

THE FATF EVALUATION PROCESS, INCLUDING
"BLACK AND GREY" LISTING

BLACKLIST, GREY LIST OR WHITEWASH?
COMPLIANCE RISKS IN THE 21ST CENTURY

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PART I

Introduction – History and Functions

Compliance Risks in 21st Century

Compliance as an issue for Regulation
regulatory, supervisory and enforcement
Increasing Importance for Countries and Financial and Non-Bank Financial
Gained Life of its Own – a huge industry

Evolution of Compliance
Concerns about compliance
From "box-ticking" to Effective systems

Post 2007-2008 Experience
Failure in Risk Systems
CRAs
FATF AML/CFT System and Process

Brief History of FATF Evaluation Process

- Introduction to FATF
 - Functions
 - History – 1989 – 2001 – 2003 and 2012
 - UN Conventions:Vienna Convention against Transnational Organised Crime 1998,Art.6 on ML; UN Merida Convention,2003.
 - Evolution = 2003 (40Rs+9SRs) and 2012 (40Rs)
- Main Functions
 - Standard-Setter - The FATF Recommendations set out a comprehensive and consistent framework of measures which countries should implement in order to combat money laundering and terrorist financing, as well as the financing of proliferation of weapons of mass destruction.
 - Mutual Evaluation
 - Typologies - works to identify national-level vulnerabilities with the aim of protecting the international financial system from misuse

History

- The original FATF Forty Recommendations were drawn up in 1990 as an initiative to combat the misuse of financial systems by persons laundering drug money.
- In 1996 the Recommendations were revised for the first time to reflect evolving money laundering trends and techniques, and to broaden their scope well beyond drug-money laundering.
- In October 2001 the FATF expanded its mandate to deal with the issue of the funding of terrorist acts and terrorist organisations, and took the important step of creating the Eight (later expanded to Nine) Special Recommendations on Terrorist Financing, Revised in 2003.
- Revision of 2012 – radical shift (see below)

Main Objectives

- FATF Recommendations set out the essential measures that countries should have in place to:
 - identify the risks, and develop policies and domestic coordination;
 - pursue money laundering, terrorist financing and the financing of proliferation;
 - apply preventive measures for the financial sector and other designated sectors;
 - establish powers and responsibilities for the competent authorities (e.g., investigative, law enforcement and supervisory authorities) and other institutional measures;
 - enhance the transparency and availability of beneficial ownership information of legal persons and arrangements; and
 - facilitate international cooperation.

FATF Institutional Structure

- FATF Institution and Operational Structure
 - International Financial Institutions
 - FATF Styled Regional Bodies (FSRBs)
 - Private Sector
 - Civil Society

Post 2012 – 360 Change in Focus

- New Recommendations accompanied by New Evaluation Methodology
 - A Major Shift in Approach to Evaluation = Focusing on 2 Main Parameters
- Risk Based Approach
- New Evaluation Methodology and Approach
 - Effective Implementation
 - Fourth Round of Evaluation – Litmus Test
- Future - countries matching Regulatory design with Effective Compliance
 - 2008 – 2018 - Next Round

Part II

Risk Based Approach

Risk Based Approach – Prior 2012 and Post 2012

Prior 2012

Limited reference to risk

Not a solid requirement and foundation for compliance

Meaning – risk was not an essential requirement for evaluation

Reference in the text as "General Interpretation and Guidance"

Risk of money laundering or terrorist financing - For each Recommendation and each essential criteria where financial institutions should be required to take certain actions, assessors should normally assess compliance on the basis that all financial institutions should have to meet all the specified requirements.

However, an important consideration underlying the FATF Recommendations is the degree of risk of money laundering or terrorist financing for particular types of financial institutions or for particular types of customers, products or transactions. A country may therefore take risk into account and may decide to limit the application of certain FATF Recommendations provided that either of the following conditions are met:

Horizontal lines for notes

Risk Post 2012

After 2012

- Radical Shift where Risk Becomes the Central Pillar of FATF Strategy and Evaluation: Recommendation 1 (New)
- Radical Change in Ownership and Burden (Very Important) – 360 degree turn-around

- The starting point for every assessment is the assessors' initial understanding of the country's risks and context, in the widest sense, and elements which contribute to them.

This includes:

- the nature and extent of the money laundering and terrorist financing risks
- the circumstances of the country, which affect the materiality of different Recommendations (e.g., the makeup of its economy and its financial sector);
- structural elements which underpin the AML/CFT system; and
- other contextual factors which could influence the way AML/CFT measures are implemented and how effective they are.

Horizontal lines for notes

Risk Post 2012

- The ML/TF risks are critically relevant to evaluating technical compliance with Recommendation 1 and the risk-based elements of other Recommendations, and to assess effectiveness. Assessors should consider the nature and extent of the money laundering and terrorist financing risk factors to the country at the outset of the assessment, and throughout the assessment process.
- Assessors should use the country's own assessment(s) of its risks as an initial basis for understanding the risks, but should not uncritically accept a country's risk assessment as correct, and need not follow all its conclusions.
- There may be cases where assessors cannot conclude that the country's assessment is reasonable, or where the country's assessment is insufficient or non-existent. In such situations, they should consult closely with the national authorities to try to reach a common understanding of what are the key risks within the jurisdiction.
- If there is no agreement, or if they cannot conclude that the country's assessment is reasonable, then assessors should clearly explain any differences of understanding, and their reasoning on these, in the Mutual Evaluation Report (MER); and should use their understanding of the risks as a basis for assessing the other risk-based elements (e.g. risk-based supervision).

Horizontal lines for notes

PART III

Mutual Evaluation After 2012- Effectiveness

FATF Methodology for ME

- Terminology - Mutual Evaluation / Assessment
- Basis for undertaking assessments of technical compliance with the revised FATF Recommendations of 2012, and for reviewing the level of effectiveness of a country's AML/CFT system
- Criteria for assessing technical compliance with each of the FATF Recommendations.
- Outcomes, indicators, data and other factors used to assess the effectiveness of the implementation
- Effectiveness assessment differs fundamentally from technical compliance. Seeks to assess the adequacy of the implementation of the Recommendations, and identifies the extent to which a country achieves a defined set of outcomes, central to a robust AML/CFT system. The focus of the effectiveness assessment is therefore on the extent to which the legal and institutional framework is producing the expected results.
- Tool for assessors but also for countries - useful for countries that are reviewing their diverse legal, regulatory and financial AML/CFT frameworks to ensure effectiveness

Mutual Evaluation Process and Requirements

Technical Compliance

- The technical compliance component of the Methodology refers to the implementation of the specific requirements of the FAT Recommendations, including the framework of laws and enforceable means; and the existence, powers and procedures of competent authorities.
- The technical compliance component of the Methodology sets out the specific requirements of each Recommendation as a list of criteria, which represent those elements that should be present in order to demonstrate full compliance with the mandatory elements of the Recommendations.
- For each Recommendation and each essential criteria where financial institutions should be required to take certain actions, assessors should normally assess compliance on the basis that all financial institutions should have to meet all the specified requirements.
- Essential Criteria – the basic requirements defining the recommendation

Process and Steps in Preparing an Evaluation

- Procedures for the FATF FOURTH ROUND of AML/CFT Mutual Evaluations - Steps
- Information Updates on Technical Compliance
- Information on Effectiveness
- Composition and Formation of Assessment Team
- Initial Quality & Consistency Review
- Face-to-Face Meeting
- Identifying Issues for Plenary Discussion
- Respecting Timelines
- The Plenary Discussion

PART IV

Evaluation Process And International Cooperation Review Group (ICRG)

ICRG – Requirements for Entering

Previously Non-Cooperative Countries and Territories (NCCT)

Referral Criteria + Jurisdictions that meet the MER referral criteria with the country having a threshold of 5 billion USD of financial sector assets.

3.Avenues to enter ICRG Process:

1. Non participation in FATF process and decision not to subject to Evaluation.
2. Nomination by a FATF or FSRB Delegation – lack of international cooperation and other failures related to the financial sector such as market integrity / banking and financial stability supervision / substantial ML, FT, or financing of proliferation threats or risks / the legal and regulatory framework of a country may result in serious vulnerabilities in the AML/CFT framework
3. Referral Based on MER

International Cooperation Review Group Process – Referral Based on MER

3. Referral based on MER Results

- After the discussion of the MER, a country, with very poor compliance with the FATF standard, will enter the ICRG pool if any one of the following applies:
 - a. it has 20 or more NC/PC ratings for technical compliance; or
 - b. it is rated NC/PC on 3 or more of the following Recommendations: R.3, 5, 6, 10, 11, and 20;
 - c. it has a low or moderate level of effectiveness for 9 or more of the 11 Immediate Outcomes, with a minimum of two low level ratings
 - d. it has a low level of effectiveness for 6 or more of the 11 Immediate Outcomes.

ICRG Process

- For one year from the ICRG referral (or approximately sixteen months after the adoption of the MER), the country will have the possibility to work with the lead body (i.e. the FATF or FSRB who adopted the mutual evaluation) to remedy its shortcomings identified in its MER under the ordinary Enhanced Follow-Up Procedures. This period will be considered as "observation period".
- Four Joint Groups will substitute the current four Regional Review Groups. Each Joint Group will be led by two co-chairs, one representing the FATF/ICRG and one representing the FSRBs.
- At the end of that observation period a Joint Group will assess the degree and quality of progress made by the country and present its findings to the next ICRG meeting. In order to inform this discussion with the Joint Group and the country under review, the Joint Group will develop a draft action plan taking into account the findings of the first Report in the Enhanced Follow-Up Process.
- The Joint Groups will generally meet three times a year in order to be able to report accordingly to each ICRG meeting. However, the Joint Groups will have flexibility in organising their work and conducting the necessary outreach to countries.
- The Joint Group will also monitor progress made by the country on its ICRG action plan. To avoid duplication with the follow-up process, deficiencies that are included in the ICRG action plan should be monitored exclusively under the ICRG process.

ICRG Process

- If the Joint Group is satisfied that the country has remedied its shortcomings identified in its MER with respects to its referral criteria, it will propose to the ICRG to remove the country from the ICRG process.
- The ICRG may then propose to the Plenary to leave it to the lead body to complete the monitoring through the Enhanced Follow-Up Process. At this stage, the country will be removed from ICRG when it demonstrates the following:
 - The country would have to reach a satisfactory level of compliance (i.e. essentially equivalent to a largely compliant although the ICRG would not do an official re-rating) with Recommendations R.3, 5, 6, 10, 11 and 20;
 - The country would have to reach a satisfactory level of compliance with 21 Recommendations overall; and
- The country must make progress towards increasing effectiveness on each Immediate Outcome that was rated as low or moderately effective.

ICRG – Public Identification and Exiting

- Once a country has agreed to an action plan with the ICRG, the country would be publicly identified as under review by the FATF but the statement would note the country's high level political commitment to address its AML/CFT deficiencies. If a country fails to provide high-level political commitment to its action plan or a country has not made sufficient progress on its ICRG action plan one year after providing its high-level commitment, the FATF would call on its members to consider the risks arising from the deficiencies associated with each jurisdiction.
- At the next ICRG meeting, the ICRG will decide – on the basis of the findings of the on-site visit report – whether the jurisdiction is ready to exit the ICRG process. If the decision is positive, the FATF should make a public statement indicating that the jurisdiction concerned has made significant progress, that the jurisdiction is no longer the subject of the formal ICRG process. The jurisdiction will then be referred back and exclusively monitored in the context of the FATF or FSRB follow-up.
- In terms of effectiveness, regard would be given to actions with a prospect of success in raising effectiveness in order to exit ICRG. Therefore any items on effectiveness that are included in an action plan should be measurable and achievable within a reasonable time frame (e.g. one to three years), and should aim to be as specific as possible.
- Overall, the country would need to demonstrate actions to increase the level of effectiveness without determination of which level of effectiveness has been achieved for the individual Immediate Outcomes.

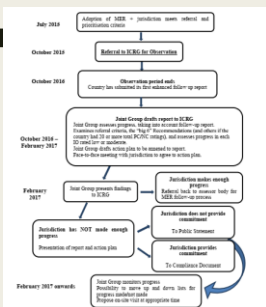
ICRG - "Grey and Black" Lists

Grey List

- When the FATF places a jurisdiction under increased monitoring, it means the country has committed to resolve swiftly the identified strategic deficiencies within agreed timeframes and is subject to increased monitoring. This list is often externally referred to as the 'grey list'. (Mauritius)

Black List

- High-risk jurisdictions have significant strategic deficiencies in their regimes to counter money laundering, terrorist financing, and financing of proliferation. For all countries identified as high-risk, the FATF calls on all members and urges all jurisdictions to apply enhanced due diligence, and in the most serious cases, countries are called upon to apply counter-measures to protect the international financial system from the ongoing money laundering, terrorist financing, and proliferation financing (ML/TF/PF) risks emanating from the country. This list is often externally referred to as the "black list". (DPRK and Iran)



Conclusions

- Main Shift - Responsibilities on Country, RBA and Effectiveness
- Evaluation is Now More Rigid – Expectations are High
- Need for Better Competencies in this field
- Country rather than Sector or Institution Approach
 - Challenges of inter-agency collaboration are Real
 - Involvement of DNFBPs
 - Need for a change in Mindset

FATF Compliance Instruments

1. FATF 40 AML/CFT Recommendations, 2012 and 2019
2. FATF Methodology for Assessing Technical Compliance with FATF 40 Recommendations and the Effectiveness of the AML/CFT System, Update 2019
3. Consolidated Process and Procedures for Mutual Evaluations & Follow-Up Process, 'Universal Procedures', Oct 2019
4. Procedures for the FATF Fourth Round of AML/CFT Mutual Evaluation, Oct. 2019
5. High Level Principles & Objectives for FATF and FSRBs, Oct. 2012
6. Jurisdictions Meeting 3rd and 4th Round Referral (FATF 2018)
7. Operational Issues – Financial Investigation Guidance, Oct 2012
