

## Global Coalition to Fight Financial Crime

### Effectiveness Expert Working Group | FATF Subgroup Working Paper

#### Questions and Recommendations on Improving the Effectiveness of the FATF Mutual Evaluation Process

*The FATF Subgroup<sup>1</sup> was established under the Effectiveness Expert Working Group initiated by the Global Coalition to Fight Financial Crime, The FATF Sub Group is one of 1 4 groups looking into questions and suggesting recommendations to improve effectiveness. The FATF Working Group was established alongside 3 other Expert Working Groups, focussed on Law Enforcement/FIUs, Regulators and the Financial Institutions. These Expert Working Groups are expected to finalise their work later this year.*

**Question 1** | To what extent should Mutual evaluations (ME) take ML/TF threat and materiality into account when they assess effectiveness? And should materiality and threat be weighted more importantly for the grey and blacklists, and if yes, how?

*Criminal markets are generating more illicit funds than at any other time in our history, with ever more harmful effects inflicted against every jurisdiction. Organised crime continues to generate huge amounts of proceeds of crime, leveraging networks to connect criminal actors, adopting poly criminality, embracing new cyber tools and opportunities afforded by the transformation to digital.<sup>2</sup>*

In order to properly assess effectiveness, there must be a thorough review of the ML/TF risk. The level of risk is informed by the threat and materiality, which must be viewed in the context of each jurisdiction. Threats will therefore impact the level of risk and the materiality of the risk will be determined by the context. Contextual factors will include the size and complexity of a jurisdictions financial and DNFBPs sectors, rule of law, corruption, financial inclusion mechanisms etc.

The understanding of the jurisdiction of its ML/TF threat (which includes the threat from major underlying predicate offences) is therefore important in terms of assessing risk and determining how effective the AML/CFT measures are that they have applied. In the context of a mutual evaluation (ME); the Scoping Note plays an important in the process in terms of determining the levels of ML/TF risks, the threats, vulnerabilities and materiality of the jurisdiction.

Currently, threat and materiality do not play a n adequately important role in the assessment of countries by the FATF and the FSBs. Materiality plays a role in determining if a jurisdiction will undergo an ICRG review or not.<sup>3</sup> However, some countries on the so-called grey list that exceed the US\$5 billion threshold do not pose a major threat to the global financial economy as a result of their lack of interconnectivity with other jurisdictions. Currently, important regional and international financial centres are not on the grey list although they met the referral criteria,<sup>4</sup> while other countries, showing a much lower cross border risk,<sup>5</sup> are on that list. An interesting study was recently published by the IMF focusing on the impact on Capital flows if countries are assessed by the FATF to have 'strategic deficiencies'.<sup>6</sup>

Materiality is important because in many instances the occurrence of a threat or risk of ML/TF is not viewed in terms of its overall impact when compared to the status of the country in terms of size, financial sector assets, infrastructure etc. but more of the fact of its existence despite the limited impact when compared to other jurisdictions.

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<sup>2</sup> John Cusack, Global Threat Assessment, [www.thefinancialcrimenews.com](http://www.thefinancialcrimenews.com)

<sup>3</sup> A jurisdiction that enters the ICRG review process as a result of its mutual evaluation results has a one year Observation Period to work with the FATF or its FATF style regional body (FSRB) to address deficiencies before possible public identification and formal review by the FATF. The FATF prioritises the review of those countries with more significant financial sectors e.g., USD 5 billion or more in financial sector assets.

<sup>4</sup> e.g., Seychelles, Gibraltar

<sup>5</sup> e.g., Burkina Faso, Zimbabwe, Jamaica

<sup>6</sup> See: <https://www.elibrary.imf.org/view/journals/001/2021/153/001.2021.issue-153-en.xml>

Countries themselves understandably have a tendency to determine "materiality" from their own point of view which focuses on the value a specific sector generates for the local economy either in terms of employment and contribution to the GDP. From the FATFs perspective, however, materiality is determined also with a focus on a country comparison and revolve around how sector X works in country A vs. country B. The difference in perspective results in diverging expectations and viewpoints and subsequent problems and frustrations during the ME process. Countries often experience the materiality considerations put forward by assessors as "arbitrary", creating a sense of being treated unfairly.

#### Recommendations:

1. Despite the limitations presented in estimating criminal activity designed to be hidden, the FATF (or any other relevant international organization) should collect data on major threats at a country level, and NRAs should take these figures as a starting point;
2. Countries should, on an annual basis, measure threat deviations and report publicly on progress made;
3. FATF should provide guidance on what the term "materiality" means, and how it is factored in the ME process;
4. In the context of going forward to the next ME round where countries have been 'grey' listed and remain on that list, materiality and threat can be considered once the information is found to be verifiable and objectively obtained and presented;
5. The ICRG procedures should introduce a new threshold for reviews that relate closer to the threat of a given jurisdiction and its interconnectivity with international financial systems.

**Question 2 | Do MEs take contextual factors (such as corruption in the public sector) into account sufficiently?**

On this subject, the FATF methodology says:

*"An effective AML/CFT system normally requires certain structural elements to be in place, for example: political stability; a high-level commitment to address AML/CFT issues; stable institutions with accountability, integrity, and transparency; the rule of law; and a capable, independent and efficient judicial system. The lack of such structural elements, or significant weaknesses and shortcomings in the general framework, may significantly hinder the implementation of an effective AML/CFT framework; and, where assessors identify a lack of compliance or effectiveness, missing structural elements may be a reason for this and should be identified in the MER, where relevant."*

Other contextual factors that might significantly influence the effectiveness of a country's AML/CFT measures include the maturity and sophistication of the regulatory and supervisory regime in the country; the level of corruption and the impact of measures to combat corruption; Such factors may affect the ML/FT risks and increase or reduce the effectiveness of AML/CFT measures<sup>7</sup>.

While most reports contain some language on these factors, usually in the introduction, only very few reports indicate that these factors had an influence on the effectiveness ratings. Where they have been taken into account (e.g., on the level of political commitment), one can argue whether those factors have a significant relevance. The contrary seems to be true: Some of the countries with weak Governance, high levels of corruption, and judiciaries that are dependent from the political power have received the best ratings: There is a worrying negative correlation between a number of FATF/FSRB effectiveness ratings and the WJP Rule of Law Index, where top performers (such as Denmark, Norway, Canada or Austria) have received considerably worse ratings as bottom performers like the Russian Federation, Egypt, Mexico or Belarus. The same can be said in relation to corruption (see for example TI Corruption Perception Index).

It seems that assessors do not follow the guidance of the methodology to a sufficient degree. As the lack of these structural elements is relevant (see FATF Methodology), recommended actions can be misleading if they are not considered. This may even have an adverse impact: Where reports call for

<sup>7</sup> FATF Methodology, 2013, last updated in November 2020, page 7

more law enforcement action, this may turn out to be infringing on fundamental human rights in a country where the judiciary is not independent<sup>8</sup>. This also puts the credibility of the reports in question.

This approach goes into both directions as contextual factors can be positive or negative. Shortcomings should have an impact on ratings and recommended actions, but good practices (such as an independent judiciary, or good governance in general) should equally have a positive impact on the results of an assessment.

### Recommendations:

1. FATF elaborates on guidance how contextual factors have to be taken into account; and how changes of those factors over time may be considered;
2. The risk and context module of the FATF/FSRB assessor training should focus more on the impact such factors should have on the assessment. Ideally, the mock scenario will address the issue more prominently;
3. Relevant indicators<sup>9</sup> are systematically collected by the Secretariats in the preparation of the assessment; and made available to the assessors ;
4. Assessors should form an opinion whether National Risk Assessments take contextual factors into account sufficiently;
5. More emphasis is given to contextual factors in the scoping notes;
6. Meetings with relevant civil society representatives during the onsite visit are organized;
7. The reports are more vocal and more candid about the impact of these factors on the outcomes of the assessment (including on ratings).

**Question 3 |** Are the ME (and ICRG) processes sufficiently transparent? Would the ME process be more effective if it included information from NGOs, academia and other „independent“ sources of information?

The FATF is a powerful organisation, despite its denomination as a “task force”. It has a strong mandate of the G-20 and the G-7, access to political decision makers. It has a number of tools to ensure that its recommendations are implemented, in particular the power to name and shame countries that have strategic deficiencies (so called “grey” and “black” lists). Through the global network, comprising the regional organisations (FSRBs), the FATF’s reach encompasses a larger membership than the United Nations. Over the past 10 years, FATF has continuously expanded its powers and outreach.

With great power there must also come great responsibility, and responsibility requires transparency and inclusiveness. Some organisations noted the lack of oversight mechanism for ensuring human rights and “humanitarian obligations”. The conclusion of the Global NPO Coalition on FATF for example finds that “establishment of best practices for clear internal policies or rules for engagement and transparency for such bodies would increase the potential for engagement and thus, incorporation of human rights and humanitarian considerations into their proceedings.”

In the context of legal persons and legal arrangements, the FATF calls for a high level of transparency. But is the FATF fully transparent on its own processes, and does it cooperate to the extent possible with providers of relevant and objective information?

Currently, the FATF and FSRB mutual evaluation (ME) procedures are published and the assessment bodies should be commended for this. However, ICRG procedures are not published, and only limited information is available (but hard to find) on the FATF website. The somewhat secretive way that the FATF handles the ICRG process leads to misunderstandings among concerned countries (in particular non-FATF members – they have no vote in the ICRG process and on applicable procedures), and often

<sup>8</sup> E.g., <https://www.bbc.com/news/world-europe-57733592>

<sup>9</sup> E.g., TI CPI, WJP Rule of Law Index, World Press Freedom Index, Tax Justice Network Financial Secrecy Index, INCSR, TIP report, etc

even among FATF members and observers. This is particularly worrying as grey-listing results in a large and statistically significant reduction in capital inflows, in particular in low- and middle-income countries.

**Recommendation:**

In the context of ME's, access to relevant, consistent and objective information is essential. Currently, the focus is on information provided by Governments and the private sector. However, this information is not fully objective and tends to focus on the positive aspects of the AML/CFT system - given the negative consequences of a failed assessment, quite a natural behaviour, of course! Assessors should collect all information available, beyond what is provided by the authorities and the private sector. As a consequence, more should be done to collect relevant information from the civil society, academia and other independent sources.

**Question 4 | What is missing in the data collection exercise?**

Despite some guidance by FATF and other FSRBS on statistics and data collection, and despite countries undergoing NRA exercises for a number of years now, there is a clear lack of data available, or it is not collected uniformly, which makes the analysis difficult. Some agencies have data available for a different time period than others. Lack of trust among agencies is also an issue and we encounter it often during NRAs: Frequently, intelligence agencies are reluctant to share their data/information with non-counterparts. Other agencies may feel less invested in this effort and might not follow guidelines or maintain relevant records.

More importantly, it is not enough to collect raw data if it is not sufficiently analyzed. Authorities need to connect the dots. For example, when conducting a data collection exercise, the data should be looked at in a more holistic way, so we can be able to determine how the data collected on the preventive side relates to the law enforcement side. For example, how does the data collected through STRs informs supervision efforts or policy decisions. This means not just the data collected by the reporting entities, but also the reporting itself. Are authorities looking at how many STRs are received per each sector or each reporting entity, and are we really analyzing it in the ME process? How does this relate to RBA supervision of the sector? And then, on the enforcement side, ML investigations often include gatekeepers. Is the information obtained through a criminal investigation informing supervisors to define supervisory actions?

Issues are often looked at as if they are a result or a conclusion, but the “how we get here” is often overlooked. For example, one may think that the end-result is the confiscation of assets or sanctioning a reporting entity. Under this assumption, the data is captured in that way. However, there is no data on what happens after confiscation, and how assets are managed. There is little discussion on these matters in MERs - IO 8, despite that R. 4 includes a specific criteria on asset management. It is very similar with sanctions: It is relevant to consider what happens once a fine is enforced.

We also lack reliable data on the volume of financial crime (both aggregated and with regard to individual categories of crime). Even more challenging is the situation when it comes to measuring the impact the measures achieve: be it on the overall scale (e.g., impact of AML as a concept) or on with regard to a specific measure (e.g., impact of PEP requirements on grand corruption; or of beneficial ownership registries on seized proceeds of crime). Without being able to measure impact more meaningfully, assessing effectiveness results inherently in significant shortcomings.

**Recommendations:**

1. FATF/FSRBS should create a binding standard on data collection and, in this context clarify frequency of reporting, data verification and on responsibilities;
2. Jurisdictions should increase availability of comparable data; also by collaborating with academia, and independent data providers;
3. Jurisdictions should enhance transparency on data collection to increase reliability of data, while maintaining confidentiality of certain datasets (e.g., on TF)

**Question 5** | Could / should FATF set out more specific expectations around the development / use of public private partnerships? Could / should FATF do more to challenge barriers to information sharing (private to private, cross border etc)?

## Introduction

FATF considers effective information sharing as one of the cornerstones of a well-functioning AML/CFT framework<sup>10</sup>. However, there is no mandatory requirement in the FATF standards to establish a PPP. For the purpose of this exercise, this paper will focus on information sharing PPPs, as they have the greatest impact on effectiveness.

## Involving the Private Sector

No one authority, group of national stakeholders or individual countries typically have all the necessary information and powers to respond to criminal financial activity, all possible steps should be taken to clarify the advantages of partnership and address identified barriers that restrict this from occurring.

Although the idea of public-private partnership (PPP) has been around for many years, the idea entered the mainstream from 2015 with the creation of the UK's Joint Money Laundering Intelligence Task Force.<sup>11</sup> Since then, the development of PPPs has advanced in a number of other countries<sup>12</sup>. Yet, a range of issues, primarily concerning legal and operational challenges in both the public and private sectors, and in particular associated with data and privacy protection, limit the effectiveness of PPPs.

## Public-Private Partnerships: Still Work in Progress

The FATF's 2017 guidance on private sector information sharing makes the case for the importance of information sharing in the context of meeting FATF's Recommendations. But it also notes the benefits of information sharing that go beyond that required by the Standards.<sup>13</sup> As recommended below, the FATF should conduct the necessary research to allow it to be more confident and affirmative in making this assertion.

A promising development for addressing some of the barriers that confront the development of more effective partnerships and information sharing is the greater use of 'privacy preserving' technology. However, despite the optimism that technology may hold the key to the development of more effective and widely embraced PPPs, there remain significant challenges to achieving this goal, particularly in the face of privacy and data protection concerns.

Following the publication of the European Commission's AML Package in July 2021, the European Data Protection Supervisor published an opinion that welcomed the objectives of the legislative package, but also put forward a number of recommendations that have the potential to restrict the ability for information sharing and partnership, for example, proposing restrictions on access to beneficial ownership registries.<sup>14</sup>

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<sup>10</sup> FATF (2017), Guidance on private sector information sharing, FATF, Paris [www.fatf-gafi.org/publications/fatfrecommendations/documents/guidance-information-sharing.htm](http://www.fatf-gafi.org/publications/fatfrecommendations/documents/guidance-information-sharing.htm). Also, FATF's Recommendations do consider the importance of partnership, notably within the public sector, and information sharing. Recommendation 2 calls for countries to ensure that "policy-makers, the financial intelligence unit (FIU), law enforcement authorities, supervisors and other relevant competent authorities, at the policymaking and operational levels, have effective mechanisms in place which enable them to cooperate, and, where appropriate, coordinate and exchange information domestically".

<sup>11</sup> For a detailed overview of these developments, see Nick Maxwell and David Artingstall, 'The Role of Financial Information-Sharing Partnerships in the Disruption of Crime' (Future of Financial Intelligence Sharing; RUSI Occasional Paper), October 2017.

<sup>12</sup> For an extensive assessment of the state of national PPPs, see Nick Maxwell, 'Survey Report: Five years of growth in public-private financial information sharing partnerships to tackle crime', (Future of Financial Intelligence Sharing), August 2020.

<sup>13</sup> Financial Action Task Force, 'FATF Guidance: Private Sector Information Sharing', November 2017, para. 71, p. 22.

<sup>14</sup> European Data Protection Supervisory, 'Opinion 12/2021: on the anti-money laundering and countering the financing of terrorism (AML/CFT) package of legislative proposals', September 2021.

### **Recommendations:**

In order to expand the benefit of PPPs in fighting financial crime, the FATF should advance its emphasis on the value of PPPs from 'nice to have' to a more positive endorsement of the value PPPs can bring to a jurisdiction's response to financial crime. With this in mind, the following recommendations are offered:

1. The FATF should more comprehensively and assertively embrace PPPs in its assessment process. A failure of the public and private sectors to work closely together in partnership means that a country's response to financial crime cannot be as effective as it could be – this should be reflected in Mutual Evaluation Reports;
2. The FATF should conduct a thematic assessment of its members and those of its regional bodies to gauge the extent to which PPPs are being leveraged to combat financial crime and the barriers that exist to the establishment and operation of PPPs;
3. The FATF should drive forward and facilitate the greater adoption of technology to support the analysis of pooled data and the secure sharing of information;
4. The FATF membership should urgently seek to address the lack of both national and regional coordination between data privacy and financial crime efforts.

#### **About the Global Coalition**

Founded in 2018, the Global Coalition to Fight Financial Crime brings together 20 organisations from the public sector, including law enforcement and policing, as well as the private sector, including banks and FinTech's, think tanks, and not-for-profits, all committed to collaborating to make the fight against financial crime more effective.

For more detail and the latest news on the work of the Global Coalition, see: <https://www.gcffc.org/>