



# **Financial Action Task Force Recommendations: Relevance & Application within Public & Private Sector Contexts**

## **Presentation Transcript**

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I'm Emery Kobor, and as you just heard, I'm with the Department of the Treasury. I'm going to be speaking today about the Financial Action Taskforce which has just revised its international standards to combat money laundering and terrorist financing. It's been a long process to revise the standards, and frankly, the fact that we have a new set of standards is really only part of the process, and I'll be talking a little bit about that as we go along this morning, what's still left to come.

I'm mindful of the fact that our real focus this morning isn't necessarily the financial action taskforce but financial inclusion, new payment methods, reaching the unbanked and the under-banked and the role that anti money laundering and counterterrorist financing policy and procedures sometimes can play.

I think often, in the development community, it's perceived that the role that those AMLCFT procedures play is as a barrier to financial inclusion. I'd like to argue this morning – and I hope I can convince you – that, actually, financial integrity – the fight against money laundering and terrorist financing – works in partnership with initiatives to promote financial inclusion. The intention is to enhance transparency and access to the financial system moving people out of cash and a cash based economy into an electronic payments infrastructure in which there is recordkeeping and access for law enforcement and pursuing criminal activity has the effect of diminishing or at least, hopefully, deterring corruption which is a rampant feature of financial systems in developing and developed countries but, also, all matter of criminalities.

So, ideally, getting people into the financial system and away from cash supports their economic growth and development opportunities as well as deterring criminality. I will be talking about how the financial action taskforce helps make that happen.

The FATF was created in 1989. It was a function of the G7 of that time, and the intent was really to try to come up with a united front against the money laundering associated with drug trafficking. That was the scourge of the moment in the '80s, and that mission has expanded. The name is somewhat of a misnomer. It was created as a taskforce with an intent to come up with international standards and then disband.

The thought was it was going to be around for a relatively short period of time, but interestingly, subsequent to establishing the standards, the real value of the FATF turned out to be the peer review process which, by necessity, continues, and I'll be talking a little bit about that as well.

But let me focus, first, on the standards. Initially, there were 40 standards in the '80s that focused exclusively on money laundering and covered everything from the necessary legal framework to financial supervision, international cooperation and obligations on the private sector as well. Then, following 9/11, there was a recognition that some of the tools associated with money laundering also can help foster terrorist financing. And so the FATF was directed by its member countries to develop standards to combat terrorist financing, and at that time, following 9/11, nine special recommendations were developed..... (Inaudible).....

Again, this is an area that seems self evident, particularly if you're a U.N. member country. There is this universal obligation to comply with the U.N. Security Council resolutions. And yet, for many countries, it's become a real challenge to establish targeted financial sanctions regime.

I won't go into great detail, but I will explain that a targeted financial sanctions regime stands outside of the normal criminal justice process, and it requires notice to all national citizens not to do business with certain targeted entities, and there has to be some mechanism to monitor and enforce that capability. That's been a bridge too far for a number of countries, but unfortunately, that weakens our efforts against terrorist financing and our ability to comply with U.N. Security Council resolutions.

The third broad group of FATF standards pertain to what are referred to as preventative measures, and here's where I think the development community tends to focus. This pertains to the obligations on the private sector, the notorious customer identification know your customer expectations. This is where people tend to get their hair on fire. Also, there are requirements that pertain to understanding the nature and purpose of an account when an account at a bank is open, knowing who the beneficial owner of the account is, who owns or controls those funds, recordkeeping obligations and one of the most important elements, if not the most important element of the preventative measures, is filing suspicious activities reports.

The intent is that financial institutions should not be passive. They should not simply be gateways to the national or international financial system without having some checks and balances to determine who's using that capability, what's their purpose, is what we're seeing, in terms of transaction activity commensurate with what we were told to expect from that account. And where's there's a divergence, where you see suspicious activity, there's an obligation to notify the proper authorities of what you're seeing.

That doesn't mean that a financial is now deputized to take on the role of a law enforcement agency. It doesn't mean that suspicious activity means the same thing as illegal activity. It just means that, when Emery Kobor came in and opened this bank account, he told me that he was, you know, just an average

civil servant living on mediocre government salary, and yet, for some reason, he comes in every two weeks and deposits large amounts of cash, often thousands of dollars at a time and seems evasive when we ask him what the source of the cash is. That's suspicious activity, and the FATF framework require that an entity that's referred to as a financial intelligence unit be the recipient of those suspicious activity reports and, often, other reporting and make them available to law enforcement often doing some analysis of their own to see, you know, we get a lot of reports about this Emery Kobor guy and somebody really ought to be investigating this.

Maybe I shouldn't take that example any further I'm starting to make myself nervous. But that's the gist of it. That's the idea behind identifying the customer, maintaining transaction records. There is the upfront deterrent aspect of that. When somebody comes into a bank or other financial institution and knows that they're going to be expected to identify themselves and there may be questions about how do you intend to use this account, that may deter illegal activity knowing that there will be suspicious activity reports filed if the financial institution sees such. That can deter criminal activity.

Ultimately, though, the thing that's counted on in that process is that, after the fact, when there is actually a criminal investigation or a terrorism investigation underway, the law enforcement community knows that they can go to the financial institution, and there are records available there. What were the records that you used to identify the individual's identity? Did you make a copy of the driver's license? Did you record the number of the identity document? We can follow up on that and then see was this legitimate document or was that fraudulent. We can see the transaction records which, ultimately, are going to be very helpful in the investigative process, and, if need be, we can follow the money trail offshore. And that's where the international cooperation element comes in.

The fourth area refers to beneficial ownership. This is increasingly important but always challenging. It's become evident that, whether we're talking about official corruption, drug trafficking or any other aspect of criminality, very often, money laundering involves the misuse of legal entity, a corporate entity that's used to open a commercial bank account and the funds that then flow through the account are explained as the proceeds associated with that commercial activity or funds to purchase some wholesale or retail goods or this sort of thing. So that becomes the cover story.

It often is very difficult to pierce that corporate veil and get beyond the ABC company and the – what turned out to be fraudulent documents associated with its incorporation or at least misleading. They clearly aren't going to be documents that explain that this company was formed to facilitate money laundering associate with this drug cartel. That information is not going to be self evident.

So the challenge that that's enumerated within the FATF recommendations is that, when a legal entity is formed, there should be an obligation to list the beneficial ownership, who owns or controls the entity. When that entity goes to open a commercial bank account for its commercial purposes, the financial institution should collect information identifying the beneficial ownership. That, again, is logical, and the purpose is self evident. Actually being able to identify a beneficial owner, particularly when we're talking about control as opposed to ownership, is a challenge.

But it's always important to keep in mind that the FATF recommendations are stretched goals. Frankly, there's no country in the world, including the United States, that finds it easy to comply with all of these standards. So they are stretched goals.

The fifth area of the standards pertains to the powers of what the FATF refers to as component authorities. These are financial supervisors, the law enforcement community, the financial intelligence unit, even border authorities because there is an obligation to have a reporting declaration in place when somebody enters or leaves the country with more than a certain amount of cash. In the United States, that's \$10,000.00. If you enter or leave the U.S. with more than \$10,000.00 in currency or monetary instruments, there is a legal obligation that you fill in a form simply recording the fact.

There isn't a requirement, in that scenario, to explain where the money came from or what you're doing with it. It's simply a record that that money came in or left the country, and there is a FATF recommendation that pertains to that. And, also, in this area, there is the obligation to collect statistics which often is easier said than done, but if all countries in the world could just incorporate in to their law enforcement communities the resources and the obligation to maintain data on money laundering methods and investigations, it would certainly make the risk assessment process and our ability to prioritize the threats a lot easier.

And the final area is international cooperation which, frankly, was really the impetus for the FATF in the first place, and certainly, as time has gone by, with the collapse of the Soviet Union and the fall of the Berlin Wall, the establishment of trade relationships globally among all nations, money does flow freely as does trade globally. And there is the problem of funds leaving a country where criminal activity has occurred and moving elsewhere, and the law enforcement community attempting to follow that money and looking for information to help them make their case or looking for cooperation in a – among other countries, law enforcement.

But, as I noted earlier, more to the point, is a situation where the – no criminal activity occurs onshore in that foreign country, but the money flows in. And certainly, on its face, when that money flows in, that seems like a good thing to their financial institutions, but there is a need for organization – or countries to sensitize the financial community and the law enforcement community to recognize that there should be an effort to spot and stop that activity and seize those funds.

Part of the collection of recommendations that pertained to international cooperation referred to having agreements and the legal capacity to extradite individuals, to freeze and seize assets and simply to share information as necessary, and this pertains not just to the law enforcement community but also to civil authority, supervisors. Bank supervisors need to be able to count on the cooperation of bank supervisors in other countries. Financial intelligence units need to be able to count on the cooperation of their counterparts in sharing information because, frankly, today, it's almost become a rare thing for any criminal enterprise that goes beyond the neighborhood to be a domestic crime. Almost invariably, all crime has become international necessitating the need for cooperation.

Now, although there are 40 recommendations, there are a group of what are referred to as core and key recommendations, and frankly, those core and key recommendation are the ones that are looked at, in the peer review process, to ultimately make the determination whether a country is going to be identified as a high risk country or as a country that, ultimately, is now cooperative. The core recommendations pertain to criminalizing money laundering and terrorist financing, and the preventative measures that have to do with customer identification and recordkeeping and suspicious activity reporting.

The key recommendations concern having legal authority to having to forfeit illicit assets, implement, targeted financial sanctions, not have secrecy law get in the way of implementing the other FATF recommendations, having adequate financial supervision on FIU, being in compliance with international treaties, providing international cooperation in law enforcement and supervisory arrangements.

That's an overview of the FATF recommendations. Let me also just emphasize, getting back to the original point with respect to financial inclusion, strong emphasis on taking a risk based approach. This gets back to the need to do a risk assessment at the outset. There is a – there has been, over time, an increasing acknowledgment and willingness for countries to apply these recommendations on a risk adjusted basis, and I think, going forward in the peer review process, the real key to that is going to be the ability of countries to be able to demonstrate what is high risk, what is low risk and why they chose to take a somewhat hands off approach in a given circumstance.

I can tell you, in the United States, the language in our regulations pertaining to a bank's obligation to identify and verify a customer is incredibly liberal. I mean really extraordinarily so. I mean so much so that, in the regulation itself, there is guidance as to how to deal with someone who's homeless who comes in to open a bank account and, obviously, has no identification and has no fixed address. And there's an explanation there of it's sufficient to get a description of where that person sleeps at night in lieu of an address. And often, it's sufficient to get somebody who may have official identification from a government source to vouch for the individual with no identification.

So there are all kinds of ways to deal with the customer identification issue. Less flexibility on things like recordkeeping, but I think, even in that context, what we're seeing more and more of, with the advent of new payment methods, is limited purpose accounts with prepaid cards, mobile payment, internet based payment services that, although mimic the functionality of a traditional bank account, may be limited purpose in that there is a cap put on how much money can be held in the account at any one time. There may be a limit as to the daily transaction volume in terms of number of value. There may be a limit or prohibition on moving funds out of the country if the account is purely for domestic services. The potential risk scenario drops way, way down, and obligations, with respect to identification, recordkeeping and so on should drop commensurate with the risks.

So that's where the FATF is going. There was a paper issued last June talking about financial inclusion and providing examples of how a number of countries apply the FATF recommendations on a risk adjusted basis to allow for financial inclusion initiatives. I know South Africa, Mexico and other countries identified programs that they have underway that take a very liberal view of compliance. And, you know, again, that liberal approach is certainly in keeping with the risk based approach of the application.

I think, as we move forward in the peer review process, the real key is going to be how effectively countries can demonstrate the risk associated with those scenarios, those customers, those accounts and how they came upon that assessment. That really is going to be the key.

And let me just sort of conclude the introductory remarks by saying that I said at the outset that we're still in the middle of this revisionary process, and let me explain that just a little bit. The recommendations themselves have been revised. That was done in concert with private sector consultations and participation of countries all over the world, but that's a fairly static list of requirements. As I said at the outset, the real value of the financial action taskforce has been the peer review process, and that process has a separate criteria list associated with it that pertain to each recommendation.

In other words, if you're on the assessment team that's doing the peer review of a country, you end up taking in with you a very detailed list of exactly what to look at, which questions to ask, what's appropriate, what's inappropriate. So that the idea is to minimize potential for subjective judgments. The idea originally, with the FATF, was to try to establish a level playing field, a level of expectations so that no one country's financial institutions would be faced with a higher burden than another country's, just opening the door for illicit flows to flow – you know, crimes to occur in your country and the assets to flow to the LAC (Latin American Countries) . That's what the FATF was trying to combat.

So, in the peer review process, we try to maintain a fairly objective approach to exactly what success, and that's referred to – that checklist is the methodology, the FATF mutual evaluation methodology, and we're in the process of completely revising that now. And that process has only just begun. I'm sure that, when that's finished, there's going to be a lot more blood on the floor than just revising the recommendations.

So that process remains underway, and I think that the more we have events like this where we can discuss the FATF recommendations and how they're interpreted and how they're implemented and where there are still barrier and misunderstandings. That certainly is going to help in revising the methodology and to make that process more understandable.

One of the questions that has not been resolved that I think that is going to be very germane to what we're discussing today is whether the FATF will continue to assess each of the recommendations in every peer review or will only look at a handful that the FATF assessment team determines are relevant for that country or the risk associated with that country.

Another question, that is on everyone's mind, is how we assess effectiveness. One of the things that was somewhat dissatisfying, from the last round of mutual evaluations, that covered all of the member countries and most of the countries of the world, was that we ended up with a very objective analysis of where there were appropriate laws and whether the appropriate laws were being implemented and who had a police department and a supervisory authority and so on and so forth. But at the end of the day, there was some real questions about whether there were countries that were objectively checking the box on – in terms of these criteria but tended to still turn a blind eye to all manner of criminality whether it's internal corruption or money laundering, organizations, terrorist financing, what have you.

So going forward, there's a real interest in trying to improve the assessment of effectiveness. That's still is somewhat elusive, at this point, but hopefully, 18 months from now, we're going to have a methodology that incorporates some measure of effectiveness. That's where we stand today.

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