The Financial Action Task Force: An Overview

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Summary

The National Commission on Terrorist Attacks Upon the United States, or the 9/11 Commission, recommended that tracking terrorist financing "must remain front and center in U.S. counterterrorism efforts" (see *The 9/11 Commission Report: Final Report of the National Commission on Terrorist Attacks Upon the United States*, U.S. Government Printing Office, July, 2004. p. 382). As part of these efforts, the United States plays a leading role in the Financial Action Task Force on Money Laundering (FATF). The independent, intergovernmental policy-making body was established by the 1989 G-7 Summit in Paris as a result of growing concerns among the summit participants about the threat posed to the international banking system by money laundering. After September 11, 2001, the body expanded its role to include identifying sources and methods of terrorist financing and has adopted nine special recommendations on terrorist financing to track terrorists' funds. The scope of activity of FATF has also broadened as a result of the global financial crisis, since financial systems in distress can be more vulnerable to abuse for illegal activities. This report provides an overview of the task force and of its progress to date in gaining broad international support for its recommendations.

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Introduction

The Financial Action Task Force on Money Laundering is comprised of 36 member countries and territories and two international organizations[1] and was organized to develop and promote policies to combat money laundering and terrorist financing.[2] In June 2009, South Korea became a full member of FATF, and India followed in June 2010. The FATF relies on a combination of annual self-assessments and periodic mutual evaluations that are completed by a team of FATF experts to provide information and to assess the compliance of its members to the FATF guidelines. FATF has no enforcement capability, but can suspend member countries that fail to comply on a timely basis with its guidelines. The FATF is housed at the headquarters of the Organization for Economic Cooperation and Development (OECD) in Paris and occasionally uses some OECD staff, but the FATF is not part of the OECD. The presidency of the FATF is a one-year appointed position, currently held by Mr. Luis Urrutia Corral of Mexico, who will serve through June 30, 2011. The FATF has operated under a five-year mandate. At the ministerial meeting on May 14, 2004, the member countries renewed the FATF's mandate for an unprecedented eight years.

The Mandate

When it was established in 1989, the FATF was charged with examining money laundering techniques and trends, reviewing the actions which had already been taken, and setting out the measures that still needed to be taken to combat money laundering. In 1990, the FATF issued a report containing a set of 40 recommendations, which provided a comprehensive plan of action to fight against money laundering. In 2003, the FATF adopted the second revision to its original 40 recommendations, which now apply to money laundering and terrorist financing.[3]

Since the terrorist attacks of September 11, 2001, the FATF has redirected its efforts to focus on terrorist financing. On October 31, 2001, the FATF issued a new set of guidelines and a set of eight special recommendations on terrorist financing.[4] At that time, the FATF indicated that it had

[1] The FATF members are Argentina, Australia, Austria, Belgium, Brazil, Canada, Denmark, Finland, France, Germany, Greece, Hong Kong, Iceland, India, Ireland, Italy, Japan, Luxembourg, Mexico, Netherlands, New Zealand, Norway, People's Republic of China, Portugal, Russian Federation, Singapore, South Africa, South Korea, Spain, Sweden, Switzerland, Turkey, United Kingdom, United States; the two international organizations are the European Commission, and the Gulf Cooperation Council. The following organizations have observer status: Asia/Pacific Group on Money Laundering; Caribbean Financial Action Task Force; Council of Europe Select Committee of Experts on the Evaluation of Anti-Money Laundering Measures; Eastern and Southern Africa Anti-Money Laundering Group; Financial Action Task Force on Money Laundering in South America; other international organizations including the African Development Bank; Asia Development Bank; European Central Bank; International Monetary Fund; Organization of American States, Organization for Economic Cooperation and Development; United Nations Office on Drugs and Crime; and the World Bank.

[2] To be admitted to the FATF, a country must (1) be fully committed at the political level to implement the 40 recommendations within a reasonable time frame (three years) and to undergo annual self-assessment exercises and two rounds of mutual evaluations; (2) be a full and active member of the relevant FATF-style regional body; (3) be a strategically important country; (4) have already made the laundering of the proceeds of drug trafficking and other serious crimes a criminal offense; and (5) have already made it mandatory for financial institutions to identify their customers and to report unusual or suspicious transactions.

[3] For the 40 recommendations, see http://www.oecd.org/document/28/0,3343,en_32250379_32236930_33658140_1_1_1_1,00.html

[4] *FATF Cracks Down on Terrorist Financing.* Washington, FATF, October 31, 2001, p. 1.

broadened its mission beyond money laundering to focus on combating terrorist financing and that it was encouraging all countries to abide by the new set of guidelines. A ninth special recommendation was added in 2005. In 2005, the United Nations Security Council adopted Resolution 1617 urging all U.N. Member States to implement the FATF 40 recommendations on money laundering and the nine special recommendations on terrorist financing. The FATF nine special recommendations are:

> 1. Ratify and implement the 1999 United Nations International Convention for the Suppression of the Financing of Terrorism and Security Council Resolution 1373 dealing with the prevention and suppression of the financing of terrorist acts;
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> 2. Criminalize the financing of terrorism, terrorist acts and terrorist organizations;
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> 3. Freeze and confiscate funds or other assets of terrorists and adopt measures which allow authorities to seize and confiscate property;
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> 4. Report funds that are believed to be linked or related to, or are to be used for terrorism, terrorist acts, or by terrorist organizations;
>
> 5. Provide the widest possible range of assistance to other countries' law enforcement and regulatory authorities in connection with criminal, civil enforcement, and administrative investigations;
>
> 6. Impose anti-money laundering requirements on alternative remittance systems;
>
> 7. Strengthen customer identification requirements on financial institutions for domestic and international wire transfers of funds;
>
> 8. Ensure that entities such as non-profit organizations cannot be misused to finance terrorism.
>
> 9. Implement a system for detecting physical cross-border transportation of currency and monetary instruments (cash couriers), including authority to stop or restrain currency or monetary instruments suspected of being related to money laundering or terrorist financing; adopting sanctions for making false declarations; and confiscating currency and monetary instruments that are related to money laundering or terrorist financing.

The FATF completed a review of its mandate and proposed changes that were adopted at the May 2004 ministerial meeting. The new mandate provides for the following five objectives: (1) continue to establish the international standards for combating money laundering and terrorist financing; (2) support global action to combat money laundering and terrorist financing, including stronger cooperation with the IMF and the World Bank; (3) increase membership in the FATF; (4) enhance relationships between FATF and regional bodies and non-member countries and; (5) intensify its study of the techniques and trends in money laundering and terrorist financing.[5] In 2010, FATF published guidelines for insurance companies and the cross-border transportation of cash and bearer bonds. FATF also adopted a set of guidelines regarding tax amnesty laws and asset repatriation. In 2010, FATF also published a report on the vulnerabilities of free trade zones for misuse in money laundering and terrorist financing. At the conclusion of the G-20 (Group of 20) Summit in Seoul, South Korea, in November 2010, the members urged

[5] http://www1.oecd.org/fatf/pdf/PR-20040514_en.pdf.

the FATF to "update and implement" the FATF standards calling for transparency of cross-border wire transfers, beneficial ownership, customer due diligence, and due diligence for "politically exposed persons."

Progress to Date

An essential part of the FATF activities is assessing the progress of its members in complying with the FATF recommendations. As previously indicated, the FATF has attempted to accomplish this activity through assessments performed annually by the individual members and through mutual evaluations. According to the 2009-2010 assessment provided by the FATF, only a few countries are considered to be non-cooperative countries. Among the countries in this group is Iran, which FATF considers to have "significant deficiencies" in its anti-money laundering and terrorist financing regime and urged other jurisdictions to protect themselves by applying counter-measures. The FATF identified four countries—Angola, the Democratic Peoples' Republic of Korea, Ecuador, and Ethiopia—that have significant deficiencies in their anti-money laundering regimes and have not committed to a plan to correct those deficiencies. Other regimes with significant deficiencies in their anti-money laundering and terrorist financing regimes are Pakistan, Turkmenistan, Sao Tome and Principe. Countries that have been identified with deficiencies in their regimes, but have made the political commitment to correcting those deficiencies are Antigua and Barbuda, Azerbaijan, Bolivia, Greece, Indonesia Kenya, Morocco, Myanmar, Nepal, Nigeria, Paraguay, Qatar, Sri Lanka, Sudan, Syria, Trinidad and Tobago, Thailand, Turkey, Ukraine, and Yemen.

Part of the difficulty the FATF faces in determining how fully member countries are complying with the special recommendations is in reaching a mutual understanding of what the recommendations mean and how a country should judge its performance relative to the recommendations, since the recommendations are periodically revised and new methodologies for analyzing money laundering and terrorist financing are adopted. In addition, a number of the recommendations require changes in laws and other procedures that take time for member countries to implement. To assist member countries in complying with the FATF recommendations, FATF has issued various interpretative notes to clarify aspects of the recommendations and to further refine the obligations of member countries.

Between 2002 and 2003, the International Monetary Fund (IMF) and the World Bank participated in a year-long pilot program to conduct assessments on money laundering and terrorist financing in various countries[6] using the methodology developed by the FATF.[7] In March 2004, the IMF and World Bank agreed to make the program a permanent part of their activities. Over the year, the IMF and the Bank conducted assessments in 41 jurisdictions. According to these assessments, the Fund/Bank reached a number of conclusions regarding the overall compliance with the FATF 40 recommendations and the eight (at that time) special recommendations. In particular, they concluded that overall compliance was uneven across jurisdictions, but that jurisdictions display a higher level of compliance with the FATF 40 recommendations than they do with the eight

[6] This group of countries is not the same as those surveyed by the FATF, although there is some overlap in coverage between the FATF and the IMF/World Bank assessments.

[7] This section is based on the IMF/Bank report: *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*. The International Monetary Fund and the World Bank, March 10, 2004.

special recommendations due to shortcomings in domestic legislation. In general, the Fund/Bank concluded that compliance is higher among high and middle income countries than in low income countries. The most common weaknesses identified by the IMF and the World Bank include:

- Poor coordination among government agencies, especially among financial supervisors, financial investigators, the police, public prosecutors, and the public.
- Ineffective law enforcement due to a lack of skills, training, or resources to investigate, prosecute, and adjudicate money laundering cases among police, prosecutors, or the courts.
- Weak supervision by financial supervisors due to understaffed or under-trained supervisors who lacked the skills or capacity to monitor and enforce compliance with money laundering or terrorist financing requirements.
- Inadequate systems and controls among financial firms to identify and report suspicious activity, or to ensure that adequate records were being maintained.
- Shortcomings in international cooperation due to strong secrecy provisions, restrictions placed on counterpart's use of information and the inability to share information unless a criminal investigation was already underway or a formal agreement was in place.

For each of the special recommendations, the IMF and the World Bank offered additional conclusions:

> 1. *Ratification and implementation of U.N. instruments.* Almost one-third of the jurisdictions assessed by the IMF/World Bank failed to comply with this recommendation.
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> 2. *Criminalizing the financing of terrorism and associated money laundering.* This Recommendation was one of the least observed by the jurisdictions reviewed.
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> 3. *Freezing and confiscating terrorist assets.* About one third of the jurisdictions that were assessed displayed serious deficiencies complying with this Recommendation, generally because there was a lack of explicit legal provisions or other arrangements that would require the freezing of funds or assets of terrorists.
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> 4. *Reporting suspicious transactions related to terrorism.* Forty percent of the assessed jurisdictions displayed 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.
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> 5. *International cooperation.* This recommendation, which covers mutual assistance and extradition in financing of terrorism-related cases, is one of the least observed recommendations, where almost half of the relevant countries exhibited significant deficiencies.
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> 6. *Alternative remittance systems.* In most jurisdictions, such remittances were judged to be irrelevant, but of those jurisdictions that were considered, one-half were found to be deficient.
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> 7. *Wire transfers.* Compliance was assessed inconsistently because there was ambiguity about whether the standard was in force. Those jurisdictions that were not in compliance generally lacked formal requirements that complete information be included in each transaction.

In February 2004, the FATF adopted a revised version of the 40 recommendations that significantly broadens the scope and detail of the recommendations over previous versions. Also, the FATF adopted a new methodology to track and identify money laundering and terrorist financing that applies to both the 40 recommendations and the eight (nine) special recommendations. As a result of the significant length and additional detail of these new requirements, the FATF decided that it will no longer conduct self-assessment exercises based on the previous method, but will initiate follow-up reports to mutual evaluations.

In 2005, the FATF issued revised standards related to wire transfers of funds. The new standards require financial institutions to include the name, address, and account number of the originator on all fund transfers. The standards also lower the reporting threshold from $3,000 to $1,000. Two FATF-style regional bodies were also created—the Eurasian Group and the Middle East and North Africa Financial Action Task Force. The first round of mutual evaluations for these two bodies was scheduled for 2006. In 2007, the FATF adopted new measures to protect the international financial system from abuse, including calling on Iran to strengthen its money-laundering and counter-terrorist financing controls and a new commitment to produce a regular global threat assessment detailing key issues of concern related to criminal and terrorist financing.

Since the start of the global financial crisis, the FATF has taken a number of steps to help governments guard against abuse of their financial systems by groups or individuals engaging in terrorist financing or money laundering. As part of these efforts, the FATF has taken a number of steps.

- The FATF issued a statement warning all FATF members and all jurisdictions to protect their financial systems from risks associated with Iran’s failure to address ongoing deficiencies in its anti-money laundering regime and in combating financial terrorism
- The FATF is completing an initiative to analyze the impact of the global financial and economic crises on international cooperation in the area of money laundering and terrorist financing and will be reporting to the G-20 in September 2009 on responses to the financial crisis.
- Completing a report on the potential for money laundering and other vulnerabilities in the football (soccer) sector.
- The FATF is preparing and will issue a list of best practices that can assist member countries in implementing measures to freeze the assets or funds of terrorists or of terrorist-related activities. The FATF argues that freezing these assets or funds is important because it 1) denies funds to terrorists, which forces them to use more costly and higher risk ways to finance their operations; 2) deters those who might be willing to finance terrorism; and 3) is one element of a broader effort to follow the money trail of terrorists, terrorist groups and terrorist activity.

Issues for Congress

Following the 9/11 attacks, Congress passed P.L. 107-56 (the USA Patriot Act) to expand the ability of the Treasury Department to detect, track and prosecute those involved in money laundering and terrorist financing. In 2004, the 108th Congress adopted P.L. 108-458, which appropriated funds to combat financial crimes, made technical corrections to P.L. 107-56, and required the Treasury Department to report on the current state of U.S. efforts to curtail the international financing of terrorism. The experience of the Financial Action Task Force in tracking terrorist financing, however, indicates that there are significant national hurdles that remain to be overcome before there is a seamless flow of information shared among nations. While progress has been made, domestic legal issues and established business practices, especially those that govern the sharing of financial information across national borders, continue to hamper efforts to track certain types of financial flows across national borders. Continued progress likely will depend on the success of member countries in changing their domestic laws to allow for greater sharing of financial information, criminalizing certain types of activities, and improving efforts to identify and track terrorist-related financial accounts.

The economic implications of money laundering and terrorist financing pose another set of issues that argue for gaining greater control over this type of activity. According to the IMF, money laundering accounts for between $600 billion and $1.6 trillion in economic activity annually. Money launderers exploit differences among national anti-money laundering systems and move funds into jurisdictions with weak or ineffective laws. In such cases, organized crime can become more entrenched and create a full range of macroeconomic consequences, including unpredictable changes in money demand, risk to the soundness of financial institutions and the financial system, contamination effects on legal financial transactions and increased volatility of capital flows and exchange rates due to unprecedented cross-border transfers.[8]

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[8] The IMF and the Fight Against Money Laundering and the Financing of Terrorism. IMF Factsheet, April 2003. http://www.imf.org/external/np/exr/facts/aml.htm.