

**Israel: Report on the Observance of Standards and Codes—
FATF Recommendations for Anti-Money Laundering and
Combating the Financing of Terrorism**

This Report on the Observance of Standards and Codes—FATF Recommendations for Anti-Money Laundering and Combating the Financing of Terrorism for **Israel** was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed in April 2003. The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of **Israel** or the Executive Board of the IMF.

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ISRAEL

**Report on the Observance of Standards and Codes (ROSC)
FATF Recommendations for Anti-Money Laundering and Combating the Financing of
Terrorism**

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April 2, 2003

EXECUTIVE SUMMARY

This report provides a summary of the assessment of Israel's observance with the FATF 40 Recommendations for Anti-Money Laundering and 8 Special Recommendations on Combating the Financing of Terrorism (FATF 40+8 Recommendations) based on the discussions held in Israel, as well as the responses and other documents provided by the authorities.

Israel has made significant progress in strengthening its regime for anti-money laundering and combating the financing of terrorism (AML/CFT) since 2000. Overall, a comprehensive legal and institutional framework for AML/CFT is now in place, and Israel complies well with the FATF 40+8 Recommendations.

The assessment, nevertheless, identified a number of areas where the regime for AML/CFT could be strengthened, including the need to ensure more consistency among the relevant supervisory authorities in addressing AML/CFT problems, as well as an enhanced information exchange among domestic and overseas supervisors. The staff urged the authorities to work on these areas to strengthen Israel's AML/CFT regime further.

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ABBREVIATIONS AND ACRONYMS

AML	Anti-Money Laundering
BOI	Bank of Israel
CFT	Combating the Financing of Terrorism
CTR	Currency Transaction Report
FATF	Financial Action Task Force
FIU	Financial Intelligence Unit
FT	Financing of Terrorism
IAE	Independent Anti-Money Laundering Expert
IMPA	Israel Money Laundering Prohibition Authority
ML	Money Laundering
MOF	Ministry of Finance
NIS	New Israel Shekel
PMLL	Prohibition on Money Laundering Law
UTR	Unusual Transaction Report

I. INTRODUCTION

1. This Report on the Observance of Standards and Codes (ROSC) for the FATF 40 Recommendations for Anti-Money Laundering and 8 Special Recommendations on Combating the Financing of Terrorism was prepared by a team composed of staff of the International Monetary Fund and an independent anti-money laundering expert (IAE) not under the supervision of Fund staff, who was selected from a roster of experts in the assessment of criminal law enforcement.¹ The report provides a summary of the level of observance with the FATF 40+8 Recommendations, and provides recommendations to strengthen observance.

II. INFORMATION AND METHODOLOGY USED FOR THE ASSESSMENT

2. In preparing the detailed assessment, Fund staff reviewed the relevant AML/CFT laws and regulations, and supervisory and regulatory systems in place to deter money laundering and financing of terrorism among prudentially regulated financial institutions. In addition, the Fund staff reviewed the regulatory systems in place for nonprudentially regulated sectors that are macro-relevant; specifically, currency service providers that have increased in number since the deregulation of foreign currency transactions in 1998. An expert not under the supervision of Fund staff reviewed the capacity and implementation of criminal law-enforcement systems. The assessment used the comprehensive methodology approved by the Fund/Bank Boards as well as the FATF, and is based, with a few exceptions, on the information available at the time of the mission - November 26-December 10, 2002.

III. MAIN FINDINGS

3. **Since an initial 2000 review of Israel's AML systems by the FATF, the authorities have made significant progress for which Israel is now recognized by the FATF and others in the international community to have a comprehensive AML/CFT legal and institutional framework.** The Prohibition on Money Laundering Law (PMLL) was enacted in August 2000, as comprehensive legislation that addresses money laundering as a criminal offence, as well as customer identification, record-keeping, and reporting requirements. Israel has promulgated numerous regulations to implement the PMLL and, in 2001, issued orders to banks, members of the stock exchange, portfolio managers, insurance companies, provident funds, and the postal bank to require customer identification, record

¹ The assessment was conducted by Kiyotaka Sasaki (MAE), Margaret Cotter (LEG), and Jack de Kluiver (U.S. Justice Department), the independent anti-money laundering expert (IAE). Throughout this report, portions of the assessment attributable to the IAE are shown in *italics*.

keeping, and the submission of unusual transaction reports (UTRs) and currency transaction reports (CTRs). In January 2002, the Israel Money Laundering Prohibition Authority (IMPA) became operational as Israel's financial intelligence unit (FIU) and began receiving UTR and CTR reports in February 2002. In other developments, IMPA joined the Egmont Group of Financial Intelligence Units (FIUs) in June 2002.

4. **Israel's institutional arrangements for AML/CFT involve numerous institutions.** The IMPA has the responsibility for receiving and disseminating reports based upon CTRs and UTRs. The Bank of Israel (BOI) has responsibility for the AML oversight of banks; the Israel Securities Authority for the securities industry; the Ministry of Finance (MOF) for insurance, currency service providers, and provident funds; and the Ministry of Communication for the postal bank. Offices within the Ministry of Justice have responsibility for ML/FT prosecutions. The police and customs service investigate ML cases, initiate seizures, and address cross-border transfers. Several interagency groups or task forces also have responsibility for various aspects of AML/CFT.

5. **Israel's AML/CFT regime, including the PMLL and associated orders and regulations, as well as the institutional arrangements, are extensive and provide an adequate framework for prevention and detection of ML/FT.** Although the implementation of PMLL is still at an initial stage, the assessment team noted a high level of awareness of AML/CFT issues, and considerable efforts to further enhance the current regime, including an amendment to the PMLL in May 2002 extending AML/CFT requirements to currency service providers. The framework permits adjustments to allow for fine tuning of the orders as needs arise, and as experience is gathered. In addition, the newly established IMPA is structured to provide significant value-added analysis to investigations by identifying more relevant CTRs and UTRs.

6. **The assessment, nevertheless, identified a number of areas where the regime for AML/CFT should be strengthened. Some of these areas were already noted by authorities before the assessment and plans for improvements were in preparation,** including the enactment of amendments to the PMLL relating to the financing of terrorism.

A. Criminal Justice Measures and International Cooperation

Criminalization of ML and FT

7. **With respect to terrorism financing, Israel has long criminalized such activity.** Israel has ratified and implemented the Vienna Convention and implemented United Nations Security Council Resolution 1373. In February 2003 Israel's ratification of the United Nations Convention on the Suppression of the Financing of Terrorism came into force, which had earlier been signed in July 2000. The authorities believe this Convention may be fully implemented based upon current law, as Israeli laws dating from 1945 and 1948 already criminalize the financing of terrorism. Amendments to the PMLL are also planned that provide additional criminal provisions prohibiting the financing of terrorism. These provisions address more directly the obligation to report regarding terrorist property. The

planned provisions for the PMLL would also make application to terrorist acts directed at non-Israeli interests explicit. Obligations to report for financial institutions that are direct and explicit, and have greater permanence than current provisions that are linked to the state of emergency within Israel, will be a welcome addition to the legal framework for CFT.

8. **Ratification of the Palermo Convention, although not expected immediately, is also close at hand.** All steps necessary for ratification to be effective, and any domestic legislation necessary for full implementation, should be undertaken as soon as possible.

9. **Money laundering is criminalized, but one of the two major money-laundering criminal offenses contains a substantial monetary threshold. The economic dynamics and implications of such a threshold should be considered.** Although acquisition, possession, and use of criminal proceeds without a showing of concealment are a criminal offense under Section 4 of the PMLL, there is a substantial monetary minimum for the conduct to be criminal. With conduct criminalized under Section 3 of PMLL without a threshold, a threshold in Section 4, although not preferred, is acceptable. However, the level (for monies at about \$80,000 over a three-month period) is high, and is likely to invite conduct just under this substantial amount for which there would be no criminal penalty. In addition, the use of two thresholds, one for monetary and another for other assets, should be reevaluated.

10. **Consideration should be given to an all-serious-crimes approach or all serious crimes over a specified penalty-plus-list approach to predicate crimes.** With the anticipated ratification of the Palermo Convention, it is important that, at a minimum, every offense under Israeli law for which there is a maximum deprivation of liberty of four years is set forth as a predicate offense. Israeli officials should consider whether an alternate approach would be easier, obviating the need to update the list, as new offenses are added to the penal code or as current offenses are found that have been overlooked.

Confiscation of proceeds of crime

11. **The legal framework for seizure and forfeiture is complex.** Statutory provisions exist in a number of laws and apply in various circumstances. In criminal matters, seizure and forfeiture are generally fully available, but as Israeli officials recognize, secondary issues need to be addressed, including a 90-day limitation for provisional freezing before indictment and procedures, and standards for restraint-order hearings. **The PMLL's provisions for civil forfeiture are narrowly drawn, making civil forfeiture largely unavailable.** A comprehensive civil forfeiture scheme, as that under consideration through amendments to the PMLL, would go a long way to support an AML/CFT program that is effective in practice in reaching criminal proceeds.

12. **With the critical importance of an effective pre-trial restraint, confiscation and seizure scheme both on an *in rem* (civil) basis and in the context of criminal proceedings, a review of confiscation/restraint mechanisms, already occurring in some**

areas and contemplated in others, is a positive step. Enhancements hold promise to support a more effective AML/CFT program.

FIU and processes for receiving, analyzing, and disseminating intelligence

13. *The IMPA collects CTR and UTR information, maintains that information, and proactively analyzes information to identify targets, and new ML or FT typologies. The IMPA acts as an effective privacy filter of collected financial information and can pass to law enforcement or intelligence agencies only financial information likely associated with criminal activity. However, law enforcement investigators cannot review CTR and UTR information themselves and must rely upon the IMPA's ability to provide them with competent analysis of suspicious financial information in a timely manner.*

14. *Through the first 10 months of operation, the IMPA has referred only 32 UTRs to law enforcement, which is less than 10 percent of UTRs filed, and it has timely executed dozens of requests for CTR or UTR information from law enforcement. The IMPA's participation in the Egmont Group and MOUs with another 10 foreign FIUs allows it to provide and obtain financial data to and from other FIUs of many other nations. The IMPA appears to be well funded, and has a very professional and qualified staff. The utility of information captured by CTRs, however, is dubious due to the unusually high reporting thresholds for currency transactions and the high percentage (37 percent of all CTRs filed) of transfers abroad that have been put into the CTR database.*

15. The Israeli legal framework (PMLL and associated orders) contains provisions prohibiting financial institutions from tipping-off customers when information is being reported to IMPA. However, in some instances these provisions are limited in scope, and though the authorities believe its interpretations of the provisions would address the issue, the provisions nonetheless merit review for effectiveness. The BOI indicated post-mission that an amendment to the Banking Order is under consideration that would address concerns of the assessors in the context of banking.

Law enforcement and prosecution

16. *As for the actual implementation under Israel's current AML/CFT criminal justice laws, Israel is to be congratulated for having obtained a relatively high level of AML/CFT criminal justice component implementation in a short period of time. However, Israel's AML provisions are only two years old, and some changes to Israel's AML provisions have yet to be enacted and fully implemented. Therefore, it is difficult to assess whether Israel has the capacity to fully implement all the criminal justice components of its AML/CFT regime until they are fully in use.*

17. *The Police and the Customs Service are authorized to investigate ML cases, with the Customs Service investigating only customs-related ML offenses. The Israel Security Agency has the primary responsibility for FT intelligence gathering. All these agencies have created and implemented comprehensive AML/ CFT enforcement programs by dedicating full-time personnel and resources to these issues. The Police and the Security Agency share*

intelligence information. The Police's AML unit is a headquarters unit that coordinates all AML investigations, organizes and conducts AML training, and liaises with other AML/ CFT governmental components.

18. *Currently, 24 prosecutors who specialize in tax and economic crimes prosecute most ML and FT cases in the Tel Aviv District Office of the state attorney's office. As there are currently less than 10 ML cases under consideration, there should be sufficient resources to handle these ML prosecutions, assuming no other offenses that the Tel Aviv Unit prosecutes take precedence. The 500 prosecutors in other state attorney's offices are permitted to handle ML cases but are encouraged to consult the specialized Tel Aviv Unit. The wide array of predicate offenses listed in the PMLL will greatly expand Israel's asset forfeiture capabilities, and it is reasonable to expect a dramatic increase in ML investigations by the Police. This will also result in a substantially larger number of asset forfeiture cases. **There is a need for wider ML and asset forfeiture prosecutorial expertise in other offices, and more ML and asset forfeiture training than presently available.***

International cooperation

19. **Israel's Legal Assistance Law permits Israeli authorities to provide a full range of legal assistance even in the absence of dual criminality or a treaty.** Laws and procedures in place for extradition for ML and FT offences meet international standards. With respect to foreign forfeiture orders, the Israeli courts are empowered to enforce such orders in drug and money-laundering matters; in late January 2003, this was extended to include terrorism and terrorism-financing crimes. The availability of effective means to enforce foreign forfeiture orders is critical in the fight against terrorism. Legislation permitting this should be a priority. In addition, while Israeli authorities may order the sharing of property forfeited at foreign request, sharing in domestic cases has not been addressed, although orders in such cases may be based in part upon information or assistance from a foreign authority. The authorities should consider an extension to permit sharing in domestic matters.

B. Preventive Measures for Financial Institutions

Prudentially-regulated sectors

20. Israel's AML legislation applies to banking corporations; members of the stock exchange; portfolio managers; insurers; and insurance agents; provident funds and companies managing provident funds; the postal bank; and providers of currency service. Seven orders were issued to each of the financial sectors that require customer identification, record keeping, and submission of UTRs and CTRs. All relevant institutions have specified supervisory authorities such as BOI for banks; Israel Securities Authority for securities firms; and the MOF for insurance, currency service providers and provident funds.

21. The supervisors for each financial sector are granted sufficient power to take actions against financial institutions who fail to fulfill their AML/CFT obligations under the PMLL and the associated orders as well as the various supervisory acts. They also have been

enhancing their supervisory oversight to ensure financial institutions' compliance with PMLL by issuing regulations, circulars, and letters that require more details to comply with PMLL. The BOI, MOF, and Israel Securities Authority have initiated onsite inspections focusing on AML/CFT compliance using inspections manuals that were developed for AML/CFT compliance.

22. In spite of the multiplicity of institutions that are responsible for AML/CFT, there appears to be a strategic level of coordination and effective implementation in the initial stages of AML/CFT enforcement. **However, cooperation with supervisors in Israel, as well as with overseas supervisors, is currently constrained for BOI and MOF.** Under current sector-specific laws, the governor of BOI and the Commissioner of Insurance of MOF may share only criminal information. The BOI, however, may share information with foreign supervisors with a letter of consent from banks and, in addition, plan amendments to legislation that will permit this same kind of cooperation with foreign supervisors. The chairperson of Israel Securities Authority may share information with supervisory and other authorities, both domestic and foreign, within his/her discretion. Consideration should be given to amendments to laws to widen the possibilities for sharing and cooperating with both domestic and foreign supervisory authorities regarding individual matters.

23. **In a system such as Israel's, where there are separate supervisory authorities for the various sectors and thus an ability to tailor approaches to the realities and particular issues presented in each sector, a divergence in supervisory approaches is expected and acceptable. However, as this relates to AML/CFT, divergences appear to go beyond what would be normal and expected.** More consistency in the supervisory approach for AML/CFT issues between sectors could be achieved through closer coordination among the relevant authorities. Following the recommendation by the assessment team, the authorities established working groups in January 2003, which are composed of representatives from the relevant authorities responsible for AML/CFT.

24. One of the significant differences in approaches among financial sectors is that **the MOF's order for customer identification, record keeping and suspicious activity reporting is limited to life insurance, thereby excluding nonlife insurance activities.** Risks of ML/FT to nonlife insurance business needs to be assessed, with subsequent consideration of the application of the AML legislation to nonlife insurance transactions.

25. Another weakness for the AML/CFT regime across all financial sectors is related to monetary thresholds. First, many of the unusual transactions listed by way of example in orders applicable in the various sectors are limited by monetary thresholds. For instance, for banking, atypical transactions and wire transfers lacking appropriate information are deemed suspicious only if in excess of NIS 200,000 (approximately \$43,000). **These thresholds signal to financial institutions that transactions that are unusual in and of themselves need not be reported, and are not appropriate in these lists.** The BOI indicated post-mission that such thresholds are being reconsidered.

26. **In addition, a list of examples of UTRs contained in a number of orders by supervisors has not been updated in a timely fashion.** Considering the short history of UTR submissions since February 2002, this seems reasonable. The IMPA and supervisors recognize the importance of providing guidance and feedback to financial institutions, and have disseminated information on trends in ML typologies on a number of occasions. They also plan to issue guidelines, as more UTRs are accumulated at IMPA (for example, the Commissioner of Insurance issued a circular on January 1, 2003). They are encouraged to maintain the awareness of financial institutions by the issuance of guidelines, as well as through offsite and onsite supervision.

27. Monetary thresholds are problematic with respect to record-keeping requirement as well. Under most of the orders issued within the various sectors, financial institutions must maintain documents for transactions of NIS 50,000 (approximately \$10,750) or more, and those underlying UTR reports. **While other provisions of law may ameliorate this situation and require the records, the threshold should nonetheless be re-evaluated to ensure records are always available to trace proceeds and prosecute cases.** Money laundering operations include related transactions, both large and small. All transaction records, or at least all those in excess of a very nominal amount, should be maintained for AML/CFT purposes. The threshold is currently under consideration by the BOI.

28. Specifically, for banking sectors that are exposed to the higher risk of ML/FT, two weaknesses are noted. First, under Section 15(a) of the Banking Order, **customer identification requirements are not applied to overseas entities of Israeli banks if AML legislation exists in the host country, regardless of the robustness of the regime.** However, banks should be required to apply the higher standards to overseas entities in host countries with weaker AML regimes. Secondly, **there are no explicit integrity requirements for managers and directors of banks.** However, the BOI plans amendments to banking legislation to establish explicit integrity requirements for managers and directors at banks in the coming Knesset session.

Nonprudentially regulated sectors (currency service providers)

29. To implement PMLL in April 2002, the MOF issued an order requiring that currency service providers register with the MOF and that they conduct customer identification, record keeping, and CTR and UTR reporting to IMPA. The registrar at the MOF conducts the oversight of currency service providers to ensure compliance with PMLL through offsite monitoring and onsite inspections, but not for prudential purposes. Although supervision of currency service providers is not for prudential purposes, currency service providers are subject to the same AML/CFT regime that is applied to prudentially-regulated financial institutions.

IV. SUMMARY ASSESSMENT AGAINST THE FATF RECOMMENDATIONS

30. Overall, current measures in Israel to prevent ML/FT are extensive and, for the most part, adequate as a framework for AML/CFT, and Israel complies well with the FATF 40+8 Recommendations. The shortfalls identified in the report are not significant and are largely in the process of being addressed by the authorities. Table 1 summarizes recommended actions in areas related to the FATF 40+8 Recommendations which would be given higher priority, while Table 2 contains other recommendations to further enhance the AML/CFT regime.

Table1. Recommended Action Plan to Improve Compliance with the FATF Recommendations

Reference FATF Recommendation	Recommended Action
Forty Recommendations for AML	
Customer identification and record-keeping rules (FATF 10–13)	Review and revise transactions records maintenance requirement with monetary threshold, as is occurring.
Increased diligence of financial institutions (FATF 14–19)	<p>Institute measures to ensure that insurance and securities firms document findings regarding possible UTRs, not just filed UTRs and CTRs, in writing and keep findings available for regulatory reviews.</p> <p>Eliminate monetary thresholds in lists of unusual transactions set forth in orders, as is occurring.</p> <p>Update and enhance tipping off prohibition in the law and associated orders, as needed to ensure effective prohibition.</p> <p>Ensure that all financial institutions, not only banks, have AML/CFT programs that cover internal policies and procedures, including internal audits, particulars regarding employee training.</p> <p>Ensure that all financial institutions have screening procedures for high standards in the hiring of employees.</p>
Measures to cope with countries with insufficient AML measures (FATF 20–21)	Have foreign branches of Israeli banks apply the higher standard between Israel and host jurisdiction for customer due diligence and record keeping.
Implementation and role of regulatory and other administrative authorities (FATF 26–29)	<p>For banking and insurance sectors, widen possibilities for sharing and cooperation with both domestic and foreign supervisory authorities.</p> <p>Review to ensure the Commissioner of Insurance may share information for purposes of all criminal matters.</p> <p>Supplement, as planned, not only for life insurance sectors, guidance and training programs for (i) ML/FT techniques, methods, and trends, and (ii) explanations of laws and requirements.</p> <p>Require integrity standards for managers and directors at banks, as planned.</p>
Other forms of cooperation—Focus of improved mutual assistance on money laundering issues (FATF 36–40)	Review restrictions relating to the enforcement of foreign forfeiture orders on a benefit/burden basis.
Eight Special Recommendations on Terrorist Financing	
VII. Wire transfers	<p>Implement requirement in Regulation 411 relating to funds transfers.</p> <p>Strengthen provisions relating to banks giving enhanced scrutiny to wire transfers that lack complete originator information</p>

Table 2. Other Recommended Actions

Reference	Recommended Action
Criminal Justice Measures and Law Enforcement	<p>Ratify the Palermo Convention, as planned, as soon as possible.</p> <p>Harmonize domestic law to implement conventions, including separate permanent legislation that addresses the financing of terrorism, as planned.</p> <p>Reconsider both thresholds for those money laundering criminal offenses that do not require showing of concealment, and the existence of two threshold amounts.</p> <p>Strengthen the knowledge standard for Section 4 offenses as planned.</p> <p>Review (as is occurring), fine tune, and enhance mechanisms under Israeli law for pre-trial restraint, confiscation, and seizure with a focus on enhanced civil forfeiture, time limitations for restraints, and procedures for hearing third-party rights.</p> <p><i>Provide IMPA access to law enforcement databases or provide law enforcement with access to IMPA's database.</i></p> <p><i>Set up regularly scheduled monthly or quarterly meetings on AML/CFT for representatives of IMPA, the Police NML, Customs, Security Agency, and relevant prosecutors.</i></p> <p><i>Have state attorney's office invest more resources on training prosecutors in ML/FT and asset forfeiture.</i></p> <p><i>Have the Police and state attorney's office develop computerized methods to track ML investigatory and prosecutorial data.</i></p>
Preventive Measures for Financial Institutions	<p>More consistency in the supervisory approach for AML/CFT issues between financial sectors could be achieved through closer coordination among the relevant authorities.</p> <p>Risks of ML/FT to nonlife insurance business needs to be assessed, with subsequent consideration of the application of the AML legislation to nonlife insurance transactions.</p>

Authorities' response

31. Israel welcomes the assessment that it complies well with the FATF 40+8 Recommendations. Israel also welcomes the assessment that it has a comprehensive legal and institutional framework for AML/CFT. As was well noted, this regime is constantly being examined, reviewed, and updated to provide answers to new problems and to the growing sophistication of criminals and terrorists.

32. Israel has provided a list of detailed comments to the assessment. One particular comment is to the suggestion that law-enforcement agencies should have direct access to the information of the FIU. The choice of an appropriate model of FIU for a country naturally depends on the country's specific environment and conditions. Israel has adopted an administrative FIU model, and has done so on the basis of a thorough study of different models offered by the international professional community, and in light of the specific circumstances and systems in Israel. The FIU model in Israel has several important advantages. Inter alia, this model allows for a balance between privacy protection of the public at large (especially since most CTRs contain innocent information, which is irrelevant to law-enforcement agencies), and the need to effectively combat money laundering and terrorism financing. This model relies on the FIU's specialization and professionalism in analyzing data and reports, and enables the FIU to disseminate selective valuable information to law-enforcement agencies and foreign FIUs. As the assessment noted, the Israeli FIU is structured to provide significant value-added to potential investigations by a strong filtering process. In addition, the model promotes "a climate of trust" between various financial institutions and the FIU, thus improving the quality and quantity of the reports made. This is a widely effective and internationally accepted model that is being used by many countries. The Israeli FIU is a member of the Egmont Group, and it has been asked to share its experience with colleagues from other countries.

33. Israel appreciates the recommendations and intends to study them very carefully. As noted, some of its recommendations touch upon issues that had already been noted by Israel prior to the team mission, and concrete plans to address these issues have already been formulated or are under preparation. Some of the other issues and comments that were raised are already being worked into the system toward implementation. Proposals for some of the other measures suggested would have to be assessed on the basis of their specific relevance to the Israeli system, using cost-benefit principles, and would also have to be examined in light of their justification applying risk-based principles.