 9 is not rated.

Customer Identification and Recordkeeping Rules (FATF 10-13)

100. Fourteen of 41 jurisdictions were rated non-compliant or materially non-compliant on FATF 10-13 which deal with customer identification and record keeping. In some cases, anonymous or fictitious accounts were not expressly prohibited. In other cases, regulations do not require official documents to be used for identification or were vague with respect to documents that are acceptable. In three cases standards for identification of corporate accounts (legal entities) were inadequate. In four cases exceptions to CCD requirements were too liberal for introductions through other financial institutions or through eligible introducers. In four cases, exemptions from identification requirements were extended too broadly to some sectors, such as insurance, or to other parties in “equivalent” status. In four cases, there was either no explicit requirement to identify customers or to take reasonable measures to do so. In six cases record keeping standards were inadequate because the record keeping requirements did not extend to liquidated companies or partnerships, or because records were not required to be maintained or immediately available within the jurisdiction, or there was no authority for law enforcement to extend the holding period beyond the legal minimum holding period. In five cases, supervisor access to identification records was restricted, including two in which access to trust records was a problem. Three cases noted problems with cross border cooperation because of limitations on supervisors’ access to identification records.

Increased Diligence of Financial Institutions (FATF 14-19)

101. These six recommendations deal with the standards that should be applied for identifying and reporting suspicious transactions. Seventeen jurisdictions were rated non-compliant or materially non-compliant for one or more of these criteria. In all such cases, weaknesses were identified with respect to Recommendation 14 (transactions that are complex, unusual, or have no apparent economic or visible lawful purpose).

102. In a number of cases, no clear laws or regulations were in place requiring financial institutions to report suspicious transactions. In some cases, where such laws or regulations were in place, the threshold for determining suspicion was overly restrictive. In other cases, there were no requirements for financial institutions to monitor unusual or complex transactions or to document such monitoring and in several cases guidance notes and training were inadequate. In six cases the procedures and the channels for reporting suspicious transactions were unclear, including two cases where the reporting requirements for ML were handled differently from FT. In addition, in some cases the responsibilities of the reporting authority were also unclear. Instances were identified in which financial officials did not have immunity if they reported suspicious transactions and in which there were no prohibitions on tipping off.

Measures to Cope with Countries with Insufficient AML measures (FATF 20-21)

103. These recommendations require AML rules and procedures to be extended to overseas branches and subsidiaries and for firms to pay special attention to transactions with high risk jurisdictions. Many countries do not have subsidiaries or branches abroad rendering FATF 20 non-applicable in these cases. Of the remaining countries almost 40 percent show weak compliance with Recommendation 20. In this area, absence of legal instrument, such as a law or regulation, that would require financial institutions to ensure that their foreign branches and subsidiaries observe appropriate AML/CFT measures consistent with home jurisdiction requirements, to the extent that local laws and regulations permit, is a primary reason for weakness. Similarly, some countries do not require financial institutions to inform their home jurisdiction supervisor/regulator when a foreign branch or subsidiary is unable to observe the appropriate AML/CFT measures of the home jurisdiction. Inadequate testing against home and host standards by financial institutions and supervisory agencies in many countries also contributes to weak compliance in this area. In several cases secrecy laws effectively precluded countries from implementing this recommendation by limiting access of overseas regulators to specific account opening and other financial information.

104. Almost half of the countries exhibit weakness with respect to requiring financial institutions to give special attention to business relations and transactions with persons from countries which do not or insufficiently apply the FATF 40+8 Recommendations. Most often the problem lies with the lack of explicit requirements in a jurisdiction and with supervisory agencies failing to provide sufficient guidance to financial institutions regarding intensified monitoring for higher risk accounts and related testing in this area. Supervisory agencies also fail, in some cases, to circulate adequate information to financial institutions, such as lists of countries with weak AML/CFT regimes and NCCT-listed countries.

Other Measures (FATF 22-25)

105. Recommendations advisory only; no assessable criteria.

Implementation and Role of Regulatory and other Administrative Authorities (FATF 26-29)

106. More than 40 percent of the countries exhibit weaknesses in the ability of the supervisor/regulator to effectively cooperate spontaneously or upon request with other domestic authorities. For slightly more than half of these jurisdictions, the absence of legal gateways or the existence of legal impediments prevent the authorities from establishing formal mechanisms to share relevant information among themselves; however, in some cases, informal communication channels have been established allowing the information to flow in the current environment. Execution and coordination problems hindered the remaining countries from exchanging information.

107. Slightly more than 40 percent of countries exhibit weaknesses with FATF 28 which calls for guidelines to be set for detecting suspicious activity. A number of competent

authorities have not established adequate guidelines which will assist financial institutions in detecting suspicious patterns of behavior by their customers. Non-issuance of guidance or issuance of incomplete guidance by the authorities appears to relate, in some cases, to the deficiencies in the legal definition of FIU's functions. In these cases, the FIU has not been charged with analyzing suspicious transactions reports and thus, the need to issue guidelines is moot. Understaffing also poses difficulties in fulfilling these responsibilities as does lack of knowledge and expertise in the area. The absence of legal provisions to require the FIU to issue guidelines is also a driver in non-compliance.

108. One quarter of the countries have inadequate legal or regulatory measures to guard against control or acquisition of a significant participation in financial institutions by criminals or their confederates. While most countries' laws require supervisors/regulators to conduct an adequate fit and proper assessment on applicants for bank acquisitions, directors, and management at the time a bank license is issued, the law frequently fails to provide for an on-going assessment of controllers at times other than licensing and renewal.

Administrative Cooperation—Exchange of General Information (FATF 30-31)

109. Recommendations advisory only; no assessable criteria.

Administrative Cooperation—Exchange of Information Relating to Suspicious Transactions (FATF 32)

110. One quarter of the countries exhibit weakness in compliance with making efforts to improve a spontaneous or "upon request" international information exchange relating to suspicious transactions, persons and corporations involved in those transactions between competent authorities. The absence of a law to facilitate international exchange of information or provide for mutual legal assistance in AML/CFT investigations or legal obstacles within the law, poses problems for most jurisdictions. In some cases, in order to exchange information, a court order or an independent approval is required, thus delaying the response time. In other cases laws restrict information exchanges to a narrow range of agencies. Additionally, the laws may prohibit confidential information or bank records from being obtained and exchanged with international authorities. In practice, assistance may also be thwarted because some countries may require MOUs or the mechanisms in place may not be utilized.

Other Forms of Cooperation—Basis and Means of Cooperation in Confiscation, Mutual Assistance, and Extradition (FATF 33-34)

111. Given the complexity of these recommendations, only about half of the jurisdictions reviewed achieved full compliance, with one quarter exhibiting minor deficiencies and the remaining quarter significant deficiencies. Jurisdictions found materially non-compliant had shortcomings related to the limited scope of their confiscation regime which did not deal with the confiscation of laundered property, of instrumentalities used in or intended to be used for ML or, in another case the regime was limited to the proceeds of drug trafficking.

Other Forms of Cooperation—Focus of Improved Mutual Assistance on Money Laundering Issues (FATF 36-40)

112. FATF 36 and 39 were not rated as they are optional recommendations.

113. Serious issues of compliance were detected in one third of the assessed jurisdiction with regard to FATF 37, which requires procedures to be in place for mutual assistance in obtaining compulsory measures. Thirteen of 41 jurisdictions were found materially non-compliant, and one was non-compliant. Material non-compliance in several jurisdictions was related to various factors: lack of general or specific mutual assistance provisions or other arrangements; weaknesses in the enforcement of mutual assistance request, including the lack of capacity to give timely and effective follow up to requests; limitations on the availability of assistance for obtaining bank or financial records in non-drug related investigations or in the early stage of ML investigations.

114. Similar shortcomings were detected with regard to FATF 38. Seven jurisdictions were found materially non-compliant with FATF 38 and two were non-compliant. The usual deficiency noted by assessments was, again, that avenues for granting foreign requests for seizure, restraint or confiscation orders were either not specified in law and/or not used in practice (material non-compliance) or simply did not exist (non-compliance).

115. Overall, FATF 40 had a better rate of compliance than the other two recommendations in this pool: With 34 of 41 countries rated either fully or largely compliant. Three jurisdictions were found materially non-compliant, and six were non-compliant. Non-compliance usually resulted from the absence of legislation making ML an extraditable offence or the exclusion of ML from the list of extraditable offences. In other cases, the absence of clear authority to extradite fugitives, including nationals, for ML offences was the main reason for such rating, in particular if there was no clear obligation to take jurisdiction should the extradition of nationals be prohibited in the jurisdiction.

Ratification and Implementation of UN Instruments—SR I

116. Almost one third of the assessed jurisdictions failed to comply with this recommendation, which requires that jurisdictions take steps to ratify and implement the ICSFT and implement other UN instruments against the financing of terrorism, such as SCR 1373. Seven jurisdictions were found materially non-compliant and six non-compliant. Material non-compliance usually related to the lack of ratification by, (for dependencies, lack of extension to) the jurisdiction of the ICSFT. Jurisdictions failing to ratify the ICSFT and to implement the SCR 1373 were rated non-compliant. Where non-compliance was established by assessment teams, the existence of domestic legislation capable of addressing the requirements of the ICSFT or the UNSCRs were regarded as immaterial.

Criminalizing the Financing of Terrorism and Associated Money Laundering—SR II

117. This Special Recommendation was one of the least observed FATF recommendations by the jurisdictions reviewed under the pilot program. Among the 40 jurisdictions assessed, more than a third had significant deficiencies, i.e., fourteen were rated non-compliant and four materially non-compliant. SR II requires that jurisdictions criminalize the financing of terrorism, terrorist acts, and terrorist organizations and that they ensure that such offenses are designated as money laundering predicate offenses. In jurisdictions that were rated non-compliant, the financing of terrorism was not criminalized in any manner, nor was its prosecution possible under any other offense, while in those rated materially non-compliant, there was some indirect and usually untested ground for prosecuting it through participation in, aiding and abetting of, complicity or conspiracy to commit terrorism or terrorist offenses. Similarly, jurisdictions were rated materially non-compliant where the financing of terrorism was criminalized but was not made a predicate offense for ML.

Freezing and Confiscating Terrorist Assets—SR III

118. Serious deficiencies were detected in about a third of the assessed jurisdictions under this Special Recommendation. There were six jurisdictions rated materially non-compliant and eight rated non-compliant. Non-compliance resulted either from the lack of explicit legal provisions or other arrangements that would require the freezing of funds or assets of terrorists, etc., listed by the UN, and/or from the lack or inadequacy of powers that would enable the authorities to seize or confiscate terrorist assets in general. Even if the legal provisions or other arrangements were in place, if other obstacles prevented the freezing of terrorist funds, the jurisdiction's rating was materially non-compliant as SR III is focused on results not on means.

Reporting Suspicious Transactions Related to Terrorism—SR IV

119. Forty percent of countries exhibit weaknesses in compliance in this area. The deficiency identified in all jurisdictions is a lack of legal and institutional measures that would require making a report to competent authorities when there is a suspicion that funds are linked to terrorist financing; or would require making a report to competent authorities when there are reasonable grounds to suspect that funds are linked to terrorist financing. While many jurisdictions have reporting requirements and adequate guidance in place which refers to money laundering, including indicators for detecting transactions, financing terrorism is not covered. The absence of an FIU is also a contributing factor to non-compliance in this area.

International Cooperation—SR V

120. This Special Recommendation, which covers mutual assistance and extradition in financing of terrorism related cases is one of the least observed recommendations among the 8 SR. Almost half of the jurisdictions assessed exhibited significant deficiencies. Ten jurisdictions were found materially non-compliant and ten were non-compliant.

Unsurprisingly, many of these jurisdictions also had shortcomings with regard to SR I (criminalization of FT) and SR III (freezing, seizure and confiscation of terrorist funds) as well, providing evidence that defective domestic law is a major cause for ineffective international cooperation too.

121. Among the material deficiencies found, the lack of criminalization of the financing of terrorism usually prevented—at least certain forms of—granting mutual assistance by jurisdictions that require dual criminality for that purpose in general or for particular measures (e.g., for compulsory measures, including freezing, seizure and confiscation of terrorist funds or other assets). Extradition being always predicated on dual criminality, jurisdictions that did not criminalize the financing of terrorism could not extradite nationals, let alone other fugitives, and were thus unable to achieve any meaningful compliance level under SR V. Certain jurisdictions failed to comply with SR V even if they had the financing of terrorism criminalized under their laws, since the lack of extradition laws, or the non-inclusion of the financing of terrorism in the list of extraditable offenses was a sufficient reason for material non-compliance.

Alternative Remittance—SR VI

122. The methodology calls for Special Recommendation VI with respect to alternative remittance systems to be rated where applicable. In most jurisdictions alternative remittance systems were not considered macro economically relevant. As a result, SR VI was evaluated in one quarter of the pilot assessment. Of the jurisdictions rated, one half were found deficient either because money or value transfer services were not required to be licensed or registered; or because preventive measures requirements were not extended to them; or because there was no effective regime for monitoring and enforcing compliance with AML/CFT requirements. In some cases, FT requirements had not been extended to money or value transfer services.

Wire Transfers—SR VII

123. Assessment of the wire transfer requirements of SR VII were not evaluated consistently across the participants in the pilot because of ambiguity about whether the standard was or was not fully in force. Of 41 jurisdictions assessed 8 were not rated. Of the remaining jurisdictions, 12 were considered to be compliant or largely compliant while 21 were rated non-compliant or materially non-compliance. Those jurisdictions that were non-compliant or materially non-compliant lacked formal requirements that complete originator information be included on all wire transfers. In some cases, guidance notes encouraged inclusion of such originator information but did not make the guidance mandatory. In other cases, guidance was judged to be inadequate.

Other Recommendations

124. The methodology addresses some AML/CFT topics that go beyond the formal scope of the FATF 40+8 Recommendations. 25 of 41 ROSCs reviewed included additional

recommended actions to address weakness in these other areas or to address general issues related to the AML/CFT regime. The issues most frequently addressed in the other recommendations sections were:

- **Laws/powers and penalties**, including, to make explicit the analysis function of the FIU, to develop case law and jurisprudence with respect to ML, to increase penalties and sanctions for various legal and regulatory infractions; and to strengthen powers with respect to confiscation and sharing of proceeds of crime.
- **Role, power, and function of the FIU**, including: authorizing an independent FIU, regularizing the staffing of the FIU, clarifying the role of the FIU vis-à-vis the supervisors, strengthening the organizational structure of the FIU; providing the FIU with wider access to official data bases; improving the training and skills of the FIU; developing management reporting systems to monitor the effectiveness of the FIU.
- **Training/skills development**, including the need for improvements across all elements of the AML/CFT regime, including supervisors, examiners, FIU analysts, financial investigators, prosecutors, the courts, and private practitioners.
- **Resources and staffing**, including the need for expanded staffing and funding all across the AML/CFT regime, including for the FIU, for supervisors, for investigators and for prosecutors, as well as the need for independent and secure sources to ensure their autonomy.
- **Law enforcement**, including enhanced training of police, customs and prosecutors in AML/CFT matters; greater exploitation of financial intelligence in investigation and prosecution, more use of confiscation and forfeiture authority, more use of computerize tracking of ML, consider adopting special investigative techniques.
- **Coordination**, including numerous observations that the many agencies involved in the AML/CFT regime need to develop more systematic procedures for coordinating and collaborating with one another.
- **Scope of Application of AML/CFT requirements**, including several suggestions that preventive measures requirements be extended to the professions, including lawyers, accountants, and auditors and to nonfinancial activities such as casinos, pawn brokers, real estate brokers, and high value goods dealers. Also, recommendations include applying Basel customer due diligence requirements commonly across the financial sector.



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THE PRESIDENT

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Managing Director
International Monetary Fund
700 19th Street, N.W.
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11 February 2004

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Dear Mr. Köhler,

The IMF, World Bank, FATF and FATF-style regional bodies (FSRBs) recently concluded a 12-month pilot programme of assessments of country compliance with money laundering and terrorist financing standards based on the FATF 40 + 8 Special Recommendations. Working together, we have made significant progress in globalising the fight against money laundering and terrorist financing (AML/CFT), but more work lies ahead. The FATF strongly supports and looks forward to continued close co-operation with the International Financial Institutions (IFIs) as part of a permanent, common, and global effort to fight money laundering and terrorist financing.

The FATF has been in dialogue with staff and management concerning the evaluation of the pilot programme. In December the FATF discussed the overall assessment and related questions with staff and identified several relevant issues that had to be considered further. In January the FATF carried out more in-depth analysis in a number of areas which have led to the conclusion that further improvements in co-operation can be achieved. I want to share some observations with you in the hope of providing useful input for designing the most optimal way forward.

First, the FATF is committed to sharing the burden of assessing countries. Going forward, the FATF and the FSRBs combined expect to assess 15 to 20 countries per year. We will also make available outside experts for IFI-led assessments on the same basis as for other ROSC assessments. To facilitate the process, the FATF will increase efforts to co-ordinate with IFI staff.

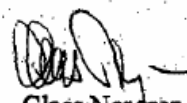
Second, based on our long experience in conducting mutual evaluations, the FATF believes there is the clear need for a comprehensive, fully integrated approach. At the request of IMF staff, the FATF conducted a study of the procedures used in the pilot programme. The report concludes that a comprehensive assessment approach is simpler, more effective, and produces reports that are integrated and consistent, particularly when compared to the "bifurcated" approach that is currently used in the IFIs' AML/CFT assessments. We would propose that the IFIs adopt the comprehensive and integrated approach for AML/CFT assessments.

This approach, in which the IMF and World Bank take responsibility for assessing and preparing written reports on the entire AML/CFT standard, is consistent with the assessments and ROSCs prepared against the other international codes and standards.

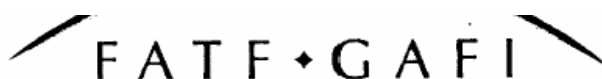
Combating money laundering and terrorist financing is now well recognised as a crucial element in creating a developed and stable financial sector. The FATF should be able to take appropriate measures in line with the FATF recommendations without specific conditions on the FATF's future activities. While the FATF has no plans at present to conduct a third round of the Non-Cooperative Countries and Territories reviews, it will retain the possibility of applying countermeasures to protect the international financial system from abuse including in situations where the FATF's recommendations are not applied or are insufficiently applied.

The FATF looks forward to working closely with the IMF, World Bank and the FSRBs to develop a programme of comprehensive, integrated and uniform AML/CFT assessments. This joint and collaborative effort will be a key element in protecting the integrity of the international financial system, and will help us meet our goal of helping countries worldwide identify and address shortcomings in their AML/CFT regimes.

Yours sincerely



Claes Norgren



*Financial Action Task Force on Money Laundering
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THE PRESIDENT

Mr. James D. Wolfensohn
President
The World Bank
1818 H Street, N.W.
Washington, DC 20433
United States of America

11 February 2004

Fax: +1 202 477 6391

Dear Mr. Wolfensohn,

The IMF, World Bank, FATF and FATF-style regional bodies (FSRBs) recently concluded a 12-month pilot programme of assessments of country compliance with money laundering and terrorist financing standards based on the FATF 40 + 8 Special Recommendations. Working together, we have made significant progress in globalising the fight against money laundering and terrorist financing (AML/CFT), but more work lies ahead. The FATF strongly supports and looks forward to continued close co-operation with the International Financial Institutions (IFIs) as part of a permanent, common, and global effort to fight money laundering and terrorist financing.

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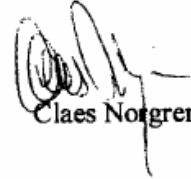
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Combating money laundering and terrorist financing is now well recognised as a crucial element in creating a developed and stable financial sector. The FATF should be able to take appropriate measures in line with the FATF recommendations without specific conditions on the FATF's future activities. While the FATF has no plans at present to conduct a third round of the Non-Cooperative Countries and Territories reviews, it will retain the possibility of applying countermeasures to protect the international financial system from abuse including in situations where the FATF's recommendations are not applied or are insufficiently applied.

The FATF looks forward to working closely with the IMF, World Bank and the FSRBs to develop a programme of comprehensive, integrated and uniform AML/CFT assessments. This joint and collaborative effort will be a key element in protecting the integrity of the international financial system, and will help us meet our goal of helping countries worldwide identify and address shortcomings in their AML/CFT regimes.

Yours sincerely



Claes Norgren

V. Abstracts of the Sections Drafted by the IAE in a Recent ROSC

...The lack of specified and itemized statistics on ML and FT related to seizure and confiscation should [...] be addressed.

... To further improve international cooperation, the [Financial Intelligence Unit] should be able to cooperate with its foreign counterparts on a reciprocal basis, even in the absence of a treaty or convention. If enacted, the draft amendment to the AML Act would allow the [Financial Intelligence Unit] to cooperate fully with foreign counterparts on a reciprocal basis...

... The reporting system has reached an acceptable level of performance. The [Financial Intelligence Unit], as a mature and experienced FIU, is adequately fulfilling its selective and supportive function as required by law. As yet, the valuable work of the [Financial Intelligence Unit] has, unfortunately, not been met with an effective law enforcement response. Apart from its supervisory responsibilities and, in light of the number of disclosures, the [Financial Intelligence Unit] seems reasonably resourced to perform its analytical task. The [Financial Intelligence Unit] should, however, endeavor to manage the available resources more effectively and to speed up the analytical process whenever it is not dependent on outside factors beyond its control. The self-evaluation of the reporting system would benefit from more detailed statistics on the performance and characteristics of all the components of the anti-money laundering effort.

... Tracing back the assets to a specific predicate offence (especially when committed in a foreign country) was identified as the main challenge in the investigation of money laundering cases. Customs monitor the cross-border movement of cash and bearer instruments over [amount] subject to mandatory declaration, but cannot seize funds under the established threshold, even if circumstances raise suspicion of illegal proceeds. Although the legal resources seem adequate enough and the AML system has all its components functioning, there is a total absence of any law enforcement results in terms of specific ML prosecutions, convictions and asset recovery. This is a matter of grave concern and should be addressed forthwith. Efforts have been made to remedy the situation with the creation of a specialized police unit for money laundering and the establishment of an interdepartmental task force (“Clearing House”), but there is still a need for specialized training, particularly for the judiciary. [...] It is important to create case law and jurisprudence to test the adequacy of the money laundering offence and identify in a certain manner the position of the courts with respect to evidentiary requirements. Furthermore, the penalties for ML do not seem to be sufficiently proportionate and dissuasive and should be brought up to international standards. As far as CFT is concerned, prosecution and mutual legal assistance are still jeopardized by the absence of a formal and comprehensive legal basis. Otherwise, international cooperation in all its forms is solid.