SM/01/258

August 15, 2001

To: Members of the Executive Board

From: The Secretary

Subject: **Anti-Money Laundering—Enhanced Contribution by the Fund**

The attached report reflects the progress being made by the staff in this area in accordance with the guidelines agreed by the Executive Board. Given its factual nature, the report is not being proposed for discussion. However, if Executive Directors express an interest in having a formal Board discussion, they should so inform the Secretary by noon on Tuesday, August 21. Management would be prepared to consider the report on August 24, the originally envisaged Board date.

Questions may be referred to Mr. Mehran (ext. 34870).

Att: (1)

Other Distribution:
Department Heads

INTERNATIONAL MONETARY FUND

Anti-Money Laundering (AML)—Enhanced Contribution by the Fund

Prepared by the Monetary and Exchange Affairs Department

In consultation with Legal and Policy Development and Review Departments

Approved by Stefan Ingves

August 15, 2001

I. Introduction and Background 2

II. Methodology Document to Review AML Elements in Supervisory Principles 3

III. Incorporating the FATF 40 Recommendations into the ROSC Program 4

IV. Other Steps 5

V. Conclusions 6

Appendix

I. Methodology Document 7

I. Introduction and Background

1. On April 13, 2001, the Boards of both the IMF and the World Bank discussed money laundering and how the two institutions could enhance their contributions to global anti-money laundering (AML) efforts. The Fund Board's conclusions are set out in BUFF/01/54 of April 29, 2001. The staff papers for the Board were subsequently posted on the Fund website.[1] The Fund's Executive Directors agreed that the Fund will take the steps below to counter money laundering. A set of similar steps was agreed by the Bank's Board.

- Intensify its focus on AML elements in all relevant supervisory principles, including by preparation of a methodology document on AML supervisory principles.
- Work more closely with major international AML groups, in particular with the Financial Action Task Force (FATF).
- Increase the provision of technical assistance.
- Include AML concerns in its surveillance and other operational activities when macroeconomic relevant.
- Undertake additional studies and publicize the importance of countries acting to protect themselves against money laundering.

2. It was generally agreed that the FATF 40 Recommendations be recognized as the appropriate standard for combating money laundering, and that work should go forward to determine how the Recommendations could be adapted and made operational for the Fund's work. Directors noted that the Fund's involvement in this area should be strictly confined to its core areas of competence, and that the Fund should not get involved in law enforcement activities.

3. Staff convened a meeting on July 26, 2001, with some representatives of the FATF. Represented were 13 FATF members, including Mrs. Lo (Hong Kong, SAR, People's Republic of China), the new President of FATF, the FATF Secretariat and representatives from the World Bank. The two main themes of the meeting were the process required to adapt the FATF 40 Recommendations for the Fund and Bank work and preparation of the methodology document to be used by IMF-World Bank assessors when reviewing AML elements as part of assessments of financial sector standards.

4. This brief note provides a progress report on developments since the Board meetings in work which has been largely undertaken jointly with the World Bank to carry out the steps to counter money laundering agreed by the Boards of the two institutions.

---

[1] http://www.imf.org/external/np/ml/2001/eng/042601.htm

II. METHODOLOGY DOCUMENT TO REVIEW AML ELEMENTS IN SUPERVISORY PRINCIPLES

5. To intensify the focus on AML elements in all relevant supervisory principles, the staffs of the Fund and Bank have drafted a methodology document. ***The latest draft is annexed to this note and comments from Executive Directors and their authorities would be welcome.*** The methodology document is intended to guide assessors in the review of AML elements in Fund and Bank financial sector assessment activities, which will be used in the financial sector assessment program (FSAP) and the offshore financial center (OFC) initiative.[2]

6. The starting point for the methodology document has been the existing principles of prudential supervision, in the areas of banking, securities, and insurance, together with the criteria developed in the standard-setters' own methodology papers. These sources are augmented, but not altered, by drawing on additional and later papers by the supervisory standard-setters relevant to AML work, and on the FATF 40 Recommendations. This approach follows the guidance of the Board that "it would not be appropriate for the Fund to become involved in law enforcement activities."[3] For the same reason, Fund and Bank staff will not assess the overall effectiveness of a country's AML regime, but only those aspects that are related to the financial supervisory systems.

7. The methodology document is intended to ensure both comprehensiveness and uniformity in the assessments of the AML elements in financial sector supervisory standards. Key to the development and finalization of the draft will be involvement of the standard-setters, including the Basel Committee on Banking Supervision (Basel), the International Association of Insurance Supervisors (IAIS), the International Organization of Securities Commissions (IOSCO), and the FATF. At the meeting with FATF on July 26, 2001, the draft was welcomed by a number of delegates and some comments were offered. The same draft has also been sent to the financial supervisory standard-setters (Basel, IOSCO, IAIS) for their comments. Staff plan to circulate a further draft in September, on the basis of comments received by then and envisage an outreach meeting, or meetings, with the supervisory standard-setters and FATF in the Fall.

8. Over the coming months we plan to use, with agreement of the authorities, the draft document in FSAP and OFC assessments. Following the receipt of comments on the draft and experience gained through the use of the draft methodology document as part of assessment activities, staff envisions finalizing the methodology document by the early part of 2002.

9. Observations regarding the AML elements coming out of the FSAP and OFC initiatives will be discussed as part of the assessment reports. Countries can volunteer to share the detailed assessments with third parties, like the FATF membership, with the

---

[2] See SM/01/205, July 2, 2001 for an update on the OFC initiative.

[3] See PIN 01/41.

approval of the Fund's management. Publication policies for the reports have already been agreed by the Board for FSSAs and for ROSCs, and the Board has been informed of such policies for OFC reports.

III. Incorporating the FATF 40 Recommendations into the ROSC Program

10. Staff is working closely with the major AML groups, especially the FATF, regional AML groups, and the United Nations Global Program against Money Laundering. The Board earlier agreed that the FATF 40 Recommendations be recognized as the appropriate standard for combating money laundering. The staff is now discussing with FATF how to adapt and make operational the FATF 40 Recommendation for the Fund's and the Bank's work, which is to formally incorporate the standard into the *Reports on the Observance of Standards and Codes* (ROSC) framework.[4] The Board agreed on a formal procedure for adding new standards to the agreed list, whereby the list should be reviewed and modified by the Fund Executive Board, in consultation with the Bank when appropriate. The Board has also indicated[5] that for the FATF 40 Recommendations to become an AML ROSC module will require uniform application, on a voluntary and cooperative basis, of a globally accepted standard.

11. At the meeting on July 26, 2001, staff and representatives from FATF member jurisdictions discussed how an AML ROSC could be made operational.[6] Staff discussed the conditions that apply to all ROSC modules, including voluntariness, uniformity of assessment methodology, and a cooperative approach. Staff noted that the Boards of the Fund and the Bank had broadly expressed the view that the FATF 40 Recommendations should be viewed as a whole. One reason for this, staff noted, was that while the Fund's and Bank's mandate was primarily related to financial system supervision, even those of the

---

[4] The Board reviewed the experience with assessing the implementation of standards on January 29, 2001, and presently there are 11 areas and associated standards for which *Reports on the Observance of Standards and Codes* (ROSCs) could be produced. See also SUR/01/13.

[5] See PIN/01/41.

[6] An FATF member country representative argued in favor of an AML ROSC module that used the FATF 40 Recommendations as the standard and the existing FATF self-assessment and mutual evaluation materials (including the FATF 25 Criteria) as the methodology document for compliance assessments. This representative stated that the Fund and FATF could jointly undertake assessments, with the Fund evaluating those of the FATF 40 Recommendations relevant for Fund and Bank work and the FATF undertaking the rest. This proposal was similar to that of the G-7 Finance Minister's Report of July 7, 2001, which states "[W]e welcome the decision of the IMF and WB to recognize the FATF 40 Recommendations as the appropriate international standard for anti-money laundering and call on the IFIs, working in collaboration with the FATF, to incorporate relevant FATF 40 Recommendations into a ROSC module on money laundering as soon as possible."

FATF 40 Recommendations that were not concerned with law enforcement extended well beyond regulated financial institutions. Staff also noted that the current FATF non-cooperative countries and territories (NCCT) process—which is involuntary, uses a different assessment methodology for suspected NCCTs, and includes a "name and shame" approach—did not conform with the ROSC conditions previously outlined. Staff suggested that it was premature to come to firm conclusions on issues which could not be settled until the FATF 40 and the FATF processes had been adapted to meet the ROSC conditions. Nevertheless, if these outstanding issues could be resolved, a ROSC based on the entire FATF 40 Recommendations could be assessed by the FATF or regional AML task forces using, among other sources, material from Fund and Bank assessments of compliance with those supervisory standards relevant to AML, provided that the jurisdiction had agreed.

12. Further discussions will be held on the ROSC process, and on the methodology document between Fund and Bank staff and FATF members in the regular FATF meeting in September, and consideration is being given to setting up a smaller group to take forward these issues. The aim is to come back to the Board with a report and proposals, as set out in the Board's conclusions to the April 13 discussion.

IV. Other Steps

13. The Fund and the Bank are helping countries to improve their anti-money laundering laws and practices through the provision of **technical assistance**. The MAE Department has begun to include AML experts on technical assistance missions (to Lebanon and Botswana) to assist the authorities in developing a comprehensive anti-money laundering regimes. These efforts are being coordinated with the United Nations Global Program against Money Laundering, who provided one of the experts.

14. A number of members of the Pacific Islands Forum have expressed concerns to staff that financial sector crime poses risks to the integrity of their financial systems.[7] LEG, in consultation with MAE, PDR, and APD, is currently addressing this macroeconomic concern by providing technical assistance to the Fiji, Kiribati, Vanuatu, Samoa, and the Marshall Islands in order to help them establish a legal and institutional framework to counter financial sector fraud and money laundering.[8] A primary focus of the TA is assisting the jurisdictions in conforming their anti-fraud and AML laws to accepted international standards, including those of Basel, IOSCO, IAIS, and the FATF (its 40 Recommendations). In addition, LEG is drawing on its expertise in the organization of multi-jurisdictional bodies to assist in the creation of a regional financial intelligence unit that will support financial system supervisors and financial institutions themselves in applying these standards.

---

[7] A number of these jurisdictions have been described as having inadequate supervisory and regulatory regimes by the Financial Stability Forum and as being non-cooperative in preventing money laundering by the FATF.

[8] The technical assistance was also provided to nonmembers—the Cook Islands, Nauru, and Niue.

15. Area departments are beginning to pay closer attention to money laundering issues in **surveillance** activities, when relevant to the macroeconomy. Examples include, inter alia, Israel, Lebanon, Panama, the Philippines, Russia, St. Kitts, and St. Vincent. The reports and actions by the FATF through the non-cooperative countries and territories exercise, as well as the self assessment and mutual evaluations prepared by the FATF on their own membership, receive greater scrutiny.

16. MAE has commissioned **research** into effects of financial crime on the macro economy, aiming at providing an indication of the significance with which crime, and financial crime and money laundering in particular, impacts industrial and developing country markets. A Fund Working Paper on some aspects of financial crime including international crime data, and the relationship between macrofinancial behavior and financial crime—is expected to be published shortly.

17. The consequences of the Board's decisions for Fund resources were estimated in the Board paper in April and the conclusions recorded that: "...additional resources are required ...and that the initial estimates will need to be reviewed in the light of actual experience." The initial work on FSAPs and OFC assessments should provide some useful information on the amount of work that is being added to the existing workload of the FSAP.

V. CONCLUSIONS

18. Since the Board discussed these issues in April, staff has completed an initial draft of the methodology document to assess AML elements in financial sector supervisory and regulatory standards that do not include law enforcement areas. The draft is now out for consultation with the standard-setters and will be used in some Fund and Fund/Bank financial sector work.

19. The meeting with the FATF representatives on July 26, 2001, was productive, with fruitful discussion regarding a mechanism for incorporating the FATF 40 Recommendations into the ROSC process, and on the methodology document.

20. Staff will report to the Board again before the 2002 Spring Meetings, by which time the Methodology Document should be finalized. This report will include an up-to-date description of progress on incorporating the FATF 40 Recommendations into a ROSC. It will also include an analysis of how the AML elements in financial supervision have been covered in those countries where the draft Methodology Document has been used in FSAPs or OFC assessments.

METHODOLOGY DOCUMENT

IMF and World Bank: Enhancing the Global Effort Against Money Laundering

Financial Supervisory Principles Assessment Methodology

Introduction

1. This paper develops a methodology for assessing financial supervisory/regulatory principles relating to anti-money laundering. The purpose is to provide assessors in the Financial Sector Assessment Program with the relevant principles in order to make an overall assessment, and to ensure a readily identifiable output from each FSAP. The paper defines money laundering, explains the roles of the Fund and the Bank, the role of the FSAP, and proposes detailed criteria for assessment purposes. These criteria are drawn as far as possible from existing supervisory papers; the criteria augment the principles laid down by the international standard–setters.

2. Money laundering is defined by FATF as "the processing of criminal proceeds in order to disguise their true origin." The number and variety of transactions used to launder money has become increasingly complex, often involving numerous financial institutions from many jurisdictions, and increasingly using non-bank financial institutions. In addition, because predicate crimes are often financial crimes, laundered proceeds may not be cash but other financial instruments, including wire-transfers. Also, the use of non-financial businesses and markets for laundering appears to be increasing.

3. Strong supervisory and regulatory systems and robust legal and institutional frameworks for financial institutions help prevent a broad range of financial sector abuses, including money laundering.[9] Supervisory/regulatory principles in banking, insurance and securities markets all have a role to play in fortifying the anti-money laundering efforts of the authorities.[10]

4. An effective anti-money laundering regime requires not only adequate implementation of financial institution supervisory principles, but an appropriate legal

---

[9] For more detailed information and analysis, see the staff papers by the Fund and the Bank for their Executive Boards and the Policy Information Notice, to be found on the Fund's website, www.imf.org

[10] The Basel Committee's Core Principles (BCP) of Effective Banking Supervision, 1997; the IAIS Core Principles of Insurance Supervision, 1999; and IOSCO's Objectives and Principles of Securities Regulation, 1998.

framework covering elements of both prevention and deterrence. As described in detail in the FATF 40 Recommendations, these elements include statutory and/or treaty provisions that:

- make money laundering a crime and provide appropriate sanctions;
- provide for the reporting, collection, and analysis of suspicious or unusual financial transactions (including those that do not involve regulated financial institutions);
- allow the freezing and seizing of assets reasonably suspected to be the proceeds of crime;
- allow the sharing of such information with other jurisdictions; and
- allow cross boarder legal assistance in prosecuting money laundering crimes; including collecting evidence and extraditing accused criminals.

5. An essential part of an appropriate legal framework is an adequate system of criminal justice, including effective and fair investigative, prosecutorial, and judicial services. Without an adequate criminal justice system, it is unlikely that anti-money laundering laws will be effective; without a fair system of criminal justice, anti-money laundering laws might be misused, resulting in violations of rights to privacy, property, or personal freedom. Therefore, a complete evaluation of a jurisdiction's anti-money laundering regime needs to go beyond a review of implementation of supervisory principles for financial institutions, and should include an examination of both the effectiveness and fairness of criminal justice systems. For this reason, what is proposed here—a limited evaluation of anti-money laundering measures found in BCP, IOSCO, and IAIS principles—cannot serve as substitute for an evaluation of a jurisdiction's complete anti-money laundering regime.

6. Effective Anti-Money Laundering (AML) policies require that financial institutions collect, analyze, and retain sensitive financial information about their customers. These policies also require that financial institutions report such sensitive information to governmental authorities in certain circumstances, including when the institution suspects that customer transactions might include the proceeds of illegal activity. With adequate legal and institutional protections, the collection and reporting of sensitive financial information can be consistent with rights to privacy. Without adequate protections, however, there may be breaches in these privacy rights. Depending on the particular situation, breaches in privacy rights can result in grave injuries to the customer. For this reason, the legal and institutional protections given customers with respect to the use of sensitive financial information are an essential part of any AML regime.

Supervisors and due diligence

7. There is increasing awareness among supervisors[11] of the importance of ensuring that the institutions they supervise have adequate controls and procedures in place so that they are not used for criminal or fraudulent purposes. Adequate due diligence with respect to those who control or use regulated financial intermediaries (which includes both fitness tests for owners/managers and know-your-customer rules) a key part of these controls. Without this, financial institutions can become subject to reputational, operational, legal, and other risks. In all financial institutions, there are four basic anti-money laundering principles that should be adhered to:

- Comply with anti-money laundering laws, including suspicious transaction reporting, to an administrative body or Financial Intelligence Unit (FIU).[12]
- Know your customer.
- Cooperate with supervisors and law enforcement agencies.
- Have in place anti-money laundering policies, procedures and training.

8. In addition to ensuring that the institutions they supervise act in all these ways, supervisors must be able and willing to (1) ensure that where licenses are required to operate financial intermediaries that the owner/managers are fit and (2) share financial information with overseas supervisors (assuming that adequate safeguards for confidential information are obtained).

9. It should be recognized that anti-money laundering principles, like financial supervisory principles more generally, operate within the broader context of a country's administrative, economic and judicial systems. For example, in formulating the Basel Core Principles for Effective Banking Supervision, the Basel Committee noted the importance of the preconditions[13] for effective supervision, emphasizing that banking supervision is only part of wider arrangements that are needed to promote stability in financial markets. These preconditions also apply, very broadly, to financial supervision in sectors other than banks. One implication is that while effective control systems within financial institutions are key to

---

[11] As used in this document the terms "supervise," "supervisor," "supervision" and "supervisory" shall be deemed in the case of IOSCO to mean also "regulate," "regulator," "regulation," and "regulatory," respectively.

[12] Financial Intelligence Units have important roles in assisting criminal enforcement aspects of an AML regime, detecting fraud and in assisting financial supervisors.

[13] See Basel Core Principles, 1997.

limiting the risks posed by money laundering, those risks are bound to be exacerbated in countries where the basic infrastructure in terms of law and administration is ineffective. In other words, AML policies are no substitute for a functioning and effective system of governance in a country.[14]

10. AML policies have developed very rapidly in recent years; and substantial further development can be expected, partly as the nature and forms of money laundering alter, partly as the authorities' responses evolve. The FATF has decided to revise the FATF 40 Recommendations, in the light of experience since they were last revisited in 1996. This draft will be updated in future as needed.

The Methodology Document

11. In constructing this document, the principles of supervision, together with the assessment criteria, laid down by the Basel Committee, IOSCO, and IAIS have been used as the starting point. These principles and criteria have been augmented by material from recent papers on relevant AML issues. Each section below, on banking, insurance, and securities, contains references to supervisory principles and practices of the three international supervisory bodies.

12. This document is addressed to those who will assess compliance with the AML supervisory principles, and to those who will be assessed. The principles in the document are relevant to participants—supervisors and financial institutions—in all three of the main financial sectors: banking, securities and insurance. The most important is the banking sector. This is because that while money launderers may use institutions in each sector, banks are most often (though not always) used for the initial placement stage, i.e., where illegal profits first enter the financial system. This is because illegal proceeds are often (but again, not always) in cash, and banks, more so than other sectors, have customers who have legitimate cash proceeds. In order to differentiate legitimate from illegitimate cash proceeds, banks need to know their customers. Fortunately, banks have a unique opportunity to understand and get to know their customers (through a combination of long-term relationship and frequent use).

13. Because of their crucial role in the payments system, launderers typically use banks in the next steps in money laundering, known as layering and integration, where illegal profits are transferred among accounts in different financial institutions, often in different jurisdictions, for the purpose of concealing their origins or their owners, or of avoiding jurisdictions where they might be frozen, seized, or used as evidence in legal proceedings. Hence in what follows more onus is put on banks than on other financial institutions.

---

[14] For the Fund's role in governance issues, see PIN N0 01/20, March 8, 2001, *[The Executive Board Reviews IMF's Experience in Governance Issues.]*

14. The supervisory and regulatory principles in this document are related to the supervisory elements in the FATF 40 Recommendations. The table at the end of this paper, based on a similar table in the paper for the Fund and Bank Boards SM/01/103, shows how the relevant FATF 40 Recommendations relate to the principles of financial supervision. (The other FATF Recommendations, covering such issues as *the 1988 United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (the Vienna Convention);* cooperation in prosecutions, confiscation or seizure of assets, are not listed here.) Nearly half the FATF 40 have some counterpart in supervisory principles, reflecting the fact that there is a wide area of overlap between AML and supervisory principles. Typically, the FATF 40 Recommendations put more emphasis on law enforcement. Achieving a high degree of compliance with principles and criteria in this paper will correspond to achieving a high degree of compliance with a subset of the FATF 40. This suggests scope for securing economies from exchanging information, where countries agree, between FATF and FSAP assessors.

The Roles of the Fund and the Bank

15. On April 13, 2001, the IMF's and the World Bank's Executive Directors agreed that money laundering is a problem of global concern, which requires international cooperation to address it.[15] Money laundering, which affects major financial centers as well as smaller financial markets, has the potential in some cases to endanger the integrity of both the international financial system, and domestic financial sectors, and has development costs, even though they may be difficult to measure.

16. Financial sector issues are central to the Fund's mandate as they are rooted in its purpose to promote macroeconomic stability and growth. The Bank's important long-term development mandate includes strengthening financial systems. Anti-money laundering issues related to financial supervision and regulation (primarily those included in BCPs, IOSCO or IAIS Principles) are part of the Fund's and the Bank's core responsibilities. But Executive Directors of both the Fund and the Bank stressed that the Fund's and the Bank's involvement in AML efforts should be strictly confined to their core areas of competence; and should not include other anti-money laundering issues associated with criminal law enforcement (primarily those not included in BCPs, IOSCO or IAIS Principles). The FATF 40 Recommendations, now being revised, are widely recognized as the key set of standards to deter the crime of money laundering.

---

[15] See the papers and conclusions on the Fund's website: http://www.imf.org/external/np/sec/pn/2001/pn0141.htm

17. Several international organizations and task forces are involved in efforts to counter money laundering; and they can be divided into three categories: (i) those that are concerned primarily with financial supervisory matters; (ii) those that are concerned with both financial supervisory and legal/criminal enforcement matters; and (iii) those that are primarily concerned with legal/criminal enforcement. The IMF and the World Bank come into group (i); FATF into group (ii); and Interpol into group (iii).

18. The motivation and opportunities to engage in illegal and criminal activities exist everywhere and no country, however developed, is immune. Nevertheless, money launderers use particularly those countries where regulations are inadequate and where financial supervision is deficient. Money launderers also seek out institutions in developed countries where banks offer a sophisticated array of financial services which can be used by criminal elements to transfer and invest funds. In that regard, implementing worldwide international standards for financial supervision, while not a panacea, can make a major contribution to countering money laundering. To enhance international AML efforts, the Executive Directors agreed that the Fund and the Bank will take the following additional steps:

- intensify their focus on anti-money laundering elements in all relevant supervisory principles,
- work more closely with major international anti-money laundering groups,
- increase the provision of technical assistance;
- include anti-money laundering concerns in Fund surveillance and other Fund operational activities when macroeconomic relevant; and
- undertake additional studies and publicize the importance of countries acting to protect themselves against money laundering.

19. Directors endorsed the proposal to develop a methodology that would enhance the assessment of financial standards relevant for countering money laundering and could be used for preparing reports in each FSAP on observance of all relevant principles. The ongoing FSAP and the Offshore Financial Centers (OFCs) assessments will allow an increasing number of members to benefit from the Fund's work on strengthening financial systems, including countering money laundering. Directors agreed that results from such FSAP/FSSA and OFCs assessments could be shared with the international community, with the agreement of the member. Publication and circulation to outside agencies of the assessments would be governed by existing Fund and Bank policies.

Use of Methodology Document in FSAPs

20. This document will be used as an integral part of the Financial Sector Assessment Program and the Fund's Offshore Financial Sector initiative. Each assessor (banking, insurance, and securities) will as now go through each of the principles, looking at criteria,

and deciding how far they are met. The assessor expert in his/her sector will cover the AML material in this methodology document—for example the much expanded BCP 15. The assessor will provide a contribution toward the separate AML section in FSAP reports, after any necessary editing and coordination among the assessors. The AML section will also include a description and where appropriate an assessment of the adequacy of the law relating to AML activities. The section will be written up in detail in the FSAP report and in summary form in the FSSA and the FSA.

21. The coverage within an FSAP of a financial sector such as insurance depends on the scale and potential risks of that sector. If the insurance sector for example is small, it may well not be covered in the FSAP and therefore would not be covered by the AML methodology document. Moreover, the degree of detail, and the depth and weight of the recommendations in a particular jurisdiction, will depend on the circumstances in the country. Some more information on how best to apply priorities should be gained by the pilot scheme in the second half of 2001, when the draft methodology document will be piloted in a number of FSAPs, and in the light of the comments received on this draft.

22. Also relevant to AML policies and their transparency is the IMF's *Code of Good Practices on Transparency in Monetary and Financial Policies*. FSAPs often include assessments of compliance with this code, which includes supervisory objectives, availability of information from agencies and the accountability and assurance of integrity of agencies. Where relevant, AML aspects of this code should be covered in the FSAP.

Chapter I: Assessing the Implementation of Anti-Money Laundering Requirements in Banks

Rationale

23. Banks remain the main channel for criminals to launder the proceeds of their crimes, both through placement of the illegal proceeds into the financial system and through layering and integration such activities may be conducted through regular banking services and operations, mostly deposits and transfers, as well as through illegal schemes, using credit or derivatives instruments, and could involve a bank's staff, managers or directors.

24. Though supervisors throughout the world do not have the same responsibilities and objectives in relation to fighting money laundering, preventing banks from being used to conduct illegal activities should be among supervisors' responsibilities and objectives, as set out in BCP 15. All of these agencies are concerned by the soundness of the business conducted by the industry, and banks' capacity to prevent their services from being used for criminal purposes. If conducted on a large scale, these activities would engender additional risks, for example, reputational risk (the potential for adverse publicity resulting in a loss of confidence in an institution: for example a bank could be an instrument, a vehicle or a victim of illegal activities, perpetrated by customers, staff or outsiders); operational risk (risk of loss arising from inadequate or failed internal processes, people or systems); counterparty risk; and legal risks (the risk that lawsuits, adverse judgments or contracts that turn out to be

unenforceable can disrupt or adversely affect the operations or conditions of a bank. In addition, other banking risks (liquidity, interest rate risks, etc.) could develop.

25. Of particular importance are the Basel Committee's Principles that address weaknesses in banks' management, organization and procedures, notably internal control and audit, and in banking regulations and supervision, especially with regard to bank secrecy and information confidentiality that prevent supervisors from accessing to or exchanging information on customers to other domestic or foreign supervisory institutions. The section below presents an expanded version of BCP 15, as prepared by Fund and Bank staff. In addition to the papers on Core Principles and its methodology, the Basel Committee on Banking Supervision has also issued two other documents related to the prevention of money laundering: the December 1988 "Prevention of criminal use of the banking system for the purpose of money-laundering"; and the January 2001 draft on Customer Due Diligence for Banks. These are used as a basis for the expanded evaluation criteria.

26. *Please note that material in ordinary typeface is taken straight from the Basel papers on the Core Principles and its methodology; extra material, including those taken from the two papers cited, is shown in italics. Bold face is for the original Basel Core Principle 15.*

27. **BCP 15: 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.**

Criteria

1. The supervisor determines that banks have in place adequate policies, practices and procedures that promote high ethical and professional standards and prevent the bank from being used, intentionally or unintentionally, by criminal elements. This includes the prevention and detection of criminal activity or fraud, and reporting of such suspected activities to the appropriate authorities.

1.1 The supervisor encourages high ethical standards of professional conduct among banks.

1.2 Banks have control systems to try to deter the offering of services or the providing of active assistance in transactions which could be associated with money-laundering activities.

1.3 Bank's board of directors is fully committed to ensuring that business is conducted in conformity with high ethical standards, and that laws and regulations pertaining to financial transactions are adhered to.

1.4 The supervisor satisfies itself that a bank's management establishes appropriate procedures and ensures their effectiveness

1.5 If financial institutions suspect that funds stem from a criminal activity, they are required to report promptly their suspicions to the competent authorities, for example financial intelligence units.

1.6 Banks ensure that all members of their staff concerned, wherever located, are informed of the bank's policy in this regard.

2. The supervisor determines that banks have documented and enforced policies for identification of customers and those acting on their behalf as part of their anti-money-laundering program. There are clear rules on what records must be kept on customer identification and individual transactions and the retention period. Information requirements for customers in terms of the detail needs to be commensurate with the assessed risk of money laundering posed by the customers.

2.1 Regulations require banks to develop clear customer acceptance policies and procedures, including a description of the types of customer that are unacceptable to bank management.

2.2 Banks conduct more extensive due diligence for high risk customers, especially foreign potentates and their families and associates and decisions to enter into such business relationships are taken at a senior management level.

2.3 It is banks' explicit policy that transactions will not be conducted nor accounts opened with costumers who fail to provide satisfactory evidence of their identity.

2.4 Similar customer identification procedures are applied across a banking institution, including its private banking business. Supervisors must also be satisfied with the identification procedures and monitoring standards that banks apply in their foreign and offshore branches and subsidiaries. Banks inform their home supervisor when a host country's local laws and regulations prohibit them from applying the home country requirements to their foreign activities.

2.5 Identification requirements apply to individual customers, as well as companies, financial institutions, trusts, associations, foundations, or other legal entities.

2.6 Through customer identification procedures, banks must make reasonable efforts to determine the true identify of a customer, and ascertain that the customer's source of wealth is not from illegal activities. This may include, where appropriate, review of the customer's credit and character, and of the type of transactions the customer would typically conduct.

2.7 Banks must be provided with originals, wherever possible, of official documents attesting the legal existence and structure of a company or legal entity, the identity of the principal owners and beneficiaries, and the provisions regulating the binding power.

2.8 Rules, whether laws, regulations, or professional agreements, define which official or reliable identifying documents are required to verify a customer's identity. Customer

information must be regularly updated, and copies of relevant documents must be kept for at least five years after the customer's account is closed or the transaction is complete.

2.9 Banks conduct customer identification due diligence on account-holders and beneficial owners of an account, as well as trustees, nominees or professional intermediaries of a legal entity whose assets are managed by a third party. For such vehicles, banks must be informed of the legal arrangements governing the entity, and customer due diligence must also be applied to the beneficiaries. Non-resident customers and numbered accounts' holders must be subject to similar scrutiny. This scrutiny should be applied when accounts are opened and periodically thereafter.

2.10 Banks must pay particular attention to correspondent banking services, notably wire transfer services provided to a financial institution in a place (1)to which the other institution has no direct access, or (2) which has in place inadequate anti-money laundering measures and practices, and to international business companies, IBCs, that conduct their business outside the country where they are registered.

2.11 Banks must exercise special care before satisfying themselves that introducers of business or intermediaries, including lawyers, accountants, and other agents, conduct sound due diligence process for the client accounts they bring or manage.

2.12 The supervisor has the power to sanction a bank, its board members, its managers or staff who fail to conduct proper customer identification due diligence.

2.13 Appropriate procedures must be defined for direct banking where transactions are carried out by a distant selling institution or when issuing stored value cards ("smart cards").

2.14 The supervisor has provided banks with guidance on customer identification requirements and procedures. Customer identification standards are consistent with the Basel Committee paper on Customer Due Diligence for Banks.

3. The supervisor determines that banks have formal procedures to recognize *and report* potentially suspicious transactions. These might include additional authorization for large cash (or similar) deposits or withdrawals and special procedures for unusual transactions.

3.1 Banks establish and regularly revise systems for detection of unusual or suspicious patterns of activity that provide managers and compliance officers with timely information needed to identify, analyze and effectively monitor high risk customer accounts.

3.2 *The supervisor brings to the attention of banks national and international findings of deficiencies concerning a country's or a jurisdiction's anti-money laundering system, and requires banks to exercise special care before conducting transactions, or dealing with customers based in such countries or jurisdictions.*

3.3 Banks maintain all necessary records on transactions, both domestic or international, to enable them to reconstruct individual transactions (including the amounts and types of currency involved if any). These records must be kept for a minimum of five years. The supervisor can impose sanctions on a bank that fail to comply with these requirements.

4. The supervisor determines that banks appoint a senior officer with explicit responsibility for ensuring that the bank's policies and procedures are, at a minimum, in accordance with local statutory and regulatory anti-money laundering requirements.

4.1 This officer's responsibilities include ongoing monitoring of staff performance, through sample testing of compliance and review of exception reports, to alert the senior management or the board of directors if anti-money laundering procedures are not properly followed.

5. The supervisor determines that banks have clear procedures, communicated to all personnel, for staff to report suspicious transactions to the dedicated senior officer responsible for anti-money laundering compliance.

5.1 Financial institutions, their directors, managers and employees, are not allowed to warn their customers when information relating to them is being reported to the competent authorities.

6. The supervisor determines that banks have established lines of communication both to management and to an internal security (guardian) function for reporting problems.

7. In addition to reporting to the appropriate criminal authorities, banks report to the supervisor suspicious activities and incidents of fraud material to the safety, soundness or reputation of the bank.

8. Laws, regulations and/or banks' policies ensure that a member of staff who reports suspicious transactions in good faith to the dedicated senior officer, internal security function, or directly to the relevant authority cannot be held liable.

9. The supervisor periodically checks that banks' money laundering controls and their systems for preventing, identifying and reporting fraud are sufficient. The supervisor has adequate enforcement powers (regulatory and/or criminal prosecution) to take action against a bank that does not comply with its anti-money laundering obligations.

10. 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.

10.1 The supervisor is able on his own initiative or upon request to exchange information relating to suspicious transactions with domestic and international financial supervisors, to the extent permitted by national and international provisions on privacy and data protection.

11. The supervisor determines that banks have a policy statement on ethics and professional behavior that is clearly communicated to all staff.

12. The home supervisor is aware of the high reputational risk that operating in some countries could create, implement additional safeguards where appropriate, and can require banks to close down the operation in question.

13.[16] The laws and/or regulations embody international sound practices, such as compliance with the relevant forty Financial Action Task Force Recommendations issued in 1990 (revised 1996).

14.[17] The supervisor determines that bank staff is adequately trained on money laundering detection and prevention.

14.1 Banks have developed an ongoing employee training program against money laundering: new staff is educated in the importance of bank's policies and requirements, and regular training is provided to ensure that staff is reminded of their responsibilities and is kept informed of new developments.

15.[18] The supervisor has the legal obligation to inform the relevant criminal authorities of any suspicious transactions.

16.[19] The supervisor is able, directly or indirectly, to share with relevant judicial authorities *(including through a FIU)* information related to suspected or actual criminal activities.

17. If not performed by another agency, the supervisor has in-house resources with specialist expertise on financial fraud and anti-money laundering obligations.

18. The competent authorities have established guidelines to assist financial institutions in detecting suspicious patterns of behavior by their customers.

19. Banks establish guidelines to detect suspicious transactions for the purpose of reviewing complex or unusual large transactions, and patterns of transactions.

---

[16] Additional criteria

[17] Additional criteria

[18] Additional criteria

[19] Additional criteria

Chapter 2: Assessing the Adequacy of AML Requirements in the Insurance Sector

Rationale

29. Because, at least in developed countries, insurance companies do not typically accept premiums in the form of cash, criminals are less likely to use insurance companies for initial placement of their illegitimate proceeds than to use banks. Nevertheless, insurance companies and insurance market supervisors must also employ measures to prevent and deter money laundering. First, insurance companies can be used for layering and integration transactions. For example, the FATF Typologies work has identified several schemes by which insurance companies are used to legitimize the proceeds of crime. Next, in developing country jurisdictions insurance companies may routinely accept premiums, especially life insurance premia paid by members of the general public, in the form of cash; in these cases, insurance companies may be used in the placement stage.

30. Insurance companies and supervisors should be sensitized to the nature and extent of money-laundering. In this regard it is helpful to review and discuss contractual and other arrangements that have been employed in the past by criminals engaged in money-laundering. Insurance companies will be expected to adopt and enforce anti-money laundering policies that will govern the activities of their staff. They will also need to ensure that their internal control systems are such as to ensure that policies adopted by their boards and management for preventing and deterring money laundering are fully implemented and that prompt follow-up action, such as reporting suspicious transactions to law enforcement officials, is taken.

31. Insurance companies should be particularly vigilant in regard to know-your-customer rules and ensure that the owner and the insured person are clearly identified. There should be appropriate authority for communication: insurance companies and their supervisors should be authorized to exchange information concerning any suspicious transactions with law enforcement authorities and should be protected from any legal liability for good faith implementation of such authority. They should also be authorized to exchange such information with supervisors and law enforcement agencies in other countries.

32. The IAIS Core Principles of Insurance Supervision. Principles 1, 2, 3, 4, 5, 10, and 16, contain criteria that are relevant for anti-money laundering efforts. For example, internal controls are extremely important, yet many Fund and Bank assessments of observance of IAIS Principles have revealed that internal control procedures within insurance companies are not well-established and insurance supervisors have not been very effective in promoting the development of good systems of internal controls. If it is not possible to rely upon internal control systems for general purposes of management and supervision, there is little likelihood that company management and staff can be relied upon to take an effective role in anti-money laundering.

33. An new Core Principle that parallels the one already existing for banking supervisors has been added below. As for essential criteria on this provision, the text below draws

extensively from the draft IAIS "Anti-money laundering Guidance Notes for insurance supervisors and insurance entities", of April, 2001.

34. In assessing the adequacy of supervision over anti-money laundering efforts, as part of the relevant section in the FSAP, assessors will need to have regard to all those IAIS Principles—1-5, 10 and 16—listed above, as well as to the new AML principle proposed here.

35. In the suggested text below, the new principle is put in bold and the suggested criteria in italics.

New Insurance Principle: Anti-Money Laundering

36. **The insurance supervisory authority must determine that insurance entities 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 insurance entity from being used, intentionally or unintentionally, by criminal elements.**

Criteria

Insurance entities should be constantly vigilant in deterring criminals from making use of them for the purpose of money laundering. The duty of vigilance is to avoid assisting the process of laundering and to react to possible attempts of insurance entities being used for that purpose. The duty of vigilance consists mainly of the following elements:

(a) Underwriting standards;

(b) Verification of identity;

(c) Recognition and reporting of suspicious customers/transactions;

(d) Keeping of records;

(e) Training.

(a) Underwriting

Thorough underwriting will enable an insurance company to understand the business written. Underwriting will include checking the presence of insurable interest when accepting applications and processing claims. In many jurisdictions the practice of buying and selling second hand endowment policies is relevant and in these cases the insurance entity and the insurance supervisor should be extra vigilant.

Criteria:

1. All insurance entities should have an effective anti-money laundering programme in place which enable them:

- in the case o*f insurers, to foster close working relationships between underwriters and claims investigators;*
- *to determine (or receive confirmation of) the true identity of prospective policyholders;*
- *to recognize and report suspicious transactions to the law enforcement authority and insurance supervisor;*
- *to keep records on policy holders for a prescribed period of time/for 5 years;*
- *to train staff (key staff should have a higher degree of training);*
- *to liaise closely with the law enforcement authority and insurance supervisor on matters concerning vigilance policy and systems;*
- *to ensure that internal auditing and compliance departments regularly monitor the implementation and operation of vigilance systems;*
- *to assure ongoing compliance with all relevant laws and regulations;*
- *to designate a Compliance Officer who is responsible for day-to-day compliance with current regulations;*
- *to establish high ethical standards in all business and require compliance with laws and regulations governing financial transactions; and*
- *to ensure cooperation with law enforcement authorities, within the confines of applicable law.*

2. An insurance entity should not enter into a business relationship or carry out a significant one-off transaction unless it is fully implementing the above systems.

3. Vigilance systems should enable key staff to react effectively to suspicious occasions and circumstances by reporting them to the relevant personnel in-house and to receive training from time to time from the institution to equip them to play their part in meeting their responsibilities.

4. As an essential part of training, key staff should receive a copy of any current instruction manual(s) relating to entry, verification and records based on the recommendations contained in these guidance notes.

(b) Verification

An insurance entity undertaking verification should establish to its reasonable satisfaction that every verification subject relevant to the application for insurance business actually exists. All the verification subjects of joint applicants for insurance business should normally be verified. On the other hand, where the guidance implies a large number of verification subjects (e.g., in the case of group life and pensions) it may be sufficient to carry out verification to the letter on a limited group only, such as the principal shareholders, the main directors of a company, etc.

Criteria

1. *An insurance entity should primarily carry out verification in respect of the parties entering into the insurance contract. On more occasions there may be underlying principals and if this is the case, the true nature of the relationship between the principals and the policyholders should be established and appropriate enquiries performed on the former, especially if the policyholders are accustomed to act on their instruction.*

2. *An insurance entity should take special care when the policyholder/beneficiary resides in another jurisdiction or when the subject matter of insurance is located outside the jurisdiction of the insurance entity.*

3. *If claims, commissions, and other monies are to be paid to persons (including partnership, companies etc) other than the policyholder then the proposed recipients of these monies should be the subject of verification.*

4. *Any reinsurance on retrocession needs to be checked to ensure the monies are paid to bona fide reinsurers for rates commensurate with the risks underwritten.*

(c) Recognition and Reporting of Suspicious Customers/Transactions

The insurance supervisory authority must determine that insurance entities have in place strict "know your customer " rules ....

Criteria

1. An important pre-condition of recognition of a suspicious transaction is for the institution to know enough about the customer to recognize that a transaction, or a series of transactions, is unusual.

2. Insurance entities should be alert to the implications of the financial flows and transaction patterns of existing policyholders, particularly where there is a significant, unexpected and unexplained change in the behavior of policyholders account (e.g., early surrenders).

3. Suspicious transactions should be recognizable as falling into one or more of the following categories:

- *any unusual or disadvantageous early redemption of an insurance policy;*

- *any unusual employment of an intermediary in the course of some usual transaction or financial activity e.g., payment of claims or high commission to an unusual intermediary;*

- *any unusual method of payment;*

1. The Compliance Officer should be well versed in the different types of transaction which the institution handles and which may give rise to opportunities for money laundering.

2. *Institutions should ensure:*

- that key staff know to whom their suspicions should be reported; and

- that there is a clear procedure for reporting such suspicions without delay to the Compliance Officer;

- Key staff should be required to report any suspicion of laundering either directly to their Compliance Officer or, if the institution so decides, to their line manager for preliminary investigation in case there are any known facts which may negate the suspicion.

9. *On receipt of a report concerning a suspicious customer or suspicious transaction the Compliance Officer should determine whether the information contained in such a report supports the suspicion. He should investigate the details in order to determine whether in all the circumstances he in turn should submit a report to the law enforcement authority.*

10. *Where a branch or subsidiary of a regulated insurance entity is in a different jurisdiction, it should report to the law enforcement authority and insurance supervisor of the host jurisdiction, documenting the enquiries, and the reasons for making/not making a report to the law enforcement authority. Those documents should be kept for a minimum of 6 years, (suggested period) or as long as an ensuing investigation remains open.*

(d) Keeping of Records

Criteria:

1. Records should be kept by the insurer after termination. In the case of a life company, termination includes the maturity or earlier termination of the policy.

2. Jurisdictions should keep records for a minimum of 5/6 years. In some jurisdictions there are prescribed periods for records keeping e.g., 6 years after the expiry for life policies and 6 years after the date of the expiry of the policy, in the case of non-life contracts.

3. *As regards records of transactions, insurers should ensure that they have adequate procedures:*

- *to access initial proposal documentation including, where these are completed, the client financial assessment (the "fact find"), client needs analysis, copies of regulatory documentation, details of the payment method, illustration of benefits, and copy documentation in support of verification by the insurers;*

- *to access all post-sale records associated with the maintenance of the contract, up to and including maturity of the contract; and*

- *to access details of the maturity processing and/or claim settlement including completed "discharge documentation."*

4. In the case of long-term insurance, records usually consist of full documentary evidence gathered by the insurer or on the insurer's behalf between entry and termination. If an agency is terminated, responsibility for the integrity of such records rests with the insurer as product provider.

5. If an appointed representative of the insurer itself is registered or authorized under the insurance law in the insurance supervisor's jurisdiction then the insurer, as principal, can rely on the representative's assurance that he will keep records on the insurer's behalf. (It is of course open to the insurer to keep such records itself; in such a case it is important that the division of responsibilities be clearly agreed between the insurer and such representative).

6. If the appointed representative is not itself so registered or authorized, it is the direct responsibility of the insurer as principal to ensure that records are kept in respect of the business that such representative has introduced to it or effected on its behalf.

7. An institution should maintain a register of all enquiries made to it by the Law.

8. Enforcement Authority or other local or non-local authorities acting under powers provided by the relevant laws or their foreign equivalent. The register should be kept separate from other records and contain as a minimum the following details;

- *the date and nature of the enquiry;*
- *the name and agency of the enquiring office;*
- *the powers being exercised; and*
- *details of the policies involved.*
- *Institutions have a duty to ensure that key staff receive comprehensive training in:*
    - the relevant laws;
    - vigilance policy and vigilance systems;
    - the recognition and handling of suspicious transactions; and
    - the personal obligations of all key staff under the relevant laws.

9. The effectiveness of a vigilance system is directly related to the level of awareness engendered in key staff, both as to the background of international crime against which the relevant laws have been enacted and these Guidance Notes, and as to the personal legal liability of each of them for failure to perform the duty of vigilance and to report suspicions appropriately.

(e) Training

Criteria

1. While each institution should decide for itself how to meet the need to train members of its key staff in accordance with its particular commercial requirements, programs will usually be appropriate for new and existing employees, requiring periodic, ongoing training.

2. *Generally, training for new employees should include:*

- *a description of the nature and processes of laundering;*
- *an explanation of the underlying legal obligations contained in the relevant laws;*
- an explanation of vigilance policy and systems, including particular emphasis on verification and the recognition of suspicious transactions and the need to report suspicions to the Compliance Officer.

Chapter 3: Assessing the Implementation of Anti-Money Laundering Requirements in Capital Markets Regulation

Rationale

37. Capital markets may be less attractive than the banking or insurance sectors for the "placement" phase of money laundering because of the low incidence of cash transactions but given their complexity and depth of liquidity, securities markets are potentially attractive for the "layering" and "integration" phases—a potential which may grow with the increased integration of the financial sector and the increased complexity of transactions in the securities markets. Capital markets supervision must include anti-money laundering provisions not only in recognition of the potential for layering and integration but also to ensure that capital markets keep pace with the whole financial sector and do not become more attractive to money launderers by comparison. In the context of increased integration of financial sector activity and given the potential for layering or integration (rather than placement), the emphasis in securities markets anti-money laundering provisions should be on adequate information sharing capacity, both domestically, and cross-border, and adequate means of reconstructing transactions for the purposes of investigations. In developing countries where cash is routinely used in relation to securities transactions, the securities markets may also be used in the placement stage.

There are four general principles particularly relevant to money laundering:

1. The regulatory authority supervising the securities markets should ensure that the supervised institutions have adequate policies and procedures in place to guard against money laundering. The regulatory authority should cooperate with domestic judicial or law enforcement authorities in money laundering investigations.

2. Market intermediaries, self-regulatory organizations (SROs), including clearance and settlement facilities, public companies and collective investment schemes should be subject to anti-money laundering laws and regulations, whether general or specific to the securities markets.

3. The regulatory authority should pay special attention to the potential in new and developing technologies to accommodate money laundering, especially those technologies that favor anonymity. The regulatory authority should, if necessary, take steps to prevent new technologies from being used for money laundering purposes.

4. As far as practicable, the regulatory authority should discourage the use of cash transactions in the securities markets as well as the use of instruments in bearer certificate form.

38. The IOSCO principles described in this methodology have been taken from the IOSCO document "Objectives and Principles of Regulation" (September 1998). The criteria proposed are those deemed relevant in relation to efforts to counter money laundering, and

are drawn from inter alia the following source: IOSCO Technical Committee, "Report on Money Laundering", October, 1992.

Please note that material in ordinary typeface is taken straight from the IOSCO documents including the Core Principles; extra material, including that taken from the paper cited, is shown in italics.

Principle 1—The responsibilities of the regulator should be clear and objectively stated.

1. The regulator should cooperate with other responsible authorities including law enforcement, governmental and other supervisory bodies.

2. There should exist adequate legal protections for regulators and their staff acting in the bona fide discharge of their functions and powers.

Principle 5—The staff of the regulator should observe the highest professional standards including appropriate standards of confidentiality.

1. Clear guidance should be given to staff regarding the appropriate use of information obtained in the course of the exercise of powers and discharge of duties.

Principle 10—The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance program.

1. The regulatory authority and SROs should have sufficient authority and resources to incorporate anti-money laundering provisions in supervision of market intermediaries, issuers, markets and collective investment schemes.

2. The regulatory authority or SRO should have the power to sanction a market intermediary, issuer, market or collective investment scheme, its management or representatives who fail to put in place and/or carry out policies and procedures related to compliance with anti-money laundering provisions.

3. The regulatory authority should have the authority to obtain and provide to another authority, domestic or foreign, information including statements and documents that may be relevant to investigating and prosecuting potential violations of anti-money laundering laws or regulations.

4. The regulatory authority and SRO should be cognizant of the risks posed by new technology to anti-money laundering efforts, particularly in the case of technology that allows anonymity for parties to transactions

5. Securities regulators should consider the sufficiency of domestic legislation to address the risks of money laundering. The regulator should also require that market

intermediaries have in place policies and procedures designed to minimize the risk of the use of an intermediary's business as a vehicle for money laundering.

Principle 11—The regulator should have the authority to share both public and non-public information with domestic and foreign counterparties.

1a. The regulator and SRO should have the authority to share public and non-public information with respect to anti-money laundering provisions with domestic and foreign counterparts including client account information, trading and transaction records and details of investigation and enforcement proceedings.

Principle 12—Regulators should establish information sharing mechanism that set out when and how they will share both public and non-public information with their domestic and foreign counterparts.

1a. The regulator and SRO should have the ability to provide "upon request" information relating to suspicious transactions, persons or corporations involved in such transactions.

1b. The regulator and SRO should be subject to policies and procedures that ensure that the provision of such information is consistent with national and international privacy and data protection standards."

Principle 13—The regulatory system should allow for assistance to be provided to foreign regulators who need to make inquiries in the discharge of their functions and exercise of their powers

1a. The regulator and SRO should have mechanisms in place to assist in the timely provision of information from market intermediaries, markets and issuers, either directly or through the regulator or SRO, to foreign regulators making inquiries related to suspicious transactions, persons and corporations.

IOSCO Principle 17—The regulatory system should set standards for the eligibility and the regulation of those who wish to market or operate a collective investment scheme.

Criteria

17.1a Regulation should specify clear criteria for eligibility to operate a collective investment scheme, with a view to ensure adequate protection of investors. The eligibility criteria may include:

- *honesty and integrity of the operator;*
- *competence to carry out the functions and duties of a scheme operator;*

- *financial capacity;*
- *standards of fiduciary responsibility;*
- *operator specific powers and duties;*
- *absence of prior felonies, money laundering connections, or other disqualifications;*
- *internal management procedures.*

17.1b The regulatory system should ensure adequate supervision of licensed collective investment schemes so as to promote high standards of competence, integrity and fair dealing. For this purpose, the regulator should have clear powers with respect to:

- *registration and authorization of a scheme;*
- *requirements for adequate record-keeping, audit trail and periodic reporting of all aspects of operations, including costs and returns, investment portfolio, adherence to stated investment policies, transactions involving conflicts of interest, etc.;*
- *requirements for identification of investors, reporting or restrictions of cash transactions, and other provisions to deter money laundering;*
- *periodic inspections to ensure compliance by scheme operators;*
- *requirements for disclosure of material risks and information regarding the investment vehicle to investors;*
- *investigations of suspected breaches;*
- *remedial action in the event of breach or default.*

IOSCO Principle 21—Regulation should provide for minimum entry standards for market intermediaries.

Criteria:

1a. The regulatory authority should take the necessary steps to prevent ownership or control of or significant participation in a market intermediary by criminals or their confederates. Supervisors should, therefore, be required to provide an employment, criminal and disciplinary history on substantial owners, major shareholders, directors, officers, and partners. A background check, including a check against police records, and regulatory records should be undertaken. The background check may extend to include information requested from foreign regulatory and criminal authorities.

2a. In the case of a change in control or new significant participation in a market intermediary, the regulatory authority should carry out a background check on the owner or participant in the same manner required at the time of licensing.

IOSCO Principle 23—Market intermediaries should be required to comply with standards for internal organization and operational conduct that aim to protect the interests of clients, ensure proper management of risk, and under which management of the intermediary accepts primary responsibility for these matters.

Criteria:

1a. Market intermediaries should be required to have in place policies and procedures designed to minimize the potential use of the intermediary as a vehicle for money laundering and which comply with anti-money laundering provisions in laws and regulations. Market intermediaries should be required to have on-going employee training related to anti-money laundering provisions and should be required to audit or review its compliance with anti-money laundering requirements.

1b. The regulatory authority or SRO should review compliance with all applicable anti-money laundering provisions as part of its supervision of market intermediaries.

2a. The regulatory authority or SRO should have guidelines to assist market intermediaries in the detection of suspicious transactions, including guidance as to what might constitute a suspicious transaction and which transactions may merit further inquiry.

2b. The market intermediary should establish guidelines to detect suspicious transactions for the purpose of reviewing complex, unusual large transactions or unusual patterns of transactions. The market intermediaries should be required to report a transaction that it suspects stems from criminal activity to the competent authority.

2c. Directors, officers and employees of market intermediaries should be protected from criminal or civil liability for breach of any restriction on disclosure of information imposed by contract, legislation or regulation if they report their suspicions in good faith to the regulator, even if they did not know precisely what the underlying criminal activity was, and regardless of whether illegal activity actually occurred.

2d. Market intermediaries should be prohibited from warning clients when information related to them is reported to the competent authority.

2e. Market intermediaries should be required to comply with instructions from the competent authority with respect to a suspicious transaction report.

2f. Directors, officers and employees of market intermediaries should be protected from criminal or civil liability for breach of any restriction on disclosure of information imposed by contract, legislation or regulation if they report their suspicions in good faith to

the regulator, even if they did not know precisely what the underlying criminal activity was, and regardless of whether illegal activity actually occurred.

3a. Market intermediaries should be prohibited from keeping anonymous accounts. Market intermediaries should be required to ascertain, insofar as possible, the beneficial owner of an account.

3b. Market intermediaries should be required by law or regulation to take reasonable measures to ascertain the identity of clients based on reliable identification documents, such as passports, identity cards or driver's licenses.

4a. If a client is a corporate entity or partnership, the market intermediary should be required to verify the legal existence and structure of such client by obtaining proof of incorporation, client's legal name, form and address, and the names of directors and officers or partners, including those with signing authority. The market intermediary may rely on a certificate of incorporation or registry certificate, board resolutions or bank mandates, memoranda or articles of incorporation, partnership agreements and identification documents for directors, officers or partners.

4b. At account opening, the market intermediary should be required to take reasonable steps to ascertain whether the account is being opened on behalf of a third party. If this is the case, the market intermediary should be required to check the identity of all parties to the account as above.

4c. In the case of foreign clients, market intermediaries may rely on a reputable source for identification of the client—this source may be an appropriately regulated foreign financial institution. The market intermediary should determine the identity of the beneficial owner.

4d. Market intermediaries should be required to keep records of client accounts, including documentation establishing the client's identity, for a reasonable minimum period of e.g., 5 years.

4e. Market intermediaries should be required to give special attention to transactions involving persons, companies or financial institutions from countries that do not or insufficiently apply international anti-money laundering standards. Whenever these transactions have no apparent economic or visible lawful purpose, their background and purpose should, as far as possible, be examined, the findings established in writing, and be available to help supervisors, auditors and law enforcement agencies.

5a. Market intermediaries should be required to retain information sufficient to establish a profile of the suspect account including (i) identity of beneficial owner (ii) volume of funds through the account and (iii) information with respect to individual transactions in the account. The ability to reconstruct an individual transaction should include origin of the funds, form of funds offered or withdrawn, identity of person undertaking the transaction,

form of instruction and authority and destination of the funds. Market intermediaries should be required to maintain records of such information for a reasonable minimum period of e.g., 5 years.

6a. Market intermediaries should be required to ensure that anti-money laundering provisions are also applied to branches and subsidiaries located in other jurisdictions, to the extent permitted by local law and regulation, especially in countries which do not or insufficiently apply international anti-money laundering standards. Market intermediaries should be required to inform the regulatory authority and/or SRO in cases where local law and regulation prohibit this implementation.

Table: Relevant FATF 40 Recommendations in Relation to the Draft Methodology Document

FATF 40 Recommendations	Methodology Document		
	BCP 15	**IAIS new principle**	**IOSCO**
	Similar Or Related Principles	**Similar or Related Principles**	**Similar or Related Principles**
8- Anti-money laundering laws and regulations applied to non-bank financial institutions	See introduction	See introduction	See introduction
CUSTOMER IDENTIFICATION AND RECORD-KEEPING RULES:			
10- Prohibition of anonymous accounts and implementation of know-your-customer policies	2	(b)	23 3a
11- Obligation to take reasonable measures to obtain information about customer identity	2	(b)	23 3b
12- Comprehensive record keeping for transactions, accounts, correspondence, and customer identification documents	2	(d)	23 4d
13- Attention paid to risks stemming from new technologies	2-14	Principles on Internet Insurance Activities' Supervision	10
INCREASED DILIGENCE OF FINANCIAL INSTITUTIONS:			
14- Detection and analysis of suspicious transactions	3	(c)	23 2
15- Reporting of suspicious transactions	3	(c)	23 2
16- Legal protection for financial institutions, their directors and staff	8		2,3
17- Confidentiality vis-à-vis customers	5-1		
18- Compliance with instructions for suspicious transactions reporting	3	(c)	23 2
19- Internal policies, procedures, controls, audit, and training programs	3, 4, 6, 9, 14	(c)	23 1
MEASURES TO COPE WITH COUNTRIES WITH NO OR INSUFFICIENT MEASURES:			
20- Anti-money laundering rules and procedures applied to branches and subsidiaries located abroad	2-4	(b)2	23 4e
21- Special attention given to transactions with these countries	12	(b)2	234e
OTHER MEASURES TO AVOID MONEY LAUNDERING:			
24- Encouraging the replacement of cash transfers	*General principle 4*		
	Integral to payment and settlement review process		
25- Prevention of unlawful use of shell corporations	2	(b)	23 3b

FATF 40 Recommendations	Methodology Document		
	BCP 15	IAIS new principle	IOSCO
	Similar Or Related Principles	Similar or Related Principles	Similar or Related Principles
IMPLEMENTATION, AND ROLE OF REGULATORY AND OTHER ADMINISTRATIVE AUTHORITIES:			
26- Adequate anti-money laundering programs in supervised banks, financial institutions or intermediaries	7, 9, 11, 12, 14	(a)	23 1
28- Guidelines for suspicious transactions' detection	3-2	(a)	23 2
29- Preventing control of, or significant participation in financial institutions by criminals	1	See criteria in introduction to insurance section, page 13	21 1a
32- International exchange of information related to suspicious transactions, and to persons or corporations involved	2-4, 10		11, 12, 13
RECOMMENDATIONS COVERED BY PRINCIPLES	**19**		

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