

**FOR  
AGENDA**

SM/02/290

September 11, 2002

To: Members of the Executive Board

From: The Secretary

Subject: **Intensified Work on Anti-Money Laundering and Combating the Financing of Terrorism—Joint Progress Report on the Work of the IMF and the World Bank**

Attached for consideration by the Executive Directors is a joint progress report on the work of the IMF and the World Bank on intensified work on anti-money laundering and combating the financing of terrorism, which is tentatively scheduled for discussion on **Monday, September 23, 2002**. Conclusions and next steps appear on page 20.

It is intended that following the Board discussion, this paper will be transmitted to the International Monetary and Financial Committee and published on the Fund's external website.

Questions may be referred to Mr. Abbott, MAE (ext. 38574) and Mr. Kyriakos-Saad, LEG (ext. 34286).

Att: (1)

Other Distribution:  
Department Heads



**INTENSIFIED WORK ON ANTI-MONEY LAUNDERING AND COMBATING  
FINANCING OF TERRORISM (AML/CFT)**

**JOINT PROGRESS REPORT ON THE WORK OF THE IMF AND WORLD BANK**

*Prepared by*

**Monetary and Exchange Affairs and Legal Departments, International Monetary Fund,  
and the Financial Sector, World Bank**

**(in consultation with other departments)**

September 10, 2002

Contents	Page
I. Summary .....	3
II. Introduction .....	4
III. Convergence on a Comprehensive AML/CFT Assessment Methodology and Associated ROSC .....	5
A. Expanded and Comprehensive AML/CFT Assessment Methodology .....	6
B. Progress Toward a Single Comprehensive AML/CFT Assessment Methodology and ROSC .....	7
IV. Intensification of AML/CFT Assessments .....	9
A. AML/CFT in FSAPs and OFC Assessments .....	9
B. AML/CFT in the Context of Article IV Surveillance.....	11
V. Capacity Building in Member Countries: Technical Assistance and Outreach.....	12
A. AML/CFT Assessments in the Bank's CASS .....	13
B. Intensified Fund/Bank Technical Assistance for AML/CFT.....	13
C. Coordination of Technical Assistance for AML/CFT .....	15
D. Outreach to Developing Countries.....	16
E. Internal Training Program on AML/CFT.....	17
VI. Research and Analysis .....	17
A. Research into Informal Funds Transfer Systems .....	17
B. Analysis of AML/CFT Legal and Institutional Frameworks.....	18
Text Table	
1. Fund/Bank Technical Assistance on AML/CFT in Twelve-Month Period.....	14

## Abbreviations

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AML	Anti-Money Laundering
APG	Asia-Pacific Group on Money Laundering
CAS	Country Assistance Strategy
CFATF	Caribbean Financial Action Task Force
CFT	Combating the Financing of Terrorism
ECA	Europe and Central Asia
ESAAMLG	Eastern and Southern Africa Anti-Money Laundering Group
FIRST	Financial Sector Reform and Strengthening Initiative
FATF	Financial Action Task Force
FIU	Financial Intelligence Units
FSA	Financial Sector Assessment
FSAP	Financial Sector Assessment Program
FSSA	Financial System Stability Assessment
FSRB	FATF – Style Regional Bodies
GAFISUD	South American Financial Action Task Force
IDB	Inter-American Development Bank
IFTS	Informal Funds Transfer System
IMF	International Monetary Fund
IMFC	International Monetary and Financial Committee
IAIS	International Association of Insurance Supervisors
IOSCO	International Organization for Securities Commissions
LAC	Latin American and Caribbean Region
NBFI	Non-bank financial institution
NCCT	Non-Cooperative Countries and Territories
OAS	Organization of American States
OFC	Offshore Financial Center
PCREV	Council of Europe Group on Money Laundering
PRSP	Poverty Reduction Strategy Papers
ROSC	Report on Standards and Codes
TA	Technical Assistance
U.N.	United Nations
UN DCCP	United Nations Drug Control and Crime Prevention

## I. SUMMARY

1. *This paper summarizes progress by the Fund and Bank in implementing their action plans to intensify work on issues of anti-money laundering and combating the financing of terrorism (AML/CFT). Considerable progress has been made on all aspects of the action plans, including:*

- *the completion of a new and comprehensive draft of the AML/CFT methodology;*
- *the conditional addition of AML/CFT to the list of standards and codes useful to the Fund and Bank's work and of the FATF 40+8 as the accompanying standard;*
- *the conditional adoption by the two Executive Boards of a 12-month pilot program of AML/CFT assessments and accompanying Reports on the Observance of Standards and Codes (ROSCs) that would involve participation of the Fund and the Bank, the Financial Action Task Force, and FATF-Style Regional Bodies (FSRBs);*
- *the inclusion of AML/CFT assessments in all FSAPs and OFC assessments and an increase in the number of OFC assessments;*
- *the use of an AML/CFT voluntary questionnaire to inform Article IV consultations and to better understand AML/CFT weaknesses worldwide;*
- *a substantial increase in AML/CFT TA;*
- *the completion of a number of internal staff AML/CFT training initiatives;*
- *the completion of a draft study on informal payment systems (Hawala); and*
- *the Fund's Secretary has facilitated the circulation to Fund Executive Directors of information requested by the IMFC, and provided by members, regarding actions related to combating the financing of terrorism.*

2. *There are two key remaining actions. The first relates to the commencement of the pilot program, which will begin once the FATF endorses the comprehensive AML/CFT methodology and accepts the other conditions for the preparation of AML/CFT ROSCs outlined in **Anti-Money Laundering And Combating Financing of Terrorism (AML/CFT) Proposals to Assess a Global Standard and to Prepare ROSCs** (SM/02/227 and R2002-0146). Staff has continued to work closely with the FATF Secretariat, in anticipation of the FATF Plenary of October 2002 at which FATF will consider endorsing the methodology and accepting the other conditions outlined in the abovementioned Board paper.*

3. *The second remaining action is to increase the delivery of TA in collaboration with other agencies. Managements of both the Fund and the Bank have assigned additional resources to TA delivery, and staff have taken a number of steps to strengthen international*

*collaboration efforts and to increase the delivery of TA by the Fund and Bank, other international organizations, and individual jurisdictions. The result has been a substantial increase in the amount of overall AML/CFT TA.*

## II. INTRODUCTION

4. The November 2001 communiqués of the IMFC and Development Committees endorsed action plans for the Fund and the Bank to intensify their involvement in anti-money laundering activities, by including combating the financing of terrorism and covering legal and institutional framework issues. In addition, the plans called for the Fund and the Bank to agree with the FATF on a comprehensive AML/CFT assessment methodology and associated ROSC process, to increase AML/CFT technical assistance, and to conduct a study of informal funds transfer systems (Hawala). The Fund was also to circulate a voluntary AML/CFT questionnaire in the context of Article IV missions and to accelerate the OFC assessment program, while the Bank was to integrate AML/CFT issues in Bank Country Assistance Strategies (CAS), where relevant.

5. An interim Progress Report on the Fund/Bank's progress on implementing these action plans was issued on April 12, 2002.<sup>1</sup> In their April 2002 communiqués the IMFC and Development Committee welcomed the progress made by the Fund and the Bank. The IMFC emphasized that efforts should be focused on completing the comprehensive AML/CFT methodology and the development of assessment procedures compatible with the uniform, voluntary, and cooperative nature of the ROSC process, and on enhancing the delivery of AML/CFT technical assistance.<sup>2</sup> The Development Committee emphasized the importance of integrating AML/CFT issues into the diagnostic work of the two institutions and of building capacity.<sup>3</sup> Both the IMFC and Development Committees looked forward to a full report on the Action Plans by the 2002 Annual Meetings.

6. The November IMFC communiqué also called on member countries to take several specific actions related to combating the financing of terrorism, creation of Financial Intelligence Units (FIU), and provision of technical assistance. Fund members have been invited, through their Executive Directors, to provide the Secretary of the IMF with information on steps they are taking to respond to the request of the IMFC. The Secretary's

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<sup>1</sup> *Intensified Work on Anti-Money Laundering and Combating Financing of Terrorism(AML/CFT): Joint Progress Report on the Work of the IMF and World Bank*, April 12, 2002 (SM/02/97 and SecM2002-0165).

<sup>2</sup> Communiqué of the IMFC, April 20, 2002.

<sup>3</sup> Communiqué of the Development Committee, April 21, 2002.

Department has circulated the information so received to all Fund Executive Directors.<sup>4</sup> In addition, the Chair of the IMFC wrote to the U.N. Security Council Counter-Terrorism Committee, the FATF, and the Egmont Group requesting that they provide information to the IMFC on their scope of action. Initial information received by the Fund as a result of this correspondence was circulated to Fund Executive Directors prior to the April 2002 IMFC meetings. Responses to recent follow-up correspondence are also being circulated to Fund Executive Directors.

7. The paper is organized as follows: Section III reviews progress in completing a comprehensive AML/CFT assessment methodology and ROSC assessment procedures; Section IV reviews progress in intensifying assessments of member's AML/CFT regimes and offshore financial centers; Section V discusses the progress in building capacity among members; and Section VI summarizes research on informal funds transfer systems and a survey on countries' AML/CFT legal and institutional frameworks, and Section VII concludes with a summary of next steps.

### **III. CONVERGENCE ON A COMPREHENSIVE AML/CFT ASSESSMENT METHODOLOGY AND ASSOCIATED ROSC**

8. **Work completed:** *The comprehensive AML/CFT assessment methodology is well advanced. The FATF and the Fund/Bank have agreed on concrete steps and a timetable to finalize the methodology by October 2002. The Boards of the Bank and the Fund have conditionally added the FATF 40+8 Recommendations to the list of areas and associated standards and codes useful to the operational work of the Fund/Bank and have endorsed a 12-month pilot program of AML/CFT assessments and accompanying ROSCs.*

9. **Work remaining:** *FATF Secretariat, in collaboration with the Fund and the Bank, is to complete a draft of the comprehensive AML/CFT methodology by the 2002 Annual Meetings. Endorsement of the final draft of the methodology and agreement to the other conditions for the preparation of AML/CFT ROSCs by the FATF Plenary on October 9–11, 2002, with reports on the outcomes of that meeting to the Fund and Bank Boards consistent with the earlier discussions.*

10. *An Interim Report on 12-month pilot program of AML/CFT assessments and accompanying ROSCs will be submitted to IMFC and Development Committee at the Annual*

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<sup>4</sup> As of August 12, 2002: 152 members have provided information in response to the Secretary's March 12, 2002 invitation, and 32 members have notified the Fund of exchange restrictions pursuant to Decision No. 144 (52/51).

*Meetings in September 2003, with a final report submitted to the Spring 2004 meeting of IMFC and Development Committee.*

#### **A. Expanded and Comprehensive AML/CFT Assessment Methodology**

11. ***A comprehensive AML/CFT assessment methodology is in an advanced state of preparation with finalization anticipated immediately following the October 2002 FATF Plenary.*** Over the course of 2002, in close consultations with their respective Boards, Fund and Bank staff have collaborated with standard setters (FATF, Basel Committee, IOSCO, IAIS, and the Egmont Group) on successive drafts of the methodology. Four versions of the methodology have been prepared: August 2001, February 2002, April 2002 and September 2002. The April 2002 version included an annex prepared by FATF dealing mainly with the implementation of laws by the criminal justice system. The September 2002 version is a draft of an integrated comprehensive methodology. The January and June 2002 FATF Plenary meetings discussed and endorsed on-going work on preparing a comprehensive methodology for assessing compliance with the FATF 40+8. Between November 2001 and August 2002 the Boards of the Fund and the Bank each met four times to discuss work on AML/CFT work, including development of the assessment methodology. This work has resulted in broad understandings on the content of the methodology and on the procedures for carrying out assessments, including a division of labor among the various groups involved.

12. In June 2002 the FATF agreed that the Secretariat would complete a draft of an integrated comprehensive methodology in time for the Fund and Bank annual meetings and that would be considered for adoption at the FATF October Plenary. That draft has been completed and retains most of the material from earlier drafts although the presentation has been reorganized to emphasize that the methodology is the basis for a comprehensive assessment of the complete FATF 40+8 standard, including implementation of criminal law enforcement.<sup>5</sup> The draft also streamlines and simplifies the treatment of the financial sectors from earlier versions. Representatives of other standard setters, as well as Fund/Bank staff, have worked closely with FATF in drafting the latest version.

13. ***The structure and content of the AML/CFT methodology reflect convergence around a global standard, as called for in the Action Plans.*** The comprehensive assessment methodology now covers the entire 40+8 Recommendations. It incorporates CFT elements and sections addressing the legal and institutional AML/CFT framework, including Financial Intelligence Units. It also addresses implementation of the AML/CFT regime in the non-prudentially regulated financial sector. Consistent with the Boards' instructions that the Fund/Bank should not become involved in assessing the implementation of criminal laws, these criteria are clearly identified in the text of the AML/CFT methodology and will be

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<sup>5</sup> ***Methodology for Assessing Compliance with Anti-Money Laundering and Combating the Financing of Terrorism Standards: FATF Secretariat Draft of August 26, 2002*** (SM/02/288, September 5, 2002).



assessed separately by experts not under the supervision of the Fund or Bank and who will have been identified by the FATF, FSRBs, the U.N., or others. The AML/CFT methodology incorporates into a single document all the elements that FATF, the other relevant standard setters, and the Egmont Group consider necessary for a full evaluation of AML/CFT regimes.

14. ***Finalization of the AML/CFT methodology is expected in October.*** A provisionally agreed text has been circulated to the Boards and to FATF delegates, international organizations, and other standard setters for information and comment. A text taking into account these comments will be presented to the October 9–11 FATF Plenary for discussion and endorsement. Following FATF endorsement, the methodology will be provided to the Boards of the Bank and the Fund in accordance with the decisions reached during their earlier meetings, in July, and August respectively.

#### **B. Progress Toward a Single Comprehensive AML/CFT Assessment Methodology and ROSC**

15. ***Work has also progressed on developing procedures that could lead to preparation of accompanying ROSCs.*** The June 2002 FATF Plenary took several steps to advance this process and make it compatible with the uniform, voluntary, and cooperative nature of the ROSC process as called for in the November 17, 2001 and April 20, 2002 IMFC communiqués. At that meeting, the FATF endorsed the use of a single, comprehensive methodology in both FATF mutual evaluation of its members and in Fund/Bank AML/CFT assessments. Further, the FATF endorsed a proposal that FATF mutual evaluations could, upon review,<sup>6</sup> result in ROSCs. FATF further proposed that its member jurisdictions identify and make available experts for IMF/World Bank-led assessment missions.

16. ***At the Fund Board meeting on July 26, 2002 and the Bank Board meeting on August 6, 2002, Executive Directors conditionally endorsed adding AML/CFT to the list of 11 areas where standards and codes are useful to the operational work of the Fund and the Bank and agreed to adopt the FATF 40 + 8 as the associated standard. They also endorsed a 12-month pilot program of AML/CFT assessments and accompanying Reports on the Observance of Standards and Codes (ROSCs) that would involve participation of the Fund and the World Bank, the Financial Action Task Force, and FATF-style Regional Bodies.*** Four principles were enumerated for Fund/Bank staff involvement in AML/CFT assessment:

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<sup>6</sup> Procedures for review of FATF mutual evaluations and for Fund/Bank-led assessments are spelled out in: *Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT)—Proposals to Assess a Global Standard and to Prepare ROSCs*, SM/02/227 and R2002-0146, paragraphs 13 and 14.

- The assessment of non-prudentially regulated financial sector activities should be confined to those that are macroeconomically relevant and pose a significant risk of money laundering or terrorism financing;
- All assessment procedures should be transparent and consistent with the mandate and core expertise of the different institutions involved, and compatible with the uniform, voluntary and cooperative nature of the ROSC exercise;
- Assessments should be followed up with technical assistance at the request of the jurisdictions concerned; and
- Assessments should be conducted in accordance with the comprehensive and integrated methodology.

**17. *Adding AML/CFT to the lists of areas for which ROSCs may be prepared was made conditional on:***

- The FATF Secretariat, in consultation with Bank/Fund staff, satisfactorily completes the draft of the comprehensive and integrated assessment methodology by the Fund/Bank 2002 Annual Meetings for consideration at the October FATF Plenary;
- Endorsement by FATF of the comprehensive methodology at its October 2002 plenary and endorsement of its use in all AML/CFT assessments;
- FATF agreement at its October Plenary to undertake its mutual evaluations consistent with the ROSC process as elaborated in Section II of SM/02/227 and R2002-0146; and
- The FATF not undertaking a further round of the non-cooperative countries and territories (NCCT) initiative, at least during the period of a 12-month pilot program.

**18. *In anticipation of agreement on the 12-month pilot program the Fund/Bank initiated consultations with the FATF and the FSRBs regarding procedures for conducting assessments based on the single comprehensive methodology and for preparing associated ROSCs.*** Fund/Bank staff have proposed that two methods of assessment be employed: (i) *Method 1*: FATF and FSRB mutual assessments, and (ii) *Method 2*: Fund/Bank- led assessments. To avoid duplication, letters have been sent to FATF and FSRBs requesting collaboration on a schedule of assessments and assistance in compiling a roster of experts. Letters have also been sent to the UNDCCP requesting assistance in compiling the roster. Following responses, letters are being sent to national authorities and the UNDCCP to request availability and financing of experts to assess areas not covered by Fund and Bank staff and to assist as necessary in the Fund/Bank review of ROSC modules prepared by FATF and FSRBs during the pilot program. Staff will discuss these arrangements with the FATF and FSRBs during the FATF Plenary in October 2002, including explaining the review procedures endorsed by the Boards.

19. Staff will report to the Boards of the Bank and the Fund on the outcome of the October FATF Plenary and whether the conditions for an AML/CFT ROSC have been met. Staff will provide an interim report back to the IMFC and Development Committee at the Annual Meetings in October 2003, with a final report on the 12-month pilot program to be completed for the Executive Boards in the Spring 2004, prior to the spring meetings of the IMFC and Development Committee.

20. In addition to continuing close discussions with the FATF, contact has been made with the FSRBs, inviting participation in assessments and accompanying ROSCs.

#### IV. INTENSIFICATION OF AML/CFT ASSESSMENTS

##### A. AML/CFT in FSAPs and OFC Assessments

21. **Work Completed:** *AML/CFT assessments are now standard components of FSAP and OFC assessments. Coverage of AML/CFT issues has been expanded to include legal and institutional arrangements, terrorist financing elements, and macro relevant parts of the non-prudentially regulated financial sector. Weaknesses in AML/CFT regimes have been identified and corrective actions are being taken by a number of members. Number of OFC assessments is being doubled in 2002. An AML/CFT questionnaire has been developed and used in the context of Article IV consultations with 58 members.*

22. **Work Remaining:** *Sustain pace of AML/CFT assessments in FSAPs, using comprehensive methodology involving FATF/FSRB identified experts. Complete OFC assessment program in 2003. Streamline distribution of AML/CFT questionnaire. Continue to assist members in addressing weaknesses in AML/CFT regimes identified through assessments.*

23. **AML/CFT issues are now being addressed in all FSAPs and OFC assessments.** AML vulnerabilities have been examined in the financial supervision assessments of the FSAPs and the OFC assessments from the start of these programs. Beginning in October 2001 the draft preliminary (August 2001 version) AML Methodology was piloted in FSAP and OFC assessments. While work with FATF to complete a comprehensive methodology continues, the version of the Fund/Bank methodology discussed by the Boards in April 2002 has since been used as the basis of Fund/Bank AML/CFT assessments in FSAPs and OFCs. Once agreement has been reached, the comprehensive AML/CFT methodology will be used in the forthcoming 12-month pilot program.<sup>7</sup>

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<sup>7</sup> In the spring of 2002 FATF prepared, as an annex, a separate draft methodology for assessing elements of the FATF 40+8 related to implementation of criminal provisions not covered in the Fund/Bank draft (considered by the two Boards as "Annex II" in April 2002). On a voluntary basis this annex is being used as a part of the UK FSAP assessment, with the Annex II assessment being carried out by a FATF expert

24. Since August 2001 when the first draft of the assessment methodology was introduced, various drafts of the methodology have been used in 21 FSAPs. Six of these assessments have been completed; the remaining 15 are ongoing and in various stages of completion. AML/CFT assessments will be included in seven additional FSAPs scheduled to begin later this year. Various drafts of the methodology have been used in eight OFC assessments since August 2001. Another 13 OFC assessments including AML/CFT assessments will be initiated over the balance of 2002. To improve consistency, staff are developing a template for standardized reporting of AML/CFT assessments in both FSAPs and OFC assessments.

25. **FSAP and OFC missions have provided the framework for raising issues and making concrete recommendations to national authorities for actions to strengthen their AML/CFT regimes.** Among the concerns identified in these assessments have been: weak legal and regulatory frameworks for AML/CFT, limited definition of predicate and money laundering offenses and of violations under AML/CFT laws and regulations; ineffective implementation of AML/CFT regimes including poor industry awareness and understaffed supervisory agencies; narrow coverage of institutions; inattention to vulnerabilities outside the banking sector; inadequate reporting and evaluation of suspicious activities; weaknesses in existing FIUs and a need to establish FIUs.

26. Several countries have already taken actions to strengthen their AML/CFT regimes in response to Fund/Bank recommendations and the assessments conducted in FSAPs and OFC assessments. For example, a large offshore financial center conducted a comprehensive review of its AML/CFT policies and implemented a strong action plan to address weaknesses identified by the assessment; a major developing country enacted new AML/CFT legislation; another major developing country established an FIU and is joining the Egmont Group; and another is upgrading its supervisory capacity on AML/CFT. Further actions are being taken by a number of countries with technical assistance from the Fund and the Bank (see below). Four OFCs have completed or are in the process of implementing plans of action to strengthen AML/CFT elements of their regulatory regimes.

27. **The OFC assessment program has been accelerated.** Nine Module 2 or FSAP assessments of jurisdictions with offshore or international financial centers were completed in 2001, and eight have taken place to date in 2002, of which one was an FSAP. Thirteen Module II assessment missions and four FSAPs have been scheduled for the remainder of the year. A streamlined template for OFC assessments has been prepared; Basel Core Principles assessments and AML/CFT assessments will be undertaken in all cases, with other standards assessed depending on scope of business conducted.

28. **Experience to date.** AML/CFT policies are being improved in most jurisdictions that have been reviewed. However, all jurisdictions would benefit from some enhancement of their laws and/or supervisory practice. A number of jurisdictions have not yet criminalized terrorist financing although several of these would have the ability to prosecute cases through other laws and associated crimes. There is virtually no OFC jurisdiction which has the supervisory resources needed for the degree of monitoring of AML/CFT required by the

methodology, although, as a result of the assessments, many jurisdictions are upgrading the resources allocated to the effort. Reform of legislation, in particular to incorporate terrorist financing and establish FIUs is ongoing. A note on progress of the OFC program was provided to the Board of the Fund for information, with a copy provided to the September 3–4 meeting of the Financial Stability Forum.

## **B. AML/CFT in the Context of Article IV Surveillance**

29. The IMF Action Plan calls for greater attention to AML/CFT issues in the context of Article IV consultations. To this end an AML/CFT questionnaire has been developed and is being distributed over time to Fund members to solicit information on their legal and institutional frameworks for AML/CFT. Responses inform Article IV discussions and in some cases have been helpful in identifying technical assistance needs.

30. The questionnaire was developed based on the February 2002 version of the AML/CFT assessment methodology. The principal focus of the questionnaire is the legal and institutional framework. To limit the burden of preparing responses, many questions can be answered by providing copies of existing documents. Further, the questions are divided into core questions and optional questions.

31. The distribution of the questionnaire began in early 2002. Early recipients of the questionnaire were selected in consultation with area departments. Under current plans, by end-2003 all countries should have been covered, except those that would be assessed in detail under FSAPs or OFC assessments during the period. As of September 10, 48 responses have been received, and about 15 questionnaires were outstanding.

32. Staff analysis of responses to the questionnaires is ongoing.<sup>8</sup> Since the questionnaire focuses only on existing laws, regulations, and institutional arrangements, it does not provide sufficient information on the extent of implementation or enforcement of the AML/CFT regime. Furthermore, in several cases the responses are incomplete. Within these limitations, the following observations on broad trends can be made:

- Respondents fall into three groups: (i) a sizeable group who appear to have all or most of a system of AML/CFT laws, regulations and institutions; (ii) another group that have established some major elements of a system, but with important weaknesses; and (iii) a smaller group where the AML/CFT framework is rudimentary or has only recently been established.
- A large majority of respondents have some form of AML law. CFT provisions are generally weaker.

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<sup>8</sup> A separate progress report on responses to the questionnaire is being circulated to the Fund's Board for information.

- Many respondents have strengthened their AML/CFT frameworks in the last two years, for example, through the preparation or passage of new legislation and the establishment of FIUs.
- The AML/CFT regime applied to banks is generally stronger than in other sectors.
- Most respondents have detailed requirements for commercial banks, and often also for non-bank financial intermediaries to verify the identity of clients and to retain records for five years, as recommended by FATF.
- Where AML legislation is in place, covered financial institutions are generally required to report suspicious transactions, and establish appropriate internal control and reporting mechanisms.
- The responses provided little information on international exchange of information regarding suspicious transactions or terrorist financing. Likewise, the responses did not provide much information on due diligence requirements that go beyond client identification.

33. Information from the questionnaire has provided background for Article IV missions to conduct non-technical consultations with members regarding their AML/CFT policies. Short reports of these discussions are being included in Article IV documents. While non-technical, these consultations have been the basis for raising awareness of AML/CFT issues, for planning future detailed assessments and for initiating requests for technical assistance.

## **V. CAPACITY BUILDING IN MEMBER COUNTRIES: TECHNICAL ASSISTANCE AND OUTREACH**

34. **Work Completed:** *TA delivery in progress in response to assessments and requests. AML/CFT concerns identified through assessments being integrated into Bank CASs and Bank/Fund TA programs, where relevant. Global TA coordination mechanism launched. Outreach through the Global Policy Dialogues underway. Internal training sessions reached 300 Bank and Fund staff; self-training modules under development.*

35. **Work Remaining:** *Make operational several initiatives. Reinforce linkages among assessments, recommendations, TA requests and TA delivery. Expand in-house capacity to deliver TA and to collaborate with other TA providers. Institutionalize coordination mechanism. Step up delivery of TA. Continue outreach through Global Policy Dialogues. Deepen internal training and expand it to reach field staff.*

36. **The Fund and the Bank have taken a number of steps to strengthen countries' capacity to address effectively AML/CFT vulnerabilities revealed through FSAPs, OFC assessments, or TA requests.** These measures include (i) incorporating AML/CFT concerns into Bank CASSs; (ii) stepping up the provision of TA; (iii) leading efforts to establish an

international mechanism for coordinating delivery of TA; and (iv) increasing outreach to developing countries to raise awareness of AML/CFT issues. The Fund and the Bank have also initiated an internal training program on AML/CFT to enhance staff capabilities to carry out these activities.

37. ***Capacity building will be a key focus of the Fund and the Bank AML/CFT effort over the coming year.*** The expanding number of AML/CFT assessments will provide the basis for more systematic identification and prioritizing of TA needs. Having regard both to speed and availability of funding, collaboration on TA projects with numerous donors, regional agencies and interested parties will be reinforced, building on the coordination mechanism that has been established. Fund direct TA will focus on developing the legal and institutional framework of AML/CFT (including FIUs) and financial supervision aspects of AML/CFT, particularly where such TA is not being provided by other donors. In order to achieve TA objectives, mobilization of technical AML/CFT skills will be a priority, both internally and in collaboration with cooperating agencies. This collaboration will also address the issue of external sources of funding for TA, as not all additional TA requests could be met from current Fund/Bank budgets. Possible new sources of funding include the FIRST initiative.

#### **A. AML/CFT Assessments in the Bank's CASs**

38. ***The Bank is integrating the results of the FSAPs into the broader range of development measures considered in the Country Assistance Strategies (CASs), which set out the priorities for the Bank's program on a three-year basis in consultation with the government.*** Following systematic reviews of FSAP findings, AML/CFT assistance has been included in 6 of 16 CASs (including CAS Progress Reports) prepared since March 2002. Technical assistance is given high priority in countries where weaknesses in the integrity of the AML/CFT regime may pose significant governance and development risks. CASs also address AML/CFT issues in greater detail in countries that have been deficient in meeting standards and best practices.

#### **B. Intensified Fund/Bank Technical Assistance for AML/CFT**

39. **Political support for countries to upgrade their AML/CFT regimes has gathered momentum.** This is reflected in wider participation in FATF-style regional bodies and increasing requests for technical assistance.

40. **The Fund/Bank are providing technical assistance for AML/CFT in response to requests and recommendations arising from AML/CFT assessments.** The focus of the Fund/Bank's direct assistance is on:

- Formulation of AML/CFT laws and regulations that meet international best practices;
- Implementation of laws, regulations, policies and procedures by financial sector supervisors and other similar government entities charged with responsibility for enforcement of AML/CFT measures;

- Establishment of legal frameworks for FIUs that meet international best practices;
- Development of training and awareness programs to address AML/CFT concerns in the public and private sectors;
- Collaboration with other parties in multilateral training programs; and
- Development of computer-based training materials.

41. *Since September 2001, the Fund/ Bank have completed, initiated or agreed to provide TA to 39 countries, and TA requests have been received from an additional 14 countries.* In 11 instances, the requests reflected weaknesses identified in FSAPs, and 10 reflected problems revealed in OFC assessments. Other requests included country responses to assessments by the FATF.

**Table 1. Fund/Bank Technical Assistance on AML/CFT in Twelve-Month Period  
September 2001 through August 2002<sup>1</sup>**

Status	FSAP Follow Up	OFC Follow Up	Other Requests	Total
Completed		1	11	12
Initiated/Agreed	3	9	15	27
Identified	8		6	14
Total	11	10	32	53
<sup>1</sup> Does not include 10 countries participating in South American regional workshop in September 2002 and the further 21 countries being targeted for the Eastern European and Central Asian conference in December 2002. An ongoing project to provide TA to 8 Pacific Island countries is recorded here as a single project.				

42. An analysis of the trends in requests for technical assistance received by the Fund and the Bank since September 2001 indicates that demand is increasing for assistance under the following categories:

- ***Drafting of AML/CFT laws and regulation.*** The number of countries assisted or that submitted requests is expected to exceed 30 in the near future.
- ***Establishing financial intelligence units.*** Including cases identified recently, some 20 countries have received or expressed interest in receiving assistance in drafting legislation for the establishment of FIUs.
- ***Strengthening supervisory systems on AML/CFT.*** 13 countries have received or expressed interest in technical assistance. Demand is particularly strong from OFCs.



43. ***The Fund and the Bank are preparing two regional conferences on AML/CFT issues with funding from the FIRST initiative.*** A multidisciplinary workshop for South American countries, being developed by the Fund/Bank in cooperation with GAFISUD, will take place in September 2002 in Montevideo and will address domestic and international cooperation on AML/CFT and the strengthening of FIUs. A conference for Central Asia and Eastern European countries, organized by the Bank and the Fund, will take place in Moscow in early December 2002. This conference will be targeted at assisting those countries in the Bank's ECA Region that do not yet have operational FIUs, and that are at a relatively early stage of addressing AML/CFT concerns. Follow-on TA requests are likely to arise from both the conferences. Further regional conferences are being planned.

### **C. Coordination of Technical Assistance for AML/CFT**

44. ***The Fund and the Bank, in collaboration with key external partners, have developed a mechanism for the coordination of TA for AML/CFT.*** Countries are pursuing AML/CFT assistance through multiple channels: through contacts with bilateral donors, through regional agencies and directly from the Fund and the Bank. Assistance requests cover the full range of AML/CFT activities, from establishing complete regimes de novo, to funding specialist staff, to organizing training programs for the private sector. As reported in April, the Fund/Bank have organized a network of contacts among participating organizations to facilitate coordination and communication of TA activities, to identify providers of TA and potential sources of funding and other resources.

45. ***The Fund/Bank organized a meeting of the key TA providers and donors in Washington on April 22, 2002.*** Participants included the FATF, the U.N. Global Program Against Money Laundering, the U.N. Counter Terrorism Committee, the Egmont Group, the FATF-style regional bodies, the regional development banks, several other international organizations and nine key bilateral TA donors and providers. The objectives of the April meeting were to reach agreement on a coordination mechanism and to develop a better understanding of the demand and supply of TA for AML/CFT, including the potential gaps and the need for additional resources to build institutional capacity.

46. ***The meeting resulted in a consensus on the following points:***

- Coordination of TA should be organized on a regional basis through the FATF-style regional bodies;
- Immediate country needs for AML/CFT TA should be identified and responded to by donors and providers;
- Donors will consider additional support for the FSRB secretariats to play an enhanced role in coordinating technical assistance in their regions;
- Urgent TA requests were identified and some specific projects initiated.

47. ***Since the April meeting, the Fund and the Bank have been working with the FSRBs and other meeting participants to develop further the regional contact point networks, assist in the identification of TA demands by the FSRBs and respond to other proposals developed at the meeting.*** The Bank has taken on the responsibility of working individually with each of the FSRB secretariats on these objectives, utilizing where possible the periodic meetings of the FSRBs as a means to address technical assistance issues. Since April, staff have participated in regional meetings with GAFISUD (May), APG (June), PC-R-EV (now MONEYVAL) (June), and ESAAMLG (August), as well as working with the CFATF secretariat to arrange a meeting with TA donors at their next Plenary.

48. As the TA priorities are collected on a regional basis, the Fund and the Bank will be working with the respective FSRB secretariats on the transmission of these requests to other donors and TA providers. Thus far, we have received aggregated TA requests from the APG, ESAAMLG and MONEYVAL. Work is still underway in GAFISUD and CFATF. We will add to this TA requests on AML/CFT issues in the financial sector compiled by other organizations, such as the UN CTC or the Egmont Group. For example, the UN CTC is directing countries to the Fund and the Bank for technical assistance on prudential and regulatory aspects necessary to meet the requirements of U.N. Resolution 1373. Once these steps have been completed, the Fund and the Bank, within budgetary availability, will work with the donors to track responses to the requests and to arrange donor meetings at the time of FSRB meetings as appropriate to assist in filling gaps in the provision of TA.

49. The Fund and the Bank have also initiated work on the development of computer-based generic training materials. This work will be coordinated with other TA providers.

50. The Fund and the Bank plan to hold another AML/CFT TA coordination meeting before the end of 2002 to assess progress and identify further steps to strengthen coordination.

#### **D. Outreach to Developing Countries**

51. ***The Bank and the Fund continue to expand and capitalize on the Global Dialogue Series, a live video conference, to establish a dialogue on AML/CFT issues with leading experts and high level country officials.*** The Global Dialogue Series is an interactive video conference with AML/CFT policy makers from five or more countries, experts in the region and Bank/Fund experts. The first of a planned series of Dialogues was held with five countries in the ECA region in January 2002. Subsequently, a dialogue was conducted in the LAC region on April 3, 2002 with representatives from Brazil, Colombia, Guatemala, Jamaica and Mexico. In addition, participation included representatives from the Inter-American Development Bank, OAS, GAFISUD (FATF-style body in South America) and the Caribbean Financial Action Task Force (CFATF). Three separate conferences are scheduled in September that will bring together representatives from African countries and African regional organizations. In addition to raising awareness, the conferences have helped identify several AML/CFT program areas needing assistance.

52. Plans for the remaining Global Dialogues are underway and include proposals for the Caribbean, South Asia, East Asia and MENA. Due to time zone differences and specific factors in these regions, consideration is being given to developing an onsite one day AML/CFT seminar for one or more of these regions. Staff expect to complete the Global Dialogue Series by early 2003.

#### **E. Internal Training Program on AML/CFT**

53. *To enhance their ability to deliver TA, the Fund and the Bank have launched a program (AML/CFT briefing sessions) to upgrade capacity of appropriate Fund/Bank staff to provide advice and technical assistance on AML/CFT issues.* The AML/CFT briefing presentations cover: AML/CFT as development priorities; Fund and Bank action plans and role; money laundering and terrorism finance techniques/processes; sequencing of country actions; and coordination with other organizations, initiatives and resources.

54. As of August 2002, twelve AML/CFT briefings have been held covering approximately 300 Fund and Bank HQ and Resident Mission staff. An AML/CFT Technical Briefing was also presented to Bank Executive Directors and their staff members, and has been presented at certain department retreats, meeting groups and international conferences. The World Bank Institute is currently making this briefing into a one hour self-training CD, which will be available to all staff shortly, and which will be particularly useful for training of field-based staff. Further training will be produced and carried out in accordance with demand and available resources.

### **VI. RESEARCH AND ANALYSIS**

55. ***Work Completed:** A Joint Fund/Bank study of the Hawala and other Informal Funds Transfer System has been drafted and will be published around the time of the Annual Meetings. An analytic report on issues and trends in AML/CFT legal and institutional frameworks has been completed.*

56. ***Work Remaining:** Consideration of the need for further study or policy proposals regarding Hawala practices.*

#### **A. Research into Informal Funds Transfer Systems**

57. A Fund/Bank team conducted a study of Hawala and other informal funds transfer systems. The purpose of the study was to explain the economic mechanisms of these systems and to explore and assess the regulatory implications, as various countries have moved in recent months to impose or tighten controls on money transfer operations.

58. The paper observes that the longstanding Hawala and other informal transfer systems do respond to legitimate financial needs and offer a competitive and efficient channel for fund transfers. However, the anonymity of the system, makes it vulnerable to money laundering and terrorist finance.

59. Attempts to tightly regulate an informal financial system may not only change the very characteristics of the business that have popularized it—speed, low cost and reach, in the process pushing it farther away from the formal sector, but also may place an additional administrative burden on financial sector regulators. Coercive measures to regulate these systems are unlikely to succeed in the absence of reforms in the formal financial sector. Financial sector modernization and reforms along with greater exchange liberalization are key in the longer term to reduce the attractiveness of informal financial transfer systems and enhance the competitiveness of the formal sector in the remittance business. Therefore the paper recommends that developing appropriate regulatory and supervisory frameworks requires a realistic and practical assessment and understanding of the specific country environment in which the money exchange dealers operate.

60. In countries where the Hawala system exists alongside a conventional banking sector, Hawala dealers should be required to register with the regulatory authorities and keep adequate financial records, in line with FATF recommendations. Simultaneously, the regulatory response must address weaknesses that may exist in the formal sector. High transaction costs, long delays in effecting money remittances, exchange controls and overly bureaucratic policies and procedures for simple money transfers in the formal sector encourage the circumvention of any regulations that hinder the operations of the informal financial system.

61. In conflict-afflicted countries, for example, because of the lack or very weak supervisory capacity in these countries regulation and even basic registration may be difficult. In these cases, priority should be given to creating an environment conducive for the entry of new private domestic and international banks, and building up the basic supervisory capacity. The authorities should also initially encourage a self regulatory process through the existing local association of Hawala dealers in these countries while the national financial system and supervisory capacity is being established. Over time more formal registration and regulation should be introduced in accordance with the money exchange dealer's respective scale of operations, organizational structure, asset size, number and volume of funds transfers and the scope of related financial activity in which the money exchange dealer is engaged.

## **B. Analysis of AML/CFT Legal and Institutional Frameworks**

62. The Fund's Legal Department conducted an analysis of legislative materials of twenty-two countries publicly available in March-April 2002, based on the criteria in Part 1 of the Fund and Bank's AML/CFT methodology (version dated February 7, 2002).<sup>9</sup> The

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<sup>9</sup> The countries and territories included: Australia, Bahamas, Belgium, Brazil, Canada, Cook Islands, Costa Rica, Fiji, Hungary, Korea, Latvia, Lebanon, Mauritius, the Netherlands Antilles, Niue, Samoa, Slovak Republic, South Africa, Switzerland, Thailand, the United Kingdom, and Vanuatu.

Legal Department has prepared a report based on the results of the analysis that provides a broad picture of the then current state of AML/CFT legislation. The report continues to have application in the delivery of technical assistance, particularly in terms of the drafting of AML/CFT legislation. This report largely corroborates the results obtained from the AML/CFT questionnaire.

63. The review indicated that in all jurisdictions surveyed, laws exist that address AML concerns. The strength of these provisions was found to vary widely, but, based on the information used in the analysis, significant limitations are the exception rather than the rule.

64. Money laundering has been established as a criminal offense in all jurisdictions reviewed. In general, the money laundering offence encompasses the laundering of proceeds generated by serious offenses, or by listed offenses or, in some cases, all offenses. Usually, predicate offenses for money laundering extend to crimes committed extraterritorially. In almost all countries surveyed, money laundering can occur regardless of the type of asset. Confiscation is generally applicable through the criminal process. Many jurisdictions have laws permitting multilateral cooperation and mutual assistance; for some, sharing of information can occur only through formal mutual legal assistance procedures.

65. Almost all jurisdictions surveyed have established FIUs, and all but a few have explicit requirements that financial institutions report transactions to the FIU. The laws often prohibit tipping-off and require that financial institutions have internal anti-money laundering programs in place. The survey also disclosed a variety of structures for FIUs, from separate administrative entities to organizations within existing ministries and offices.

66. Many of the standards particularly important for CFT are not addressed in the provisions reviewed. At the time of the survey, many jurisdictions were only beginning to focus on CFT measures and the financing of terrorism was not criminalized in most countries in the sample.

67. The absence of specific provisions in the laws surveyed that relate to certain matters covered in the Fund/Bank assessment methodology may not necessarily indicate a lack of measures to address those standards; regulations and other binding measures, which are beyond the scope of the survey, could fill the gaps to a certain extent. As the survey relied on laws gathered from public information sites that had not necessarily been updated to reflect amendments and new legislation, some information may not be current. Furthermore, the sample of countries was dictated largely by the availability of information and an attempt to achieve wide coverage, but is not representative. In addition, as the survey method involved a desk review of laws, but neither implementation nor, for the most part, decrees, regulations and guidance notes were reviewed. Nor was there any opportunity to clarify matters through discussions with national authorities. Therefore, the results may not be indicative of actual practice in the jurisdictions surveyed.

## **VII. CONCLUSIONS AND NEXT STEPS**

68. As reviewed in this report, considerable progress has been made in implementing all aspects of the action plan. The policy development and organization work is well advanced. The immediate next step would be to ensure a successful outcome at the FATF Plenary in October 2002 with FATF endorsement of the comprehensive AML/CFT methodology, and other conditions outlined by the Fund and Bank Boards for the preparation of AML/CFT ROSCs, as well as reports on the outcome to the Boards. The next step will be to commence the 12-month pilot program of assessments using the comprehensive methodology, and to step up the implementation of technical assistance. Staff will report to the Fund and Bank Boards on the experiences with the 12-month pilot program, including resource implications. It is well recognized that strengthening AML/CFT regimes worldwide will involve capacity building, strengthening financial sectors and supervisory reform, and will be a medium/long-term effort. The budget consequences of this AML/CFT work will require further consideration.