



IMF POLICY PAPER

February 20, 2014

REVIEW OF THE FUND'S STRATEGY ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM

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- The **Staff Report** on the Review of the Fund's Strategy on Anti-Money Laundering and Combating the Financing of Terrorism, was prepared by IMF staff and completed on February 20, 2014 to brief the Executive Board on March 12, 2014.
- A **Press Release** summarizing the views of the Executive Board as expressed during its March 12, 2014 consideration of the policy paper.

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REVIEW OF THE FUND'S STRATEGY ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM

EXECUTIVE SUMMARY

The Fund's Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) program represents an important contribution to the international community's response to money laundering and terrorist financing over the past decade. The program originally focused primarily on (a) AML/CFT assessments – as part of the Reports on the Observance of Standards and Codes (ROSC) program and of the Financial Sector Assessment Program (FSAP) – and (b) capacity development activities. Following guidance provided by the Board in 2011, money laundering, terrorist financing and related predicate crimes issues (hereinafter also referred to as financial integrity issues) are being raised in the context of surveillance when they are judged to affect domestic and balance of payments stability. Moreover, some recent Fund-supported programs have also incorporated financial integrity issues.

The Financial Action Task Force (FATF) – the AML/CFT standard setter – revised the AML/CFT standard (in 2012) and the common assessment methodology and procedures (in 2013). Staff actively participated in these revisions, in line with the Board guidance of 2011. The revised standard and assessment methodology focus to a much greater extent than before on money laundering or terrorist financing risks and on the effectiveness of AML/CFT measures. This change is consistent with the direction of reform urged by the Board. The FATF has also strengthened its quality and consistency controls, ensured that comparable measures are adopted by the FATF-style regional bodies (FSRBs), and added an ex post review mechanism to address reports that do not meet the quality benchmark.

Implementation of the current requirement for every FSAP to be associated with a comprehensive AML/CFT assessment has been challenging, mainly because of difficulties in coordinating AML/CFT assessments and FSAP cycles. This paper, therefore, proposes to adjust that policy. AML/CFT issues should continue to be addressed in all FSAPs, and staff will continue to participate in the global FATF/FSRB assessment program, burden sharing arrangements, and quality control procedures to generate ROSCs. However, in order to ensure timely substantive contributions to the FSAP and eliminate scheduling frictions with the FATF/FSRBs in cases where comprehensive assessments against the current standard are not possible, staff proposes to derive key findings from the best available information, including existing reports which would be supplemented as necessary by staff.

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ABBREVIATIONS AND ACRONYMS

AML/CFT	Anti-Money Laundering and Combating the Financing of Terrorism
CD	Capacity Development
FATF	Financial Action Task Force
FIU	Financial Intelligence Unit
FSAP	Financial Sector Assessment Program
FSRB	FATF-Style Regional Body
FSSA	Financial Sector Stability Assessment
IMFC	International Monetary and Financial Committee
PEP	Politically Exposed Person
ROSC	Report on the Observance of Standards and Codes
TTF	Topical Trust Fund
WMD	Weapons of Mass Destruction

INTRODUCTION

1. For more than a decade, the Fund has made important contributions to the efforts of the international community to combat money laundering¹ and terrorist financing.²

Traditionally, the key aspects of the Fund's Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) program have been: (a) assessments of countries' compliance with the AML/CFT standard established by the Financial Action Task Force (FATF—see Box 1), and (b) capacity development (CD) activities. The assessments of the FATF standard have formed part of both the Reports on the Observance of Standards and Codes (ROSC) program and the Financial Sector Assessment Program (FSAP). The CD activities have, since 2009, been mostly externally funded. These CD activities, which continue to be an important part of the Fund's AML/CFT program, are described in more detail in Appendix II.

2. The Executive Board last undertook a review of the AML/CFT program in 2011. Two main conclusions arose from the 2011 Board discussion:

- First, Directors recognized that AML/CFT assessments are an important part of the FSAP and ROSC programs and saw merit in exploring ways to strengthen AML/CFT assessments, including the possibility of conducting targeted, risk-based assessments; and
- Second, the majority of the Board endorsed the coverage of AML/CFT issues and their related predicate crimes in the context of surveillance on a mandatory basis, in specific circumstances where problems with money laundering, terrorist financing, or predicate crimes³ may undermine the stability of the member's domestic financial system, may have important spillover effects on other members and, while not affecting the financial system, may still undermine the member's external stability.⁴

¹ Money laundering is the process by which the illicit source of assets obtained or generated by criminal activity is concealed to obscure the link between the funds and the original criminal activity.

² Terrorist financing involves the raising and processing of funds to supply terrorists with resources. While money laundering and terrorist financing differ in many ways, they often exploit the same vulnerabilities in financial systems that allow for an inappropriate level of anonymity and opacity in the execution of financial transactions.

³ Predicate crimes are the underlying crimes that give rise to money laundering. Traditionally, the most important of these crimes was considered to be narcotics trafficking. As the 1990s progressed, however, the increasing recognition of the significance of the proceeds generated by non-drug-related crimes led to the designation of such crimes as predicates to money laundering. The FATF standard designates the following categories of offenses as predicate offenses to money laundering: participation in an organized criminal group and racketeering; terrorism, including terrorist financing; trafficking in human beings and migrant smuggling; sexual exploitation, including sexual exploitation of children; illicit trafficking in narcotic drugs and psychotropic substances; illicit arms trafficking; illicit trafficking in stolen and other goods; corruption and bribery; fraud; counterfeiting currency; counterfeiting and piracy of products; environmental crime; murder, grievous bodily injury; kidnapping, illegal restraint and hostage-taking; robbery or theft; smuggling; (including in relation to customs and excise duties and taxes); tax crimes (related to direct taxes and indirect taxes); extortion; forgery; piracy; and insider trading and market manipulation.

⁴ See *IMF Executive Board Reviews Efforts in Anti-Money Laundering and Combating the Financing of Terrorism*, Public Information Note (PIN) No. 11/74, June 27, 2011.

3. Following the Board's guidance, Fund staff has been active in the following areas:

- **FATF Cooperation:** Fund staff worked with Bank staff, the FATF, the FATF-Style Regional Bodies (FSRBs), and other key stakeholders on the development of a new AML/CFT standard and assessment methodology that are more risk-based. The revised standard was adopted on February 16, 2012, and staff informed the Board of the main changes to the AML/CFT standard in August 2012 (Information Note).⁵ In addition, staff worked closely with the FATF to develop a new assessment methodology that focuses to a greater extent than before on the effectiveness of AML/CFT regimes. Finally, in response to recent developments that had an impact on Fund-supported programs, staff stepped up cooperative efforts with the FATF to adopt procedures to achieve greater quality and consistency of future assessments.
- **Fund activities (mainly surveillance and Fund-supported programs):** Staff completed a guidance note that identifies a number of considerations related to the inclusion of AML/CFT issues in surveillance on a mandatory basis, and in financial stability assessments under the FSAP. Specifically, the guidance note provides that AML/CFT issues should be discussed (a) in the context of surveillance when they undermine a member's balance of payments and domestic stability, or the effective operation of the international monetary system and (b) in the context of financial stability assessments, when they threaten the stability of the domestic financial system. Since then, staff has worked closely with departments to implement this new framework in specific Article IV consultations. Separately, staff has also responded to the greater demand for coverage of financial integrity issues in the context of Fund-supported programs.

⁵ See *Revisions to the Financial Action Task Force (FATF) Standard – Information Note to the Executive Board*, July 17, 2012 (<http://www.imf.org/external/pp/longres.aspx?id=4683>).

Box 1. The Financial Action Task Force

Membership: The FATF was established by the G-7 countries in 1989 in response to mounting concern over money laundering. Its membership has grown from 14 countries, at its inception, to 34 jurisdictions and two regional organizations, at present, representing most major financial centers in all parts of the globe.

The FATF network: The FATF is complemented by eight FSRBs and is considering granting the FSRB status to a ninth regional body.⁶ Together, they represent some 180 countries around the world.

Recommendations: The FATF 40 Recommendations constitute the international standard for AML/CFT and, since February 2012, for combating the financing of proliferation of weapons of mass destruction. They encompass a broad range of issues including the regulation of services provided by financial institutions and some nonfinancial businesses and professions, cross-border movements of currency, the transparency of legal entities, substantive and procedural criminal law, institutional capacity, sanctions, as well as domestic and international cooperation.

Peer review, transparency and follow-up: Part of the FATF's and FSRBs' mandate is to conduct "mutual evaluations" (or peer reviews) of their members, publish the results of these reviews and follow-up on the progress made by the assessed countries in addressing the main deficiencies identified in the course of the evaluation. As a result, the majority of the Fund's members have committed at ministerial level to implementing the FATF standard as well as undergoing regular mutual evaluations.

Role of the IFIs: Both the Fund and the World Bank are observers to the FATF. Staffs of both institutions participate in the FATF working groups and plenary meetings, which take place three times per year. Staff conduct assessments of countries' AML/CFT regimes using the same methodology as the FATF/FSRBs.

4. The purpose of this paper is to:

- Seek the Executive Board's endorsement of the FATF 2012 Recommendations and of the 2013 assessment methodology (see section on the revised AML/CFT standard and assessment framework, below);
- Report on progress on the integration of AML/CFT issues in Fund surveillance and program work (see section on the coverage of financial integrity issues in surveillance and Fund-supported programs, below); and
- Propose an adjustment to the ROSC and FSAP policies concerning AML/CFT to ensure that AML/CFT information is incorporated into all FSAPs while introducing flexibility in the nature and scope of the AML/CFT analysis (see section on the inclusion of financial integrity issues in the FSAP, below).

⁶ The eight FSRBs are: the Asia/Pacific Group on Money Laundering (APG); the Caribbean Financial Action Task Force (CFATF); the Council of Europe Committee of Expert on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (MONEYVAL); the Eurasian Group (EAG); the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG); the Financial Action Task Force on Money Laundering in South America (GAFISUD); the Inter-Governmental Action Group against Money Laundering in West Africa (GIABA); and the Middle East and North Africa Financial Action Task Force (MENAFATF). Although not yet recognized as an FSRB by the FATF, the Groupe d'Action contre le Blanchiment en Afrique Centrale (GABAC) has initiated a mutual evaluation round of its members.

Box 2. Previous Executive Board Discussions of the AML/CFT Program

- Starting in the late 1990s, the Fund endorsed the international standards on banking, insurance, and securities regulation and supervision, which included AML measures.
- In 2000, the Fund responded to a call from the IMFC to expand its work in the area of AML. In 2001, it recognized the FATF 40 Recommendations as the appropriate standard for combating money laundering, intensified its AML work and, after the events of September 11, 2001, extended it to CFT.
- In 2002, AML/CFT was added to the list of 11 areas where standards and codes are useful to the operational work of the Fund and for which assessments are undertaken. The Fund conditionally endorsed the (then) FATF 40+8 Recommendations as the relevant standard, and agreed that AML/CFT ROSCs prepared by the FATF/FSRBs could be submitted to the Fund/Bank Boards (following a pro forma review conducted by staff).
- In 2004, the Executive Board agreed to make AML/CFT assessments and technical assistance a regular part of the Fund's work.
- In 2006, the Executive Board reaffirmed the principle, established in 2004, that every FSAP should be accompanied by a comprehensive AML/CFT assessment and specified the modalities under which this principle should be implemented, namely, that AML/CFT assessments should be conducted approximately every five years and, to the extent possible, within 18 months of the FSAP mission.
- In 2011, the Executive Board reviewed the Fund's AML/CFT program and gave strategic guidance on further integration of AML/CFT and related issues into the Fund's surveillance and financial stability assessments under the FSAP. It also provided guidance to shift towards targeted, risk-based AML/CFT assessments in cooperation with the FATF and other key stakeholders.
- In 2012, staff briefed the Executive Board about the main changes to the AML/CFT standard adopted by the FATF in February 2012.

THE REVISED AML/CFT STANDARD AND ASSESSMENT FRAMEWORK

A. Move Toward a More Risk-based Approach to AML/CFT

5. At the time of the Executive Board's June 2011 discussion of the Fund's AML/CFT program, the FATF was in the process of revising the AML/CFT standard. Directors noted that the comprehensiveness of the FATF standard set a high benchmark, compliance remained low, assessments were resource intensive, and country-specific issues may not have received full attention. They saw merit in exploring ways to strengthen AML/CFT assessments, including the possibility of conducting targeted, risk-based assessments. Directors agreed that the methodology for conducting such assessments and criteria for the selection of issues to be assessed with respect to specific countries needed to be developed in cooperation with the FATF, FSRBs, and other stakeholders. In line with this guidance, Fund and Bank staff proposed to the FATF a shift from comprehensive to targeted, risk-based assessments, paying greater attention to the specific threats and vulnerabilities of the assessed country.

6. In February 2012, the FATF adopted a revised set of Recommendations and interpretative notes which, together, constitute the new AML/CFT standard. As reported in the Information Note, the most important changes in the standard from the Fund’s perspective are:

- The increased prominence of the so-called risk-based approach to AML/CFT;
- The inclusion of tax crimes in the list of designated predicate offenses to money laundering;⁷
- The greater emphasis on action against corruption,⁸ and
- The limited extension of the standard to proliferation financing-related issues.⁹

7. The revised AML/CFT standard pays greater attention to the level of money laundering or terrorist financing risks. The most significant change in this respect is the new requirement (included in FATF Recommendation 1) on countries to identify, assess, and understand the risks of money laundering and terrorist financing that they face, and, on the basis of that assessment, ensure that measures to prevent or mitigate money laundering and terrorist financing are commensurate with the risks identified. Countries should also require financial institutions and designated non-financial businesses and professions to identify, assess, and take effective action to mitigate their money laundering or terrorist financing risks.

8. These changes are welcome and, subject to the Executive Board’s endorsement of the revised standard, will have implications on the Fund’s AML/CFT program. The revised AML/CFT standard, including through its extension to proliferation financing-related issues, provides a strong basis for Fund advice to protect the integrity of the international financial system. The risk-based approach to implementing AML/CFT measures is in line with the Board’s 2011 guidance. In addition, the inclusion of tax crimes as predicate offenses to money laundering will provide greater

⁷ The standard requires that countries provide in their domestic law that tax crimes are predicate offenses to money laundering. While the standard does not contain a definition of “tax crimes,” it requires that countries apply the crime of money laundering to all serious proceeds-generating offenses.

⁸ Financial institutions and designated non financial businesses and professions (DNFBPs) should be required to apply enhanced due diligence to individuals who are or have been entrusted with prominent public functions – the so-called politically-exposed persons (PEPs) – not only by a foreign country (as was the case previously), but also, on a risk basis, by their own country or by an international organization. In the case of international organizations, this refers to “members of senior management, i.e., directors, deputy directors and members of the board or equivalent functions.” While this development should help ensure that the financial sector is not misused to launder the proceeds of corruption, it may impose, in some cases, additional customer due diligence requirements upon members of the Fund’s Executive Board and senior management in the conduct of their financial transactions.

⁹ The standard now imposes a requirement on countries to implement targeted financial sanctions to comply with UN Security Council Resolutions on the proliferation of weapons of mass destruction (WMD) and its financing. This new requirement is similar in its approach to the targeted financial sanctions applicable in the context of the fight against terrorist financing (which the Executive Board has endorsed), but has a narrower application: it addresses exclusively the freezing without delay of funds or other assets of persons or entities designated by the UN Security Council as being involved in illicit proliferation of WMD and on domestic cooperation.

opportunities for the Fund to offer policy recommendations on tax issues such as international tax coordination and information sharing.¹⁰

9. The FATF also adopted the revised assessment methodology and procedures in February and October 2013, respectively. While the shift to a risk-based framework did not go as far as staff would have liked, the new assessment framework reflects a significant move to incorporate analysis of each country's context, including money laundering or terrorist financing risks and the effectiveness of the AML/CFT measures in mitigating these risks. The new approach was also supported by independent academics in a recent review of the global framework for AML/CFT assessments.¹¹ Areas of greater importance and risk should receive greater attention. For example, if the assessed country is a center for company registration, assessors should look more closely at beneficial ownership requirements than they would in another country. As a result of these changes to the methodology, assessments should yield more relevant and meaningful information than previously and create stronger incentives for AML/CFT regimes to focus on risks (see Box 3).

10. Like assessments against other standards, however, AML/CFT assessments are not audits, and do not, for example, evaluate the level of compliance of individual financial institutions. As a result, they cannot fully predict or prevent major money laundering or terrorist financing crises or financial crises that may result from or be affected by such events.

¹⁰ See also paragraphs 16 and 18 of the Information Note on the benefits of the inclusion of tax crimes in the list of designated predicate offenses. With the limited extension of the standard to proliferation financing-related issues, the Fund will assess compliance with the standard in this respect, and may address these issues in the context of surveillance, FSAPs and Fund-supported programs if they are relevant in these contexts. The Fund may also provide assistance to members in the implementation of the new standard in this respect.

¹¹ A group of scholars affiliated with the Center on Law and Globalization approached staff in 2012 and asked to study a small number of AML/CFT assessment reports with the relevant countries' express agreement. On January 30, 2014, they released a report outlining their views about the global regime in place to assess AML/CFT controls, and the interrelationship of this regime with the work of the Fund. Overall, their report questions whether the benefits of AML/CFT systems outweigh their costs, noting the limited evidence of such benefits. It is also critical of an approach to assessments of different countries against "one size fits all" international standard, which it does not deem sufficiently meaningful. In that respect, it is critical of the IFIs, FATF and FSRBs' past assessments' efforts. Against this background, however, and while noting the remaining challenges, the report validates the approach taken by staff and the FATF in the design of the new assessment methodology to focus increasingly on individual countries' context and the effectiveness of AML/CFT controls in mitigating risks.

Box 3. 2013 Methodology for Assessing Compliance with the FATF Recommendations and Effectiveness of AML/CFT Systems

The new methodology includes two interrelated components: It focuses equally on the legal and regulatory frameworks and on the results achieved from their implementation against the country's specific ML/FT risk profile. It provides for an interrelated, two-step approach that consists of a mainly desk-based assessment of technical compliance with the AML/CFT standard, followed by an on-site assessment of the effectiveness of the AML/CFT regime as measured by the extent to which specific objectives are being met.

The starting point for assessors is to understand the country's risks and context. The concept of "risk" takes account of the threats (e.g., criminals with money to launder); the vulnerabilities (e.g., weaknesses in the financial system that criminals will use to launder that money); and the harm caused (e.g., damage done by the original crime and the laundering). The notion of "context" includes:

- The country's situation (e.g., general makeup of the economy and financial sector);
- The structural foundations of the AML/CFT regime (e.g., an effective judicial system, sound government institutions and rule of law); and
- Other factors that affect the implementation of AML/CFT measures (e.g., level of corruption or maturity of the country's regulatory regime).

This understanding of the country's risks and context then guides:

- The assessment of technical compliance, which looks at whether the country meets the requirements of the FATF Recommendations, principally as they relate to the legal and institutional framework.
- The assessment of effectiveness, which looks at the extent to which eleven immediate outcomes¹² are met. The predefined outcomes are central to a robust AML/CFT system. This assessment differs fundamentally from that of technical compliance; assessors must, for each outcome, use their judgment to reach a holistic conclusion as to how well a country is operating from an AML/CFT perspective. The focus is, therefore, on the extent to which the AML/CFT framework is producing the expected results.

Technical compliance and effectiveness are rated separately, but are considered together in the conclusions. These conclusions provide prioritized and integrated recommendations for AML/CFT regime improvements, focusing on the key deficiencies identified in the context of the country's risks.

¹² The immediate outcomes are: (i) Money laundering and terrorist financing risks are understood and, where appropriate, actions coordinated domestically to combat money laundering and the financing of terrorism and proliferation; (ii) International cooperation delivers appropriate information, financial intelligence, and evidence, and facilitates action against criminals and their assets; (iii) Supervisors appropriately supervise, monitor and regulate financial institutions and DNFBPs for compliance with AML/CFT requirements commensurate with their risks; (iv) Financial institutions and DNFBPs adequately apply AML/CFT preventive measures commensurate with their risks, and report suspicious transactions; (v) Legal persons and arrangements are prevented from misuse for money laundering or terrorist financing, and information on their beneficial ownership is available to competent authorities without impediments; (vi) Financial intelligence and all other relevant information are appropriately used by competent authorities for money laundering and terrorist financing investigations; (vii) Money laundering offenses and activities are investigated and offenders are prosecuted and subject to effective, proportionate and dissuasive sanctions; (viii) Proceeds and instrumentalities of crime are confiscated; (ix) Terrorist financing offenses and activities are investigated and persons who finance terrorism are prosecuted and subject to effective, proportionate and dissuasive sanctions; (x) Terrorists, terrorist organizations and terrorist financiers are prevented from raising, moving and using funds, and from abusing the NPO sector; (xi) Persons and entities involved in the proliferation of weapons of mass destruction are prevented from raising, moving and using funds, consistent with the relevant UNSCRs.

B. Quality and Consistency Controls

11. From the Fund’s perspective, AML/CFT assessments must be of high quality and consistent with the standard. This is important (a) to ensure that all member countries are treated uniformly, and (b) because the findings of AML/CFT assessments are increasingly incorporated into various areas of the Fund work – regardless of whether the assessments were conducted by the Fund or another assessor body.

12. The architecture for conducting AML/CFT assessments is unique because the Fund and the Bank rely on assessments conducted by others. Assessments may be conducted not only by the Fund and the Bank, but also by the FATF and the eight FSRBs. As mentioned above (Box 1), some 180 countries have now joined the FATF and/or an FSRB, and committed to undergo regular mutual evaluations. Ensuring the quality and consistency of AML/CFT assessments across the range of assessor bodies has been challenging.¹³ The FATF and FSRB assessments are peer reviews; they are, therefore, conducted by assessors with varying degrees of skills and experience, and the discussions leading to their approval have at times steered away from purely technical considerations. While the assessments are challenging and resource-intensive for all assessor bodies, experience has shown that the FATF assessments are generally of high quality while those of the FSRBs have been mixed.

13. AML/CFT assessment reports have been used by the Fund primarily in the context of the FSAPs (see Appendix I). Under the agreed burden-sharing arrangements, assessments conducted by the FATF, or one of the FSRBs, can be used for FSAP purposes to the same extent as Fund and Bank assessments. They are converted into a ROSC after a pro forma review by Fund staff: staff does not review the substance of FATF/FSRBs assessments but only ensures that the ROSCs adequately reflect the findings of the assessments. The pro forma review does not give staff an opportunity to address potential deficiencies in the report or in the way the assessment was conducted.

14. Over the years, the findings of AML/CFT assessments have also become increasingly relevant to the Fund’s surveillance and program work (see the next section below). In the area of surveillance, financial integrity issues are being discussed not only on a voluntary basis, but also, in some instances, on a mandatory basis. AML/CFT issues can also be relevant for Fund-supported programs when they are critical to achieving the program’s objectives or for financing assurances purposes. As recently demonstrated in the case of Cyprus, an unduly generous assessment report can give the authorities and other stakeholders a false sense of security about the adequacy of AML/CFT controls, that may not withstand the scrutiny associated with a Fund-supported program.

¹³ From the beginning of the burden sharing arrangements, the Fund has been aware of the potential risk of accepting, as part of the ROSC and FSAPs, assessments of inconsistent quality. This risk was confirmed in a 2006 independent review of AML/CFT assessments conducted at the Fund’s Executive Board’s request (see *IMF Executive Board Reviews the Quality and Consistency of Assessment Reports for Anti-Money Laundering and Combating the Financing of Terrorism and the Effectiveness of Coordination*, PIN No. 06/72, June 30, 2006). While steps were taken during the previous round to increase the quality and consistency and led to improvements, they were not always successful.

15. Recognizing the need to improve quality and consistency of assessments, the FATF has recently taken steps to ensure that all assessor bodies are positioned to provide consistently high quality reports.

These steps include a stronger common foundation (such as mandatory training for all assessors, a clear report template and ex ante quality and consistency controls). In particular, the October 2013 *Procedures for the FATF Fourth Round of AML/CFT Mutual Evaluations* include an enhanced review mechanism that requires reviewers to be drawn from a global pool of qualified experts from the FATF, FSRBs, and the IFIs. The review process will be overseen by a FATF working group; three reviewers (or more) will be allocated to each assessment, and will comprise two reviewers from FATF delegations and one from another assessor body. The review process will begin at the stage of scoping the on-site assessment mission. Reviewers are required to ensure that the draft report reflects a correct interpretation of the FATF standard and application of the methodology, and to highlight areas where the analysis and conclusions are identified as being clearly deficient. Reviewers' comments on the draft assessment report, along with the assessment team's response(s), will be made available to FATF members in advance of the plenary discussion of the report.

16. Since the FATF's internal procedures do not address quality and consistency of reports prepared by the other assessor bodies, the FATF also articulated in February 2014 universal procedures for AML/CFT assessments

which (a) require all assessor bodies to have effective and robust mechanisms in place, with the same essential features as the mechanism adopted by the FATF, to ensure the quality and consistency of their reports,¹⁴ and (b) include an ex-post global quality control mechanism to deal with the risk that substandard reports are being adopted. With the assessed country's approval, these procedures would also apply to Fund and Bank AML/CFT assessments. In order to preserve the integrity of the FSAP and ROSC programs, Fund and Bank staff will participate actively in the review process of other assessor bodies and, as necessary, refer problematical reports for the ex post review. If the assessor bodies do not implement the universal procedures and/or take corrective action to address deficiencies identified through the ex-post review process, their reports should not be published and the FATF may consider what further action may be necessary.

17. Staff proposes to change the current practice of converting all externally-prepared AML/CFT assessment reports into ROSCs upon staff's pro forma review.*

Moving forward, staff proposes to convert these reports into ROSCs only (a) in the context of an FSAP, and (b) when these reports have undergone a quality and consistency review in conformity with the universal procedures, and are not clearly deficient.¹⁵ By participating in the global review process, staff will

¹⁴ These features include a review of the scoping note for the assessment and the involvement of external reviewers.

* This staff proposal was not endorsed by the Board because many Directors, representing the majority of the Board, preferred to maintain the current system of converting all assessments into ROSCs, underscoring that the FATF's strengthened quality and consistency controls will ensure that these reports meet the requisite quality standards.

¹⁵ A report would be considered clearly deficient when major quality and consistency problems have been identified. In such cases, it would be submitted to the FATF's ex post review, and staff would not convert the report into a ROSC in the event that the review does not lead to the clear deficiencies being satisfactorily addressed. In such instances, in the event that staff needs to reach conclusions about a country's AML/CFT regime, staff may need to supplement

(continued)

contribute to ensuring that any concerns about particular reports are addressed effectively, collectively and in a timely manner by the broader FATF/FSRBs community. Accordingly, and with the introduction of robust quality and consistency controls by all assessor bodies, staff anticipates that the likelihood of a final assessment report being clearly deficient is low.

18. A pilot phase of assessments under the new methodology is now called for. Lessons drawn from the first five assessments of FATF members¹⁶ may result in adjustments in the assessment methodology, procedures, or both. As a further means of ensuring a correct and consistent application of the new methodology, the FATF and Asia-Pacific Group on Money Laundering (APG) have proposed that other assessor bodies, including the IFIs, participate in the first assessments of their members.¹⁷ The participation of Fund staff in the first FATF and APG assessments would ensure the optimal implementation of the revised methodology. Although staff would play an active role in these assessments, it would not be subject to the FATF and APG's instructions,¹⁸ and the final report would not be a Fund report, but a FATF, or joint FATF/APG mutual evaluation report. The Fund will be conducting its own first assessment (of Italy) under the revised methodology in January 2015, and staff is considering inviting FATF and possibly FSRBs experts to join the assessment team to allow for greater sharing of experiences among assessor bodies. The initial stages (i.e., the technical compliance analysis) of the first two FATF assessments are currently underway; early indications are that, despite the initial intention to lighten the assessment burden, assessments conducted under the new methodology will be as resource-intensive as in the past, if not more.

19. In conclusion, overall, the revisions of the AML/CFT standard, assessment methodology and procedures are welcome developments. The 2012 FATF Recommendations (with their greater attention to money laundering or terrorist financing risks) and the 2013 assessment methodology (with its emphasis on the effectiveness of AML/CFT systems) will contribute to assessments that focus on areas of particular concern in the assessed countries, and address these concerns in a pragmatic way. Staff expects future assessment reports to be more meaningful, both for the assessed countries and the broader AML/CFT community including the Fund, and to provide clear and prioritized advice tailored to the countries' circumstances. The new set of procedures adopted by the FATF should ensure greater quality and consistency of assessments across all assessor bodies. On the basis of the above, staff recommends the endorsement by the Executive Board of the 2012 FATF Recommendations as the relevant standard for AML/CFT ROSCs and AML/CFT inputs into other areas of Fund and Bank work, and of the 2013 assessment methodology as the basis for assessments against the 2012 standard.

information drawn from a report with its own analysis. See chapter on inclusion of financial integrity issues in the FSAP, below.

¹⁶ These are the assessments of Norway (April 2014), Spain (May 2014), Belgium (July 2014), Australia (FATF - jointly with the APG) and Italy (January 2015 – which will be conducted by the Fund under the burden sharing agreement with the FATF).

¹⁷ In addition to the assessments mentioned above, the APG has also invited Fund staff to participate in its November 2014 assessment of Malaysia.

¹⁸ Staff will continue to owe their duty entirely to the Fund, in line with Fund's Rules and Regulations (N-3).

COVERAGE OF FINANCIAL INTEGRITY ISSUES IN SURVEILLANCE AND FUND-SUPPORTED PROGRAMS

A. Surveillance

20. As noted above, in 2011 the majority of the Board¹⁹ endorsed the coverage of AML/CFT issues and their related predicate crimes in the context of bilateral surveillance and modular financial stability assessments under the FSAP. In particular, AML/CFT issues should be discussed when they threaten a member's balance of payment and domestic stability or the effective operation of the international monetary system on a mandatory basis (in the context of surveillance) or the stability of the financial system (in the context of stability assessments under the FSAP).²⁰

21. There are a number of ways in which money laundering, terrorist financing or related predicate crimes (e.g., corruption, tax crimes, and fraud) can undermine the stability of a country's financial system or its broader economy. These include the following:

- **Weak AML/CFT frameworks may lead to impeded or lost access to global financial markets.** In an effort to protect their financial sectors, national supervisors, often in response to FATF/FSRBs calls for action, are increasingly prohibiting their banks from dealing with financial institutions from countries with actual or perceived weaknesses in their AML/CFT frameworks, or at least, to subject transactions with institutions from such countries to stricter conditions. In addition to limiting access to global financial markets, this may increase these countries' costs of trade financing.²¹
- **Domestic stability can also be threatened by criminal activities.** For instance, significant levels of tax crimes (e.g., VAT fraud and tax evasion) may affect the government's revenue stream to a point where its fiscal balance is severely undermined. The potentially adverse effects on financial stability that may arise from large scale "Ponzi schemes" in the financial sector have been well-publicized and may undermine a country's economy including through large-scale bank insolvencies that ensue when bank's balance sheets are not properly valued, or by large outflows of capital from the banking system as the scale of the fraud becomes known.

22. The negative effects of money laundering, terrorist financing, or related predicate offenses will typically be transmitted through a country's financial system. For instance, the injection of large amounts of criminal proceeds arising from corruption, tax evasion, or drug trafficking may subject a country's banking system to volatile inflows and outflows that can threaten

¹⁹ See *IMF Executive Board Reviews Efforts in Anti-Money Laundering and Combating the Financing of Terrorism*, PIN No. 11/74, June 27, 2011.

²⁰ See *Anti-Money Laundering and Combating the Financing of Terrorism - Inclusion in Surveillance and Financial Stability Assessments - Guidance Note*, December 14, 2012 (<http://www.imf.org/external/pp/longres.aspx?id=4726>).

²¹ On impediments on trade financing, see the 2011 Article IV for the United Arab Emirates and the box on the consequences on financial sanctions against Iran.

its stability. Incidents of terrorism and terrorist financing may undermine the stability of a country's financial system – either because of a history of terrorist incidents or through the effect of a single but significant event.

23. However, there are circumstances in which money laundering, terrorist financing or related predicate crimes will have an adverse effect on the stability of the broader economy without necessarily directly involving the financial system. This will be the case particularly in countries where illegal transactions are conducted in cash and the proceeds of crime are never introduced into the banking system. This phenomenon, itself, may impede the development of the country's banking system which in turn would impede economic growth. Beyond their effect on the banking system, however, these cases may undermine broader macroeconomic stability in at least two important ways: (a) economic policymakers will have great difficulty in gaining a real understanding of the state of the economy and in formulating sound economic policies; and (b) large illegal sectors can represent deadweights on formal economies resulting in sub-optimal growth. In extreme cases, unchecked criminal activity can rise to the level of threatening state functions and the rule of law, with associated adverse economic effects.

24. Money laundering, terrorist financing and related predicate crimes may also have adverse spillover effects on the stability of other countries. For example, extensive criminal activities in one country may lead to illicit transfers from and large short-term capital flows to another country with potentially destabilizing effects on that country's economy. The availability of money laundering services in one jurisdiction may encourage and facilitate tax evasion in neighboring countries with adverse effects on their fiscal positions. Spillovers can also be transmitted through non-balance of payments channels, such as market contagion (e.g., financial fraud in a domestic bank triggers transmission when it defaults on interbank liabilities). Such spillovers may be of such nature and magnitude as to significantly affect global stability.

25. The 2012 staff Guidance Note sets out a number of specific questions and criteria that guide staff in determining whether financial integrity issues should be included in surveillance. These questions and criteria help staff assess (a) the impact of financial integrity issues on the stability of a country's financial system; (b) the threats to financial sector stability arising from predicate crimes; (c) the adverse effect of financial integrity issues on the stability of the broader economy; and (d) their adverse spillover effects and the impact on global stability. When financial integrity issues are included in surveillance, staff provides the authorities with policy advice on the measures that should be taken to address the threats presented by money laundering, terrorist financing, or different types of predicate crimes (see examples in Box 4). In some instances, these threats can also be addressed by other Fund policies (e.g., the 1997 Guidance Note on the Role of the Fund in Governance Issues), or other standards and codes (e.g., the Code of Good Practices on Fiscal Transparency or the Basel Core Principles for Effective Banking Supervision).

26. Judgment and flexibility is being exercised by staff in the application of these questions and criteria. Staff is analyzing member countries' economic developments from a financial integrity perspective on an ongoing but flexible basis. The greater the potential impact of money laundering, terrorist financing and related predicate crimes on a members' domestic or

balance of payments stability, the more intensive staff's engagement. Working closely with the Strategy, Policy and Review, Monetary and Capital Markets, and Fiscal Affairs, and the relevant area Departments, the Legal Department's engagement has ranged from participation in missions (when financial integrity issues are particularly complex or require specialized knowledge), the drafting of briefs and questions for the mission members, to less resource-intensive desk-based reviews of Article IV policy notes and staff reports. Staff also provides, where needed, HQ-based support to country teams during missions. The elaboration, in the Guidance Note, of clear criteria coupled with the Legal Department's outreach efforts have made inclusion of financial integrity issues in surveillance more transparent and thus more acceptable to members.

27. Since 2011, financial integrity issues have been included on a mandatory basis in a number of Article IV Consultations. These include Afghanistan, Greece, Indonesia, Iraq, Italy, Iran, Libya, Nigeria, Pakistan, Singapore, Turkey, and Russia. These engagements – of a varying degree of intensity – have highlighted key financial integrity issues for the authorities and provided tailored policy advice to address money laundering or terrorist financing per se, as well as corruption, tax evasion, smuggling, fraud, organized crime, weak compliance with the AML/CFT and/or anti-corruption standards, lack of transparency of corporate vehicles, integrity of economic citizenship programs, and concerns about financial and non-financial sector supervision. Box 4 provides more detail on the inclusion of financial integrity issues in some Article IV consultations.

Box 4. Selected Cases of AML/CFT Inclusion in Article IV Consultations (Since 2011)

Indonesia. Indonesia was publicly identified by the FATF as a jurisdiction not making sufficient progress in addressing strategic shortcomings in its AML/CFT framework. Although the authorities enacted, in February 2013, a new CFT law that focused on the criminalization of terrorist financing, the FATF remained concerned about deficiencies in the CFT framework. Addressing these concerns is important to protect Indonesia's financial sector from heightened scrutiny from foreign financial institutions, avoid possible countermeasures, and facilitate an exit from the FATF monitoring process. To this end, staff advised the authorities to make further efforts to strengthen the AML/CFT regime.

Italy. The authorities saw the cost of corruption to the economy to be a significant drag on business. The level of tax evasion in the country was also a concern. Staff acknowledged the authorities' efforts in tackling both crimes, including the conduct of more risk-based tax audits, the lowering of thresholds for cash transactions and the adoption of a new anti-corruption law. In 2012, the authorities' efforts against tax evasion had raised higher revenue than during the previous year. Staff advised that further strengthening the AML tools (including by criminalizing self-laundering and reinforcing due diligence regarding persons entrusted with prominent public functions) could strengthen anti-corruption efforts, and that stepping up efforts to combat tax evasion would raise revenue and more fairly distribute the tax burden. It highlighted that further initiatives, including strengthening and making greater use of AML tools to tackle tax evasion, broadening the scope of false accounting offenses, and providing the revenue authority with access to suspicious transaction reports related to tax crimes would also support the authorities' efforts.

Singapore. The large size and rapid growth of assets under management and weaknesses identified during the 2008 AML/CFT assessment exposed Singapore's financial sector to the risk of being used as a harbor or conduit for illicit assets. Staff welcomed measures already in place or in the process of implementation (including making tax evasion a predicate crime for money laundering, bolstering the framework for international tax cooperation and sharing of tax information), as well as Singapore's commitment to undergo a comprehensive AML/CFT assessment in 2015. Staff advised the authorities to make further efforts to address previously identified deficiencies regarding transparency of beneficial ownership of companies and trusts established or operating in Singapore. Staff further advised strengthening the effective implementation of the AML/CFT standards, particularly by pursuing tax evasion as a predicate crime, and ensuring that service providers report suspicious transactions and close accounts where evidence of beneficial ownership is incomplete. This will help address the reputational risk that may arise from opaque ownership structures in the offshore wealth management sector.

28. Going forward, financial integrity issues will continue to be discussed on a mandatory basis in a limited number of Article IV consultations. Staff will raise them in those cases where the risks they pose are of sufficient magnitude that they become relevant under the Integrated Surveillance Decision. The methodology utilized for this purpose will continue to be guided by the questions and criteria outlined in the 2012 Guidance Note.

B. Fund-supported Programs

29. In a limited number of cases, AML/CFT measures have been incorporated into conditionality under Fund-supported programs.²² The reasons for the relevance of these issues have varied. For example, in the case of Cyprus, addressing weaknesses in the AML/CFT financial

²² For instance, Afghanistan, Cyprus, Greece, Kyrgyzstan, Sao Tome and Principe, and Uganda.

sector supervision was considered necessary to obtain adequate financing assurances, as other lenders expressed significant misgivings about the state of affairs in this area. In the case of Greece, implementation of AML/CFT measures is helping improve fiscal revenue, strengthen financial sector supervision, and undertake necessary structural reforms to improve the business environment (see Box 5). In the case of Afghanistan, addressing deficiencies in economic and financial sector governance, including with respect to money laundering, terrorist financing, financial fraud, corruption, and drug trafficking, was considered critical to achieve the program objectives.

Box 5. Financial Integrity Issues under the Fund-supported Program for Greece

From the outset of the Fund-supported program for Greece, addressing tax evasion and corruption in tax administration was considered crucial to support fiscal consolidation.²³ According to estimates, unreported income for 2009 for the self-employed alone (e.g., doctors, accountants and lawyers) stood at a lower bound of €28 billion. This is to be compared with a GDP for 2009 of €235 billion and a tax base of €98 billion. At the tax rate of 40 percent, the foregone tax revenues would have accounted for 31 percent of the budget deficit shortfall in 2009.²⁴

In July 2011, in an effort to support revenue administration efforts, the authorities committed to make a more effective use of available AML tools.²⁵ In this context, financial institutions play a crucial role since they are likely to possess relevant information relating to suspected tax evasion that may be relevant for the tax administration. Enforcing reporting requirements by the banking supervisor and creating the necessary synergies between the Financial Intelligence Unit (FIU), the tax authorities, and the judicial authorities, was therefore needed.

In March 2012, two AML-related prior actions were introduced in the program. They sought to (a) clarify the Bank of Greece's rules on financial institutions' obligations to detect and report to the FIU transactions suspected of being related to the proceeds of tax evasion and (b) introduce measures to ensure that complaint reports related to confirmed unpaid tax debts arising from an audit were transmitted to the prosecution services and to the FIU (as required under the system in place). These prior actions were implemented and, since then, staff has continued to monitor the implementation of the AML framework in support of the anti-tax evasion efforts and to provide capacity development to the Bank of Greece to create risk-based supervisory tools focusing on tax evasion issues.

In parallel, anti-corruption measures have been gradually stepped up. The current program includes a commitment by the authorities to align their anti-corruption legal framework with relevant international standards and the implementation of an anti-corruption plan. In addition, an anti-corruption coordinator has been established to ensure the coherence and effectiveness of the authorities' efforts.

30. Moving forward, financial integrity issues will continue to be raised in the context of Fund-supported programs when they are critical to financing assurances or to achieving program objectives. As in the case of surveillance, these issues may either relate to money laundering or terrorist financing as such, or to the underlying predicate criminal activities (such as

²³ See *Greece – Staff Report on Request for Stand-by Arrangement*, IMF Country Report No. 10/110, May 2010.

²⁴ Artavanis, Morse, & Tsoutsoura (2012) *Tax evasion across industries: soft credit evidence from Greece*, Fama-Miller Center for Research in Finance, Chicago Booth Paper No. 12-25.

²⁵ In Greece, most tax evasion offenses are predicate offenses to money laundering and it is therefore possible to use the AML framework to support anti-tax evasion efforts.

tax evasion, corruption, drug trafficking, or financial fraud). In such cases, staff will provide the authorities policy advice on the measures that should be taken to address the threats presented by money laundering, terrorist financing, or different types of predicate crimes.

INCLUSION OF FINANCIAL INTEGRITY ISSUES IN THE FSAP

31. The FSAP policy includes a mandatory link between FSAPs and comprehensive AML/CFT assessments. In 2004, after an initial pilot phase, the Executive Board decided to make AML/CFT assessments a regular feature of the ROSC program and of the FSAP.²⁶ The current policy requires that every FSAP incorporate a full AML/CFT assessment which should be conducted approximately every five years²⁷ and, to the extent possible, within 18 months before or after the relevant FSAP mission.²⁸ This applies to the financial stability assessments which, for the 29 jurisdictions with systemically important financial sectors, must take place every five years as a mandatory part of the Fund's bilateral surveillance under Article IV of the Fund's Articles,²⁹ except when they are conducted as a separate financial stability module,³⁰ which, in practice, is rare. Inclusion of AML/CFT issues in the FSAP process is intended to enable Fund and Bank staff to incorporate financial integrity issues into broader financial sector reform efforts. The IMF Executive Board reaffirmed its decision in 2006 and 2011, noting that AML/CFT assessments are an important part of the ROSC and FSAP programs.³¹

32. The treatment of the AML/CFT standard by the Fund and the Bank is unique for several reasons. First, it is the only standard for which a comprehensive assessment is mandatory in all FSAPs irrespective of the level of risks to the financial sector. Second, unlike other standards,

²⁶ This requirement also applied to the conduct of assessments under the Fund's Offshore Financial Center (OFC) program, which was formally incorporated into the FSAP program in 2008. See *IMF Executive Board Integrates the Offshore Financial Centers Assessment Program with the FSAP*, PIN No. 08/82, July 9, 2008.

²⁷ The five year rule was designed to ensure that countries undergo regular AML/CFT assessments.

²⁸ The purpose of the 18 month timeframe was to ensure that reasonably current findings of the AML/CFT assessment are reflected in the country's FSSA while providing flexibility to coordinate the timelines of multiple assessor bodies. The five year and 18 month rules were introduced in 2006. See footnote 13 above.

²⁹ *IMF Executive Board Reviews Mandatory Financial Stability Assessments under the Financial Sector Assessment Program – Update*, Press Release No. 14/08, January 13, 2014.

³⁰ In this respect, the paper *Financial Sector Assessment Program After Ten Years – Experience and Reforms for the Next Decade* (IMF policy paper, August 28, 2009) notes that "The [risk-focused partial ROSC updates] option would not apply to AML/CFT standards, which would continue to be assessed in their entirety. Moreover, initial FSAPs and full FSAP updates would continue to incorporate a full AML/CFT assessment, consistent with existing IMF Board guidance, which also provides flexibility in the timing of the AML/CFT assessment). When FSAP modules are conducted separately in-between "full" updates, on the other hand, it may or may not be appropriate or necessary to incorporate a full AML/CFT assessment." The December 2012 Guidance Note on inclusion of AML/CFT issues in surveillance and financial stability assessments sets out the considerations that staff should take into account when examining the relative importance of AML/CFT issues with respect to other financial stability issues.

³¹ See footnote 13 above and *IMF Executive Board Reviews Efforts in Anti-Money Laundering and Combating the Financing of Terrorism*, PIN No.11/74, June 27, 2011.

there is no latitude under the existing policy for targeted (as opposed to comprehensive) assessments. Third, as mentioned above, it is also the only standard for which the IFIs accept assessments prepared by other assessor bodies (i.e., the FATF and FSRBs) for the purposes of the ROSCs and the FSAPs.

33. The policy on AML/CFT for FSAPs has been successful in important respects. All but three countries that have had an FSAP during the period 2004–2013 have, at some point, been assessed against the 2003 FATF standard. The inclusion of AML/CFT assessments in the FSAPs has contributed to the global dissemination of the standard and deepened the international understanding of and attention to its provisions, and – as reflected in the greater integration of AML/CFT issues in Fund surveillance and supported programs – it has become increasingly clear that robust AML/CFT controls contribute to financial stability and development. In addition, numerous countries have joined the FATF/FSRBs network, while the FATF itself has expanded to include 28 of the 29 countries designated for mandatory FSAPs and 18 of the G-20 countries.³²

34. The difficulty of aligning the FATF/FSRBs schedules with the FSAP timeline, however, has impeded the timely input of AML/CFT content into Financial System Stability Assessments (FSSAs)/Financial Sector Assessments (FSAs).³³ While concerted efforts have been made to coordinate the timing of FSAPs and assessments carried out by the FATF/FSRBs, the different assessor bodies operate under different planning horizons³⁴ and different assessment cycles,³⁵ and most assessor bodies suspended their assessment programs during the 2009–2013 revision of the AML/CFT standard and assessment methodology.³⁶ As a result, only 51 percent of assessments were completed within 18 months of the FSAP mission, and as indicated in the table below, in only about 30 percent of the FSAPs conducted since 2004 has it been possible to incorporate timely AML/CFT content in the FSSA. Timely input was not possible for the other approximately 70 percent of FSAPs either because an AML/CFT assessment already underway was finalized after the publication of the

³² Of the 29 countries designated for mandatory financial stability assessments under the FSAP, only Poland is not a FATF member. Of the G-20, only Indonesia and Saudi Arabia are not FATF members. All three countries are longstanding, active FSRB members, and Saudi Arabia participates in the FATF through the Gulf Cooperation Council, which itself is a FATF member.

³³ The Financial System Stability Assessment (FSSA) for the Fund and the Financial Sector Assessment (FSA) for the Bank are the key deliverables for FSAPs.

³⁴ The FATF and FSRBs typically try to plan their mutual evaluations schedules several years ahead; FSAPs are usually planned a year or so in advance. In addition, most FSAPs are conducted upon request (unlike mutual evaluations, which are mandatory for FATF and FSRB members); until a request is made, their scheduling is uncertain.

³⁵ While the FSAP cycle has, for systemically important countries, retained its five to six year frequency of assessments, FATF and the FSRBs often have a longer round of assessments. In the case of the FATF, it is anticipated that the upcoming fourth round of mutual evaluations (that is scheduled to begin in 2014) will last between seven to potentially ten years depending on whether and to what extent the FATF membership is increased in the coming years.

³⁶ The length of the suspension in the assessment cycles varied from one assessor body to another: it was, for example, of three years for the FATF (which adopted its last mutual evaluation report against the previous standard in February 2011 and is planning to conduct its first assessment against the revised standard in March 2014). The IFIs adopted a similar timeframe, although they did conduct a limited number of assessments against the previous standard where this was necessary (e.g., Rwanda and Panama).

FSSA, the assessment was more than five years old, or because the assessment was conducted after the FSAP. In all these cases, the substance of the AML/CFT input was limited and outdated,³⁷ thus frustrating the objective of incorporating financial integrity issues into broader financial sector reform efforts.³⁸ Table 1 below summarizes how the current policy was implemented.

³⁷ Where the assessment was not conducted or not finalized in line with the FSAP requirements, the AML/CFT input into the FSSA in most cases consisted of a summary of the previous assessment (if the country had undergone a previous assessment) and of the progress reported by the authorities to address the main deficiencies identified (if a progress report was available), as well as of an indication of the dates of any upcoming assessment.

³⁸ In particular, it has limited the ability of subsequent FSAPs to follow-up on deficiencies against the AML/CFT standard identified in those assessments finalized after publication of the FSSA.

Table 1. Practice of Providing AML/CFT Input for FSSA/FSAs Under Current Policy¹

	Optimal: Key Findings with a current ROSC	Second Best: Key Findings without a current ROSC	Sub-Optimal: No Key Findings
Basis	From an AML/CFT assessment conducted within 18 months prior to the FSAP mission and finalized before the FSSA. ²	Country assessed under the most current methodology, more than 18 months and less than 5 years prior to the FSAP mission. ³	No full assessment under the most current by methodology by the time of the FSSA. ⁴
FSAPs: 2004-2013	32%	21%	47%

¹This table reports only on the practice of providing timely AML/CFT information into the FSSA and not whether the tenets of FSAP AML/CFT policy relating to timeliness and frequency of assessments were technically observed.

²Included rare circumstance when there was an FSAP re-assessment and there had been a significant deterioration of the AML/CFT environment since the last AML/CFT assessment, and agreement reached under the burden sharing agreement to bring next assessment forward.

³Key findings were supported by a technical note (updating the information from the latest assessment, including from follow-up reports).

⁴Policy allowed AML/CFT assessments to be completed up to 18 months after the FSAP mission. Thus, if an assessment was underway, but incomplete, the FSSA usually included reference to the timing of the forthcoming ROSC and the ROSC was circulated as a supplemental document after the FSSA.

35. There is no longer a compelling need for Fund or Bank staff to conduct as many comprehensive AML/CFT assessments as they have done in the past. The original policy was motivated by a concern that, in the absence of an FSAP, members would not participate in an AML/CFT assessment. However, most Fund and Bank members are now also members of the FATF/FSRBs network and are therefore subject to regular AML/CFT evaluations irrespective of their participation in the FSAP.³⁹ In an effort to better align its cycle with the five year cycle for mandatory FSAPs, the FATF recently redesigned its follow-up to mutual evaluations to incorporate a targeted

³⁹ Out of 188 members, only 19 are not part of the FATF or of an FSRB, and some of these (highlighted with an asterisk) have become observers to an FSRB as a first step to becoming members (GABAC members in italics): Burundi, *Cameroon*, *Central African Republic*, *Chad*, *Democratic Republic of Congo*, Djibouti, Eritrea, Ethiopia*, *Equatorial Guinea*, *Gabon*, Iran, Kiribati*, Kosovo, Micronesia*, Republic of Congo (Brazzaville), Rwanda*, Somalia, South Sudan, and Tuvalu.

assessment update (with an on-site mission and with re-ratings) five years after the first comprehensive evaluation against the 2012 standard. It is expected that FSRBs will adopt a similar approach. Moreover, the requirement for comprehensive AML/CFT assessments under every FSAP differs from the trend, across standards assessments more generally, toward targeted ROSCs.⁴⁰

36. Going forward, staff proposes to focus its efforts on ensuring the timely input of AML/CFT information into every FSAP. Coverage of AML/CFT issues in FSAPs will remain mandatory and should, where possible, be based on a comprehensive quality⁴¹ AML/CFT assessment conducted by the IFIs or the FATF/FSRBs against the prevailing standard and finalized within a reasonable period prior to each country's next scheduled FSAP. Five years after the first comprehensive assessments, coverage should be based on a FATF/FSRB targeted update and follow-up reports.⁴² Reliance on comprehensive assessments, or on targeted updates and follow-up reports, will enable staff to be in a strong position to prepare a ROSC⁴³ and key findings for inclusion in the FSAP.⁴⁴ Achieving this objective will require:

- Ongoing coordination of FSAP and FATF/FSRBs assessment schedules;
- Authorization to accept and conduct for ROSC purposes targeted updates in line with FATF/FSRBs processes and burden-sharing arrangements; and⁴⁵
- Full participation in robust quality and consistency controls as recently adopted by the FATF to mitigate the risks associated with the Fund's and the Bank's reliance on reports prepared by external assessor bodies.

37. Nevertheless, there will be instances where staff will need flexibility to draw on other sources of information in order to provide timely input in the FSAP. During an initial transitional period, this will frequently be the case because, considering that the new round of assessments has only just begun, comprehensive assessments under the new standard will not always be available. Even after that transitional period, however, there will be occasions – albeit rare – where a comprehensive assessment or a targeted update is outdated due to the inability to align the FSAP and FATF/FSRBs schedules. In either case, staff may need to prepare key findings on the basis of the

⁴⁰ The Fund's Executive Board decided in September 2009 to allow risk-based ROSCs to be conducted for the banking, insurance, and securities supervision standards, and, in March 2011, extended this approach to all ROSCs other than AML/CFT (see *IMF Executive Board Reviews Experience with the Financial Sector Assessment Program, Options for the Future, and Complementary Reforms in Surveillance and the Assessment of Standards and Codes*, PIN No. 09/123, September 29, 2009).

⁴¹ An assessment will be deemed of adequate quality when it has been subjected to a review process equivalent to that adopted by the FATF and, where applicable, has been revised to remedy quality and consistency issues identified through the FATF's global ex post quality review.

⁴² Follow-up reports contain a mix of information, only some of which may be useful for producing a ROSC and key findings.

⁴³ With ratings and recommendations.

⁴⁴ Specifically, in the FSSA for the Fund and the FSA for the Bank.

⁴⁵ Targeted assessments are currently an option for other standards and codes assessments, but not for AML/CFT.

best available information, including: the most recent assessment report; Fund surveillance or program reviews touching on AML/CFT related issues (including DARs relating to banking, insurance, and securities supervisory standards); and FATF/FSRBs follow-up and other reports (e.g., from the International Cooperation Review Group). As necessary, staff could potentially also join the FSAP mission for a review of the most significant AML/CFT issues for the country. In such cases, staff would present the key findings in the context of the current standard and methodology; however, staff would not prepare a ROSC or ratings.

38. The proposed approach would enable staff to always provide timely, substantive AML/CFT input into the FSAP, but does not obviate the need for increased and earlier coordination on AML/CFT in the FSAPs. The Fund and the Bank will continue to rely on the FATF and FSRBs mutual evaluation reports to serve the FSAP in instances where the IFIs cannot conduct the AML/CFT assessment themselves. Earlier coordination between the relevant Departments within both institutions (for example, prior to the Financial Sector Liaison Committee meetings)⁴⁶ would prove helpful in reaching greater alignment of the FSAP and FATF/FSRBs schedules.

39. Greater consistency amongst the findings of the different standards assessment under the FSAP is also desirable. There is a direct correlation between certain requirements of the AML/CFT standard, on the one hand, and those of the standards for banking supervision, insurance supervision, and securities regulation, on the other.⁴⁷ It is therefore important that the findings of the assessments under these standards be consistent. To this effect, a sharing of expertise often takes place in practice, for example, between the Fund's experts on AML/CFT and on banking supervision for the assessment of Basel Committee Core Principle 29 dealing with abuse in financial services, but more in-depth and early coordination (for example prior to the onsite mission and prior to the finalization of the assessment) would be advisable.

40. The increased work on surveillance and Fund-supported programs, not surprisingly, has had resource implications for the Legal Department. Fortunately, these new activities have been carried out during a period when, because of the process of modifying the FATF standard, there have been few assessments. Accordingly, the resources that would normally have been devoted to carrying out the Fund's share of assessments (6 to 7 assessments per year) have been devoted to surveillance and program work. However, in light of the fact that assessments under the new standard are beginning to take place, the existing resource complement will be insufficient if the Fund continues to carry out the same number of assessments. The problem will be exacerbated

⁴⁶ The Financial Sector Liaison Committee (FSLC) was created in September 1998 to strengthen collaboration between the Fund and the Bank in the financial sector as a means for ensuring greater consistency in the advice provided to countries and improving the utilization of scarce resources. FSLC was constituted as a joint committee of senior staff from the Fund and the Bank. It aims at coordinating and prioritizing FSAPs.

⁴⁷ The 2013 methodology specifically refers, under the criteria for the assessment of the level of technical compliance with FATF Recommendations 26 (which deals with the regulation and supervision of financial institutions), to the Core Principles which are relevant for AML/CFT, including Basel Committee on Banking Supervision (BCBS) Principles 1-3, 5-9, 11-15, 26, and 29; International Association of Insurance Supervisors (IAIS) Principles 1, 3-11, 18, 21-23, and 25; and International Organization of Securities Commission (IOSCO) Principles 24, 28, 29 and 31; and Responsibilities A, B, C, and D.

by the Fund's participation in the FATF and FSRBs assessment review processes that are described in paragraphs 15 and 16 above. Moreover, it is not possible for the resources devoted to AML/CFT capacity development activities to be diverted to surveillance work because these resources are externally financed and targeted at capacity building. Accordingly, and taking into account the overall budget constraints and the priority that needs to be given to supporting the Fund's core mandate, the intention is to reduce the number of Fund-led assessments to 2 to 3 per year. Staff will prioritize assessments of countries on a regular FSAP cycle and, as described above, rely on ongoing collaboration with the World Bank and the FATF/FSRBs to ensure that meaningful AML/CFT input is provided to every FSAP in a timely fashion.

RECOMMENDATIONS

41. In light of the above, staff recommends that Directors:

- Endorse the revised FATF 2012 Recommendations and 2013 Methodology for assessing compliance with the FATF Recommendations and the effectiveness of AML/CFT systems;
- Continue to support the direction taken by staff in including financial integrity issues in Article IV consultations and Fund-supported programs;
- Endorse staff's proposals to convert FATF/FSRBs assessments into ROSCs only when conversion is necessary for the purposes of the FSAP, and when the reports have been prepared in conformity with the FATF's universal procedures for AML assessments and are not clearly deficient;*
- Endorse staff's proposal to generate targeted ROSC updates in line with the FATF/FSRBs processes and on the basis of extended burden sharing agreements; and
- Endorse staff's proposal to adjust the FSAP policy on AML/CFT to allow staff to derive key findings from the best available information in cases where there is no timely comprehensive assessment under the current standard and methodology.

* As noted above in relation to paragraph 17, this staff proposal was not endorsed by the Board.

Appendix I. The Current Framework for the AML/CFT Assessment Program – State of Play

Fund and Bank staff conduct AML/CFT assessments in the context of the FSAP, and, in some limited cases, on a “standalone basis” (i.e., under the ROSC program but outside the context of an FSAP). During their June 2011 discussion of the Fund’s AML/CFT program, Fund Directors noted that AML/CFT assessments are an important part of the FSAP and ROSC programs. The current framework to conduct assessments differs from the rules governing ROSCs in other areas in at least three important respects: (a) FSAP policy requires that every FSAP incorporate a full AML/CFT assessment; (b) Fund members are required to undergo a full AML/CFT assessment approximately every five years; (c) a unique burden-sharing arrangement is in place between the Fund and the Bank, on the one hand, and the FATF and the FSRBs on the other to avoid duplicating assessment efforts.

Since 2006, Fund staff has been operating under a Board mandate to conduct 6 to 7 assessments across the Fund’s membership. In practice, staff has been conducting 4 to 5 assessments per year. Over the past two years, however, due to a hiatus in global AML/CFT assessment activity related to the revision of the standard and assessment methodology, the number of AML/CFT assessments has further declined. Between June 2011 and the end of 2013, Fund staff conducted four AML/CFT assessments: three comprehensive assessments⁴⁸ and one targeted.⁴⁹ During this period, staff has also prepared focused technical notes on AML/CFT compliance in support of FSAPs for four countries.⁵⁰

Assessments by the Fund under the new standard may begin as soon as the Executive Board has endorsed the revised standard and assessment methodology. Italy has asked the Fund to conduct its upcoming assessment. The FATF and FSRBs are expecting the Fund to continue to honor the burden sharing arrangements and thus to continue conducting regular assessments of their members.

⁴⁸ Namely those of Georgia, Rwanda and Panama.

⁴⁹ In the case of Liechtenstein, the Fund prepared a Technical Note focusing on 37 of the 40+9 Recommendations. The scope of the assessment was established in accordance with the MONEYVAL (the FSRB of which Liechtenstein is a member) procedures for its 4th round of mutual evaluations. Particular attention was given to the main ML/TF risks identified by staff.

⁵⁰ The United States, the United Kingdom, China and Turkey.

Appendix II. The Fund's AML/CFT Capacity Development (CD) Program

Prior to the downsizing exercise in 2008-2009, the Fund's AML/CFT CD was financed primarily through internal resources. Since then however, the model underlying the IMF's AML/CFT CD program has undergone a complete transformation. In FY2008 this internally funded model was replaced with a new framework under which almost all of the Fund's AML/CFT CD is financed with external resources.

Since 2009, the bulk of the Fund's AML/CFT CD activities to its members is externally financed. Most of the Fund's AML/CFT CD is now financed through a multi-donor Topical Trust Fund (TTF).⁵¹ These resources are supplemented by other multilateral and bilateral subaccounts.⁵² This funding enables Fund staff to deliver customized CD based on countries' engagement and needs, while focusing on the Fund's key areas of expertise. Box 1 below provides an example of a successful project supported by the AML/CFT TTF in Paraguay.

Box 1. Paraguay's New National AML/CFT Strategy

On June 11, 2013, Paraguay's President Luis Federico Franco Gómez signed Decree 11200/13 approving Paraguay's first national AML/CFT strategy. The IMF's TTF-funded CD program that supported the development of the strategy began in September 2012 and was conducted in collaboration with the Inter-American Development Bank (IADB). The IMF and the IADB acted mainly as facilitators to the process, sharing their international and regional experiences and advising the authorities on ensuring consistency with international AML/CFT standards.

The strategy provides a comprehensive and credible plan to help protect the integrity of Paraguay's economic system and preserve public order and national security from the threats of organized crime and terrorism. The strategy organizes Paraguay's AML/CFT efforts consistent with international best practices. In particular, it promotes the full development of a risk-based approach to AML/CFT to allocate resources more efficiently. The CD project benefitted from strong political support within Paraguay, which ensured coordination across 20 public sector entities and private firms. Paraguay's then President-elect Horacio Cartes, attended the official launch of the strategy and recently committed to implementing it upon his assuming the Presidency in August 2013.

⁵¹ The TTF leverages IMF expertise and experience to deliver tailored and sustained AML/CFT CD over the medium term. The TTF is currently supported by 12 donors (Norway, Switzerland, Canada, the United Kingdom, Japan, Kuwait, Qatar, Saudi Arabia, Luxembourg, Korea, the Netherlands, and France) who committed US\$27.7 million for the first five years of operations, i.e. from May 2009 through April 2014. As of December 18, 2013, donors have pledged US\$18.9 million to support a new Phase II of the AML/CFT TTF (2014-2019). An external independent evaluation of the TTF activities from 2009 to 2012 was very positive.

⁵² These accounts are notably funded by Japan, Canada, United Kingdom, Kuwait, Qatar and Libya, and donors to the South Sudan Trust Fund.