

**FOR
AGENDA**

SM/01/103

April 5, 2001

To: Members of the Executive Board

From: The Secretary

Subject: **Enhancing Contributions to Combating Money Laundering—
Policy Paper**

Attached for consideration by the Executive Directors is a paper prepared by the Fund and World Bank staffs, on enhancing contributions to combating money laundering. Issues for discussion appear on pages 21 and 22. This subject will be brought to the agenda for discussion on a date to be announced shortly. Following the Board discussion, the summings up from the Fund and World Bank Board meetings would be transmitted by the Managing Director of the Fund and the President of the World Bank with a joint cover note, to serve as the report requested by the International Monetary and Financial Committee. The staff proposes the publication of the policy and background papers after the Executive Board completes its discussion together with a PIN summarizing the Executive Board's discussion.

Questions may be referred to Mr. H. Evans (ext. 34918), Mr. Gajdeczka (ext. 37124), Mr. R. Gordon (ext. 34103) and Mr. M. Moore (ext. 38631).

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INTERNATIONAL MONETARY FUND AND WORLD BANK

Enhancing Contributions To Combating Money Laundering: Policy Paper

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April 5, 2001

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I. INTRODUCTION

1. The International Monetary and Financial Committee (IMFC), at its September 2000, meeting, requested “the Fund to prepare a joint paper with the Bank on their respective roles in combating money laundering and financial crime, and in protecting the international financial system.” Moreover, the two institutions were asked to explore incorporating work on financial system abuse, particularly with respect to international efforts to fight against money laundering into its various activities, as relevant and appropriate.

2. An informal question and answer session with the Fund Board was held in February 2001 on the basis of the staff paper *Financial System Abuse, Financial Crime and Money Laundering—Background Paper* (SM/01/46); in September 2000, Bank staff prepared an information note for the Bank Board on *The Role of the World Bank Group in Promoting the Integrity of Financial Markets* (September 21, 2000). These documents provide relevant background material for this paper. A joint Fund/Bank workshop on financial abuse, with seven outside speakers (including the current President of the Financial Action Task Force (FATF)), was held at the Fund on February 27, 2001.

3. Although no formal conclusions were drawn from these meetings, the following propositions seemed to gain some acceptance:

(i) while financial abuse covers a variety of activities, it would be productive at the present time to concentrate on the role of the Fund and Bank in efforts to combat money laundering;

(ii) the Fund and the Bank are already helping countries strengthen their financial supervision and regulation, as well as legal and governance structures, contributing to the prevention of financial sector crime and money laundering;

(iii) substantial efforts relevant to countering money laundering are undertaken by other bodies and closer international cooperation would benefit all; and

(iv) the Fund’s and the Bank’s work on strengthening financial supervision through the application of financial standards, including the preparation of relevant Report on the Observance of Standards and Codes (ROSC), overlaps with the financial/supervisory aspects of the Financial Action Task Force 40 Recommendations (FATF 40).

4. This paper proposes that the Fund and the Bank strengthen their role in the global fight against financial sector abuse, and money laundering specifically, by (i) publicizing, through official statements and other forms of outreach, both the need to put in place the necessary economic, financial, and legal systems designed to protect against money laundering and the role that the Bank and the Fund are playing in helping to meet this need; (ii) recognizing the FATF 40 as a standard for anti-money laundering useful for Fund/Bank operational work, (iii) when undertaking Financial Sector Assessment Program (FSAP), ROSCs and Offshore Financial Center (OFC) assessments, intensifying the focus on anti-

money laundering elements in the assessment of supervisory standards—Basel Committee Principles (BCPs), International Organization of Securities Commissions’ Objectives and Principles for Securities Regulation (IOSCO Principles), and the International Association of Insurance Supervisors Insurance Supervisory Principles (IAIS Principles)—and producing a detailed assessment which, with the concerned country’s permission, could be published or shared with the FATF and/or the appropriate regional anti-money laundering task forces; (iv) working more closely with the major international anti-money laundering groups; and (v) increasing the provision of technical assistance (TA) from the Bank and Fund in this area.

5. Section II discusses work currently undertaken by the Fund and Bank that is relevant to countering financial abuse, especially with respect to helping national authorities improve their systems of financial regulation and supervision so as to create the environment within financial institutions to deter financial crime and money laundering. The paper then reports in Section III on the wider international efforts, including the work of the FATF and regional anti-money laundering task forces, in combating money laundering. Steps to enhance the Fund and Bank contributions to anti-money laundering efforts are proposed in Section IV. Section V discusses the resource implications. The key questions before Executive Directors (Section VI) are (a) whether the FATF 40 should be recognized as a standard for Fund and Bank operational work; and (b) how to enhance work on money laundering issues in Fund and Bank activities, in particular in technical assistance, including with respect to FSAP, ROSCs and OFC assessments, as well as in the context of technical assistance.

II. THE FUND’S AND THE BANK’S ACTIVITIES RELEVANT TO THE COUNTERING OF FINANCIAL SYSTEM ABUSE

6. Money laundering is a problem of global concern, requiring concerted and cooperative action on the part of a broad range of institutions. The Fund and the Bank’s principal contributions to the fight against money laundering have been in their work to promote stronger financial, economic, and legal systems in general. Strengthened supervisory systems and robust legal and institutional framework for financial institutions help prevent a broad range of financial sector abuses, including money laundering. This section first discusses the activities special to each institution, then turns to those pursued jointly.

A. Fund Activities

7. Financial sector issues are central to the Fund’s mandate as they are rooted in its purpose to promote macroeconomic stability and growth.¹ Anti-money laundering issues related to financial supervision and regulation (primarily those included in BCPs, IOSCO or IAIS Principles) are germane to the Fund’s core responsibilities, while other anti-money

¹In April 1997, at the conclusion of the Biennial Review of Fund Surveillance, the Board called for increased attention in the period ahead to capital account and financial sector and banking sector issues (SUR/97/38, April 3, 1997). At the conclusion of the 2000 Biennial Surveillance Review, Directors recognized financial sector issues as one of the core issues in Fund surveillance (SUR/00/32, March 21, 2000).

laundering issues associated with criminal law enforcement (primarily those not included in BCPs, IOSCO or IAIS Principles) are beyond the Fund's core areas. Under existing Fund policies, anti-money laundering issues other than those relating to financial sector regulation and supervision are covered under surveillance and conditionality, as with other governance matters,² only if they pass the macro-relevance test.³ The Fund could raise the issue of cross-border implications of money laundering, e.g., during the Article IV consultation, for a given member when this is macro-relevant for other members or important for stability of the international financial system (under Article XII, Section 8).

8. The Fund in its broad operational activities—surveillance, conditionality and technical assistance—promotes stronger financial systems, including through FSAPs, OFC assessments, and ROSC exercises. The Fund's work helps national authorities strengthen their supervisory and regulatory systems which, in turn, helps both to promote the safety and soundness of the financial sector and to create an environment that prevents financial system abuse. In particular, assessments of observance of international standards, codes, and best practices in the areas of financial supervision, prudential regulation, transparency of fiscal and monetary policies, and data provision and dissemination have the potential to play a major role in fostering financial market integrity. In this context, the Fund staff has followed the guidance given in *Concluding Remarks Following the Executive Board Discussion of the Fund's Role in OFC Assessments (Offshore Financial Centers—The Role of the Fund)* (BUFF/00/98), July 14, 2000). Directors stressed that effective anti-money laundering measures were important for the integrity of the financial system as well as for fighting financial crime, and that such measures were part of the core supervisory principles covering all financial sectors. Directors also noted, however, that anti-money laundering measures promoted by FATF included law enforcement measures, which would not be appropriate for the Fund to assess.

Surveillance and conditionality

9. The emphasis on financial sector soundness in Article IV surveillance has increased in recent years.⁴ In an earlier review **of the coverage of financial sector issues in**

² See *Summing Up by the Acting Chairman of the Review of the Fund's Experience in Governance Issues*, Executive Board Meeting 01/14, February 14, 2001, (BUFF/01/22, February 22, 2001). The 1997 Guidance Note on Governance stressed a more comprehensive treatment of governance issues within the IMF's mandate and expertise. The note recommends, *inter alia*, a more comprehensive treatment in the context of both Article IV consultations and IMF-supported programs of those governance issues that are within the IMF's mandate and expertise.

³ While the empirical evidence on the magnitude of financial system abuse including money laundering is limited, significant macroeconomic effects on individual countries cannot be ruled out.

⁴ See *Summing Up by the Acting Chairman, Biennial Review of the Implementation of the Fund's Surveillance and of the 1977 Surveillance Review*, (SUR/00/32, March 21, 2000).

Article IV surveillance, staff found that assessments of banking systems and prudential and supervisory frameworks were discussed in almost every report reviewed.⁵ As a follow-up and in order to provide a snapshot of the treatment of financial system abuse issues, a sample of staff reports in the context of Article IV consultations and use of Fund resources was reviewed for references to financial system abuse issues. Taking into account that explicit operational guidance to staff on the Fund's role in addressing anti-money laundering issues is both limited and recent, the sample focused on staff reports for members hosting major financial centers and those members included in the lists published by the Financial Stability Forum (FSF), FATF, and OECD.⁶ Accordingly, the staff survey covered 48 staff reports issued during January 1999–December 2000.⁷ Staff reports were examined for the coverage of money laundering, other financial crime (e.g., pyramid schemes, fraudulent sale of financial instruments), tax evasion, and corruption related to the financial sector. The reports were also reviewed for coverage of banking secrecy, which may contribute to financial abuse, as well as of the offshore financial activities that may be subject to less stringent regulation and supervision and thus potentially susceptible to financial system abuse.

10. More than half of the staff reports reviewed included references to financial system abuse-related issues. Specifically, 19 reports covered money laundering, six referred to financial crime generally, eight to banking secrecy, 12 to tax avoidance (or tax havens), and six to corruption. Six staff reports included specific references to the authorities' reaction to their countries being placed on one of the lists promulgated by the FSF, FATF or OECD alleging substandard compliance with their particular criteria.

Technical assistance

11. Staff has provided technical assistance on the design of prudential regulation and banking supervision schemes of many Fund members.⁸ The most extensive TA in this

⁵ Sixty-six Article IV consultation reports for emerging market and transition economies in 1998 and 1999 were reviewed. See *Biennial Review of the Implementation of the Fund's Surveillance and of the 1977 Surveillance Decision*, (SM/00/40, February 18, 2000), pages 23-26.

⁶ Major financial centers include Germany, Hong Kong SAR, Japan, Luxembourg, Singapore, Switzerland, United Kingdom, United States. Others countries include Antigua and Barbuda, Bahamas, Bahrain, Barbados, Belize, Costa Rica, Cyprus, Dominica, Grenada, Israel, Lebanon, Liberia, Malaysia (Labuan), Maldives, Malta, Mauritius, Panama, the Philippines, Russia, Seychelles, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Tonga, and Vanuatu.

⁷ The sample includes 3 use of Fund resources reports, 2 combined Article IV and use of Fund resources reports and 43 Article IV reports.

⁸ Technical assistance reports by MAE during January 1992–October 2000 were surveyed for references to money laundering. Of a total of 998 MAE technical assistance reports electronically available, 115 reports contained references to money laundering.

area has been provided in the context of OFCs, FSAP, and ROSC modules.⁹ **The OFC assessment program** has involved missions to 17 jurisdictions between October 2000 and March 2001. A progress report on the program (SM/01/43) was provided to the Fund Board on February 9, 2001. Anti-money laundering legislation, regulations and practices are being put in place by a number of jurisdictions, some with the support of Fund TA. Many of these OFC jurisdictions intend to request a Fund assisted assessment of financial sector standards and codes or an FSAP-type comprehensive assessment of their financial systems. FSAPs and ROSCs involve both the Fund and the Bank, and are discussed below.¹⁰

B. Bank Activities

12. Consistent with its development mandate and comparative strengths, the Bank Group has been contributing to the global efforts to combat financial abuse and money laundering in three ways:

- First, helping countries identify and address structural and institutional weaknesses that may contribute to the lack of market integrity and potential for financial abuse.
- Second, participating in targeted international efforts to combat money laundering based on its mandate and expertise.
- Third, ensuring that the Bank Group's own financial transactions do not inadvertently undermine international actions to curb illegal practices.

Strengthening structural and institutional underpinnings

13. As a global development institution, helping countries put in place strong economic, financial and legal foundations is the principal contribution that the Bank can make to the efforts to combat financial abuse. In recent years, the Bank has stepped up these efforts and is taking a more systematic approach in partnership with others, especially the Fund. There are three main related areas of work that are of particular relevance to increasing resilience against financial abuse, and where the Bank has deepened its involvement:

14. **Anti-corruption, governance and public financial management.** The Bank has greatly expanded its program in the areas of anticorruption, governance and public financial

⁹ This work has been discussed by the Executive Board. See, for example, *Offshore Financial Centers—The Role of the Fund* (SM/00/136 and BUFF/00/98), *Financial Sector Assessment Program—A Review—Lessons from the Pilot and Issues Going Forward* (SM/00/263, November 27, 2000 BUFF/00/190, December 12, 2000), and *Experience with Basel Core Principles Assessments* (SM/00/77).

¹⁰ Currently, assessment of BCPs are defined as being within the Fund's direct operational focus (Group 1). IOSCO and IAIS Principles are defined as being within both the Fund and Bank's operations focuses (Group 2). All three are generally assessed under the FSAP, and separate ROSC modules on these standards have increasingly been prepared as part of the FSAPs. See *Assessing the Implementation of Standards—A Review of Experience and Next Steps* (SM/10/11, January 12, 2001).

management.¹¹ Since the launch of the Anti-Corruption program in 1997, the Bank has supported more than 600 lending and non-lending activities in approximately 90 countries aimed at stimulating institutional reforms needed to reduce corruption and strengthen governance. These include, for example, adaptable program loans and technical assistance operations designed to enhance capacity and reform incentives in the civil service (including for employees of public financial regulatory bodies); reforms in the financial sector, in public financial management systems, and in tax and customs administration; and programmatic adjustment loans that focus on improving accountability and transparency in the public sector through strengthened legal, regulatory and judicial systems and reforms in expenditure management and financial accountability. Economic and Sector Work (ESW) to deepen understanding of the sources and mechanisms of corruption and other types of institutional dysfunction has expanded markedly, with increased use of diagnostic instruments and surveys and the new Institutional and Governance Review. CAS task managers are now required to take corruption into account when formulating country programs and designing individual lending operations, and each CAS is reviewed for its realism in dealing with in-country governance issues. There has been a marked increase in the amount of analytical work done on public expenditure and financial management systems, increasingly in partnership with borrowers and donors. Stronger control and governance of public finances, in particular, are seen as essential foundations for adjustment and programmatic lending across the board.

15. **Strengthening financial systems.** The Bank deploys a wide array of activities to help countries carry out financial sector reform, with focus primarily on longer-term development issues. Prior to the Asian crisis, financial sector lending (adjustment and investment loans as well as technical assistance) amounted to US\$2.2 billion per year on average, but financial sector lending increased dramatically in the aftermath of the recent financial crises, amounting to an average of US\$4 billion over the past three years. In the 1990s the focus has shifted to a wide range of structural and policy dimensions affecting the financial sector, including, inter alia, the legal, regulatory, and supervisory framework for the banking industry, the insurance sector, capital market development, payment and settlement systems and bank restructuring and privatization.¹² In the current fiscal year, the Bank's financial sector staff are also undertaking economic and sector work in more than 22 countries (in addition to the FSAPs), conducting policy analysis and research on cross-cutting financial sector policy issues, and implementing more than 130 technical assistance projects in nearly 50 countries and regions.

¹¹ For more detailed information on the Bank's governance, anticorruption, and public sector reform programs, see *Helping Countries Combat Corruption: Progress in the Bank since 1997*, September 2000, and *Reforming Public Institutions and Strengthening Governance: A World Bank Strategy*, November 2000.

¹² See *Strategy for the Financial Sector: Draft Final Report (R2000-169)*, August 19, 2000, discussed by the World Bank's Board of Executive Directors on October 19, 2000.

16. **Market infrastructure and integrity.** Financial market integrity requires a well functioning legal framework and sound practices. The Bank has increased its efforts in several areas that are key to a robust market infrastructure, and that have been highlighted in the wake of recent financial instability. In particular, the Bank has stepped up its programs to strengthen legal and judicial reform and institutions, corporate governance, accounting and auditing and market transparency.¹³ In this, the Bank has sought to develop its partnerships with other institutions to enhance leverage and reduce costs. For example, it has established the *Global Corporate Governance Forum* with the OECD which is aimed at promoting a broad based dialogue and at helping developing and transition economies strengthen their corporate governance regimes. Similarly, the Bank participates and plays a catalytic role in the *International Forum on Accountancy Development*, which is a broad based public-private partnership to support sound accounting and auditing practices at the global and country level.

Contribution to international efforts to combat money laundering

17. The Bank has been contributing to international efforts targeted at money laundering more specifically in three ways: (a) by participating in international discussions (e.g., FSF, FATF, OECD Forum on Harmful Tax Competition); (b) focusing on financial abuse in the context of economic and sector work and policy dialogue, and now in a more focused way through the joint FSAP program; and (c) providing limited technical assistance to countries to strengthen anti-money laundering programs.¹⁴

18. The Bank has recently focused its efforts in small developing economies which are especially susceptible to potential financial abuse, including money laundering, and need support in putting in place the policy and institutional foundations and specific provisions that are needed to reduce the risks of such abuse. The recent Financial Sector Strategy Paper¹⁵ affirms the Bank's commitment to helping small economies tackle the development challenges that may stem from international initiatives aimed at fighting money laundering. As noted in the background document for last Fall's First Annual Small States Forum,¹⁶ some small states have become successful at providing both onshore and offshore financial

¹³ For further details on the Bank's role in helping countries strengthen corporate governance and accounting and auditing, see *International Financial Architecture: An Update of Bank Activities*, September 13, 2000 (DC/2000-20) and *Assessing the Implementation of Standards: A Review of Experience and Next Steps*, The International Monetary Fund and the World Bank, March 2001.

¹⁴ One such case is the Colombian Financial Market Development Project program which aims to establish a Financial Intelligence Unit that will collect, monitor and analyze relevant information on suspicious transactions from the financial and the private sectors.

¹⁵ *Strategy for the Financial Sector: Draft Final Report* (R2000-169), August 19, 2000.

¹⁶ See *First Annual Small States Forum: Background Information Document*, September 25, 2000, accessible at www.worldbank.org/smallstates.

services, and the Bank supports their efforts to ensure that their regulatory and supervision frameworks are in line with international standards. Through the CAS, the Bank identifies financial sector issues and outlines the role it will play to address them, working in close collaboration with the IMF and other partners.

Fiduciary and safeguard rules

19. The Bank has also tightened its fiduciary safeguards to ensure that its own lending is used for the purposes intended and not be subject to financial abuse.¹⁷ For project lending, the Bank asks borrowers to comply with well-specified requirements to ensure financial accountability and abuse prevention of funds made available by the Bank. For adjustment lending, in addition to safeguards for its own funds, the Bank works with countries to strengthen their overall public financial management. The number of country financial accountability and procurement assessments is growing quickly, and the procurement and financial management capacity of all implementing agencies is assessed before investment projects are presented to the Board for approval. Similarly, when extending loans or guarantees, or investing in equity instruments, IFC and MIGA follow international best practice based on their extensive experience, and apply rigorous scrutiny to projects in countries unfavorably rated by the FATF or the FSF.

20. The Bank Group is particularly attentive to structure its own financial operations, be they Bank's, IFC's or MIGA's funding, investment or derivative transactions, in a way that does not inadvertently undermine international efforts to curb money laundering. Although Bank practices are not jurisdiction-specific, they reflect the high standards of care and due diligence with which the Bank Group operates to mitigate risks, including reputational risk. Internal risk management guidelines limit Bank's financial transactions to counterparties with credit ratings of "A" or better. In addition, the Bank has a specific prohibition on the maintenance of deposits in OFCs, primarily out of concern with reputational risks, and investment activities are limited to instruments with ratings of "A" or better. In borrowing activities, the Bank deals only with reputable and well-established underwriters. Similarly, IFC's Treasury activities are subject to stringent guidelines approved by its Finance Committee and, in the case of liquid assets investments, investment authority approved by the Board. Currently, about 80 percent of securities held in the IBRD/IDA/MIGA portfolios are issued by governmental entities, with the remainder in Asset Backed Securities.

C. Fund/Bank Joint Work

21. The Fund and the Bank have been contributing jointly to the countering of financial system abuse in the context of FSAP and ROSC program.

22. **The Financial Sector Assessment Program**, introduced in 1999, aims to identify both financial vulnerabilities and development needs. At the most general level, joint

¹⁷ Fourteen Bank's eligible countries are on the FATF's and FSF's lists of NCCTs and OFCs.

Fund/Bank FSAP work reduces the opportunities for financial crime through improving financial supervision and the preconditions (legal, governance, administrative, etc.) for effective regulation and supervision. More specifically, FSAPs assess, by examining supervisory core principles, the susceptibility of the financial system to financial crime and money laundering, for example, because of excessive bank secrecy laws. All FSAPs include an assessment of BCPs (in particular CP15, which relates directly to money laundering); most contain assessments of the equivalent IOSCO and IAIS principles. The principle findings from the FSAPs are communicated to the Fund's and Bank's Executive Boards in the form of a Financial Sector Stability Assessment report (FSSA) and a Financial Sector Assessment report. As of end-March 2001, 14 FSSAs and nine FSAs have been issued to Executive Directors.

23. In the area of anti-money laundering, advice and recommendations arising from FSAPs include (i) introduction of legislation to do away with anonymous banking accounts; (ii) improvements to "know-your-customer" procedures in the context of the assessment of BCP 15; (iii) modifications to secrecy legislation to verify implementation of know your customer requirements; and (iv) implementation of new anti-money laundering laws.

24. The IMF and the Bank have also been collaborating closely in assessing progress in implementing selected international standards through the program on Reports on Observance of Standards and Codes. The international community has emphasized the development and implementation of standards as one of the key elements in strengthening the architecture of the international financial system by promoting the sound functioning of members' economic and financial systems. The assessment and disclosure of observance of standards can highlight potential vulnerabilities, help national authorities in their efforts to strengthen domestic economic and financial sector policy frameworks, and promote transparency and market discipline. Largely in the context of the FSAP, the Bank and the Fund conduct assessments of relevant financial sector standards (the Basel Core Principles, the IOSCO Principles and the IAIS Principles) that lead to the preparation of ROSCs. As of end-March, 2001, 38 ROSC modules in these three areas have been completed for 23 countries, of which 21 have been published.

III. INTERNATIONAL EFFORTS TO COUNTER MONEY LAUNDERING

25. Several international organizations and task forces are involved in efforts to counter money laundering. They can be divided into (i) those that are concerned primarily with financial/supervisory matters, including (in addition to the Fund and the Bank) the Basle Committee, the IOSCO, and the IAIS; (ii) those that are concerned with both financial/supervisory and legal/criminal enforcement matters, including the FATF, the various regional anti-money laundering task forces, the United Nations, the Council of Europe, the European Union, the Organization of American States, and the Commonwealth Secretariat; and (iii) those that are primarily concerned with legal/criminal enforcement matters, including the Egmont Group of Financial Intelligence Units and Interpol. This

section briefly discusses those groups whose purview includes legal/criminal enforcement matters.¹⁸ A summary of the nature and activities of these groups is found in Table 1.

Table 1. International Organizations Engaged in Anti-Money Laundering Activities

Organization	Operational Standard	Legally Binding	Membership	Focus	Implementation
FATF	FATF 40	no	mostly industrialized countries	prevention and enforcement	mutual evaluation
	25 Criteria	no			one way evaluation
Regional anti-money laundering task forces	FATF 40	no	open/regional	prevention and enforcement	mutual evaluation
UN Global Program	Treaties	yes	most countries	enforcement	UN General Assembly
	Model laws, other sources	no		prevention and enforcement	surveillance and technical assistance
Council of Europe C.E. Committee	Treaty	yes	largely council membership	enforcement	Council of Europe
	Various sources	no		prevention and enforcement	technical assistance
EU	Directive	yes	EU	mostly prevention	EU Commission
O.A.S. C.I.C.A.D.	Model regulations	no	O.A.S. members	prevention and enforcement	technical assistance
Commonwealth	Model law	no	commonwealth members	prevention and enforcement	technical assistance
Egmont Group	Model agreement	no	diverse membership	enforcement	technical assistance and mutual assistance in investigations
INTERPOL FOPAC	Various sources	No	most countries	enforcement	mutual assistance in investigations

26. **The Financial Action Task Force's 40 Recommendations** are widely recognized as the key set of standards to deter the crime of money laundering. These recommendations involve both financial/supervisory and legal/criminal enforcement matters. FATF members evaluate their compliance with these crime-fighting standards through self-assessment and mutual evaluation exercises. These latter exercises involve standardized questionnaires, checklists, and on-site evaluations, and result in reports identifying weaknesses and areas for improvement. In addition, the FATF has produced a set of 25 Criteria Defining Non-Cooperative Countries or Territories (NCCTs), based on, but not identical to the FATF 40, which it has used to evaluate 29 non-FATF members. The evaluations identified weaknesses and grouped countries based on their degree of compliance, and a list of NCCTs has been

¹⁸These groups are described in greater detail in Annex I.

published. Various **regional anti-money laundering groups** (including the Caribbean FATF, Asia Pacific Group, and the Eastern and Southern Africa Anti-Money Laundering Group) have endorsed the FATF 40 recommendations, and also carry out mutual evaluations similar in nature to those of FATF members, although not necessarily using the same materials for evaluations as the FATF.

27. The two **United Nations**-sponsored treaties concerning money laundering focuses primarily on legal/criminal enforcement matters, addressing the matter of international cooperation in particular.¹⁹ While generally consistent with the FATF 40, they often are more detailed. As part of a program in technical assistance, the **UN Global Program Against Money Laundering** has promulgated model laws that, while consistent with the FATF 40, address both financial/supervision and legal/criminal enforcement matters in greater detail; the Global Program also evaluates compliance with the UN treaties. In addition, both the **Organization of American States Inter-American Drug Abuse Control Commission (CICAD)** and the **Commonwealth Secretariat** have prepared model laws that address both financial/prevention and legal/criminal matters. At their meeting in September 2000, the **APEC Finance Ministers** called for the creation of an APEC working group to conduct a survey of the domestic legal and regulatory frameworks for fighting financial crimes, and to report to the Ministers' meeting in September 2001.

28. The **Council of Europe**-sponsored anti-money laundering treaty also focuses primarily on legal/criminal enforcement matters and, like the UN models, is both consistent with, though more detailed than, the FATF 40. The Council's **Select Committee of Experts on the Evaluation of Anti-Money Laundering Measures (PC-R-EV Committee)** undertakes voluntary evaluation of compliance with the Treaty (as well as with the FATF 40) and provides technical assistance in improving anti-money laundering policies. The current **European Union** anti-money laundering Directive is primarily concerned with financial/supervision matters, and is consistent with the original, but not the current, FATF 40; a draft proposed amendment would bring the standards in line with the current FATF 40. The EU Commission is charged with ensuring compliance with EU Directives.

29. The **Egmont Group of Financial Intelligence Units** model agreement on information sharing among jurisdictions is the most important standard on this topic. It is both consistent with the FATF 40 and more detailed. The Egmont Group also provides technical assistance on the design and implementation of financial intelligence units. The **Interpol Bureau des Fonds Provenant d'Activités Criminelles (FOPAC)** is the main institution coordinating international anti-money laundering investigations, and has considerable expertise in the legal/criminal enforcement areas. It provides technical assistance in drafting and implementing laws relating to criminal enforcement.

¹⁹ The two treaties are the UN Conventions (i) Against Illicit Traffic in Narcotics Drugs and Psychotropic Substances (the Vienna Convention), and (ii) Against Transnational Organized Crime (the Palermo Convention).

30. The efforts of these groups have resulted in widespread recognition of the seriousness of the problem of money laundering, and in the adoption, by over 100 countries, of various types of anti-money laundering laws. Each of these groups accepts the primary importance of the FATF 40 as a key standard for anti-money laundering policies. However, mandates, memberships, and focuses of these groups vary. As a result, the details with respect to standards used by them vary also, as do their methods of assessment or assistance to improve compliance. There is, therefore, scope for more effective coordination of international activities against money laundering. Such coordination could focus on the recognition of modalities for assessing anti-money laundering principles and on the identification and delivery of technical assistance. The Fund and the Bank, within their fields of competence, could play a useful role in such coordination efforts.

IV. ENHANCING CONTRIBUTIONS TO COMBATING MONEY LAUNDERING: ISSUES FOR THE FUND AND THE BANK

31. The breadth and cross-cutting nature of the global agenda to curb money laundering calls for a cooperative approach among many different international institutions. International efforts against money laundering are led by the relevant specialized institutions, notably the FATF, the regional anti-money laundering groups and the UNDCP. The Bank and Fund's work in financial sector areas has complemented anti-money laundering efforts, while remaining within their respective mandates and areas of expertise.

32. The Fund and the Bank can increase their participation in the global fight against financial abuse and money laundering by (i) publicizing both the need to put in place the necessary economic, financial, and legal systems designed to protect against money laundering and the role that the Bank and the Fund are playing in helping meet this need; (ii) recognizing the FATF 40 as a standard for anti-money laundering useful for Fund/Bank operational work, (iii) intensifying the focus on anti-money laundering elements in relevant supervisory principles, (iv) working more closely with the major international anti-money laundering groups, and (v) increasing the provision of technical assistance in this area. These proposals are discussed below and summarized in Box 1.

Publicize the importance of countries acting to protect against financial abuse and money laundering

33. The Fund and the Bank can publicize in general terms both the need to put in place the necessary economic, financial, and legal systems designed to protect against financial abuse and money laundering and the role that the Fund and the Bank are playing in helping meet this need. The IMFC and DC, as well as the Boards of the Fund and the Bank could make appropriate public statements; the Fund and the Bank could better publicize their respective activities; and both institutions could undertake additional studies, engaging in workshops, focusing on the macroeconomic and development affects of money laundering.

Box 1. Steps to Enhance the Fund's and Bank's Contribution to International Efforts Countering Money Laundering

- **Publicize importance of countries acting to protect against financial abuse and money laundering.** The IMFC and DC, as well as the Boards of the Fund and the Bank, to make appropriate public statements; the Fund and the Bank to publicize relevant information on their activities; and both to undertake additional studies, engage in workshops etc. with respect to the macroeconomic and development affects of money laundering.
- **Recognize the FATF 40 as a standard for anti-money laundering useful for Fund/Bank operational work.** The FATF (and possibly regional groups) could be invited to prepare a ROSC module provided that the underlying ROSC process is observed, i.e., that there is uniformity of treatment, the FATF 40 is used for all assessments (including FATF non-members) and the approach to assessments is cooperative and voluntary. At this time the conditions for the ROSC process are not met and therefore the staffs do not recommend that FATF (or other groups) be invited to prepare ROSC modules.
- **Intensify focus on anti-money laundering elements in relevant supervisory principles.** The Fund and the Bank to develop a methodology document for determining compliance with key anti-money laundering elements in the relevant BCP, IOSCO and IAIS principles (see Annex II). The methodology document would draw from guidance material available from relevant organizations/entities, including Basel Committee, IOSCO, IAIS and the FATF. (About half of the FATF 40, which pertain to financial/supervisory matters, would be relevant in crafting the methodology document.) Detailed assessments could be published or shared with the FATF and other regional anti-money laundering task forces.
- **Work more closely with major international anti-money laundering groups.** The Fund and the Bank would work more closely with other international anti-money laundering groups, including participating in more meetings and joint workshops, and exchanging information, particularly on compliance with financial standards. To avoid confusing different purposes and methods, the Fund and the Bank would not undertake joint missions with the FATF or regional task forces.
- **Increase the provision of technical assistance.** The delivery of TA by the Bank and the Fund when combined with other bilateral and multilateral TA providers would achieve greater efficiency and effectiveness.

34. The Boards of the Fund and the Bank could seek a statement by IMFC and the DC that would (i) recognize that money laundering is a global concern requiring concerted and cooperative action on the part of a range of institutions, with the lead taken by the FATF and the UNDCP,²⁰ that effective anti-money laundering measures are important to all Fund and

²⁰ Recognizes the key anti-money laundering statements, including the FATF 40, the UN Conventions Against Illicit Traffic in Narcotics Drugs and Psychotropic Substances (the Vienna Convention) and Against

(continued)

Bank members (though especially to those with large financial markets) and that implementing such measures is a primary responsibility of national authorities; and (ii) encourage the Fund and the Bank to enhance their current contributions to counter money laundering by helping countries strengthen their economic, financial and legal systems broadly.

35. Next, the Fund and the Bank could communicate to the public more effectively their various contributions to preventing financial abuse and money laundering. They could do this by emphasizing in their public outreach activities the role that the institutions play, through support of economic programs and technical assistance in helping countries to develop and reform their financial systems and assisting them towards putting in place a proper regulatory and supervisory environment. In particular, the activities with respect to financial sector standards and codes assessed by the Fund and the Bank could be stressed. Methods for improving outreach could include speeches, articles, and seminars.

36. The Fund and the Bank could undertake additional research into the macroeconomic and development effects of financial crime and money laundering. Because the scale and consequence of financial sector abuse in general, and of money laundering in particular, are not well understood (for the obvious reason that illegal activities are difficult to measure) such additional research would be difficult. At a minimum, however, the research would review effects of financial crime on the macro economy and would aim at providing an indication of the significance with which crime impacts industrial and developing country markets. The output of such research could be brought together in 2002 in a paper for both the Fund and Bank Boards.

Recognize the FATF 40 as an international anti-money laundering standard

37. The Fund and the Bank could recognize the FATF 40 as the internationally accepted standard for anti-money laundering policies useful for Bank and Fund operational work, which would increase the number of recognized standards to 12. The FSF already includes the FATF 40 among its 12 key standards for sound financial systems. In deciding to recognize the FATF 40, Directors could consider the relevance of the FATF 40 to macroeconomic stability and financial soundness. Directors may also wish to consider whether the FATF 40 are broadly recognized as an international standard,²¹ and if they are appropriate for developing as well as developed countries.²² In this context it should be noted

Transnational Organized Crime (the Palermo Convention) and the relevant UNDCP model laws; and invitations to members to abide by these principles.

²¹ Other internationally recognized money laundering standards are discussed in Section II.

²² In the *Summing Up by the Acting Chairman Assessing Implementation of Standards—A Review of Experience and Next Steps* (SUR/01/13)(29/1/01), a number of Directors expressed concerns of ownership and of ensuring that all members had a role in shaping and guiding work on standards. In this context, Directors may wish to note that the FATF 40 were drafted primarily by the industrialized countries.

that the FATF recommendations have become outdated and that, as a result, the FATF is revising its existing 40 recommendations to reflect the evolution of money-laundering activities and to address inconsistencies in the treatment within the FATF membership and vis-à-vis non-members. The process of revising the FATF 40 recommendations is likely to extend beyond 2001. The FATF 40 is not, however, the only standard undergoing revision.

38. With respect to assessment, neither the Fund nor the Bank could be expected to assess compliance with those aspects of the FATF 40 that relate to legal/criminal enforcement matters.²³ One possibility would be for the Fund and the Bank to assess only those aspects of the FATF 40 relating to financial/supervisory matters. However, experts from both FATF and the UNDCP have stated—most recently at the February workshop - that the FATF 40, while covering many areas that are primarily financial/supervisory in nature, were designed to be assessed as a unified whole. Separating out those principles that concerned legal/criminal enforcement matters from financial regulation and supervision would be highly problematic in their view.

39. One possibility would be to invite the FATF (perhaps in cooperation with regional task forces and other anti-money laundering organizations) to assess compliance with the FATF 40. FATF would prepare a ROSC module on anti-money laundering provided that established Bank-Fund guidance for incorporating standards as ROSCs were observed. The FATF and the regional groups are already carrying out assessments of compliance with the FATF 40 Recommendations.²⁴ However, the FATF applies the FATF 40 when conducting mutual evaluations of its members, but the FATF uses a different standard, the FATF 25 Criteria, to assess jurisdictions that are not FATF members. Evaluations by the FATF of non-members are involuntary and involve a “name and shame” approach to induce compliance. The FATF is also considering the possibility of recommending that sanctions be imposed on non-complying jurisdictions in some circumstances.²⁵ For ROSCs, a single international standard—such as the FATF 40—should be applied in a uniform fashion and on a voluntary basis.²⁶

²³ At the July 2000 discussion of OFC assessments (*Concluding Remarks on Offshore Financial Centers and the Role of the Fund*), Directors noted that law enforcement measures were not appropriate for the Fund to assess.

²⁴ It should be noted that these task forces have very small secretariats, and that evaluations are conducted by national experts from FATF and regional group members, including law enforcement personnel.

²⁵ Among the sanctions envisaged by FATF are financial restrictions by members of FATF that could be in violation of Article VIII 2(b) of the Fund’s Articles, and we understand could violate WTO rules as well. Staff have spoken to FATF Secretariat to make this point, in the expectation that FATF will find alternative approaches not at odds with international law.

²⁶ “[A]ssessments must be independently conducted and consistently applied across all countries” *Summing Up by the Acting Chairman Assessing Implementation of Standards—A Review of Experience and Next Steps* (SUR/01/13)(29/1/01).

40. Because the FATF process lacks conformity with the principles of the Bank-Fund ROSC initiative, the two staffs recommend that FATF would not be invited at this time to prepare a ROSC module on the FATF 40. Instead, the two staffs could contribute to the ongoing revision of the FATF 40 and discuss with the FATF the principles behind the ROSC procedures, and come back to the Board with a report and recommendations.

Intensify focus by the Fund and the Bank on relevant anti-money laundering principles

41. Independent of a decision to recognize the FATF 40 as a standard for operational work, the Fund and the Bank could deepen the emphasis on anti-money laundering elements of the BCP, IOSCO and IAIS Principles, which are already assessed under the FSAP. Observance of these and other principles helps ensure that financial institutions have in place needed management and risk control systems, which are crucial in helping to prevent financial crimes, including money laundering. The Fund and the Bank could deepen their assessment of compliance with the anti-money laundering elements of BCPs and the IOSCO and IAIS principles drawing on a new methodology document (to be developed) that sets out criteria for assessment and procedures for preparation of the report. Such a methodology document, while not directly using the FATF 40 as a standard, would cover the essence of the FATF 40 relating to financial/supervision matters (about half of the FATF 40).²⁷ Using the methodology document, a focused assessment of relevant anti-money laundering elements will be included as part of the detailed assessments of compliance with BCPs, IOSCO and IAIS Principles.

42. The release of detailed assessments, including the focused assessment of relevant anti-money laundering elements, would follow the policy established for technical assistance reports. In addition, the country concerned could share the reports with the FATF and other regional anti-money laundering task forces. Because of the Fund and Bank's comparative advantage in the financial sector, the detailed assessments could reduce the burden on the FATF and other anti-money laundering groups by limiting duplication of efforts.

43. As more FSAPs are undertaken, the coverage of anti-money laundering issues in financial sector work will deepen. In line with the Fund and Bank Executive Boards' guidance, the schedule for FSAPs should give the highest priority to systemically important countries. The Fund and the Bank would send a clear signal of the importance of effective anti-money laundering measures for national financial systems and the international financial system. It would also emphasize that both the Fund and the Bank are giving heightened attention to governance as an important factor influencing economic performance.

²⁷ See Annex II: FATF 40 Recommendations on the Principles of Supervision. That document could draw on those standards and principles currently used by other international task forces and groups that deal primarily with financial/supervisory matters.

Work more closely with major international anti-money laundering groups

44. The Fund and the Bank could work more closely with other international anti-money laundering groups and task forces. The most important of these are the FATF and the regional anti-money laundering task forces. Fund and Bank staff attend the main FATF meetings and now also some of the regional groupings.²⁸ Staff could work more closely with FATF by playing a role in the current substantial revisions to the FATF 40 and exchanging information, particularly on compliance with financial standards. On the sharing of information, FATF has already agreed to share results from their exercises with Fund and Bank staff conducting financial assessments, for example in the context of FSAPs.²⁹ In addition, Bank and Fund members that have undergone assessments could voluntarily share information on the observance of relevant principles with FATF. Such exchanges would eliminate some duplication between FATF and Bank and Fund assessments, and improve the quality and timeliness of assessments by both institutions. The staffs do not propose to undertake joint missions with the FATF or regional task forces.

Increase the provision of technical assistance

45. The Bank and the Fund could help countries improve their anti-money laundering laws and practices through the provision of technical assistance. At present, TA for anti-money laundering is provided bilaterally (especially from FATF members), by the UNDCP, Egmont Group, INTERPOL, and to a more limited extent through the capacity building of the Bank, the Fund and other multilateral agencies. Bank and Fund staff should coordinate more closely with these other TA providers, sharing knowledge and experience (within the confines of confidentiality protocols) wherever possible.

46. In the context of their regular activities, the Fund and the Bank already solicit information on TA and training needs to enhance countries' capacity to strengthen adherence to international standards, including in some areas directly pertinent to countering financial sector abuse and specifically money laundering. To assess comprehensively the scale of needed resources (human and financial), however, would require an evaluation of institutional and legal infrastructure. The G7 has offered to provide TA to jurisdictions that commit to make improvements in their regimes to counter money laundering.³⁰ The Fund and

²⁸ The Fund is also an observer at the Asia/Pacific Group on Money Laundering, at the African group (GIABA) and at the Council of Europe Select Committee of Experts; it is not an observer at any of the other three regional FATF-type meetings: Caribbean (CFATF), Eastern and Southern Africa Group (ESAAMLG), and South American (GAFISUD). The Bank is an observer at the Asia/Pacific Group on Money Laundering, the Council of Europe Select Committee of Experts, and the two African groups (GIABA, and ESAAMLG).

²⁹ All sharing of information from the FATF with the Fund or the Bank is on a case-by-case basis and only with the prior consent of the country concerned.

³⁰ See Statement of the Group of Seven Finance Ministers and Central Bank Governors, Palermo, Italy (February 17, 2001), EBD/01/20 (February 20, 2001).

the Bank have been asked to play a role in coordinating this effort. Such an assessment of TA needs, coordination of TA delivery, and direct provision of TA would represent a significant resource commitment for the Fund and the Bank that would take both institutions into areas outside their expertise and mandates. The Boards need to consider whether they want the Fund and the Bank to (i) increase TA in relevant prevention areas; (ii) identify TA needs for addressing money laundering issues; or (iii) coordinate all TA on money laundering, i.e., also in law enforcement areas. A preferred option would be to increase TA in relevant prevention areas, with the extra work by the Fund and the Bank focusing on adherence to relevant standards (outside law enforcement). More general TA and coordination of all money laundering TA would probably be best left to the FATF, the UN and others.

47. **Priority for countries listed as NCCTs.** The FATF has proposed to give priority for TA to jurisdictions identified as NCCTs. Although the NCCT list is published, the NCCT process is not transparent and deliberations determining whether to list jurisdictions are held in closed sessions. Some of these jurisdictions are on the schedule of OFC assessments. In general, however, assessment of TA needs and of other support would be available to the entire membership (i.e., would not be targeted at specific groups, e.g., OFCs, listed NCCTs) and could, within the context of the Fund's and Bank's priorities for TA and resource availability, respond to those where financial abuse and money laundering are a significant policy issue.

V. RESOURCE IMPLICATIONS

48. The resource implications of the Bank and Fund contributions to the international efforts against money laundering cover four broad areas: (i) extra diagnostic work including through FSAP, ROSCs and OFC assessments; (ii) extra work on surveillance and program countries; (iii) closer collaboration with FATF and the regional task forces; and (iv) the delivery of technical assistance. Table 2 breaks out the staffs' resource estimate by area, which for the Fund equates to roughly five extra staff years and for the Bank an extra annual cost of US\$600,000. Staff notes that resource estimates are tentative, particularly with regard to distribution among the four broad areas. Firmer estimates would be possible as experience is gained.

49. For the Fund and Bank, the decision on how to rank this work within overall priorities and whether and how to ensure appropriate staffing and funding for this work would need to be considered as part of their respective budget reviews and discussions, which could entail requests for supplemental budget resources and for the mobilization of appropriate external resources. The Fund and the Bank would continue to use experts from cooperating institutions (with a dollar cost to the Fund and the Bank, as well as an opportunity cost to the institutions concerned), but would also need to provide the infrastructure to support this TA program.

50. Not included in the estimate is the anticipated work involved in incorporating the anti-money laundering standards into the Bank and Fund diagnostic work, in particular, the

development of appropriate templates and methodology. This would entail perhaps one an additional one staff year in the first year.

Table 2. Additional Staff Resources for Anti-Money Laundering Work

	IMF Number of staff weeks	Bank Budget thousand dollars 1/
FSAP and OFC assessments	60	150
Technical assistance, capacity building, and additional diagnostic work	60	300
Collaboration with FATF, the regional task forces and other related organizations, as well as research	40	150
Surveillance and program countries	40	Not applicable
Total	200	600

¹ Bank staff are examining the possibility for redeployment to cover this cost.

51. FSAP and OFC assessments would include additional diagnostic work analyzing the relevance of money laundering to the macro-economy, reviewing related legislation, meeting with officials in charge, assessing implementation of the corresponding Basel, IAIS, and IOSCO principles, and summarizing the findings of these assessments. In fiscal year 2002, 24 FSAPs and 7 OFC (Module 2 and 3) assessment missions are planned, which would require about ten additional staff days each, including for the preparation of the report.

52. An important incremental cost would include the delivery of technical assistance and support for capacity building that results from the FSAP and OFC missions. Technical assistance missions and capacity building support would be also provided to countries and jurisdictions where money laundering is an identified concern, but for which a mission would not have been anticipated under the FSAP or OFC initiative. Fund staff would anticipate an extra 15 missions a year, each lasting two weeks in the field and two further weeks at headquarters. (TA would continue to be available from other providers.) In the case of the Bank, a significant proportion of this cost would be included in and covered by redeployment within regular country programs.

53. Closer collaboration with FATF, FATF-style bodies and other related organizations means staff attendance at more meetings. The Fund and the Bank would mainly increase their participation in appropriate FATF proceedings, notably in the review process of the FATF 40 recommendations and in the definition of assessment methodology and procedures for FATF assessments. The Bank and Fund would need to develop a closer cooperation with international and regional anti-money laundering bodies, in which they already have observer status. Also captured in this resource category are additional costs associated with research of financial abuse and money laundering.

54. The extra amount of time required on surveillance and program missions and subsequent follow-up, which would only apply to the Fund, is difficult to estimate, since it is likely to vary greatly between countries. This work might require an additional staff year.

VI. ISSUES FOR DISCUSSION

For Fund and Bank Directors

55. Do Directors consider that financial abuse (including money laundering in particular) is a major threat to the development and stability of financial systems and institutions of members?

56. Do Directors agree that the Fund and the Bank are already making significant contributions to members' efforts to prevent financial abuse, including money laundering, through their enhanced efforts to help members strengthen their economic, financial and legal systems, as set out in Section II of the paper? Do Directors agree that international anti-money laundering efforts should be reinforced by more intensive efforts by the Fund and Bank?

57. Do Directors agree that the Fund and the Bank can play a complementary role in global anti-money laundering efforts by intensifying their work, as set out in Box 1? In particular, do Directors agree that ongoing financial sector work, including FSAP, should be used as a vehicle for assessing more closely compliance with the supervisory principles relevant to anti-money laundering? If so, do Directors agree that the staffs' recommendation provides a suitable way to accomplish this goal?

58. Do Directors consider that the existing FATF 40 Recommendations should be recognized by the Fund and Bank as an anti-money laundering standard useful for their operational work?

59. Do Directors agree that at this time the FATF (as well as other bodies engaged in anti-money laundering efforts) should not be invited at some point to prepare a ROSC module?

60. How do Directors view the proposals for closer cooperation with FATF and other bodies engaged in anti-money laundering efforts, for example, through participation in the review of the FATF 40, and in FATF-style regional groups?

61. Do Directors agree that the Fund and the Bank should strengthen their policy dialogue with members on relevant money laundering concerns and provide extra technical assistance and support for capacity building (in areas of their mandate and in line with Fund and Bank priorities for TA), as a complement to other international institutions' efforts?

62. Should the Fund and the Bank develop and publish more analytical work on financial abuse, notably money laundering?

For Fund Directors

63. Do Directors agree that the Fund should allocate additional resources to support the proposed increased participation by the Fund in international anti-money laundering efforts? How should the Fund mobilize these extra resources, from external sources?

64. Do Directors consider that cross border implications of money laundering should be raised by staff during the Article IV consultation for a given member even if it is not macro-relevant for that member?

For Bank Directors

65. Do Directors agree that the most important contribution that the Bank can make to global efforts to combat financial abuse is to help countries strengthen their structural and institutional underpinnings?

66. Do Directors agree that the joint Bank-Fund program to support anti-money laundering efforts outlined above is consistent with the Bank's development mandate and comparative strengths?

**FATF AND OTHER ANTI-MONEY LAUNDERING ORGANIZATIONS THAT INCLUDE
LEGAL/CRIMINAL ENFORCEMENT MATTERS WITHIN THEIR OBJECTIVES**

67. Anti-money laundering groups can be categorized by a number of different criteria. These include the focus of the principles or standards developed or otherwise advanced by the organization (whether they focus primarily on financial/prevention matters or on legal/criminal enforcement matters), the legal nature of the principles (whether they are binding obligations or only recommendations), the nature of the group's membership (whether it is universal, regional, or selective based on criteria other than region), and the group's activities in carrying out its mandate (voluntary mutual evaluation, involuntary evaluation, technical assistance). These criteria can be used to help evaluate the both the appropriateness of the standards and modalities used by each group with respect to evaluation of compliance with standards and technical assistance.

68. The **Financial Action Task Force** proposed the original FATF 40 Recommendation in 1990. A revised version was complete in 1996; the FATF membership is currently engaged in a further update. The recommendations include both financial/prevention and legal/criminal enforcement matters. The recommendations do not constitute legally binding treaty commitments. Membership in the FATF consists primarily of the wealthy industrial countries.³¹ As a task force with a secretariat of only five staff, the FATF is essentially the collective work of its membership. Using questionnaires and check lists based primarily on both the FATF 40 and on other sources, all FATF members engage itself assessment and mutual evaluation exercises to identify weaknesses in anti-money laundering measures and propose remedies to those weaknesses; each has now undergone such evaluations. Evaluations include on site visits, typically over three days, and typically include three experts, a financial regulation expert, a lawyer, and a criminal enforcement expert. In addition to the FATF 40, the FATF has proposed a list of 25 Criteria Defining Non-Cooperative Countries or Territories. Although based on 14 of the FATF 40 from both legal/criminal and financial/prevention areas, the 25 Criteria also extend beyond the FATF 40, primarily by expanding on the issue of the effectiveness of implementation. The FATF has used these criteria to evaluate 29 non-FATF members, judging 15 to be "non-cooperative." In addition, the FATF provides fora for the sharing of information on money laundering.

69. The **regional anti-money laundering task forces** include the Caribbean FATF, the Asia Pacific Group on Money Laundering, and the Eastern and Southern Africa Anti-Money Laundering Group, and are independent of the FATF. Other regional groups are also in the process of being organized. These regional groups have not participated directly in the rafting

³¹The member states of the G-10 and the EU, the EU Commission itself, plus Australia, Argentina, Brazil, Hong Kong SAR, Iceland, Mexico, Norway, New Zealand, Switzerland, Singapore, and the Gulf Cooperation Council; both the Fund and the Bank are both non-member observers. FATF has indicated that it intends to limit further membership to a small number of select candidates.

70. of the FATF 40, although FATF has indicated that they will be consulted in the redrafting of the Recommendations. While these organizations have generally recognized the FATF 40 as standards, because their memberships represent different interests (including with relation to stage of development), they may emphasize different standards or, in some cases (e.g. the Caribbean FATF 19 Recommendations) create their own in addition to the FATF 40. These standards are also not-binding. Unlike the FATF, membership is generally open to any country that undertakes a commitment to implement effective anti-money laundering policies. Like the FATF they are task forces only, with small secretariats. They also engage in self-assessment and mutual evaluation exercises in a manner similar to the FATF, but may concentrate on different issues, particularly when they relate to countries in different stages of economic and financial development. It should be noted that relatively few mutual evaluations have been completed as yet. They do not participate in the FATF non-cooperation exercise. They also provide a forum for sharing information.

71. The **United Nations** has proposed two key treaties relating to money laundering, the 1988 Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (the Vienna Convention) and the 2000 Convention Against Transnational Organized Crime (The Palermo Convention), which has only recently been opened for signature. Unlike the FATF 40, which are recommendations only, the terms of the Vienna Convention are binding under international law for the 158 countries that have acceded to the convention. Both conventions, however, deal only in part with money laundering, and both concentrate on legal/criminal enforcement matters, although with more specificity than do the relevant FATF 40. The United Nations Office for Drug Control and Crime Prevention's **Global Program Against Money Laundering** has adopted a number of key model laws and treaties, including the model laws on Money Laundering, Confiscation, and International Cooperation (primarily for civil law jurisdictions), Money Laundering and Proceeds of Crime, Mutual Assistance in Criminal Matters, and Foreign Evidence (primarily for common law jurisdictions), and the model treaties on Mutual Assistance in Criminal Matters and on Extradition. These models conform with both the Vienna and Palermo conventions, and many have been adopted (with some alteration) in a large and growing number of jurisdictions. These models address both financial/prevention and legal/criminal enforcement aspects of anti-money laundering policy with greater specificity than do the FATF 40. Unlike the FATF, the Global Program does not sponsor mutual evaluation exercises; nor does it evaluate individual countries for compliance with UN conventions or models except in the context of a request for technical assistance. However, the Global Program does monitor's financial systems generally for weaknesses in anti-money laundering measures. It also provides technical assistance to countries, and helps coordinate technical assistance from other sources. The Global Program, along with Interpol, operates the International Money Laundering Information Network, which includes a searchable database on anti-money laundering legislation.

72. The **Council of Europe** proposed the 1990 Convention on Laundering, Search, Seizure, and Confiscation of the Proceeds of Crime, which covers many of the legal/criminal enforcement matters covered in both the Vienna and Palermo conventions. The terms of the convention are binding on the 30 countries, ranging geographically from the United

Kingdom to the Russian Federation, that have acceded to the convention. The Council, through its **Select Committee of Experts on the Evaluation of Anti-Money Laundering Measures** (PC-R-EV Committee) also provides technical assistance in evaluating the effectiveness of anti-money laundering measures and in improving those measures.

73. The **European Union** has issued a Directive on the Prevention of the Use of the Financial System for the Purpose of Money Laundering (91/308/EEC). This Directive, which is binding on members of the EU, deals almost exclusively with financial/prevention areas and is largely consistent with the relevant recommendations of the original FATF 40. The European Commission, aided by a Money Laundering Contact Committee, is empowered to ensure compliance of EU members with the Directive. In addition, a draft Amendment to the Directive has been proposed that would both bring the Directive into compliance with the 1996 version of the FATF 40 and, in some areas, extend beyond the FATF 40, including by providing greater detail in some areas.

74. The **Organization of American States**, while not proposing any binding treaty obligations, has issued, through the **Inter-American Drug Abuse Control Commission** (CICAD), Model Regulations Concerning Laundering Offenses Connected to Illicit Drug Trafficking and Other Serious Crimes. The Model addresses both legal/criminal and financial/prevention matters, in most cases with greater specificity than do the FATF 40. The CICAD also provides a limited amount of technical assistance to OAS members, but does not generally assess compliance with standards.

75. The **Commonwealth Secretariat** has prepared a non-binding Model Anti-Money Laundering Law covering both legal/criminal and financial/prevention matters, which are generally addressed with greater specificity than the FATF 40. The CICAD also provides a limited amount of technical assistance to members of the Commonwealth, but does not generally assess compliance with standards.

76. The **Egmont Group of Financial Intelligence Units** has produced a Model Information Sharing Agreement. The Egmont Group consists of financial intelligence units (FIUs) from 53 jurisdictions. The Group fosters international cooperation among FIUs regarding the dissemination of information concerning financial crime and money laundering. It has a secure website for sharing information, and helps coordinate technical assistance from its members with respect to the operation of FIUs.

77. The **International Criminal Police Organization** or Interpol consists of 178 member states. **Interpol Bureau des Fonds Provenant d'Activités Criminelles** (FOPAC), one branch of Interpol, specializes in cooperation in anti-money laundering investigations. In addition, FOPAC provides some technical assistance in creating and implementing anti-money laundering measures in member states, focusing on the legal/criminal enforcement area. FOPAC, along with the UN Global Program, operates the International Money Laundering Information Network. It also undertakes research into anti-money laundering measures.

FATF 40 RECOMMENDATIONS AND THE PRINCIPLES OF SUPERVISION

78. This Annex is divided into two parts. The first discusses the elaboration of a methodology document that will set out the process by which financial sector assessors could review compliance with anti-money laundering standards in the BCP, IOSCO and IAIS Principles, while using the relevant FATF 40 for additional guidance. The second section provides a discussion of the FATF 40 recommendations—including a discussion of the law enforcement recommendations—and the anti-money laundering standards in the BCP, IOSCO and IAIS Principles, with examples of how the standards are comparable. A table that lists the FATF 40 recommendations as they relate to the individual supervisory standards for the financial sector follows the second section.

Methodology document for anti-money laundering standards in financial sector supervision

79. Under the staffs' proposal, the Fund and the Bank would develop a methodology document for assessing compliance with anti-money laundering elements in the relevant BCP, IOSCO and IAIS Principles. Using the methodology document, a focused assessment of relevant anti-money laundering elements will be included as part of the detailed assessments of compliance with BCPs, IOSCO and IAIS Principles. The release of the focused assessment of relevant anti-money laundering elements (included in the assessments of financial sector supervisory standards) would follow the policy established for technical assistance reports, which would include sharing the assessment with the FATF and other regional anti-money laundering task forces. The development of a methodology document for anti-money laundering standards in financial sector supervision would follow the precedent for the development of the Core Principles Methodology paper.³²

80. Similar to the steps used in the preparation of the Core Principles Methodology paper, the development of the methodology document for anti-money laundering standards in financial sector supervision would follow a transparent process. Once drafted, the methodology document would be shared with experts, both in supervision and in anti-money laundering. Thus it is envisaged that the draft set would be shown to the main supervisory groupings (Basel, IOSCO, IAIS) and to FATF, the regional FATF-style bodies, the UNDCP, the Council of Europe's Select Committee of Experts, etc. An agreed methodology could be posted on the Fund's and Bank's websites. The methodology document would be updated from time to time to take account of experience in use, and revisions to supervisory principles and to anti-money laundering recommendations.

³² Essential and additional criteria were developed by the Basel Committee, following wide-ranging consultation, including with the Fund and Bank, to supplement, particularly for the purposes of assessment, the Core Principles of Effective Banking Supervision and were published in the Core Principles Methodology (BIS, October 1999).

Comparison of the FATF 40 recommendations and the Financial Sector Standards

Law enforcement recommendations

81. The FATF 40 Recommendations cover law enforcement, regulation of the financial system, and international cooperation. Those FATF recommendations, 15 in all, pertaining to the broad areas of law enforcement relate to (i) the criminalization of money laundering (FATF 1, 4, 5 and 6); (ii) the seizure and confiscation of money laundering proceeds (FATF 7, 35 and 38); and (iii) the international cooperation in the investigation, prosecution and extradition of crime suspects (FATF 3, 31, 33, 34, 36, 37, 38, 39, and 40).

82. The staffs of the Fund and Bank note that it would be particularly problematic to undertake or oversee the assessment of these law enforcement recommendations, as the Fund and the Bank do not have sufficient expertise in most legal/criminal enforcement matters. Moreover, assessing the application of legal/criminal enforcement matters would take the staff into the areas of criminal investigation and prosecution (including requests for information on crime matters, for freezing and seizing of assets, and for extradition, from foreign jurisdictions.)

83. The staffs express the caution that criminal laws vary widely among jurisdictions and the area of international cooperation depends on the laws are applied. In such variations are potentially serious conflicts. For example, even the temporary freezing of assets of a suspected criminal might result not only in irreparable harm to him or her, but (providing that the frozen assets are of sufficient magnitude) to the institution itself or even the financial system. Such authority, if exercised without sufficient safeguards, could be used, for example, to extort fines (if the alleged money launderer pays a fine the government will unfreeze his assets), or simply to punish political opponents. Therefore, the details with respect to how criminal enforcement aspects of anti-money laundering laws are enforced are extremely important; depending on the particular jurisdiction, these details can be extremely difficult to discern, analyze, and evaluate, even for experts. In the area of information sharing, it would be troublesome to expect one jurisdiction to accede to requests for information from another jurisdiction whose criminal laws, or whose implementation of those laws, are substandard. For these reasons, the Fund and the Bank should minimize their involvement with the legal/criminal enforcement aspects of anti-money laundering.

The other FATF recommendations

84. The remaining recommendations relate largely to the regulation of the financial system (including payment systems). In total around half the FATF 40 have a similar or closely related analogue in supervisory principles. That number is liable to change when the current revision to the FATF 40 is finalized.

85. The FATF 40 recommendations on the regulation of financial systems overlap significantly with the Basel, IOSCO and IAIS principles of supervision. Basel Core

Principle 15, relating to money laundering and financial crime more generally, together with the criteria for assessment the Basel Committee considers both essential and useful,³³ were set out in Annex VII to the Background Paper (SM/01/46), and that annex also set out how nearly all the essential criteria in BCP 15 had analogues in the FATF 40 recommendations. IOSCO Principle 23 and IAIS Principle 11 cover much of the same ground.

86. Where some of the FATF 40 (e.g., recommendation 32 relating to international exchange of information) are themselves in several parts, the similarity or relationship exists over part and not all of the relevant recommendation or criteria.

87. An example of how several of the FATF 40 are similar to existing standards for financial sector supervision is provided by recommendation 32:

“Exchange of information relating to suspicious transactions

Each country should make efforts to improve a spontaneous or “upon request” international information exchange relating to suspicious transactions, persons and corporations involved in those transactions between competent authorities. Strict safeguards should be established to ensure that this exchange of information is consistent with national and international provisions on privacy and data protection.”

88. This recommendation is closely related to a number of Basel, IOSCO, and IAIS principles. As an example, BCP 15 states that: “Banking supervisors must determine that banks have adequate policies, practices and procedures in place, including strict “know-your-customer” rules, that promote high ethical and professional standards in the financial sector and prevent the bank being used, intentionally or unintentionally, by criminal elements.” This BCP 15 has as an essential criteria the following:

“The supervisor is able, directly or indirectly, to share with domestic and foreign financial sector supervisory authorities information related to suspected or actual criminal activities.”

³³ See prior footnote.

Table 3. FATF 40 Recommendations with Relation to International Standards for the Financial Sector

FATF 40 Recommendations	International Standards for the Financial Sector					
	BCP		IAIS		IOSCO	
	Similar Principles	Related Principles	Similar Principles	Related Principles	Similar Principles	Related Principles
8- Anti-money laundering laws and regulations applied to non-bank financial institutions				2 & 16		8, 9 & 10
CUSTOMER IDENTIFICATION AND RECORD-KEEPING RULES:						
10- Prohibition of anonymous accounts and implementation of know-your-customer policies	15		11		23	
11- Obligation to take reasonable measures to obtain information about customer identity	15		11		23	
12- Comprehensive record keeping for transactions, accounts, correspondence, and customer identification documents	14 & 15		5, 12 & 13		23	
13- Attention paid to risks stemming from new technologies		13		Principles on Internet Insurance Activities' Supervision		23, 25, 26, 27 & 28
INCREASED DILIGENCE OF FINANCIAL INSTITUTIONS:						
14- Detection and analysis of suspicious transactions	15		5		23 & 28	27
15- Reporting of suspicious transactions	15		5		23 & 28	27
16- Legal protection for financial institutions, their directors and staff	15		Part of the review process		Part of the review process	

FATF 40 Recommendations	International Standards for the Financial Sector					
	BCP		IAIS		IOSCO	
	Similar Principles	Related Principles	Similar Principles	Related Principles	Similar Principles	Related Principles
17- Confidentiality vis-à-vis customers		Part of the review process		Part of the review process		Part of the review process
18- Compliance with instructions for suspicious transactions reporting	15			Part of the review process	28	
19- Internal policies, procedures, controls, audit, and training programs	15			Part of the review process	23	
MEASURES TO COPE WITH COUNTRIES WITH NO OR INSUFFICIENT MEASURES:						
20- Anti-money laundering rules and procedures applied to branches and subsidiaries located abroad		23 & 24		15 & 16		11, 12 & 13
21- Special attention given to transactions with these countries		23 & 24		15 & 16		
OTHER MEASURES TO AVOID MONEY LAUNDERING:						
24- Encouraging the replacement of cash transfers	Integral to payment and settlement review process					
25- Prevention of unlawful use of shell corporations	15		11		23	
IMPLEMENTATION, AND ROLE OF REGULATORY AND OTHER ADMINISTRATIVE AUTHORITIES:						
26- Adequate anti-money laundering programs in supervised banks, financial institutions or intermediaries	15			Part of the review process	23	
28- Guidelines for suspicious transactions' detection		Part of the review process		Part of the review process	28	

FATF 40 Recommendations	International Standards for the Financial Sector					
	BCP		IAIS		IOSCO	
	Similar Principles	Related Principles	Similar Principles	Related Principles	Similar Principles	Related Principles
29- Preventing control of, or significant participation in financial institutions by criminals	3 & 4		2 & 3		17 & 21	
32- International exchange of information related to suspicious transactions, and to persons or corporations involved		1-6, 15, 23, 24 & 25		11, 12 & 13		15 & 16
RECOMMENDATIONS COVERED BY PRINCIPLES	19					

BCP: Basel Core Principles; IOSCO: IOSCO Principles of Securities Regulation; IAIS: Insurance Core Principles.

Notes:

BCP 15 requires that laws and regulations comply with FATF 40 recommendations, including appointment of a senior compliance officer, and refers to the Prevention of Criminal Use of the banking system for the purpose of money laundering (December 1988).

IOSCO 8, 9 and 10 requires anti-money laundering legislation, policies and procedures be in place and refers to the Report of IOSCO Technical Committee on Money Laundering (October 1992).

The Core Principles For Systematically Important Payment Systems state that “Safety and efficiency are not the only public policy objectives for payment system and design. Other objectives... such as crime prevention.. can play a role in the design of systematically important payment systems.”

MONEY LAUNDERING: CASE STUDIES

89. This Annex contains six case studies of alleged money laundering as reported in a number of different public documents. Staff makes no judgment as to the accuracy or reliability of the facts as reported in those documents.

1. Raul Salinas and Citibank, source: statement by U.S. prosecutor, Department of Justice, 11.9.99
2. Accounting firm (anonymous), source: FATF 1998-99 Report
3. Offshore financial centers (mostly anonymous), source FATF, 1998-99 Report
4. Shell corporations, source FATF 1998-99 Report
5. GAO Investigation into the Russian connections, source: U.P.I. report, 12.2.00
6. FSA (London) money laundering (Abacha) investigation, source: FSA press notice, 3.8.01

Raul Salinas, Citibank, and Alleged Money Laundering³⁴

90. Mr. Salinas was able to transfer US\$90 million to US\$100 million between 1992 and 1994 by using a private banking relationship formed by Citibank New York in 1992. The Funds were transferred through Citibank Mexico and Citibank New York to private banking investment accounts in Citibank London and Citibank Switzerland. Beginning in mid-1992, Citibank actions assisted Mr. Salinas with these transfers and effectively disguised the funds' source and destination, thus breaking the funds' paper trail. Citibank:

- set up an offshore private investment company named Trocca, to hold Mr. Salinas's assets, through Cititrust (Cayman)³⁵ and investment accounts in Citibank London and Citibank Switzerland;
- waived bank references for Mr. Salinas and did not prepare a financial profile on him or request a waiver for the profile, as required by then Citibank know your customer policy;
- facilitated Mrs. Salinas's use of another name to initiate fund transfers in Mexico; and
- had funds wired from Citibank Mexico to a Citibank New York concentration account—a business account that commingles funds from various sources—before forwarding them to Trocca's offshore Citibank investment accounts.

³⁴ Source: GAO report November 9, 1999 on Private Banking, GAO/T-OSI-00-3. Statement for the Record of Robert H. Hast, Acting Assistant Comptroller General for Investigations, Office of Special Investigations.

³⁵ Cititrust (Cayman) was an affiliate of Citicorp, located in the Cayman Islands. Citicorp is now known as Citigroup, Inc.

91. No U.S. documentation identified Mr. Salinas as Trocca's beneficial owner or connected.

92. Mr. Salinas to the Trocca funds transferred through Citibank Mexico and Citibank New York. According to Citibank New York's Vice President (VP) for Legal Affairs, whom Citibank designated as its representative to us, Citibank's actions violated only one aspect of the then Citibank know your customer policy: Citibank should have prepared a financial profile (i.e., a financial background check detailing the source of Mr. Salinas's funds) or waived the requirement before accepting Mr. Salinas as a customer. By investigating his financial background, Citibank could have verified the source of Mr. Salinas's wealth and transferred funds. Limited by the ongoing Department of Justice investigation, we could not determine whether Citibank's actions violated law or regulation. (We determined that the case is still pending in the Southern District of New York.) The Federal Reserve also did not comment on whether Citibank's sanctions were violations because information available to it at the time we inquired was insufficient for it to make a determination. However, on the basis of the details we presented, the Office of the Comptroller of Currency (OCC) stated that the actions did not violate civil aspects of the Bank Secrecy Act. Further, private banking know your customer policies were then voluntary and not governed by law or regulation. A comparison of Citibank actions and Citibank testimony in the 1994 money laundering trial shows that the two were inconsistent concerning due diligence and know your customer practices in private banking. For example, Citibank's testimony implied a stricter adherence to due diligence than actually occurred during the Salinas transactions.

Accounting Firm³⁶

Facts

93. Beginning in May 1994, two alleged narcotics traffickers used an accounting firm to launder criminal proceeds generated from amphetamine sales. The 'clients' of the firm would on a regular basis hand their accountant cash in brown envelopes or shoeboxes for which no receipt was issued. The funds were then stored in the accountant's office until he decided how they could be introduced into the financial system and laundered. At any one time, there were between US\$38,000 and US\$63,000 stored in the accountant's office. The law enforcement agency investigating the matter found that the accountant established company and trust accounts on behalf of his clients and opened personal bank accounts in the names of relatives. He then made structured deposits to those accounts with the funds received from the alleged traffickers. Additionally, he transferred approximately US\$14,000 overseas—again, using structured transactions—to purchase truck parts, which were later brought back into the country and sold at a profit, and also used some of the funds to purchase properties. The accountant and three of his colleagues (who were also implicated in the scheme)

³⁶ Source: Financial Action Task Force, Annex to the 1998-99 FATF Report on money laundering typologies.

reportedly laundered approximately US\$633,900 and received a 10 percent commission for his services.

Results

94. The accountant and his colleagues are believed to have acted from the beginning with the suspicion that the clients were involved in illegal activities. Even after obtaining further specific knowledge of his clients' involvement in narcotics trafficking, he and his associates allegedly continued to facilitate money laundering.

Lessons

95. This case highlights the key role that financial experts can play in the laundering of criminal proceeds. Many of the services provided (establishment of specialized accounts or business entities, making real estate investments) are potential money laundering mechanisms that may be beyond the abilities of the less sophisticated criminal.

Offshore Financial Centers³⁷

Facts

96. In December 1997, M-Bank, acting as an international clearing bank, received a wire transfer for US\$1.4 million that appeared to originate from a U.K. law firm. The transfer was to be credited to the account of 'AZ Brokerage International, Ltd.' in G-Bank. Due to the initials used in the company's name, M-Bank suspected that AZ Brokerage International, Ltd. might be controlled by Mr. 'AZ', who was known to be involved in dubious financial activities. The bank also knew that Mr. AZ had served two years in a foreign prison for his connections to a false monetary instrument scheme and that his personal assets were subject to bankruptcy proceedings. M-Bank decided to make a suspicious transaction report to the FIU, and, at the same time, they informed G-Bank of their suspicion. G-Bank subsequently disclosed to the FIU that Mr. AZ was operating a number of accounts opened under the names of various companies, including AZ Brokerage International, Ltd. Preliminary inquiries made by the FIU revealed, among other things, the following:

- A third financial institution, D-Bank, had submitted a report to the FIU a few weeks earlier. The report stated that D-Bank had concluded its banking relationship with Mr. AZ after having received several "suspicious approaches" from him and from foreign sources.
- Mr. AZ appeared to be the principal of 20 legal entities registered in the national company registry. All of these business entities operated from his home address.

³⁷ Source: Financial Action Task Force, Annex to the 1998-99 FATF Report on money laundering typologies.

- The names of the businesses indicated involvement in various types of financial activity, such as “AZ Fiduciary & Nominees,” “AZ Investment & Finance,” “AZ Insurance Guaranty Fund,” etc.
- The holding company, AZ Holding, Ltd. was stated to have a fully paid share capital of 20 million U.S. dollar confirmed by the company’s state authorized accountant.
- None of the companies were licensed to provide any type of financial or brokering services in the country of registry, according to the financial supervisory authority.

97. The FIU requested that the banks disclose additional information on their banking relationship with Mr. AZ or legal entities controlled by him. G-Bank was further requested to freeze the amount of US\$1.4 million as soon as it was credited to the account controlled by Mr. AZ. This additional information revealed that a number of deposits had been made to the relevant accounts prior to the FIU disclosures. All deposits were made by international wire transfer, and the largest amounted to US\$1.5 million. Most of the funds received had been immediately used to purchase bank drafts that were sent to individuals and companies in the United Kingdom and the United States. It was also noted that the purpose of one wire transfer to a U.S. law firm was stated as being a “legal fee for establishment of AZ Merchant Bank.”

98. The above mentioned information was submitted to a criminal investigation team, and the next day Mr. AZ requested that G-Bank transfer several hundred U.S. dollars to an offshore bank account in the name of an individual. The transaction was stopped, and Mr. AZ was arrested as he was due to depart on holiday to the Caribbean where he had planned to meet with several apparently associated individuals. Documents subsequently seized provided the following information:

- The stated share capital of AZ Holding, Ltd. was based on a Certificate of Deposit with the face value of US\$20 million and issued by a Panamanian financial institution.
- Mr. AZ, in addition to the business entities registered in his country, also held beneficial and formal positions in a number of business entities incorporated in several offshore jurisdictions, including “AZ Private Bank, Ltd.” registered in Antigua.
- The name of the above mentioned “AZ Merchant Bank, Inc.” had been changed to “AZ Banque de Commerce, Inc.” on the advice of the solicitor that later arranged for U.S. incorporation.
- Mr. AZ claims to provide various types of financial services, including private banking and issue of ‘proof of funds’ for use in various types of high-yield investment programs, etc.

- A large number of foreign clients—mainly from Eastern Europe and the United States—had made the initial payment in amounts between US\$5,000 and US\$50,000 to get access to his services.

99. After the arrest of Mr. AZ, the investigation team was contacted and later visited by several individuals who claim to represent the beneficiaries of three of the deposits amounting to nearly US\$3.5 million—including US\$1.6 million that had been frozen. However, no beneficial party was prepared to make a formal statement or to provide documentary evidence of the source of the funds. No formal claims for the release of the seized funds had been received eleven months after the investigation began.

Results

100. Mr. AZ was released from custody during the on-going investigation. It appeared, however, that he immediately resumed the same business upon his release. The investigative authority has recently requested the assistance of foreign law enforcement authorities in their investigation regarding US\$20 million that had been transferred from an offshore financial center to the account of one of Mr. AZ's companies.

Lessons

101. This case illustrates how financial services providers operating in one country or through an offshore financial center may facilitate money laundering, as well as legitimate business transactions. With any one jurisdiction having only one part of the picture, it is difficult to determine exactly how the whole scheme works. The fact that, after blocking the transfer of funds for eleven months, there were still no concrete claims from the beneficial owners for their return is also a further indication that the funds may not have been of strictly legal origin. This case is also a good example of how financial institutions can work with each other and anti-money laundering authorities to pull together a picture of the suspected laundering scheme.

Shell Corporations and Secretarial Companies³⁸

Facts

102. During 1995/1996 financial institutions in a European country made suspicious transaction reports to the financial intelligence unit which receives such reports. The reports identified large cash deposits made to the banks which were exchanged for bank drafts made payable to a shell corporation based and operated from an Asian jurisdiction. The reports identified approximately US\$1.6 million being transferred in this way to an account held by the shell corporation at a financial institution in the Asian jurisdiction. At the same time police had been investigating a group in that country which were involved in importing

³⁸ FATF, 1997-98 Report on money laundering typologies.

drugs. In 1997 police managed to arrest several persons in the group, including the principal, who controlled the company in the Asian jurisdiction. They were charged with conspiring to import a large amount of cannabis. A financial investigation showed that the principal had made sizeable profits, and a large percentage of this has been traced and restrained. A total of approximately US\$2 million was sent from the European country to the Asian jurisdiction, and subsequently transferred back to bank accounts in Europe, where it is now restrained.

103. Two methods were used to launder the money. The principal purchased a shell company in the Asian jurisdiction which was operated there by a secretarial company on his instructions. The shell company opened a bank account, which was used to receive cashiers orders and bank drafts which had been purchased for cash in the country of origin. The principal was also assisted by another person who controlled (through the same secretarial company) several companies, which were operated for both legitimate reasons and otherwise. This person laundered part of the proceeds by sending the funds on to several other jurisdictions, and used non-face to face banking (computer instructions from the original country) to do so.

Results

104. Seven persons including the principal are awaiting trial in the European country on charges of drug trafficking, and the principal and three other persons face money laundering charges.

Lessons

105. It shows how desirable and easy it is for criminals (even if not part of international organized crime) to use corporate entities in other jurisdictions, and to transfer illegal proceeds through several other jurisdictions in the hope of disguising the origin of the money.

106. It demonstrates the ease with which company incorporation services can be obtained, and shows that many of the companies which sell shelf/shell companies, as well as the secretarial companies which operate them, are not likely to be concerned about the purpose for which the shell company is used.

107. Highlights the need for financial institutions to have a system which identifies suspicious transactions not just at the front counter, but also for non-face to face transactions such as occurred in this case.

108. The length of time it can take to conduct international financial investigations and to trace the proceeds of crime transferred through several jurisdictions, and the consequent risk that the funds will be dissipated.

GAO Investigation Into The Russian Connections³⁹

109. Citigroup, one of the biggest banks in the United States, faces allegations that it was involved in suspected money laundering activities. The so-called “Russian Connection,” also known as “Funny Money from the East,” has hit again.

110. The General Accounting Office, the financial watchdog of the U.S. Congress, alleged last week that Citigroup and the Commercial Bank of San Francisco allowed US\$800 million and US\$600 million respectively to flow through their accounts from suspicious Eastern European and Russian sources. The funds were later wired abroad, primarily to tax havens. The two banks are accused of violating industry standards (“known-your-customer rules”), and the GAO raised suspicions of money laundering activities.

111. The two banks have acknowledged that “know your customer” rules may have been violated. However, the GAO cannot accuse Citigroup of money laundering as it is not a prosecutorial agency. The investigation now may be handed over to the Federal Bureau of Investigation.

112. In fact, only a U.S. federal prosecutor has the authority to bring indictments in money laundering cases. Money laundering and ignoring “know your customer” rules are different violations.

113. According to Scott Horton, partner in charge of Russia and the Commonwealth of Independent States (CIS) at the New York law firm of Patterson, Belknap, Webb and Tyler, “the rules are based upon Federal Reserve regulations and rules of the Office of Comptroller at the Department of Treasury.” Still, they fell short of being a federal crime.

114. Money laundering, on the other hand, is a federal crime in which proceeds from criminal activities, often in cash, are “laundered” through the banking system until they look “legal” and clean. Examples would be proceeds from drug trafficking, prostitution, illegal gambling and arms smuggling. Money from the East comes in two varieties: outright “dirty” money, and funds which are squirreled to the West in order to evade taxes. But often the two are mixed.

115. In many jurisdictions, tax evasion in a foreign land is not a crime. However, money that came to the United States as the result of a systematic defrauding of tax authorities may qualify in this country as money laundering, especially if tax evasion was a criminal offense under the foreign law.

116. What is important, said Horton, is that the United States keeps its financial system clean. Integrity of the banking institutions is the key for a healthy economy. This is the public interest behind the efforts of U.S. prosecutors to fight this crime.

³⁹ UPI, December 2, 2000, summarizing a GAO report, October 2000, GAO-01-120.

117. Venerable banks, including the Bank of New York (BONY) and the Republic Bank of New York, were in the middle of a much larger scandal in the fall of 1999, in which fuzzy transactions in excess of US\$6 billion were uncovered. The transfers originated in Russia and involved some 10,000 transactions since October 1998.

118. The federal investigation into those two New York banks involved the FBI, the New York Federal Reserve Bank, the New York Banking Commission and the British law enforcement and national security agencies. It is still going on.

119. Some key former employees of BONY admitted violation of banking rules and cooperated with the prosecution.

UK FSA investigation into money laundering in accounts linked to Abacha⁴⁰

120. The FSA announced today that it has completed its investigation into the handling by banks in the U.K. of accounts linked to General Sani Abacha, the former President of Nigeria.

121. The Investigation, which has taken three months, focused on the anti-money laundering controls at 23 banks in the U.K. where accounts linked to Abacha family members and close associates were identified. The investigation found that 15 of the banks had significant control weaknesses. Eight of these banks have corrected the weaknesses since the accounts were opened through strengthening their anti-money laundering controls.

122. Phillip Thorpe, Managing Director of the FSA, said:

“The extent of the weakness identified is frankly disappointing. When we launched the investigation we said that we could order banks to take immediate action if problems were found. We are ordering the 7 banks with significant control weakness to rectify the problems our investigation discovered, and are setting them strict deadlines by which to correct these failings. Potential breaches of the Money Laundering Regulations are also being discussed with the appropriate law enforcement authorities.”

123. He also warned that when the FSA’s new anti-money laundering enforcement powers come into effect later this year, they will be rigorously applied. He said:

“When the Financial Services and Markets Act comes into effect we will have a statutory objective to help reduce financial crime. New powers will enable us to deal more effectively with any failures in anti-money laundering systems and controls. The new tools available to us will include the imposition of civil and public censure on the outcome of disciplinary proceedings. It is imperative that standards of

⁴⁰ FSA Press Notice, 3.8.01.

compliance with U.K. anti-money laundering requirements are high if London is to maintain its reputation for clean financial markets.”

124. The FSA investigation identified 42 personal and corporate account relationships linked to Abacha family members and close associates in the U.K. These accounts were held at 23 banks which included U.K. banks and branches of banks from both inside and outside the European Union.

125. In total, turnover on the 42 accounts amounted to US\$1.3 billion for the four years between 1996 and 2000. The US\$1.3 billion relates only to the turnover on the accounts over

this period; it does not necessarily represent the proceeds of crime or the amount of money received into the U.K.

126. Some 98 percent of the US\$1 billion went through the 15 banks with significant control weaknesses. The FSA found that a number of the banks had reported suspicions to the National Criminal Intelligence Service (NCIS) on a timely basis.

127. The following deficiencies were found at one or more of the 15 banks:

- Inadequate senior management oversight of the account opening process for customers who could be classified as higher risk;
- Weaknesses in the verification of the identify of beneficial owners of companies;
- Over reliance on introductions by existing customers;
- Inadequate understanding of the source of the customer’s wealth;
- Shortfalls in following industry guidance on reporting suspicious transactions to the national Criminal Intelligence Service;
- Weaknesses in record retrieval and retention.

128. The FSA is also taking the following action:

- An FSA Task Force has been established to co-ordinate the implementation of immediate remedial action programmes covering the seven banks where current failings were identified at the time of the investigation. These banks are being set strict deadlines by which to rectify the problems.
- Potential breaches of the Money Laundering Regulations are being discussed with the appropriate law enforcement authorities.
- The FSA is participating with key international regulators in developing guidance for financial firms on handling accounts of high profile political figures.