

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
- 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
 - FAFT 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 Approaqch
 - 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:

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
- 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.

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.
- <u>Assessors should use the country's own assessment(s) of its risks</u> 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).

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 AMIUCFT 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 <u>Methodology</u> 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 creatin 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

Effectiveness

- New Requirement for Evaluation perhaps more important (Why)
- FATF Expectations Assessing effectiveness is intended to: (a) improve the FATF's focus on outcomes: (b) identify the extent to which the national AML/CFT system is achieving the objectives of the FATF standards, and identify any systemic weaknesses; and enable countries to prioritise measures to improve their system.
- prioritize measures to improve their system. Definition: "The extent to which the defined outcomes are achieved". In the AML/CFT context, effectiveness is the extent to which financial systems and economies mitigate the risks and threats of money laundering, and financing of terrorism and profileration. This could be in relation to the intended result of a given (a) policy, law, or enforceable means; (b) programme of law enforcement, supervision, or intelligence activity; or (c) implementation of a specific set of measures to mitigate the money laundering and financing of terrorism risks, and combat the financing of policiferation.
- Goal of assessing effectiveness provide an appreciation of the country's AML/CFT system and how well it works.
- Assessing effectiveness is based on a fundamentally different approach to assessing technical compliance with the Recommendations. It does not involve checking whether specific requirements are met, or that all elements of a given Recommendation are in place. Instead, it requires a judgment as to whether or to what extent defined outcomes are being achieved, i.e. effectively met in practice The assessment process is reliant on the judgment of assessors, who will work in consultation with the assessed country.

Measuring Effectiveness

THE FRAMEWORK FOR ASSESSING EFFECTIVENESS

- Tor its assessment of effectiveness, the FATF has adopted an <u>approach focusing on a hierarchy of</u> <u>defined outcomes</u>. At the highest level, the objective in implementing AML/CFT measures is that "Financial systems and the broader economy are protected from the threats of money laundering and the financing of terrorism and proliferation, thereby strengthening financial sector integrity and contributing to safety and security". In order to give the right balance between an overall
- Understanding of the effectiveness of a country's AML/CFT system, and a detailed appreciation of how well its component parts are operating, the FAIT assesses effectiveness primarily on the basis of eleven immediate Outcomes. Each of these represents one of the key goals which an effective AML/CFT system should achieve, and they feed into three Intermediate Outcomes which represent the major themaic goals of AML/CFT measures.
- This approach does not seek to assess directly the effectiveness with which a country is implementing individual Recommendations; or the performance of specific organisations, or institutions.
- It is essential to note that it is the responsibility of the assessed country to demonstrate that its AML/CFT system is effective. If the evidence is not made available, assessors can only conclude that the system is not effective.

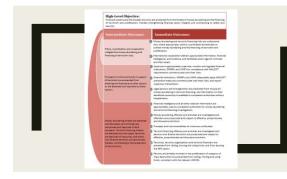
Note the similarity with RBA in terms of obligation placed on countries

Effectiveness

- An assessment of effectiveness should consider each of the eleven Immediate Outcomes individually, but does not directly focus on the Intermediate or High-Level Outcomes. For each of the Immediate Outcomes, there are two overarching questions which assessors should try to answer:
 - ver. To what extent is the outcome being achieved? Assessors should assess whether the country is effective in relation to that outcome (i.e. whether the country is achieving the results expected of a well-performing MRULCF system). They should base their conclusions principally on the Core Issues, supported by the examples of information and the examples of specific factors; and taking into account the level of technical compliance, and contextual factors.
 - What can be done to improve effectiveness? Assessors should understand the reasons why the country may not have reached a high level of effectiveness and, where possible, make recommendations to improve its ability to achieve the specific outcome. They should base their of specific factors that could support the conclusions on care issues, including activities, processe, resources and instructure. They should also consider the effect of technical deficiencies on effectiveness, and the relevance of contextual factors. If assessors are satisfied that the outcome is being achieved to a high degree, they would not need to consider in detail what can be done to multither improvements, or ongoing efforts needed to sustain a high level of effectiveness).

Effectiveness: Core Issues

- Core Issues to be considered in determining whether the Outcome is being achieved
- The core issues are the mandatory questions which assessors should seek to answer, in order to get an overview about how effective a country is under each outcome. Assessors' conclusions about how effective a country is should be based on an overview of each outcome, informed by the assessment of the core issues.
- Assessors should examine all the core issues listed for each outcome. However, they may vary the degree of detail with which they examine each in order to reflect the degree of risk and materiality associated with that issue in the country. In exceptional circumstances, assessors may also consider additional issues which they consider, in the specific circumstances, to be core to the effectiveness outcome (e.g., alternative measures which reflect the specificities of the country's ANL/CET system, but which are not included in the core issues or as additional information or specific factors). They should make clear when, and why, any additional issues have been used which are considered to be core.



Follow-Up Process

- Intended to: (i) encourage members' implementation of the FATF Standards; (ii) provide regular monitoring and up-to-date information on countries' compliance; (iii) apply sufficient peer pressure and accountability. .
- peer pressure and accountability. Following adoption of a MER, the country could be placed in either regular or enhanced follow-up. Regular follow-up is the default monitoring mechanism for all countries. Enhanced follow-up is based on the FATS traditional policy that deals with members with significant deficiencies (for technical compliance or effectiveness) in their AML/CFT systems, and involves a more intensive process of follow-up. .
- Whether under regular or enhanced follow-up, the country will have a follow-up assessment after five years .
- Countries in enhanced follow-up would typically first report back four Plenary meetings after the adoption of the country's MER, and subsequently report twice more at intervals of three Plenary meetings. .
- After the discussion of the MER:a country will be placed immediately into enhanced follow-up if any one of the following applies: (i) it has 8 or more NC/PC ratings for technical compliance, or .
- .
- (ii) it is rated NC/PC on any one or more of R.3, 5, 10, 11 and 20, or .
- (iii) it has a low or moderate level of effectiveness for 7 or more of the 11 effectiveness outcomes, or •
- (iv) it has a low level of effectiveness for 4 or more of the 11 effectiveness outcomes.

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)

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

3 Avenues to enter ICRG Process:

I. 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 (ie, the FAT or FSRB who adopted the mutual evaluation) to remedy its shortcoming identified in its MER under the ordinary Enhanced Follow-Up Procedures. This period will be considered as "<u>observation period</u>".
- 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 outrach 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 AMUCFT deficiencies. If a country fails to provide high-devel 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.
- dehences associate with extri production. 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 to 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 (CRG. 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.

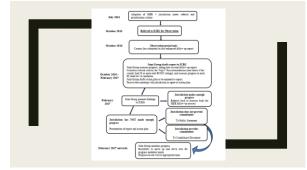
ICRG - "Grey and Black" Lists

Grey List

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

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 FAT calls on all members and urges all jurisdictions to apply enhanced due dilgence, 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 Chainenges of inter-agency cond
 Involvement of DNFBPs
 Need for a change in Mindset

FATF Compliance Instruments

- I. 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