

# Combating Money Laundering and the Financing of Terrorism

*A Comprehensive Training Guide*



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Effects on  
Economic Development  
and International Standards

*Workbook*





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and International Standards

*Workbook*



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1 2 3 4 12 11 10 09

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ISBN: 978-0-8213-7569-3  
eISBN: 978-0-8213-7570-9  
DOI: 10.1596/978-0-8213-7569-3

#### **Library of Congress Cataloging-in-Publication Data**

Combating money laundering and the financing of terrorism : a comprehensive training guide.  
p. cm.

“A World Bank and International Monetary Fund publication.”

Includes bibliographical references.

ISBN 978-0-8213-7569-3 -- ISBN 978-0-8213-7570-9 (electronic)

1. Money laundering. 2. Terrorism--Finance. 3. Terrorism--Prevention. I. World Bank.

II. International Monetary Fund.

HV8079.M64C56 2009

332.1068'4--dc22

2009009952



# About the Training Modules

*Combating Money Laundering and the Financing of Terrorism: A Comprehensive Training Guide* is one of the products of the Capacity Enhancement Program on Anti-Money Laundering and Combating the Funding of Terrorism (AML/CFT), which has been co-funded by the Governments of Sweden, Japan, Denmark, and Canada. The program offers countries the tools, skills, and knowledge to build and strengthen their institutional, legal, and regulatory frameworks to successfully implement their national action plan on these efforts.

This workbook is one of the following training course modules:

## **MODULE 1: EFFECTS ON ECONOMIC DEVELOPMENT AND INTERNATIONAL STANDARDS**

Module 1 introduces the fundamental concepts of money laundering and terrorist financing; their implications for development from economic, social, and governance perspectives; and existing international standards and key international players in the fight against money laundering and terrorist financing.

## **MODULE 2: LEGAL REQUIREMENTS TO MEET INTERNATIONAL STANDARDS**

Module 2 covers satisfying the international standards on AML/CFT and the legislative action that this usually requires. In exploring those implications and possible legislative needs, this workbook answers the following questions:

- What are the international conventions and treaties that deal with AML/CFT?
- What legal and institutional arrangements satisfy international standards?
- What are the legal issues related to international cooperation?
- Where can one find model laws?

## **MODULE 3A: REGULATORY AND INSTITUTIONAL REQUIREMENTS FOR AML/CFT**

Module 3a introduces the regulatory and institutional requirements for AML/CFT and addresses the following issues:

- Responsibility for effective supervision
- Institutions subject to AML/CFT compliance
- The principal regulatory and institutional requirements
- Internal audit and compliance programs
- Professional associations and their roles
- Enforcement of AML/CFT requirements

## **MODULE 3B: COMPLIANCE REQUIREMENTS FOR FINANCIAL INSTITUTIONS**

Module 3b considers AML/CFT from the perspective of a bank or other financial institution and provides the necessary information for employees of such institutions who deal with a wide range of AML/CFT issues. It also provides additional inputs for compliance officers of financial institutions. A separate section of the workbook deals with some issues that are more pertinent to compliance officers.

#### **MODULE 4: BUILDING AN EFFECTIVE FINANCIAL INTELLIGENCE UNIT**

Module 4 examines the financial intelligence unit (FIU) and its role in the national AML/CFT regime and addresses the following issues:

- Basic concepts of the FIU, suspicious transaction reports, and how they fit into AML/CFT regimes
- Building FIU functionality
- Coordination and cooperation at the policy and operational levels
- Skills, integrity, and security of FIU personnel

#### **MODULE 5: DOMESTIC (INTERAGENCY) AND INTERNATIONAL COOPERATION**

Module 5 introduces the importance of interagency and international cooperation in the fight against money-laundering activities.

#### **MODULE 6: COMBATING THE FINANCING OF TERRORISM**

Module 6 focuses on combating the financing of terrorism (CFT), a new area for many countries compared to the anti-money laundering (AML) effort. The workbook starts with a brief review of the CFT issues raised in the previous workbooks, addresses some general questions related to CFT, and then discusses the FATF Nine Special Recommendations on Terrorist Financing in combination with the international obligation of states.

#### **MODULE 7: INVESTIGATING MONEY LAUNDERING AND TERRORIST FINANCING**

Module 7 introduces the practice of investigating activities that involve laundering of the proceeds of crime and discusses investigations of terrorist financing activities.

### **Acknowledgments**

The initial work for this training program was provided by Emiko Todoroki and Azuma Miura, the World Bank. Module 3a was further written and developed by Manuel Vasquez, International Monetary Fund. The draft was reviewed by John McDowell, the World Bank and Thomas Grahn, Financial Supervisory Authority of Sweden. Pedagogical guidance was provided by Sheila Jagannathan, and peer review was conducted by Emiko Todoroki, the World Bank. In 2007 and 2008, updates and review were provided by Klaudio Stroligo, Cedric Mousset, Paul Allan Schott, and Emiko Todoroki, the World Bank. Key sources for this workbook include Financial Action Task Force on Money Laundering, “The Forty Recommendations” (2003) and “Special Recommendations on Terrorist Financing” (2005); and Paul Allan Schott, *Reference Guide to Anti-Money Laundering and Combating the Financing of Terrorism, Second Edition*, the World Bank, 2004.

#### **CAPACITY ENHANCEMENT PROGRAM ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM**

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Composition: Precision Graphics, Champaign, Illinois



# Effects on Economic Development and International Standards

**Module 1** introduces the fundamental concepts of money laundering and terrorist financing; their implications for development from economic, social, and governance perspectives; and existing international standards and key international players in the fight against money laundering and terrorist financing. In this module the following key issues will be addressed:

- 1. Understanding money laundering and terrorist financing** **3**
  - 1.1 What is money laundering? [4](#)
  - 1.2 How does money laundering occur? [5](#)
  - 1.3 What is terrorist financing and how does it compare and contrast with money laundering? [7](#)
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- 2. The implications of money laundering and terrorist financing for development** **18**
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  - 3.1 Why is there a need for an international framework to combat money laundering and terrorist financing? [23](#)
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- 3.5 Are there any other international bodies involved in fighting money laundering and terrorist financing? 28

#### **4. Assessing compliance with international standards**

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- 4.1 Why assess compliance? 40
- 4.2 Who assesses compliance with the international standards? 40
- 4.3 Is there a standard method for assessing compliance? 40

##### **At the end of Module 1, you will be able to**

- understand what money laundering is and how it is similar to and different from terrorist financing;
- understand the basic terminology and give examples of how money is being laundered;
- achieve a general understanding of the international standards in this area;
- recognize the international participants in the fight against money laundering; and
- describe how compliance assessments take place and the methodology used for assessment.

# 1

## Understanding money laundering and terrorist financing



### How much do you know?

#### True or false?

- 1) Only drug dealers launder funds.  
a) True      b) False
- 2) The proceeds of any illegal activity could be subject to money laundering.  
a) True      b) False
- 3) Proof of a predicate offense is a prerequisite for a conviction of terrorist financing.  
a) True      b) False
- 4) Money laundering takes place only in developing countries.  
a) True      b) False
- 5) Although money laundering may occur through the banking sector, the securities industry is completely immune to money laundering.  
a) True      b) False
- 6) Financial Action Task Force (FATF)-Style Regional Bodies (FSRBs) are specialized organs of the United Nations dealing with terrorist financing.  
a) True      b) False
- 7) The FATF is the international standard setter for anti-money laundering and terrorist financing measures.  
a) True      b) False
- 8) Money laundering is an engine for economic and social development.  
a) True      b) False

- 9) Only the International Monetary Fund (IMF) and the World Bank may assess countries' compliance with anti-money laundering international standards.  
a) True      b) False
- 10) *Hawala* systems are informal fund transfer systems.  
a) True      b) False

You will be asked the same questions at the end of this module. Let's see how much you learned!

### 1.1. What is money laundering?

Mr. A is a drug trafficker who has a drug-trading business with a daily turnover of \$100,000 in cash. One day Mr. A took \$120,000 to a casino to buy chips/tokens. He stayed several days gambling with small amounts. Upon leaving the casino, he converted his chips/tokens in checks payable to third parties, which were then deposited in a securities firm. The money was later withdrawn and invested in a number of legitimate grocery shops owned by the trafficker and his cohorts.

**QUESTION 1.** Analyze the story above by asking yourself the following questions. Check the answers once you have responded.

1) What is the source of the funds?

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2) How many transactions took place in the example above?

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3) Did Mr. A always keep his money in cash?

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4) Where did he finally invest his money?

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**QUESTION 2.** The operation described above is a money laundering operation. Provide below a definition of money laundering.

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## 1.2. How does money laundering occur?

Money is laundered in a number of ways. Broadly speaking, a complete money laundering operation is often analyzed using three essential stages, although the three stages is not a requirement to be considered as money laundering:

**Placement:** This is the first stage in which illicit funds are separated from their illegal source. Placement involves the initial injection of the illegal funds into the financial system or carrying of proceeds of crime, such as cash, across borders, among others. *How?*

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The launderer could deposit the cash into a regulated financial institution, such as a bank or securities company. He or she could also buy expensive assets, such as cars, antiques, or jewelry with cash. Crossing the national borders with dirty cash without declaring it to the customs authorities could also be considered as the first stage of money laundering although there is no injection into the financial system yet.

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**Layering:** After injecting the illicit funds into the financial system, laundering the funds usually involves creating multiple layers of transactions that further separate the funds from their illegal source. The purpose of this stage is to make it more difficult to trace these funds to the illegal source. *How?*

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The launderer may buy or sell securities, precious metals, or other expensive assets. He or she may also wire the funds across the world through various accounts held in different banks, possibly by several shell companies operating under his control.

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**Integration:** The final stage in a money laundering operation involves injecting the illegal funds into the legitimate economy. The funds now appear as clean and legitimate assets. The purpose of the integration of the funds is to allow the

criminal to use the funds without raising suspicion that might trigger investigation and prosecution. **How?**

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The launderer may purchase an expensive house with a mortgage loan in which repayment is paid using the laundered money in a bank account. The launderer may also set up a business, such as a restaurant or a video rental shop, where the illegal funds could be injected into the business and reappear as fictitious profits or loan repayment. The launderer may also set up a web of front companies with fictitious import/export businesses and use false invoicing and fictitious transactions to integrate the funds as normal earnings from trade.

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**QUESTION 3.** Looking at the scenario in section 1.1, can you identify the three stages of the described laundering operation? What methods did the launderer use at each stage?

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Here is the Bank of Credit and Commerce International (BCCI) case, which is a good example of money laundering.

## Case study The Bank of Credit and Commerce International

The story of the BCCI is one of complex criminality whereby bankers used their own bank to launder money.

BCCI was founded in the early 1970s as the first multinational bank for the Third World. Its corporate structure was designed from the beginning to avoid effective banking regulation and supervision. The bank was first registered in Luxembourg and then in Grand Cayman, both jurisdictions with strong bank secrecy traditions. Further, the BCCI established the headquarters of its operation in England. The fragmentation of the corporate structure contributed to the difficulty in supervision. Similar patterns of compartmentalization could also be found in its auditing practices and in the strict practice of watertight Chinese walls separating the various operations of the BCCI.

This deliberately evasive structure of the BCCI allowed it to engage in dubious operations ranging from covering the bank's losses, embezzlement, and personal enrichment of the

staff, moving money secretly, fraud, and money laundering. To achieve its purposes, the BCCI relied on various methods, including mirror-image trading, front men, and off-balance-sheet accounting techniques. In 1988 the bank was indicted for drug money laundering, and several BCCI bankers were convicted in 1990 on counts of laundering drug proceeds. This was the beginning of the demise of the BCCI.

The role of the BCCI in the laundering of the corruption proceeds of Manuel Noriega, the former president of Panama, provides an example of its laundering activities. Appropriating the funds of the Panama National Guard for his personal use, Noriega deposited \$23 million in BCCI accounts in Luxembourg and London between 1982 and 1986. In 1986, Noriega, with the help of the BCCI, started a laundering operation aimed at obscuring the paper trail linking Noriega to the embezzled funds. To achieve that, the money was transferred from the various accounts held by

Noriega in BCCI to the accounts of the Banco Nacional de Panama at the Union Bank of Switzerland in Zurich and the Deutsche Sudamerikanische Bank in Hamburg, Germany. All the transfers were done in the name of Finley International, a company chaired and directed by Mr. Akbar, who happened to also be the president of Capcom, a commodities future company closely linked to the BCCI. While the accounts were nominally held by the Banco Nacional de Panama, they were in reality opened and controlled by Noriega himself.

The funds were further shuffled to create more layers of transactions. They were first consolidated into a single account held by the Banco Nacional de Panama at the Middle East Bank in London and then transferred to the accounts of

“Finley’s International Ltd.” in the same bank. At last, Finley instructed the Middle East Bank to transfer \$20.5 million to Capcom where the money was credited to two coded customer accounts managed by Capcom and for which Mr. Akbar possessed power of attorney. Another \$2.6 million was paid to a coded account at the Trade and Development Bank in Geneva. All the transfers described above were portrayed as legitimate business transactions involving business capital, payments of fees, and bank deposits. This complex operation resulted in giving the funds legitimate appearance and obscuring the audit trail that linked them to Noriega. (This account is based on the Report to the Committee on Foreign Relations—United States Senate by Senator John Kerry and Senator Hank Brown in December 1992.)

### 1.3. What is terrorist financing and how does it compare and contrast with money laundering?

**QUESTION 4.** What is terrorist financing? Please select the answer you think is most appropriate.

- a) It is a finance activity by terrorists. Therefore, all terrorists’ financial activities are considered terrorist financing. It has only to do with financial activities by terrorists.
- b) It is financial support given to terrorists through laundering money. This is the only source of terrorist financing.
- c) It is financial support given to terrorists. The source of money may be from both illicit and legitimate sources.
- d) It is financial support given to terrorists by a governmental body and not from public sources.

After you attempt an answer, consider the following analysis:

**Terrorist financing** is the act of providing financial support to terrorists or terrorist organizations to enable them to carry out terrorist acts.

This definition is based on the internationally accepted definition of terrorist financing as provided by the United Nations (UN) International Convention for the Suppression of Financing of Terrorism (1999) and on Recommendation II of the Financial Action Task Force (FATF) Special Recommendations on Terrorist Financing and its Interpretative Note.

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Article 2 of the International Convention for the Suppression of the Financing of Terrorism provides:

1. Any person commits an offense within the meaning of this Convention if that person by any means, directly or indirectly, unlawfully and willfully, provides or collects funds with the intention that they should be used or in the knowledge that they are to be used, in full or in part, in order to carry out:

- a) An act, which constitutes an offense within the scope of and as, defined in one of the treaties listed in the annex;\* or
- b) Any other act intended to cause death or serious bodily injury to a civilian, or to any other person not taking an active part in the hostilities in a situation of armed conflict, when the purpose of such act, by its nature or context, is to intimidate a population, or to compel a government or an international organization to do or to abstain from doing any act.

2. [ . . . ]

3. For an act to constitute an offense set forth in paragraph 1, it shall not be necessary that the funds were actually used to carry out an offense referred to in paragraph 1, subparagraphs (a) or (b).

\*The annex includes a list of all the international conventions that criminalize specific terrorist acts, such as the Convention for the Suppression of Unlawful Acts against the Safety of Civil Aviation (1970) and the International Convention for the Suppression of Terrorist Bombings (1997).

For the purposes of FATF Special Recommendation II and this Interpretative Note the following definitions apply.

- *terrorist financing* includes the financing of terrorist acts, and of terrorists, and terrorist organizations
- *terrorist* refers to any natural person who: (i) commits, or attempts to commit, terrorist acts by any means, directly or indirectly, unlawfully and willfully; (ii) participates as an accomplice in terrorist acts; (iii) organizes or directs others to commit terrorist acts; or (iv) contributes to the commission of terrorist acts by a group of persons acting with a common purpose where the contribution is made intentionally and with the aim of furthering the terrorist.
- *terrorist act* includes: (i) An act which constitutes an offense within the scope of, and as defined in one of the following treaties: Convention for the Suppression of Unlawful Seizure of Aircraft (1970), Convention for the Suppression of Unlawful Acts against the Safety of Civil Aviation (1971), Convention on the Prevention and Punishment of Crimes against Internationally Protected Persons, including Diplomatic Agents (1973), International Convention against the Taking of Hostages (1979), Convention on the Physical Protection of Nuclear Material (1980), Protocol for the Suppression of Unlawful Acts of Violence at



Airports Serving International Civil Aviation, supplementary to the Convention for the Suppression of Unlawful Acts against the Safety of Civil Aviation (1988), Convention for the Suppression of Unlawful Acts against the Safety of Maritime Navigation (1988), Protocol for the Suppression of Unlawful Acts against the Safety of Fixed Platforms located on the Continental Shelf (1988), and the International Convention for the Suppression of Terrorist Bombings (1997); and (ii) Any other act intended to cause death or serious bodily injury to a civilian, or to any other person not taking an active part in the hostilities in a situation of armed conflict, when the purpose of such act, by its nature or context, is to intimidate a population, or to compel a government or an international organization to do or to abstain from doing any act.

- *terrorist organization* refers to any group of terrorists that: (i) commits, or attempts to commit, terrorist acts by any means, directly or indirectly, unlawfully and willfully; (ii) participates as an accomplice in terrorist acts; (iii) organizes or directs others to commit terrorist acts; or (iv) contributes to the commission of terrorist acts by a group of persons acting with a common purpose where the contribution is made intentionally and with the aim of furthering the terrorist act or with the knowledge of the intention of the group to commit a terrorist act.

Unlike criminal organizations, the primary aim of terrorist groups is non-financial. Yet, as with all organizations, terrorist groups require funds to carry out their activities. This simple fact—the need for funds—is key in fighting terrorism. Follow the money. Follow the financial trail. This is the core objective of all measures that aim to identify, trace, and curb terrorist financing. Take a look at the role of finance in determining the capacity and gravity of terrorist attacks.

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The case of the 1993 attack on the World Trade Center provides evidence of both the importance of financing for terrorist groups and the importance of following the financial trail in investigating incidents of terrorism. According to the testimony of the then-FBI Director Louis Freeh before Congress in 1999, the terrorists were unable to achieve the destruction they originally intended because of shortage of funds. This limited their capacity to purchase explosive material sufficient to build a bomb of the size they intended. It also forced them to implement the operation ahead of the original schedule. These facts were revealed by Ramzi Yousef, who was captured and convicted as the mastermind behind the 1993 bombing. The investigative value of following the money trail is evident in the fact that the main evidential lead in the case stemmed from the attempt of the perpetrators to reclaim the deposit they paid to rent the truck that they used to transport the bomb to the site of the attack. This transaction set the police on the right track that eventually led to the identification of the perpetrators.

(Testimony of Louis J. Freeh, director, FBI, before the Senate Committee on Appropriations Subcommittee for the Departments of Commerce, Justice, and State, the Judiciary, and Related Agencies, February 4, 1999.)

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**BUT HOW DO TERRORISTS FINANCE THEIR ACTIVITIES? WHAT IS THE SOURCE OF THEIR FUNDS?**

There is a recent trend in the methods used to finance terrorism. Terrorist financing has now become privatized. Previously, terrorism relied on the financial support of states, but state-sponsored terrorism has declined in recent years, and terrorists now rely increasingly on private sources to finance their operations.

Some of the major sources of terrorist financing include:

- Drug trafficking
- Extortion and kidnapping
- Robbery
- Fraud
- Gambling
- Smuggling and trafficking in counterfeit goods
- Contributions and donations
- Sale of publications (legal and illegal)
- Funds derived from legitimate business activities<sup>1</sup>

**QUESTION 5.** What is the difference between the sources of terrorist funds and the sources of laundered funds?

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**QUESTION 6.** What are some similarities between the processes used for money laundering and financing of terrorism?

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**QUESTION 7.** Read the following hypothetical case and identify the sources that the terrorists used to generate their funds. How many layers did they create before delivering the funds to the terrorist organizations? Can you name three of the methods they used to hide the money trail?

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<sup>1</sup> Source: XII Report on Money Laundering Typologies 2000–2001, FATF p. 19.

## Hypothetical case

A criminal investigation in country A into a large contraband cigarette-smuggling operation revealed that the operation was run by a terrorist cell to funnel funds to an organization that was based in country B and that was identified as a terrorist organization by the antiterrorism law of country A. In addition to the contraband trade, the terrorist cell also controlled a gas station, which was run by a front company. Money generated by their contraband activities was deposited into various accounts held by nominees in country A. The money was then transferred to numbered accounts (accounts identified by numbers only) in offshore jurisdictions. Later on, the money was wire-transferred into bank accounts held by nominees in country B. The money was then withdrawn and delivered to the terrorist organization.

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**QUESTION 8.** Return to the question posed at the beginning of this section: What is terrorist financing? Reconsider your answer on the basis of the discussion.

- a) It is a finance activity undertaken by terrorists. Therefore, only the terrorists' financial activities are considered terrorist financing.
- b) It is financial support given to terrorists through money laundering. This is the only source of terrorist financing.
- c) It is financial support given to terrorists. The source of money may be from both illicit and legitimate sources.
- d) It is financial support given to terrorists by a governmental body and not from the public.

You will learn more about terrorist financing and how to combat it in Module 6.

### 1.4. Where do laundering and terrorist financing operations take place?

**QUESTION 9.** Reexamine the BCCI case in section 1.2. How many jurisdictions were involved in the laundering of Panama strongman Manuel Noriega's funds? Can you identify any particular characteristics of these jurisdictions?

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Money laundering and terrorist financing are global crimes. Money launderers and financiers of terrorism internationalize their operations to achieve various objectives:

- a) To avoid jurisdictions with strong regulatory and law enforcement frameworks
- b) To take advantage of the constraints of communication and cooperation between regulators and law enforcement officers across national borders
- c) To exploit regulatory and law enforcement weaknesses that characterize certain jurisdictions
- d) To add layers to the transactions to make it difficult to follow the trail of the transactions

Money laundering and terrorist financing can exploit any jurisdiction, so no country is immune. You will find that these activities take place in both developed and developing countries.

Analysis shows that criminals, like legitimate business operators, consider the legal framework of a location when choosing a base for their operations. It is now well established that strong legal frameworks in the world's major financial centers have pushed criminals to find other havens for their funds.

Jurisdictions with financial secrecy laws figure prominently in money laundering operations, especially at the layering stage. These jurisdictions are also sometimes referred to as *financial havens* or *offshore financial centers*. The BCCI case discussed in section 1.2 clearly shows the use of financial-secrecy havens for criminal purposes. It is important to note that offshore financial centers and financial-secrecy rules have legitimate uses within certain limits. Protection of business information is important for businesses and markets, but the regulatory and other relevant authorities must ensure that secrecy regulations are not abused.

**QUESTION 10.** Can you think of some reasons why legitimate business entities use offshore financial centers? List three below.

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**QUESTION 11.** What are the main characteristics of a perfect financial haven?

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The list of businesses that are vulnerable to money laundering and terrorist financing is growing. Examples of these businesses are:

- Cash-intensive businesses, such as bars and restaurants, are suitable for the placement of drug proceeds and the proceeds of other cash-based criminal activities.
- Trade in high-value items, such as expensive cars, antiques, and real estate provides another suitable vehicle for the laundering of funds.
- Banks and other nonbank financial institutions are particularly vulnerable because of the high volume of money and financial transactions and because they have access to the international financial system.
- Foreign exchange bureaus and remittance offices are also vulnerable because they are cash intensive and have access to the international financial system.
- Accountants, lawyers, notaries, and company formation agents have technical skills that are indispensable to highly sophisticated money laundering operations.

Although terrorist financiers use techniques that resemble those used by money launderers—and they may exploit the same channels of finance—certain businesses and activities are considered to be particularly vulnerable to exploitation by the former. These include nonprofit organizations and informal money transfer systems.

## “” **Module discussion**

In your own country, where do you think money laundering takes place? In your opinion, is there any particular sector that is more vulnerable than others? Why? In the BCCI case, you have seen how banks could be used for money laundering; let's see how other sectors are used to launder illegitimate funds and to secretly pass money to terrorists.

### **Money laundering through securities firms**

Mafia-related Organization O generated substantial amounts of money from various frauds. To launder the proceeds, Organization O executed a plan to feed large sums of money into a stock market. The first step was to deposit the money in a private bank in Country R, controlled by Organization O itself. Subsequently, these funds were used to purchase two publicly listed companies established in Country V; one of the companies was a stock brokerage and the other a small bank. Numerous small investors from abroad using false names purchased the shares of these two firms. None of the investors bought shares above a certain percentage of ownership that would trigger reporting under Country V's laws.

Through a fictitious general shareholders' meeting in which lawyers were involved, a new Board of Directors was appointed with people acting as front men for Organization O. Later on, the two companies applied for share increase and raised approximately US\$42 million. In reality, the proceeds of the market manipulation along with the original funds were laundered by transferring the money from Country V to banks in Europe, from where it was transferred to Company N in Country Y, an offshore financial center. Company N owned marble mines in South Africa. The same money made the same circuit again, passing through banks in Europe and North America and reinvested in the brokerage company and the bank in Country V, thus stimulating foreign investment in the share capital of the two companies. This process of share buying and selling artificially raised the face value of the shares sixfold. The overpriced shares were then delivered to the members of Organization O. None of the operations above could have been possible without securities brokers who were complicit in knowledge and traded these shares.<sup>2</sup>

### **Money laundering through the insurance sector**

Mr. L purchased marine property and casualty insurance for a phantom ocean-going vessel from a reputable insurance company through an intermediary. He paid large premiums on the policy and bribed the intermediaries so that regular claims were made and paid. However, he was very careful to ensure that the claims were less than the premium payments, so that the insurer enjoyed a reasonable profit on the policy. The money launderer requested that the claims be wire-transferred to bank accounts held by a third party. Some of the accounts were held in offshore financial havens. The well-reputed insurance company processed the claims promptly and wire-transferred the funds out of its bank accounts.<sup>3</sup>

### **Money laundering online**

Mr. X is a rogue financier who accumulated substantial wealth by manipulating the securities markets. He placed his ill-gotten gains in an offshore financial center. His problem is that he cannot flaunt his wealth without raising suspicion. To display his wealth, he needs to have a good story to tell. He establishes an online company offering services payable through the Internet. Mr. X then purchases his own services and pays for them using credit and debit cards tied to accounts under his control, which are in the offshore center and contain his criminal proceeds. Mr. X then invoices the credit card company, which in turn forwards the payment for the service rendered. Mr. X can now have the lifestyle he has earned through his cost-efficient and thriving online business.<sup>4</sup>

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<sup>2</sup> Based on *Report on Money Laundering and Terrorist Financing Typologies 2002–2003*, FATF, p. 15.

<sup>3</sup> Source: *Report on Money Laundering Typologies 2003–2004*, FATF, p. 16.

<sup>4</sup> Based on *Report on Money Laundering Typologies 2000–2001*, FATF, p. 4.

### Terrorist financing through charitable institutions

Organization P is a nonprofit organization. It had branch offices in different countries where it had cooperative development projects. Organization P had its headquarters in country X and a branch office in Country Y. Mr. T was in charge of Organization P's branch office in Country Y. He was not on the payroll of Organization P's headquarters. In his capacity as branch manager, he received donations from different people and international bodies to support development projects in remote parts of Country Y. The donors did not know the total amount of money collected. They were also not very effective in monitoring the implementation of the projects partly because of the location of the projects. Mr. T diverted the funds to a terrorist organization for carrying out terrorist activities.<sup>5</sup>

### Terrorist financing through the informal fund transfer system

Mr. H runs a small business with annual total transactions of approximately \$200,000. His private accounts showed total transactions of \$3 million annually. It turned out that Mr. H's business was "headquartered" in Country N for an international "underground bank" with "branches" in several Asian and European countries. Relying on family, ethnic, and business ties, he managed to transfer funds all over South Asia. While his informal money transfer system was used to transfer the remittances of workers in Europe to support family and relatives in Asia, it was also used to transfer funds between terrorist organizations and their operatives in Asia and Europe.<sup>6</sup>

**QUESTION 12.** Considering the case of "Money laundering through securities firms," can you identify the characteristics of the securities market that make it vulnerable to money laundering?

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**QUESTION 13.** In reviewing the case on "Money Laundering through the insurance sector," it is evident that Mr. L has lost money on these transactions voluntarily. What did he achieve?

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<sup>5</sup> Based on *Report on Money Laundering Typologies 2002–2003*, FATE, p. 5.

<sup>6</sup> Hypothetical case stylized from different reported cases relating to the use of the informal money transfer system for money laundering and terrorist financing purposes.

**QUESTION 14.** Why is the insurance sector attractive to money launderers? If you are familiar with the insurance business, provide your personal analysis.

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**QUESTION 15.** Name three characteristics of the Internet that make it a good medium for money laundering operations.

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**QUESTION 16.** Concerning the case “Terrorist financing through charitable institutions,” what was the source of the funds Mr. T used to finance terrorism? How is that different from the source of the funds in the BCCI-Noriega money laundering case discussed in section 1.2?

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**QUESTION 17.** What does an informal money transfer system mean?

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## What have you learned?

We have learned a number of facts about money laundering and terrorist financing that can help us understand their impact on development:

- Money launderers and terrorist financiers take advantage of the financial system, including differences between or among countries' supervision, regulation, disclosure, and AML/CFT requirements. Although we did not go into the details, money launderers and terrorist financiers can also take advantage of designated non-financial businesses and professions (DNFBPs), such as casinos, real estate agents, dealers in precious metals and stones, lawyers, accountants, and trust and company service providers.
- Various methods are used to launder money and finance terrorism.
- Money laundering and terrorist financing allow criminals to defeat the efforts of law enforcement and escape the penal consequences of their acts.
- Money laundering allows criminals to retain the gains of their illegal activities and use it to achieve power and influence.
- Money laundering and terrorist financing enable criminals to finance their enterprises.
- Criminals and terrorists need the assistance and cooperation of otherwise legitimate players, such as bankers and lawyers, to process their funds.

# 2

## The implications of money laundering and terrorist financing for development

In this section, we look at how money laundering and terrorist financing can affect a country's macro economy, rule of law, financial system, economic liberalization, and good governance.

The managing director of the IMF described macroeconomic impact of money laundering in a speech:<sup>7</sup>

"[. . .] While we cannot guarantee the accuracy of our figures—and you have certainly a better evaluation than us—the estimates of the present scale of money laundering transactions are almost beyond imagination—2 to 5 percent of global GDP would probably be a consensus range. This scale poses two sorts of risks: one prudential, the other macroeconomic. Markets and even smaller economies can be corrupted and destabilized. We have seen evidence of this in countries and regions which have harbored large-scale criminal organizations. In the beginning, good and bad monies intermingle, and the country or region appears to prosper, but in the end, Gresham's law operates, and there is a tremendous risk that only the corrupt financiers remain. Lasting damage can clearly be done when the infrastructure that has been built up to guarantee the integrity of the markets is lost. Even in countries that have not reached this point, the available evidence suggests that the impact of money laundering is large enough that it must be taken into account by macroeconomic policy makers. Money subject to laundering behaves in accordance with particular management principles. There is evidence that it is less productive, and therefore that it contributes minimally, to say the least, to optimization of economic growth. Potential macroeconomic consequences of money laundering include, but are not limited to: inexplicable changes in money demand, greater prudential risks to bank soundness, contamination effects on legal financial transactions, and greater volatility of international capital flows and exchange rates due to unanticipated cross-border asset transfers.

Moreover, I should add that while, from the viewpoint of the Fund as a financial institution, I emphasize the economic costs, we must also remember the social and political dimensions of crime and related money laundering—the suffering

<sup>7</sup> Source: *Money Laundering: The Importance of International Countermeasures*, address by Michael Camdessus, managing director of the IMF (Paris, Feb. 10, 1998).

of the victims and the overall weakening of the social fabric and collective ethical standards. All of this lends urgency to anti-laundering efforts, which attack criminal activity at the most vulnerable point—where its proceeds enter the financial system.

But, does this mean that we should abandon the liberalization of the financial markets? This high-minded argument is often raised by those of our critics who believe that the IMF should halt its efforts to move its members away from control-based, toward market-based, financial systems because such systems open up possibilities for money launderers. Some have argued that keeping in place centralized credit allocation and foreign exchange control systems is necessary to identify money launderers—even if we now know that such systems are inimical to economic growth. However, I am reassured that Recommendation 22<sup>8</sup> of the FATF's 40 Recommendations is very clear on this point: "Countries should...monitor the physical cross-border transportation of cash and bearer instruments—without impeding in any way the freedom of capital movements." Information, rather than control of the transactions, is the key to the basic "know your customer" approach of the FATF. More generally, the value of adequate information to guide the supervision of financial markets has been made very clear by recent events in Southeast Asia. It is not just free financial markets that the IMF advocates, but also modern financial markets—in which there is a good measure of transparency and prudential regulation to ensure the fairness, soundness, and legality of the systems [ . . . ]"

## **2.1. How do money laundering and terrorist financing affect the macro economy?**

We have seen how money launderers need to invest in legitimate businesses or assets to launder their funds. They often transfer money across jurisdictions to create layers of financial transactions to obscure the audit trail. Both practices have serious macroeconomic implications.

Money launderers choose their investments, not to obtain the highest rate of return but to avoid detection. The result is that they often put these large amounts of money in less-productive activities, as long as such activities provide opportunities of avoiding detection. This has implications for the efficiency and productivity of both domestic and world economies.

In addition, money launderers move their money in and out of jurisdictions, sometimes rapidly, to obscure the audit trail. The rapid movement of large amounts of money in and out of a country can destabilize small developing economies.

<sup>8</sup> The reference to this Recommendation 22 is based on previous FATF 40 Recommendations of 1996 and differs from the current Recommendation 22 of the FATF 40 Recommendations (revised in 2003). The similar requirements are now addressed in the Special Recommendation IX.

**QUESTION 18.** Country A is an oil-producing country suffering from endemic corruption. Large amounts of government revenues are systematically appropriated and transferred out of the country. Country B is a neighboring country with good financial and communication infrastructure. As an aspiring offshore financial center, it has lax laws on the formation of companies and trusts. It also has a strong commitment to bank secrecy. The corrupt officials of Country A have developed a habit of transporting their funds to Country B and depositing their money in its financial sectors, as well as purchasing real estate. What do you think the impact of this massive injection of funds is on (1) asset prices and (2) exchange rates?

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## **2.2. How do money laundering and terrorist financing affect the rule of law?**

Establishing a legal system based on the rule of law is considered a precondition for economic development. That is because markets need reliable institutions to be able to function. Rule of law presumes that there is a transparent system of clear and certain rules that is applied consistently to all subjects. Money laundering and terrorist financing mechanisms allow criminals to defeat law enforcement and to escape the consequences of their acts. Pervasive money laundering and terrorist financing undermine the rule of law in the society.

## **2.3. How do money laundering and terrorist financing affect the financial system?**

A well-functioning financial system is an important contributor to economic development. The use of the financial system to advance criminal purposes, such as money laundering and terrorist financing, undermines the function and integrity of the financial system. As the BCCI case in section 1.2 illustrated, controlling a bank is an effective way for international organizations to achieve their purposes. The BCCI case also illustrates the costs of allowing criminality to infiltrate financial institutions. Losses to depositors, destabilization of the financial system, and costs to the taxpayers are but the obvious and calculable costs of such activities. The other consequences of money laundering and terrorist financing on financial systems also cannot be ignored. For example, if a bank or another financial institution is closed down by authorities because of a high volume of seized or confiscated deposits of dirty money, or because sanctions are applied against the financial institution due to the commitment of money laundering or terrorist financing criminal offense, this can certainly have an enormous impact on the financial system in a certain country.

Criminals seeking to launder their funds and to finance terrorist activities engage in deliberate acts of corrupting bank officers and other financial market professionals, such as insurance and securities brokers. This corruption undermines the confidence in the financial market and spills over into other forms of criminality, such as fraud and extortion.



### Exercise

Reread the two cases of money laundering in the securities and insurance sectors in section 1.4 and analyze the role played by the securities and insurance officers in the scheme. Were they knowing or unknowing participants?

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Can you give examples from your country of collusion between financial market professionals and criminals?

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#### **2.4. What are the effects of money laundering and terrorist financing on economic liberalization?**

It is now a widely held view that liberalization of a country's economy and its integration into the global economy are important for economic development. Money laundering and terrorist financing undermine liberalization in the following ways:

First, countries that are suffering the outflow of funds or are concerned about the outflow of funds because of pervasive economic crime often try to impose capital controls to fence in funds and prevent them from leaving the jurisdiction. Second, countries concerned about the use of the financial system for money laundering and terrorist financing purposes may take measures to control financial dealings with jurisdictions that do not have adequate money laundering control policies. Third, countries that are viewed as weak in their control of money laundering and terrorist financing would suffer attracting investments whether direct or indirect investments. Fourth, use of trade to launder money (trade-based money laundering) impacts legitimate trades by necessitating authorities to be more vigilant in clearing goods at the customs.

These incidents restrict the liberal flow of funds and pose a regulatory burden on legitimate cross-border economic activity. Although the success of capital controls is debatable, the burden of prudential restrictions could be reduced through the harmonization of anti-money laundering and terrorist financing measures across the world.

### **2.5. What are the effects of money laundering on governance?**

Corruption is a pervasive problem in many developing countries. It is now well established that good governance is a prerequisite for economic development. Government revenues badly needed in these countries for economic development often end up in bank accounts in major financial centers around the world. This could not be achieved without reliance on money laundering techniques and without complacent officers of financial institutions. A well-functioning anti-money laundering system makes it difficult for corrupt officials to expatriate their ill-gotten funds. It also allows such funds to be repatriated in cases where they have been deposited abroad. This is because anti-money laundering measures create channels of information that help to trace the fleeing funds. They also enable cooperation among law enforcement officers in different countries.

**QUESTION 19.** Corruption can take many forms. List the sources of illegal funds that a person who holds a prominent public position may try to launder.

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# 3

## International standards and standard setters

### 3.1. Why is there a need for an international framework to combat money laundering and terrorist financing?

The cases we have discussed so far reveal that money laundering and terrorist financing are often cross-border activities. We also learned that criminals choose the place of their operations after assessing the risk of detection. The lower this risk, the better it is for criminals. This logic applies when laws and regulations or enforcement of those laws and regulations vary among jurisdictions. Achieving a degree of harmony among different jurisdictions has the potential to defeat money launderers and terrorist financiers by making all jurisdictions equally unfriendly to their operations. Adopting international standards is one way to coordinate and harmonize the laws against money laundering and terrorist financing.

**QUESTION 20.** Are you familiar with any other situations where countries must set standards and harmonize their laws and regulations to prevent abusers from taking advantage of countries' differing rules and regulations?

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### 3.2. What are the international standards to fight money laundering and terrorist financing? What organization sets those standards?

In 1989, the G7 summit established the Financial Action Task Force (FATF) to prevent money laundering. Its mandate was “to assess the results of cooperation already undertaken, in order to prevent the utilization of the banking system and financial institutions for the purpose of money laundering, and to consider additional preventive efforts in this field, including the adaptation of the legal and regulatory systems so as to enhance the multilateral judicial assistance.” The FATF began its work in Paris in 1990 and since then has produced the most comprehensive set of anti-money laundering standards; these are known as the FATF Forty Recommendations. As more countries accepted the FATF Recommendations, they became the global minimum standard for an effective anti-money laundering system. In 2001, the FATF introduced an additional set

of Eight Special Recommendations, addressing the special problems of terrorist financing. In 2004, the FATF added the ninth Special Recommendation, on cash couriers. This is why we now refer to the full set of FATF anti-money laundering and terrorist financing recommendations as the FATF 40 + 9 Recommendations.

The detailed analysis of this set of international standards will be set out in the more advanced modules. In this introductory module, you need to become familiar only with the basics of the standards. But before we do that, let's learn a little bit more about the FATF.

### **3.3. What is the FATF, what does it do, and who are its members?**

The FATF is an international task force that functions as an inter-governmental policy-making body with a specific purpose to establish international standards, and develop and promote policies, both at the national and international levels, to combat money laundering and terrorist financing. The FATF reviews its operations on a regular basis. On May 14, 2004, a Ministerial Meeting of FATF members made the decision to extend the FATF's life for another eight years. The last review took place during 2007–08 as a mid-term review of the mandate of the FATF for 2004–12, and the revised mandate was published after the ministerial meeting of FATF members in April 2008 reaffirmed the revised mandate. The FATF has a small secretariat hosted by the Organisation for Economic Co-operation and Development (OECD) in Paris. See Appendix B for the FATF's new mandate.

As of June 2008, the FATF had 34 members, including 32 countries and territories and 2 organizations. The original membership of the FATF was 16 members. In addition, the FATF has two observer countries and five associate members, consisting of five FATF-Style Regional Bodies (FSRBs) that fulfill certain conditions. See Appendix C for more about the FATF's membership.

FSRBs are task forces with regional jurisdiction that are modeled on the FATF in their mandate, functions, and methods of operation. Currently there are eight functioning FSRBs for the Caribbean, Europe, Asia/Pacific, Eastern and Southern Africa, South America, Eurasia, the Middle East and North Africa, and Western Africa.

The FATF has four core functions:

- 1) Setting standards
- 2) Ensuring their implementation in its member countries
- 3) Studying the techniques and typologies of money laundering and terrorist financing
- 4) Conducting outreach activities that aim to spread the standards globally

#### **STANDARD SETTING**

The first product of the FATF was the first edition of the Forty Recommendations in 1990, which provided the first comprehensive international anti-money laundering framework. Throughout its history, the standard-setting function



continued to be very important. The Forty Recommendations were revised twice, first in 1996 and then most comprehensively in 2003. In addition, in 2001 the FATF mandate was expanded to cover terrorist financing and the FATF issued the Eight Special Recommendations dealing with the subject. In 2004, the FATF added the ninth Special Recommendation on cash couriers.

FATF standard-setting activities are not confined just to setting the general standard in the form of broad recommendations. In addition, the group continually issues Interpretative Notes and guidance on best practices, which, in fact, takes the process of harmonization to a deeper level.

The standard-setting role of the FATF received special reinforcement when the Boards of the World Bank and the IMF agreed to recognize the FATF Forty Recommendations as the appropriate standard for combating money laundering and to mandate that the institutions take steps to use the recommendations in the World Bank's and IMF's activities. This gave more impetus to the global reach of the FATF standards.

#### **ENSURING COMPLIANCE**

The FATF not only sets standards to combat money laundering and terrorist financing, but also implements rigorous internal review mechanisms that aim to ensure the compliance of countries with the standards. The FATF uses two types of review mechanism:

- 1) A self-assessment exercise based on a standard questionnaire that was designed by the FATF and used by its members to report on their anti-money laundering systems on an annual basis. The secretariat then uses the answers to compile reports on the level of compliance with the recommendations and on the specific successes and failures in each reporting country's system.
- 2) A mutual evaluation process in which each country is evaluated by a team of experts drawn from other member countries. The team uses a standard questionnaire and is guided by a preset list of issues in assessing the level of the examined country's compliance with FATF standards. The report is then discussed by the plenary and finalized. On the basis of the report, the assessed countries are to take certain measures to rectify shortcomings in their systems.

The FATF has conducted two full rounds of mutual evaluation. The first started in 1992 and was completed in 1995, and the second started in 1996 and was completed in 1999. The first round of evaluation focused on assessing the quality of the legal and regulatory framework by reference to the FATF Recommendations. The second round focused instead on the more difficult question of the effective implementation of anti-money laundering laws and regulations within the country concerned.

Since 1999, the FATF has carried out similar processes of mutual evaluation of new members. With this process completed, in 2004 the FATF launched a new full round of mutual evaluation of its members. In 1999, the FATF launched an

initiative aimed at taking action against certain nonmember countries that had been assessed by the FATF to have deficiencies in their anti-money laundering systems. The initiative resulted in the publishing of a blacklist of countries designated as Non-Cooperative Countries and Territories (NCCTs). Between June 2000 and September 2001, 23 countries were designated as NCCTs and asked to modify their legal systems in accordance with the FATF Recommendations. Following amendments to their legal regimes, all 23 countries were removed from the list by October 2006.

#### STUDYING TECHNIQUES AND TYPOLOGIES

The third main role of the FATF is to provide a forum for sharing information on money laundering techniques and typologies and the best policies and measures to counter them. Through the group of multidisciplinary experts that meet in plenary sessions and in its various working groups, the FATF pools information on the state of the art in money laundering and terrorist financing and counter-measures. As part of this function, the FATF publishes an annual report on money laundering and terrorist financing typologies that draws on the experience of its member countries and member countries of some FSRBs.

#### OUTREACH

Communication and publicity should be sustained and further developed, in particular by reaching out not just to the public and governments, but also to parties affected by the FATF's standards: financial institutions and certain designated non-financial businesses and professions (DNFBPs). For example, the president/secretariat could attend key meetings and forums of the private sector organizations to highlight the FATF's work and receive feedback. Alternatively, there could be more focus on liaison mechanisms with associations or bodies representing such entities, subject to reasonable resource implications.

### 3.4. What do the FATF Recommendations include?

The FATF Recommendations include the minimum measures that countries should have in place within their criminal justice and regulatory systems, the preventive measures that financial institutions and some non-financial businesses and professions should adopt, and the measures for international cooperation.

The Forty Recommendations require countries to implement a basic set of measures:

- *Criminalization*: to criminalize money laundering and terrorist financing. While initially the focus was on drug proceeds, the definition of money laundering offenses has now expanded to include at least all serious offenses.
- *Provisional measures and confiscation*: to put in place measures to identify, trace, freeze, or seize, and, finally, to confiscate the illegal proceeds and funds of terrorists and of those who finance terrorism and terrorist organizations.

- *Customer due diligence*: to impose duties on financial institutions and some non-financial businesses and professions to know their customers and to abolish the use of anonymous accounts. Obligations of additional care when dealing with persons holding a public function and in relation to cross-border correspondent banking also need to be put in place.
- *Record keeping*: to impose obligations on financial institutions and some non-financial businesses and professions to keep records on all the transactions that they conduct.
- *Suspicious transactions reporting*: to impose an obligation on financial institutions and some non-financial businesses and professions to report if they suspect that funds are the proceeds of criminal activity, or are related to terrorist financing, without alerting the clients.
- *Internal controls*: to ensure that financial institutions and some non-financial businesses and professions adopt internal mechanisms that allow them to comply with the regulatory requirements.
- *Implementation*: to create regulatory and supervisory agencies that are capable of implementing the international standard set by the Recommendations and to give them sufficient powers.
- *International cooperation*: to put in place a system that allows it to cooperate with other countries on all issues related to money laundering and financing of terrorism, including formal and informal exchange of financial and law enforcement information, preservation and confiscation of assets, and extradition.

The Nine Special Recommendations require countries to implement a basic set of measures, which—when combined with the FATF Forty Recommendations on money laundering—set out the basic framework for detecting, preventing, and suppressing the financing of terrorism and terrorist acts. They include:

- I. Ratification and implementation of UN instruments related to financing of terrorism
- II. Criminalizing the financing of terrorism and associated money laundering
- III. Freezing and confiscating terrorist assets
- IV. Reporting suspicious transactions related to terrorism
- V. International cooperation relating to the financing of terrorism, terrorist acts, and terrorist organizations
- VI. Requirements for alternative remittance transfers
- VII. Requirements for wire transfers
- VIII. Requirements for nonprofit organizations
- IX. Requirements for cash couriers

**QUESTION 21.** The FATF Recommendations are:

- a) A set of best practices in the area of money laundering and terrorist financing control that countries should aspire to follow.
- b) A set of minimum standards that countries need to achieve to have a sufficiently functioning anti-money laundering and counter-terrorism financing system.
- c) A maximum set of obligations for countries to achieve to have a functioning anti-money laundering and counter-terrorism financing system.

**QUESTION 22.** The FATF Recommendations are developed for all countries, so all countries are expected to implement them.

- a) Yes, all countries need to follow the FATF Recommendations.
- b) No, countries that are not members of the FATF do not need to follow the Recommendations.

### **3.5. Are there any other international bodies involved in fighting money laundering and terrorist financing?**

Four other types of organizations combat money laundering and terrorist financing by setting standards, developing technical understanding, facilitating international cooperation, and implementing the international standard:

- International organizations and bodies with wider mandates that have adopted initiatives in fighting money laundering and terrorist financing. These include the UN, the World Bank, the IMF, and the Basel Committee on Banking Supervision.
- FSRBs, which are task forces with regional jurisdiction that are modeled on the FATF in mandate, functions, and methods of operation.
- Regional organizations with wider mandates that have adopted initiatives against money laundering and terrorist financing. For example, the Organization of American States, the Council of Europe, and the Asian Development Bank (ADB).
- Groups of special players in the fight against money laundering and terrorist financing. For example, the Egmont Group, which is a network of financial intelligence units (FIUs).

Let's now learn a little more about each of the major participants in this global effort.

#### **International organizations**

##### **THE UNITED NATIONS**

The UN Office on Drugs and Crime (UNODC) coordinates the main efforts of the UN with regard to money laundering control and prevention. The UNODC implements the Global Program against Money Laundering (GPML), which is a

research and technical cooperation initiative that aims to increase the effectiveness of international efforts against money laundering. In addition to providing technical assistance to governments in the field, the GPML coordinates the International Money Laundering Information Network (IMoLIN) Web site and the Anti-Money Laundering Information Database (AMLID).

The IMoLIN was the product of a 1996 agreement among the leading international organizations involved in the fight against money laundering. It is a common Web site where information can be shared between national and international anti-money laundering agencies. It serves the global anti-money laundering community by providing information about national money laundering laws and regulations and country contacts for assistance. The information on IMoLIN is freely available to all Internet users, whereas AMLID is a secure database.

Since the events of September 11, 2001, the UN Security Council has assumed an active role in combating terrorism and gives special attention to the issue of combating terrorist financing (CTF). The Security Council issued Resolution 1373 (2001), which requires all UN member countries to take comprehensive measures to suppress terrorism. The resolution placed special emphasis on the area of financing of terrorism and all other forms of direct and indirect assistance. The resolution established the Counter-Terrorism Committee (CTC), which monitors the implementation of the resolution and assesses countries' compliance through a procedure of self-assessment and reporting mechanisms. Resolution 1373 imposes binding obligations on all UN member countries with the aim of combating terrorism in all its forms and manifestations. The resolution requires the member countries to:

- deny all forms of financial support for terrorist groups (operational paragraph [o.p.] 1a, b, c, d);
- suppress the provision of safe haven, sustenance, or support for terrorists; (o.p. 2a, c, d, g, 3f, g);
- share information with other governments on any groups practicing or planning terrorist acts (o.p. 2b, 3a, b, c);
- cooperate with other governments in the investigation, detection, arrest, and prosecution of those involved in such acts (o.p. 2b, f, 3a, b, c);
- criminalize active and passive assistance for terrorism in domestic laws and bring violators of these laws to justice (o.p. 2e); and
- become party as soon as possible to the relevant international conventions and protocols relating to terrorism (o.p. 3d).

Several international instruments that are central to the fight against money laundering and terrorist financing were created under the auspices of the UN. These include:

- The UN Convention against the Illicit Traffic in Narcotic Drugs and Psychotropic Substances (1988). One of the most important contributions of this instrument is that it has provided what has become a globally

accepted definition of the offense of money laundering. The convention also contained detailed provisions on international cooperation.

- The UN Convention against Transnational Organized Crime (2000) is commonly referred to as the Palermo Convention. It is the first binding international instrument that deals with organized crime in a comprehensive manner. The convention has contributed significantly to the codification of anti-money laundering standards of prevention and control.
- The United Nations Convention against Corruption (2003). This convention is an important step in the fight against corruption. As the first comprehensive instrument in this regard, it places particular emphasis on taking profit out of crimes of corruption, a fundamental strategy for control and prevention. For this purpose, the convention deals comprehensively with the question of money laundering and codifies a comprehensive regime of prevention and control through regulation and criminalization. The convention also elaborates on measures to seize, confiscate, and recover the proceeds of corruption.
- The International Convention for the Suppression of the Financing of Terrorism (1999). This was the first international instrument to address the financing of terrorism. The definitions established by the convention provide the basis for the current international standard in this area. According to the Security Council Resolution 1373 and the FATF Special Recommendations, countries are now required to ratify this convention and ensure its effective implementation.

#### **THE WORLD BANK AND THE INTERNATIONAL MONETARY FUND**

In July 2002, the Boards of the World Bank and the IMF made a decision to add the FATF Recommendations to the list of standards and codes that are relevant to the operational work of the Bank and the IMF, and from which Reports on the Observance of Standards and Codes could be prepared. This decision acknowledged the FATF Recommendations as an international standard for money laundering control and prevention and included an assessment of compliance with this standard in financial sector assessment programs that the Bank and the IMF carry out. Since then, the Bank and the IMF have expanded their involvement in anti-money laundering and terrorist financing efforts.

In April 2004 the Boards of the Bank and the IMF made a decision to endorse the continued involvement of the Bank and the IMF in fighting money laundering and terrorist financing, and adopted a more integrated and comprehensive approach to their work in this area. While the Bank and the IMF would continue to assess countries' compliance with the standards, they would commit more resources to supplying technical assistance to help countries bring their systems into compliance with international standards. As part of their technical assistance efforts, the Bank and the IMF organized a Global Policy Dialogue Series that promoted awareness of money laundering and terrorist financing

control and prevention. The Bank and the IMF also provided technical assistance to jurisdictions on a bilateral basis or through regional initiatives.

#### **THE BASEL COMMITTEE ON BANKING SUPERVISION**

The Basel Committee on Banking Supervision was established in 1974 by the central bank governors of the Group of Ten countries. It meets in plenary form four times a year and has a number of technical working groups and task forces that meet regularly.

The committee's members come from Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Spain, Sweden, Switzerland, the United Kingdom, and the United States. Countries are represented by their central bank or by the authority with formal responsibility for the prudential supervision of the banking business where this is not the central bank.

The committee does not produce legally binding norms. Instead, it formulates broad supervisory standards and guidelines and recommends statements of best practice, in the expectation that individual authorities will take steps to implement them through detailed arrangements—statutory or otherwise—which are best suited to their own national systems. The purpose of the committee is to encourage convergence and approximation among countries' supervisory approaches. It does not aim at achieving deep and detailed harmonization of rules.

The Basel Committee produced the first set of international principles for combating money laundering. This occurred in 1988, when the Committee issued its "Statement on the Prevention of Criminal Use of the Banking System for the Purpose of Money Laundering." The statement sets out the basic principles of customer identification, which precludes assistance to criminals and encourages cooperation with law enforcement officers.

In October 2001, the Basel Committee published a detailed guidance paper on customer due diligence, looking at the best practices in this area from a wider prudential perspective as well as from an anti-money laundering perspective.<sup>9</sup> Subsequently in February 2003, *General Guide to Account Opening and Customer Identification*<sup>10</sup> was added to *Customer Due Diligence for Banks*.

#### **THE INTERNATIONAL ASSOCIATION OF INSURANCE SUPERVISORS**

Established in 1994, the International Association of Insurance Supervisors (IAIS) promotes worldwide cooperation among insurance supervisors in setting standards for insurance sector supervision and enhancing coordination between insurance sector supervisors and other financial market supervisors. The IAIS has 180 members.

<sup>9</sup> Basel Committee on Banking Supervision, *Customer Due Diligence for Banks*, October 2001.

<sup>10</sup> Basel Committee on Banking Supervision, *General Guide to Account Opening and Customer Identification*, February 2003.



In October 2003, the IAIS approved and issued the *Insurance Core Principles and Methodology*, which revised the core principles for the supervision of insurers. The Insurance Core Principle 28 requires insurance supervisory authorities to take effective measures to deter, detect, and report money laundering and financing of terrorism consistent with the FATF Recommendations.

In 2004, the IAIS issued *Guidance Paper on Anti-Money Laundering and Combating the Financing of Terrorism for Insurance Supervisors and Insurance Entities*.<sup>11</sup> This document elaborated on the possibilities for, and methods of, money laundering in the insurance sector and the duties of both the supervisors and the supervised entities in fighting money laundering.

### **THE INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS (IOSCO)**

IOSCO is recognized as the international standard setter for securities markets and its wide membership regulates more than 90 percent of the world's securities markets. IOSCO promotes cross-border enforcement and exchange of information among the international community of securities regulators.

IOSCO's objectives and principles of securities regulation include actions that supervisory authorities should take to minimize risk of money laundering in the sector. In 2002, IOSCO established a Task Force on Client Identification and Beneficial Ownership and issued a report in May 2004 entitled "Principles on Client Identification and Beneficial Ownership for the Securities Industry." Subsequently in October 2005, Anti-Money Laundering Guidance For Collective Investment Schemes was issued to clarify application of global standards to the operation of collective investment schemes.

### **FATF-Style Regional Bodies**

#### **THE ASIA/PACIFIC GROUP ON MONEY LAUNDERING**

The Asia/Pacific Group on Money Laundering (APG) was established in 1997. Its regional scope covers South Asia, Southeast Asia, and East Asia and the South Pacific with 38 member jurisdictions as of July 2008. The purpose of the APG is to facilitate the adoption, implementation, and enforcement of internationally accepted standards against money laundering and the financing of terrorism.

The functions of the APG include improving the understanding of money laundering and terrorist financing typologies in the region through systematic analyses of typologies, monitoring the implementation of international standards through processes of self-assessment and mutual evaluation, and providing technical assistance to member jurisdictions.

<sup>11</sup> *Guidance Paper on Anti-Money Laundering and Combating the Financing of Terrorism for Insurance Supervisors and Insurance Entities*, IAIS, October 2004.



#### **THE CARIBBEAN FINANCIAL ACTION TASK FORCE**

The Caribbean Financial Action Task Force (CFATF) is the oldest FSRB. It was established in 1992 by a group of 30 countries of the Caribbean basin to ensure the proper implementation and enforcement of the international AML/CFT standards. Like other FSRBs, one of the core functions of the CFATF is to monitor the implementation of international standards by its member jurisdictions through processes of self-assessment and mutual evaluation. The CFATF also conducts technical analysis of money laundering and terrorist financing typologies in the region and publishes reports. In addition to implementing the FATF Recommendations, the CFATF also implements its own set of 19 recommendations, which are geared to address the peculiarities of the money laundering and terrorist financing phenomenon in the region.

#### **THE COUNCIL OF EUROPE SELECT COMMITTEE OF EXPERTS ON THE EVALUATION OF ANTI-MONEY LAUNDERING MEASURES**

The Council of Europe Select Committee of Experts on the Evaluation of Anti-Money Laundering Measures (MONEYVAL) was established as the PC-R-EV in 1997 by the Committee of Ministers of the Council of Europe, as a subcommittee of the European Committee on Crime Problems of the Council of Europe (CDPC). Its main purpose is to monitor the implementation of anti-money laundering and countering financing of terrorism standards in Council of Europe member countries that are not members of the FATF. In 2002, the PC-R-EV formally changed its name to MONEYVAL. Currently it has 30 members (28 permanent members and 2 temporary members). As do other FSRBs, MONEYVAL conducts mutual evaluations of its members and reviews members' self-assessment exercises. MONEYVAL has concluded two rounds of mutual evaluations and is currently conducting a third round of mutual evaluations.

#### **THE EASTERN AND SOUTHERN AFRICA ANTI-MONEY LAUNDERING GROUP**

The Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG) was established in 1999 as an FSRB for eastern and southern Africa. It comprises 14 countries. It monitors the implementation of AML/CFT international standards in its member countries through self-assessment exercises and mutual evaluation. The ESAAMLG also conducts technical analysis and publishes reports of money laundering and terrorist financing typologies in the region, and provides and facilitates technical assistance to the member countries.

#### **THE SOUTH AMERICAN FINANCIAL ACTION TASK FORCE**

The South American Financial Action Task Force (GAFISUD) was established in December 2000 to monitor the implementation of anti-money laundering standards in its member countries. The GAFISUD currently has 10 members. Similarly to other FSRBs, the GAFISUD monitors the implementation of inter-

national standards through processes of self-assessment and mutual evaluation, undertakes typologies studies, facilitates international cooperation, and provides technical assistance to member jurisdictions.

#### **EURASIAN GROUP ON COMBATING MONEY LAUNDERING AND FINANCING OF TERRORISM**

The Eurasian Group on Combating Money Laundering and Financing of Terrorism (EAG) was established in Moscow in October 2004. It currently has seven members and started its first round of mutual evaluations in 2007. The main goals of the EAG are to facilitate implementation of international standards; carry out joint programs within the FIU sphere of competency; conduct evaluations of the effectiveness of existing AML/CFT mechanisms; coordinate technical assistance cooperation; and analyze trends (typologies) in the AML/CFT sphere and exchange experience in combating these crimes.

#### **MIDDLE EAST AND NORTH AFRICA FINANCIAL ACTION TASK FORCE**

The Middle East and North Africa Financial Action Task Force (MENAFATF) was established at an inaugural ministerial meeting held in Manama, Bahrain, in November 2004. Its headquarters is in the Kingdom of Bahrain and it currently has 17 members. MENAFATF monitors implementation of international standards through self-assessment and mutual evaluation, undertakes typologies studies, facilitates international cooperation, and provides technical assistance to member jurisdictions.

#### **INTERGOVERNMENTAL ACTION GROUP AGAINST MONEY LAUNDERING IN AFRICA**

The Authority of Heads of State and Government of the Economic Community of Western African States (ECOWAS) decided to establish the Intergovernmental Action Group against Money Laundering in Africa (GIABA) in December 1999. GIABA's mandate was revised in January 2006 to fully incorporate and properly reflect the imperative to fight the financing of terrorism.

The objectives of GIABA are to protect the national economies and the financial and banking systems of signatory states against the proceeds of crime and to combat the financing of terrorism; to improve measures and intensify efforts to combat the proceeds from crime; and to strengthen cooperation among its members. GIABA consists of all ECOWAS members and currently has 15 members.

### **Regional organizations**

#### **THE ASIAN DEVELOPMENT BANK**

The Asian Development Bank (ADB) has long been involved in money laundering control and prevention both directly and indirectly. In April 2003, the ADB adopted a policy to refine its role in this area according to three principles: (1) to streamline the ADB's efforts so they fall within the wider context of its goals and objectives; (2) to avoid duplicating the work of other agencies, including

the FATF and the APG; and (3) to consider carefully the needs of the ADB's developing member countries.

The policy has three key elements:

- 1) Assisting developing member countries in the establishment and implementation of effective legal and institutional systems for AML/CFT
- 2) Increasing collaboration with other international organizations and aid agencies
- 3) Strengthening internal controls to safeguard the ADB's funds

The ADB finances technical assistance projects to combat money laundering and terrorist financing. This sometimes takes the form of a standalone project and is introduced as an element in wider financial sector and legal reform projects.

#### **THE INTER-AMERICAN DEVELOPMENT BANK**

The Inter-American Development Bank (IADB) Group is the main source of multilateral financing for economic, social, and institutional development in Latin America and the Caribbean. It also plays a leading role in regional integration. The IADB pays special attention to questions of money laundering and terrorist financing in its client countries. In this regard, it has partnered with the Inter-American Drug Abuse Control Commission (CICAD) to provide technical assistance on money laundering control and prevention. One of the IADB's initiatives involved training bank regulators and bank officers in the detection of money laundering transactions. The IADB also considers money laundering issues when it provides loans to client countries for financial sector reform.

#### **THE INTER-AMERICAN DRUG ABUSE CONTROL COMMISSION**

CICAD is an agency of the Organization of American States (OAS) that

- fosters multilateral cooperation on drug issues in the Americas;
- executes action programs to strengthen the capacity of CICAD member states to prevent and treat drug abuse, combat production and trafficking of illicit drugs, and deny the traffickers their ill-gotten gains; and
- promotes drug-related research, information exchange, specialized training, and technical assistance.

In 1996, through the Summit of the Americas, CICAD was asked to conduct a follow-up to the implementation of the Plan of Action of Buenos Aires, on the control of money laundering. The *CICAD Model Regulations Concerning Laundering Offenses Connected to Illicit Drug Trafficking and Other Serious Offenses* was amended repeatedly to reflect developments in the international standards. Since 1996, because of the mandates received by CICAD, the Group of Experts on money laundering that developed the model regulations in 1996 began to meet on an annual basis, and in some cases biannually. Also in 1999, a series of technical cooperation programs were executed as a product of joint efforts between the IADB and the OAS/CICAD.

The CICAD created an Anti-Money Laundering Unit in 2001 to meet the increased demand for training and technical assistance by the member states of OAS. In 2001, given the clear relationship between the mechanisms to prevent money laundering and that of the financing of terrorism, CICAD expanded its sphere of action to include this area by working closely with the Inter-American Committee against Terrorism (CICTE). The principal functions of the unit consist of organizing meetings for the Group of Experts and executing programs and training seminars, as well as organizing technical assistance and studies and analyses on the different technical aspects of money laundering and the financing of terrorism.

#### **THE INTER-AMERICAN COMMITTEE AGAINST TERRORISM**

In 1998, CICTE was established as part of the OAS, comprising competent national authorities of the member states. The committee renewed its focus after the events of September 11, 2001. On September 21, 2001, the 23rd Meeting of Consultation of Ministers of Foreign Affairs adopted a Resolution Strengthening Cooperation to Prevent, Combat, and Eliminate Terrorism (RC.23/RES.1/01).

In 2002, CICTE established an Executive Secretariat within the OAS General Secretariat. A key milestone in 2002 was the drafting and signing of the OAS Convention against Terrorism. This landmark document was signed by 30 of the Organization's Member States at the OAS General Assembly in Bridgeton, Barbados, on June 3; it was put into effect in July 2003.

#### **THE EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT**

The European Bank for Reconstruction and Development (EBRD) has elaborate internal procedures and practices that focus primarily, but not exclusively, on reducing the prospects of financial institutions and intermediaries that the EBRD finances or channels funds through of being used as vehicles for money laundering. These procedures and practices relate, for example, to due diligence, representations, covenants, and compliance with local laws, as well as best practices and EBRD nomination of directors to local banks.

Also, where EBRD funds are being channeled through offshore jurisdictions, particular care is taken to ensure that there are both sound business reasons for doing so and that the place of incorporation is an acceptable one for the FATF Recommendations. It is a categorical commitment of the EBRD, according to its "Anti-terrorist Statement," that it will not provide financing to entities or individuals that, according to UN Security Council Committees, may be supporting terrorist activities. Moreover, the EBRD will not finance any contracts for the supply of goods, works, or services awarded to such entities and individuals on their projects. The statement also confirms that the EBRD closely follows the work of the FATF.

### THE COUNCIL OF EUROPE

The Council of Europe is a standard setter widely known for its two money laundering– and terrorist financing–related conventions (the Strasbourg Convention and the Warsaw Convention). It also adopted two conventions related to terrorism. In addition, it provides AML/CFT technical assistance to all its members (currently 47 countries).

### THE EUROPEAN UNION

The European Union (EU) adopted three money laundering– and terrorist financing–related directives and several other legally binding documents related to money laundering, corruption, and organized crime.

### THE COMMONWEALTH SECRETARIAT

The heads of government of the Commonwealth established in 1965 the Commonwealth Secretariat as its principal organization. Its purpose is to implement the decisions of the 53 member governments. The Commonwealth Secretariat crafts legal cooperation among its member countries in constitutional law, transnational crime, human rights, trade law, and other emerging areas of law.

In 2000, the Commonwealth Secretariat published *The Model of Best Practice for Combating Money Laundering in the Financial Sector*, which reviewed the existing international legal framework for fighting money laundering. It also addressed issues of particular relevance to some of its members, such as laundering the proceeds of corruption.

In the aftermath of the events of September 11, 2001, the Commonwealth issued a Statement on Terrorism (October 25, 2001) committing members to implementing UN Security Council Resolution 1373, in keeping with the fundamental values of the association, including support for democracy, human rights, the rule of law, freedom of belief, freedom of political opinion, justice, and equality. Within this context, heads of government agreed that any member state that aided, supported, instigated, financed, or harbored terrorists, or permitted such activities within its jurisdiction, violated the fundamental values of the Commonwealth and should have no place in it.

The Commonwealth has set up the Commonwealth Committee on Terrorism, which is charged with developing a Commonwealth plan of action for fighting terrorism. The plan of action concentrates on helping member countries execute the UN Security Council Resolutions, the UN Conventions on Terrorism, and the international standards. The committee also sought to sharpen international cooperation in penal matters between member countries and, in this regard, extend the existing framework of the Commonwealth.

## **EUROPOL**

Europol is a European law enforcement organization that seeks to improve the effectiveness and cooperation of its member states in the fight against terrorism, unlawful drug trafficking, and other serious forms of international organized crime. In the area of money laundering, Europol offers member states' law enforcement authorities significant operational and analytical support by way of its Europol Liaison Officers (ELOs) and analysts. Europol also has a specialized financial group within its serious crime department that supplies member states with adequate support in fighting money laundering at the EU level.

In 2001, Europol opened an Analytic Work File for suspicious transactions. Its main objective is to compile suspicious transactions handled by police or justice authorities of the member states. The next step is to identify potential links among suspicious transactions and to provide specialized law enforcement agencies of the member states with long-term analytical support.

In the fight against terrorism, Europol and the member states have developed an operational strategy, based on previous and different experiences of the member states, for directional guidelines. To date, within the framework of the Europol Terrorism Task Force, Europol and seconded experts from the member states have achieved significant expertise and have exchanged operational information on the financing of terrorism.

## **Other specialized organizations**

### **THE EGMONT GROUP**

The Egmont Group was established in 1995 by a group of financial intelligence units (FIUs), which are governmental agencies set up for the purpose of collecting financial information, analyzing it, and disseminating it to appropriate governmental or law enforcement agencies. The group takes its name from the Egmont Arenberg Palace, where the FIUs first met with the goal of improving international cooperation. Their work is central to the fight against money laundering and terrorist financing. Although every FIU operates differently, most FIUs can exchange information under certain provisions with foreign counterpart FIUs. In addition, many FIUs can assist by providing government administrative data and public record information to their counterparts; this can be very useful to the investigators.

The FIU members of the Egmont Group meet regularly to find new ways to cooperate, especially in the areas of information exchange and in training and the sharing of expertise. There are currently 106 countries with recognized operational FIU units and others in various stages of development. Countries must go through a formal procedure established by the Egmont Group to meet the Egmont definition of an FIU. The Egmont Group as a whole meets once a year, conducting its business through working groups and committees. One of the main goals of the Egmont Group is to create a global network by promoting

international cooperation among FIUs. It also develops principles and standards of best practice for international cooperation and information sharing.

#### **THE WOLFSBERG GROUP**

The Wolfsberg Group currently comprises 11 global banks. Together, they develop financial services industry standards and related products that support know-your-customer (KYC) and AML/CFT policies. The group was organized in 2000 at Chateau Wolfsberg in northeastern Switzerland to work on draft private banking guidelines for combating money laundering. Since then, the Wolfsberg Group issued Wolfsberg Standards that consist of various sets of AML principles and guidelines. This includes those relating to correspondent banking and private banking. In 2004, the Wolfsberg Group focused on the development of a due diligence model for financial institutions, in cooperation with Banker's Almanac, thereby fulfilling one of the recommendations made in the Correspondent Banking Principles.

#### **INTERPOL**

Interpol is the largest international police organization in the world. Organized in 1923 to facilitate cross-border police cooperation, Interpol today has 186 member countries spread over five continents. It supports and assists all organizations, authorities, and services whose mission is to prevent or combat international crime.

The Interpol General Assembly has passed a number of resolutions in recent years that have called on member countries to concentrate their investigative resources on identifying, tracing, and seizing the assets of criminal enterprises. These resolutions have also called on member countries to increase the exchange of information in this field and encouraged governments to adopt laws and regulations that would allow police access to the financial records of criminal organizations and the confiscation of proceeds gained by criminal activity. Interpol has been involved in the fight against terrorism since 1985; a special subdirectorates is dedicated to terrorism. Interpol also advocates the disruption of terrorist financing as essential to controlling and preventing terrorist activities.

**QUESTION 23.** An FSRB is:

- a) A member organization of the FATF
- b) A regional organization that deals with money laundering issues and that has been designed to function and operate on the model of the FATF

**QUESTION 24.** The FATF is the only international body that works in the area of money laundering and terrorist financing control.

- a) True
- b) False



# 4

## Assessing compliance with international standards

### 4.1. Why assess compliance?

Assessing compliance with an international standard is a way to achieve harmonization. A peer-review mechanism ensures that all countries make sufficient efforts to meet the minimum international standard. This is part of the global process of implementing international standards. In this sense, anti-money laundering standards are no different.

### 4.2. Who assesses compliance with international standards?

As you learned in section 3.3 of this module, one main function of the FATF is to ensure compliance with the Recommendations. You have seen that the FATF conducts mutual evaluation of its members.

Each FSRB engages in similar evaluations of its members' compliance with international standards on money laundering and terrorist financing. These evaluations are considered central to the function of each group.

The Boards of the World Bank and the IMF endorsed the use of the FATF Recommendations by adding them to the list of standards and codes relevant to the operational work of the Bank and the IMF, and for which Reports on the Observance of Standards and Codes (ROSCs) could be prepared. This decision was significant in acknowledging the FATF Recommendations as the international standard on money laundering and terrorist financing; it also included a way to assess compliance with this standard in financial sector evaluations carried out by the Bank and the IMF.

### 4.3. Is there a standard method for assessing compliance?

Working together with the FATF and FSRBs, the World Bank and the IMF developed a comprehensive assessment methodology. This methodology is used for all the assessments of compliance with international standards in this area. As mentioned above, these include the FATF, FSRBs, the World Bank, and the IMF. The purpose of developing a comprehensive methodology is to ensure a consistent assessment process. This, in turn, creates greater harmony of rules and practices across national jurisdictions. As we know, this is one of the ultimate objectives of standard setting and is the only guarantee of reducing the advantages criminals find in the varying regulations across international jurisdictions.



The comprehensive methodology addresses in detail all the necessary elements of the AML/CFT standard established in the FATF Recommendations. We are not going into the details of the methodology in this module because the understanding of the AML/CFT systems, which are covered by subsequent modules, is a prerequisite for understanding the assessment methodology. However, if you are interested in the assessment methodology, please visit the FATF website.<sup>12</sup>

### Check your understanding

Now, consider again the pretest that you attempted at the beginning of the module.

#### True or False?

- 1) Only drug dealers launder funds.  
a) True      b) False
- 2) The proceeds of any illegal activity could be subject to laundering.  
a) True      b) False
- 3) Proof of a predicate offense is a prerequisite for a charge of terrorist financing.  
a) True      b) False
- 4) Money laundering takes place only in developing countries.  
a) True      b) False
- 5) Although money laundering may occur through the banking sector, the securities industry is completely immune to money laundering.  
a) True      b) False
- 6) FATF-Style Regional Bodies (FSRBs) are specialized organs of the United Nations dealing with terrorist financing.  
a) True      b) False
- 7) The FATF is the international standard setter for anti-money laundering and terrorist financing measures.  
a) True      b) False
- 8) Money laundering is an engine for economic and social development.  
a) True      b) False

<sup>12</sup> <http://www.fatf-gafi.org/>

- 9) Only the IMF and the World Bank may assess countries' compliance with anti-money laundering international standards.  
a) True      b) False
- 10) *Hawala* systems are informal fund transfer systems.  
a) True      b) False



## Appendix A: References

### FATF Recommendations

- *The Forty Recommendations* (FATF, June 2003)  
<http://www.fatf-gafi.org/dataoecd/7/40/34849567.pdf>
- *Special Recommendations on Terrorist Financing* (FATF, October 2004)  
<http://www.fatf-gafi.org/dataoecd/8/17/34849466.pdf>

### Useful Web sites

- African Development Bank Group  
<http://www.afdb.org/>
- Asian Development Bank (ADB)  
<http://www.adb.org/>
- Asia/Pacific Group on Money Laundering (APG)  
<http://www.apgml.org/>
- Basel Committee on Banking Supervision (BCBS)  
<http://www.bis.org/bcbs/>
- Caribbean Financial Action Task Force (CFATF)  
<http://www.cfatf.org/eng/>
- Commonwealth Secretariat  
<http://www.thecommonwealth.org/>
- Council of Europe Select Committee of Experts on the Evaluation of Anti-Money Laundering Measures (MONEYVAL) [European regional AML body for Eastern Europe and offshore jurisdictions that are not members of the FATF]  
<http://www.coe.int/moneyval/>
- Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG)  
<http://www.esaamlg.org/>
- Egmont Group  
<http://www.egmontgroup.org/>
- European Bank for Reconstruction and Development (EBRD)  
<http://www.ebrd.org/>
- Financial Action Task Force on Money Laundering (FATF)  
[http://www.fatf-gafi.org/pages/0,2966,en\\_32250379\\_32235720\\_1\\_1\\_1\\_1\\_1,00.html](http://www.fatf-gafi.org/pages/0,2966,en_32250379_32235720_1_1_1_1_1,00.html)

- Financial Action Task Force on Money Laundering in South America (GAFISUD)  
<http://www.gafisud.org/home.htm>
- Inter-American Development Bank (IDB)  
<http://www.iadb.org/>
- Inter-American Drug Abuse Control Commission (CICAD)  
<http://www.cicad.oas.org/EN/Default.asp>
- International Association of Insurance Supervisors (IAIS)  
<http://www.iaisweb.org/>
- International Monetary Fund (IMF)  
<http://www.imf.org>
- International Organization of Securities Commissions (IOSCO)  
<http://www.iosco.org>
- United Nations (UN)  
<http://www.un.org/>
- Wolfsberg Group  
<http://www.wolfsberg-principles.com/index.html>
- World Bank  
<http://www.worldbank.org> and <http://www.amlcft.org>

### Reference Documents

- *Report on Money Laundering Typologies 2003–2004* (FATF, February 2004)  
<http://www.fatf-gafi.org/dataoecd/19/11/33624379.pdf>
- *Report on Money Laundering Typologies 2002–2003* (FATF, February 2003)  
<http://www.fatf-gafi.org/dataoecd/29/33/34037958.pdf>
- *Core Principles for Effective Banking Supervision* (Basel Core Principles) (BCBS, September 1997)  
<http://www.bis.org/publ/bcbsc102.pdf>
- *Customer Due Diligence for Banks* (BCBS, October 2001)  
<http://www.bis.org/publ/bcbs85.pdf>
- *General Guide to Account Opening and Customer Identification* (BCBS, February 2003)  
<http://www.bis.org/publ/bcbs85annex.htm>
- *Prevention of Criminal Use of the Banking System for the Purpose of Money-Laundering* (BCBS, December 1988)  
<http://www.bis.org/publ/bcbsc137.pdf>
- *Guidance Paper on Anti-Money Laundering and Combating the Financing of Terrorism* (IAIS, October 2004)  
<http://www.iosco.org/library/pubdocs/pdf/IOSCOPD205.pdf>
- *Insurance Core Principles and Methodology* (IAIS, October 2003)  
[http://www.iaisweb.org/\\_temp/Insurance\\_core\\_principles\\_and\\_methodology.pdf](http://www.iaisweb.org/_temp/Insurance_core_principles_and_methodology.pdf)

- *A Resolution on Money Laundering* (IOSCO, October 1992)  
<http://www.iosco.org/library/resolutions/pdf/IOSCORES5.pdf>
- *Principles on Client Identification and Beneficial Ownership for the Securities Industry* (IOSCO, May 2004)  
<http://www.cnbv.gob.mx/recursos/IOSCO6.pdf>
- *Anti-Money Laundering Guidance For Collective Investment Schemes* (IOSCO, October 2005)  
<http://www.iosco.org/library/pubdocs/pdf/IOSCOPD205.pdf>
- *United Nations Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances: Vienna Convention* (UN, 1988)  
[http://www.unodc.org/pdf/convention\\_1988\\_en.pdf](http://www.unodc.org/pdf/convention_1988_en.pdf)
- *United Nations Convention for the Suppression of the Financing of Terrorism* (UN, 1999)  
<http://untreaty.un.org/English/Terrorism/Conv12.pdf>
- *United Nations Security Council Resolution 1373* (UN, September 2001)  
<http://www.un.org/Docs/scres/2001/sc2001.htm>
- *Financial Havens, Banking Secrecy, and Money Laundering* (UN, May 1998)  
[offers a very good analysis of banking secrecy and offshore financial centers]  
<http://www.imolin.org/imolin/en/finhaeng.html>
- *The BCCI Affair: A Report to the Committee on Foreign Relations United States Senate by Senator John Kerry and Senator Hank Brown* (December 1992) [see Chapter 21, “Capcom: A Case Study of Money Laundering”]  
[http://www.fas.org/irp/congress/1992\\_rpt/bcci/](http://www.fas.org/irp/congress/1992_rpt/bcci/)
- *Corruption in Empirical Research—A Review: Transparency International Working Paper* (Johann Graf Lambsdorff, November 1999) [offers a good review of the causes of corruption and the impact of corruption on various aspects of the economy and it is based on a review of the empirical research on these matters]  
<http://www.transparency.org/>

## Publications

- *Legal Globalization: Money Laundering Law and Other Cases* (Heba Shams, British Inst of Intl & Comparative, April 2004) [For a thematic history of the evolution of AML standards, read chapter 2; to understand the relationship between money laundering control and globalization, read chapter 3.]
- *Money Laundering and the International Financial System* (Vito Tanzi, IMF Working Paper No. 55, May 1996) [It is one of the earliest attempts at economic analysis of the impact of money laundering.]



## Appendix B: The Mandate for the Future of the FATF (FATF Revised Mandate 2008–2012)

### I. Introduction and Background

1. Since its creation in 1989, the Financial Action Task Force (FATF) has worked to ensure that its 40+9 Recommendations are recognized globally as the international standards for anti-money laundering and combating the financing of terrorism (AML/CFT). The work of the FATF, covering more than 170 jurisdictions, has had a significant impact on the global detection and prevention of money laundering and terrorist financing, and is critical to the implementation of more robust AML/CFT regimes around the world.
2. The FATF, since its establishment, has focused its work on three main activities: standard setting, ensuring effective compliance with the standards, and identifying money laundering and terrorist financing threats. These activities will remain at the core of the FATF's work for the remainder of this mandate. Going forward, the FATF will build on this work and respond to new and emerging threats, such as proliferation financing and vulnerabilities in new technologies that could destabilize the international financial system.
3. A mid-term review was conducted in 2007 to ensure that the FATF is equipped to respond flexibly to new challenges. The FATF mandate, revised through this mid-term review process, will expire in December 2012.

### II. FATF Standards

4. The core work of the FATF since its creation has been to combat money laundering (40 Recommendations), and since 2001, terrorist financing (9 Recommendations). The FATF has taken concerted action to combat these threats. The FATF continues to revise and clarify these standards, and will continue to do so when necessary. This approach has so far provided the right balance between giving the required stability to the FATF standards, while allowing for the necessary flexibility to respond to the changing nature of the threats faced. Maintaining this balance between stability and flexibility allows for more predictability, and consistent implementation globally.

### III. Promoting Global Implementation of the Standards

5. Full and effective roll-out of the 40+9 Recommendations in all countries is one of the fundamental goals of the FATF. Members are assessed through the mutual evaluation process, which is an essential and long-standing core activity of the FATF. This peer review process has now been extended through the FATF-Style Regional Body (FSRB) network to more than 170 countries, and is the critical mechanism for promoting timely and effective implementation of FATF Recommendations and for contributing to the creation of a level playing field throughout the membership and beyond. Countries that are not FSRB members will be encouraged to join the relevant regional body. The FATF will complete the third round of mutual evaluations of its membership (using the common assessment methodology) to determine the degree to which all members have implemented the 40+9 Recommendations. Also, the FATF will continue to undertake appropriate follow-up action from mutual evaluations to ensure that members correct, as quickly as possible, any deficiencies that are identified through the mutual evaluation process.
6. All countries, including nonmembers, should implement the FATF Recommendations effectively, to ensure a more effective global system for combating AML/CFT risks. However, many countries, in particular low-capacity countries, face challenges in the implementation of FATF standards. To minimize both their own vulnerabilities and the associated risks for the international financial system, the FATF, in close collaboration with the FSRBs and other international partners, will develop strategies to facilitate the implementation of the FATF Recommendations by countries facing capacity constraints. As a first step the FATF and FSRBs will continue their work to support the effective implementation of the FATF standards in these countries.

### IV. Identifying and Responding to New Threats

#### *(a) High-risk jurisdictions*

7. A key element of the FATF's work will continue to be its action to identify and address risks posed by jurisdictions with significant deficiencies in their AML/CFT regimes to protect the international financial system from criminal threats. Action such as the Non-Cooperative Countries and Territories exercise led to significant improvements in the AML/CFT regimes of more than 20 countries.
8. In 2006, the FATF adopted a new surveillance process—the International Co-operation Review Group—to identify, examine, and engage with vulnerable jurisdictions that are failing to implement effective AML/CFT systems. The FATF will continue to use this process to reach out to those countries and, where appropriate, will take firm action when a country chooses not to engage with the appropriate FSRB or the FATF or to reform its systems.

***(b) Systemic money laundering and terrorist financing threats***

9. The FATF is uniquely placed to analyze and draw international attention to emerging money laundering and terrorist financing vulnerabilities, and has significantly enhanced its process for the identification of money laundering and terrorist financing threats (the typologies process). The generation and dissemination of in-depth typologies studies is central to the work of the FATF and provides a solid foundation for ongoing policy development at the national and international levels. The FATF will continue to produce such studies, which present detailed information about the methods, trends, and techniques of money laundering and terrorist financing, and provide practical input to policy makers and the standard-setting process. In pursuing this work, the FATF will continue its expanded co-operation with the FSRBs and other international bodies, and will also harness the experience and expertise which the private sector can bring to this process.
10. Looking forward, the FATF will intensify its surveillance of systemic criminal and terrorist financing risks to enhance its ability to identify, prioritize, and act on these threats. In this context, and drawing on contributions from the FATF membership, the private sector, and the FSRBs, it will support the development of national threat assessments through best practice guidance and establish stronger and more regular mechanisms for sharing information on risks and vulnerabilities. The results of the enhanced strategic surveillance function will be disseminated publicly via the publication of a regular global threat assessment.
11. The FATF will also examine the available data to measure the impact of AML/CFT regimes on underlying criminal and terrorist activity, encouraging research into the effectiveness of its regime. It will examine the feasibility of implementing cost-benefit analysis across the field of AML/CFT policy.

***(c) Emerging threats***

12. Globalization has created potential new risks as criminals and terrorists seek to penetrate the global financial system. The FATF will remain at the center of international efforts to protect the integrity of the financial system and will respond to the significant new threats emerging which are related to, but may fall outside, its core activities. The FATF will only consider limited expansions of its field of action where it has a particular additional contribution to make.
13. Proliferation financing is an example of an area where the FATF can add value to the wider efforts of the international community and, consistent with the needs identified by the UN Security Council Res-



olutions, the FATF will continue to work on this issue. In doing so, the FATF will ensure that it does not duplicate existing efforts elsewhere.

## **V. Relations with Stakeholders and Partners**

### ***(a) Outreach to the private sector and the public***

14. The private sector is at the front line of the international battle against money laundering, terrorist financing, and other illicit financing threats. The FATF has significantly increased its engagement with the private sector, through events with industry groups and the production of joint analysis on issues of common concern, soliciting private sector input to the typologies process, and through the establishment of a new private sector consultative forum. Looking forward, it will deepen its engagement with the private sector, through holding regular dialogues between the FATF and the private sector in support of our common objective of a more effective implementation of FATF standards.
15. More generally, in accordance with better regulation practice, the FATF will maintain high levels of transparency in its work, through direct communication, outreach, and awareness-raising across all stakeholders, and making use of all available channels of communication.

### ***(b) Relations with other international organizations***

16. The FATF relies on and values its close partnerships with other international organizations, including the United Nations, the International Monetary Fund, the World Bank, and the Financial Stability Forum, in the delivery of its objectives. The FATF has conducted targeted outreach to improve the FATF's knowledge of particular issues and to ensure that the FATF standards do not conflict with the work of other international organizations. In particular, the IMF and the World Bank have made an important contribution to global efforts to combat money laundering and terrorist financing in non-FATF member countries, and the FATF supports this valuable contribution to the global effort. The FATF will continue to work actively with all partners to further FATF objectives and to draw on their knowledge in developing FATF policy.

### ***(c) Relations with Associate Members and FSRBs***

17. The FSRBs, several of which are now associate members of the FATF, play an important leadership role in their respective regions and provide important regional expertise and input into the FATF policy-making function. The FATF and FSRBs will continue to strengthen their working relationships, as well as extending outreach at a regional level with key partners.

## **VI. Operational Issues**

### ***(a) FATF Structure and Organization***

18. The FATF's task force structure has enabled it to respond decisively and promptly to emerging threats and to accommodate efficiently several expansions in its membership. This structure remains broadly the right one for the organization and should be maintained.
19. Over the long term, it will be vital for the FATF to evolve if it is to maintain an effective response to the constantly changing threats facing the international financial system. It will therefore be essential that the structure, organization, and operational planning of the FATF remain flexible and able to adapt to meet new challenges as they arise.

### ***(b) Membership***

20. The FATF has gradually increased its membership, and since 2000 has admitted six new members and has accepted two observer countries that are expected to become members in due course. The FATF will continue to work actively toward the membership of the remaining two countries. The FATF will maintain its open approach and will consider the structure of the global AML/CFT architecture, including the enhanced role played by associate members and FSRBs, and FATF membership, once the current expansion is completed. In this regard, the strategic importance of a country, the geographic balance of FATF membership overall, and a country's commitment to implementing the FATF standards will remain the guiding principles of future membership decisions.
21. The FATF currently has 22 observer organizations/bodies. To make the most effective and efficient use of these relationships the FATF will review its policy on observer status.

### ***(c) Presidency***

22. Each Presidency will continue to be designated by the Plenary for the duration of one year, and will be supported by a Vice-Presidency, which will be the Presidency-designate.

***(d) The Steering Group***

23. The seven-member Steering Group is an advisory body for the President. The composition of the Steering Group will continue to reflect the geography and size of the FATF as well as include the President, the immediate past Presidency, and the Presidency-designate.

***(e) The Secretariat and Budget***

24. The Secretariat will continue to support the work of the FATF, including through the working groups and ad hoc groups to ensure coordination and consistency.
25. The current arrangements for financing FATF activities will be retained. The cost of the Secretariat and other services will be met by the FATF budget, through the OECD, with member contributions in line with OECD scales, and with the option of additional contributions.

**VII. Ministerial Accountability**

26. The FATF is accountable to the Ministers of its membership. To strengthen this accountability, the FATF President will report annually to Ministers on key aspects of FATF work, including on global threats. Given the potentially destabilizing effects of criminal and terrorist action against the international financial architecture, occasional ministerial meetings will provide an ongoing accountability mechanism whereby Ministers can shape the strategic direction of FATF policy making.



## Appendix C: FATF membership

To guard its decision-making capacity, the organization sets certain criteria for the recruitment of new members (Source: *FATF Annual Report 2003–04*, p. 12):

- To be fully committed at the political level to implement the FATF Recommendations and to undergo regular mutual evaluations
- To be a full and active member of the relevant FATF-Style Regional Body (where one exists), or be prepared to work with the FATF or even to take the lead to establish such a body (where none exists)
- To be a strategically important country
- To have already made the laundering of the proceeds of drug trafficking and other serious crimes a criminal offense
- To have already made it mandatory for financial institutions to identify their customers and to report unusual or suspicious transactions

The balance between inclusion of more countries and ensuring the efficiency of the group is a tricky one. This is particularly so considering that the FATF is challenged by the continuous geographic expansion of money laundering and terrorist financing activities. The tightening of controls in FATF member countries was in itself a trigger for this change in money laundering geography. This means that the FATF has long been aware of the need to expand its regime to more countries without expanding its membership.

To achieve that, the FATF resorted to various alternatives:

- Carefully and strategically selecting new members, as we saw previously
- Offering some agencies an observer status
- Paying special attention to achieving geographic balance when recruiting new members
- Conducting worldwide consultation that includes nonmembers on high-priority policy issues, such as the review of the international standard
- Maintaining an ambitious outreach program that promotes its message throughout the world, and as part of that encouraging the establishment of FSRBs



# Answers

## Module 1 Answers

### Answer 1

- 1) The money involved was most likely derived from crime—namely, drug trafficking, given his drug trafficking business.
- 2) Mr. A conducted five transactions using the funds: first, he bought chips/tokens in a casino; second, he converted to check; third, the check was deposited in a securities firm; fourth, the money was withdrawn; and, finally, he invested it in a grocery business.
- 3) At the casino, Mr. A converted his cash into deposits and then withdrew it in checks drawn on the casino's bank accounts.
- 4) Mr. A finally invested his money in a number of legitimate grocery shops.

### Answer 2

Money laundering is the processing of criminal proceeds to disguise their illegal origin.

The internationally accepted definition of this offense is the one provided by the UN Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (Vienna Convention, 1988). According to Article 3 of the convention, money laundering means the following conduct when committed intentionally:

The conversion or transfer of property, knowing that such property is derived from criminal activity or from an act of participation in such activity, for the purpose of concealing or disguising the illicit origin of the property or for assisting any person who is involved in the commission of such activity to evade the legal consequences of his action;

The concealment or disguise of the true nature, source, location, disposition, movement, rights with respect to, or ownership of property, knowing that such property is derived from criminal activity or from an act of participation in such activity;

The acquisition, possession, or use of property, knowing, at the time of receipt, that such property was derived from criminal activity or from an act of participation in such activity. This is not an obligatory element of the definition since it is subject to country's constitutional principles and basic concepts of its legal system.

The Vienna Convention did not in fact use the term *laundering*. The scope of the offense as defined by the convention was limited to funds derived from a drug-trafficking offense. This has now changed. The international standard expands the scope of money laundering at least to funds derived from any “serious crime.” You will learn a lot more about money laundering offenses and the offenses that generate the funds, so-called predicate offenses, in subsequent modules.

### **Answer 3**

Placement: Depositing the money into the casino.

Layering: Withdrawing the money from the casino, depositing the money into the securities firm, and withdrawing it from the firm.

Integration: Investing the money in a chain of grocery shops.

### **Answer 4**

Go to Question 8.

### **Answer 5**

While the source of laundered funds is always criminal, terrorist financing is *sometimes* derived from legal sources. Terrorists also resort to crime to generate funds for their activities, and in these cases their financial activities are very similar to those of launderers. In fact, it is difficult to determine from the financial transactions alone whether they are linked to terrorism or to other types of criminality. Making this determination requires other types of intelligence and investigative work.

### **Answer 6**

Even though terrorists are not in business for the money, and even though they sometimes derive their funds from legitimate sources, terrorists still need to hide the movement of these funds and deliver them to their destination as discreetly as possible. To achieve this objective, terrorists use the same methods as money launderers to handle their funds. Analysis of terrorist financing methods reveals that money launderers and terrorist financiers use front companies, shell companies, nominees and structuring, credit cards, electronic fund transfers, among others. In addition, there is evidence of abuse of informal money transfer systems and nonprofit organizations by terrorist financiers.

### **Answer 7**

They used both legitimate and illegitimate sources of funding. The contraband trade in cigarettes, which exploited the tax differences between jurisdictions, was clearly criminal. The gas station, on the other hand, is a perfectly legitimate business.

They created four layers between the source and the destination of the money:

- (1) money was deposited into bank accounts held by nominees in country A;
- (2) money was transferred to numbered accounts in an offshore jurisdiction;
- (3) money was transferred to accounts held in the names of their nominees in country B; and
- (4) the money was delivered to a terrorist organization.

They used front companies, nominees, offshore jurisdictions with bank secrecy, wire transfers, and numbered accounts.

### **Answer 8**

The correct answer is (c). It is financial support given to terrorists. The source of money may be from both illicit and legitimate sources.

### **Answer 9**

The BCCI-Noriega laundering operation involved five jurisdictions: Panama, Luxembourg, Switzerland, Germany, and the United Kingdom.

It can be observed that, apart from Panama, where the illegitimate activity that generated the funds originated, all the other jurisdictions, where the money laundering took place, are large financial centers of economically developed countries.

### **Answer 10**

Some of the reasons are:

Legitimate companies take advantage of tax concessions generally provided by these centers.

A large number of financial service providers often operate in these centers, which allows business enterprises access to a variety of financial services at a competitive price.

Companies use offshore financial centers to avoid onerous regulations; this allows them flexibility in their business operations.

Firms may use offshore financial centers to protect their business information.



**Answer 11**

Major characteristics:

- Lax financial regulation and supervision
- Provisions for creating/registering corporations within a short time
- Corporate secrecy laws
- Excellent facilities for electronic communications
- Weak law enforcement culture/practice
- Strong bank secrecy laws
- Large tourist trade, which can help maintain major inflows of cash
- Use of major world currency, preferably the U.S. dollar, as the local currency
- A high degree of economic dependence on the financial services sector
- A geographic location that facilitates business travel and communications

Additional characteristics:

- A free-trade zone
- Availability of a flag-of-convenience shipping registry

*Source:* United Nations Office on Drugs and Crime

**Answer 12**

Securities markets are highly international. Many companies are traded on different domestic exchanges, and investment is open to investors from all over the world. This gives the launderers the advantage they seek by using multiple jurisdictions. Organization O exploited this characteristic by simulating foreign investment movements across several jurisdictions.

Brokers' reliance on commissions may tempt them to relax their compliance with regulatory obligations to avoid losing clients to their competitors. The case also provides an obvious example of the risks.

Trading is easy. Customers can open accounts with an investment service provider in person or remotely via the phone or the Internet, thus making customer due diligence more demanding. Organization O used several front men as small foreign investors and bought and sold the shares repeatedly across jurisdictions, exploiting the ease of trading in this market.

**Answer 13**

Mr. L's goal was not to defraud the insurance company but to give his illegal funds a legitimate appearance. By setting up a fictitious marine business and creating fictitious losses and liabilities, Mr. L managed to give his illegal funds a legitimate appearance as claims payments from a reputable insurance company. Mr. L can now move his funds freely in the financial system. Financial institutions are likely to accept payments originating from insurance companies without suspicion.

**Answer 14**

“The experts viewed the insurance sector as potentially vulnerable to money laundering because of the size of the industry, the easy availability and diversity of its products, and the structure of its business. In regard to this last point, it is important to note that insurance is, in some jurisdictions, often a cross-border business and more frequently than not involves the distribution of its products through brokers or other intermediaries who are not necessarily affiliated with, or under the control or supervision of, the company that issues the product. Moreover, because the beneficiary of an insurance product is often different from the policyholder, it is sometimes difficult to determine when and for whom it is necessary to perform consumer due diligence (for the policy holder only or also for the beneficiary?).”

*Source: Report on Money Laundering and Terrorist Financing Typologies, 2003–2004, FATF, para. 59.*

**Answer 15**

The Internet is truly global, and there are still unresolved issues of jurisdiction in its regulation.

Internet communication offers the opportunity for near anonymity, which a money launderer can certainly appreciate.

Because of the lack of uniformity in maintaining online communication records, it is difficult for investigators to follow the path of communication. This is an ideal situation for the money launderer, whose objective is to confound the audit trail.

Online communications occur at a high speed and are unmatched by the investigators’ capacity to gather information. (See *Report on Money Laundering Typologies, 2000–2001*, FATF, pp. 12–14.)

**Answer 16**

Mr. T diverted funds originally derived from legitimate sources. The donors were public bodies with developmental objectives and individuals with an interest in development. In the BCCI case, the money was corruption money. This is one of the fundamental differences between money laundering and terrorist financing. The funds in terrorist financing are sometimes derived from legal sources.

**Answer 17**

“An informal money or value transfer system is one in which money is received for the purpose of making it of an equivalent value payable to a third party in another geographical location, which may or may not be in the same form. Such transfers generally take place outside of the conventional banking system through nonbank financial institutions, or other business entities whose primary business activity may not be the transmission of money.”

Based on: *Report on Money Laundering Typologies, 2002–2003*, FATF, p. 19.

**Answer 18**

“Large inflows or outflows of capital could significantly influence variables, such as the exchange rates and the interest rates, or even the prices of particular assets toward which the money is invested, such as land and houses. In some countries identified with money laundering activities, there have been increases in asset prices (land and houses) that often could not be explained by the changes in the countries’ policies. When the exchange rate is free to fluctuate, the inflow of large amounts of laundered money into a country would lead to its appreciation and/or to an expansion of the country’s monetary base. The appreciation of the exchange rate would reduce the competitiveness of traditional exports and would encourage more imports. The expansion of the monetary base, in the absence of sterilization, would also put some upward pressure on domestic prices.”

*Source:* Vito Tanzi, “Money Laundering and the International Financial System,” IMF Working Paper No. 96, May 1995, p. 8.

**Answer 19**

The sources of the funds that a person who holds a prominent public position may try to launder include not only the proceeds of bribes, illegal kickbacks, and other obvious forms of corruption, but also embezzlement or outright theft of state assets or funds from political parties and unions, as well as tax fraud. In certain cases, a person holding a public position may be directly implicated in other types of illegal activities, such as organized crime or narcotics trafficking.

*See: Report on Money Laundering and Terrorist Financing Typologies, 2003–2004, FATF, p. 18.*

**Answer 20**

Countries, through the work of the Basel Committee on Banking Supervision, try to harmonize prudential regulations to prevent banks from avoiding important prudential regulations by setting their operations in countries with a lower regulatory threshold.

Concern for the environment is prompting sympathetic countries to push for harmonization of environmental standards. The purpose of these efforts is to prevent corporations from moving their production activities to jurisdictions with lax environmental requirements.

Labor rights constitute another area where regulatory variations between countries offer corporations opportunities for forum shopping and put pressure on countries to relax their standards. Harmonization of regulatory standards is one way to limit variations in the regulatory burden that give rise to forum shopping and regulatory competition.

Tax laws offer another contentious example. Corporations constantly exploit differences in tax treatment and set up their operations in the jurisdictions that offer them the least burdensome tax treatment.

**Answer 21**

The answer is (b). Because the legal systems of countries vary substantially, the Recommendations represent the minimum on which countries could agree. Therefore, they do not represent the ultimate set of best practices that countries should aspire to achieve. They also do not represent the exact standard that countries should not exceed. Countries can improve on the content of the Recommendations and adopt measures that go beyond their scope. They are a set of minimum standards that accept the existing variations among countries in their legal systems.

**Answer 22**

The answer is (a). The FATF Recommendations are recognized as the international standard, and therefore all countries, including nonmember countries, are expected to follow and implement them.

**Answer 23**

The answer is (b). FSRB is an FATF-Style Regional Body.

**Answer 24**

The answer is (b). Other organizations and groups play roles in developing and enforcing the international anti-money laundering and terrorist financing regime. There are FSRBs, which work regionally, and global standard setters, such as the Basel Committee and the IOSCO, which set standards on money laundering and terrorist financing relating to their scope of operations. International financial institutions play an active role enforcing and implementing standards. The United Nations has a program dedicated to capacity building in this area. Other groups and organizations are also involved in various capacities and ways. Countries also develop norms to fight money laundering and terrorist financing through a growing web of international treaties.

**Check your understanding****Answer 1. False.**

Initially, concern was focused on the proceeds from drugs. It has since expanded to include the proceeds from all serious offenses. In many countries around the world, predicate offenses for money laundering now include the proceeds from all serious criminal offenses or a list of designated categories of predicate

offenses. For the latter, the FATF Recommendations list 20 designated categories of offenses as a minimum that countries should include. See Module 2 for further detail.

**Answer 2. True.**

Defining the exact scope of money laundering as an offense is essentially a matter for national jurisdictions, and there also are national variations to be discussed in the subsequent modules.

**Answer 3. False.**

A predicate offense is the offense that generates the proceeds that are then laundered. Terrorist financing is distinct from money laundering in that it sometimes involves the use of legally derived funds for terrorism. There isn't always an illegal activity generating funds in the case of terrorist financing.

**Answer 4. False.**

Money laundering takes place wherever it is possible to hide funds.

**Answer 5. False.**

There is evidence of money laundering through the securities sector and often in collusion with securities professionals.

**Answer 6. False.**

FSRBs are regional organizations that address money laundering and terrorist financing issues and have been designed in terms of functions, structures, and operations on the model of the FATF.

**Answer 7. True.**

The FATF is the standard setter for AML/CFT matters and is recognized as such by the Executive Boards of the IMF and the World Bank. Other groups and international organizations, such as Basel Committee and the UN, also engage in setting standards (conventions) or providing guidance.

**Answer 8. False.**

Although some economies seem to have gained some economic advantage by luring fugitive money, the rewards are short term. Worse, the systemic effects of money laundering and terrorist financing detract in the long run from the development objectives of any country.

**Answer 9. False.**

The FATF and FSRBs also assess their members. All assessors use the same methodology to evaluate the level of compliance with the international standard. However, some FSRBs, for example, MONEYVAL, may also include in their evaluation process standards adopted by regional organizations, such as the EU AML/CFT Directives.

**Answer 10. True.**

Although they may be sometimes abused for money laundering and terrorist financing purposes, *hawala* systems are simple informal money transfer systems that perform a number of legitimate functions.



Money laundering and the financing of terrorism are global problems that not only threaten a country's security, but also compromise the stability, transparency, and efficiency of its financial system, consequently undermining its economic prosperity. The annual global estimate for money laundering is more than \$1 trillion, valued in U.S. dollars. Efforts to counter these activities are known as anti-money laundering and combating the financing of terrorism (AML/CFT) programs.

The *Combating Money Laundering and the Financing of Terrorism* training program was developed by the World Bank's Financial Market Integrity Unit, with support from the governments of Sweden, Japan, Denmark, and Canada. The program will help countries build and strengthen their AML/CFT efforts by training all relevant staff in both the public and private sectors, such as staff in financial intelligence units, financial supervisory authorities, law enforcement agencies, and financial institutions.

*The training guide's modules are:*

**Module 1: Effects on Economic Development and International Standards**

**Module 2:** Legal Requirements to Meet International Standards

**Module 3a:** Regulatory and Institutional Requirements for AML/CFT

**Module 3b:** Compliance Requirements for Financial Institutions

**Module 4:** Building an Effective Financial Intelligence Unit

**Module 5:** Domestic (Inter-Agency) and International Cooperation

**Module 6:** Combating the Financing of Terrorism

**Module 7:** Investigating Money Laundering and Terrorist Financing

The modules cover all the Financial Action Task Force on Anti-Money Laundering's Forty Recommendations and Nine Special Recommendations, with the original texts. Each module is targeted at a specific group of professionals in a jurisdiction's AML/CFT regime, although they may also benefit from gaining wider knowledge through the other modules included in this program. Each module provides questions at the beginning and end to assess how much has been learned. The training guide contains numerous case studies, discussions and analyses of hypothetical and actual examples of money laundering schemes, and best practices in investigation and enforcement, which will help readers fully understand the implementation of successful AML/CFT programs.

