



**Financial Action Task Force
on Money Laundering**
Groupe d'action financière
sur le blanchiment de capitaux

**ANNUAL REPORT
2002–2003**

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FINANCIAL ACTION TASK FORCE ON MONEY LAUNDERING

ANNUAL REPORT 2002–2003

SUMMARY

1. Germany¹ chaired the fourteenth round (2002-2003) of the Financial Action Task Force (FATF). The major achievement of the round was the recent completion of the review of the Forty Recommendations. The other significant achievements of the round were the admission of South Africa and the Russian Federation as full members of the FATF, the development of guidance to implement the Eight Special Recommendations to counter the financing of terrorism, and increased collaboration with the International Financial Institutions in assessing national systems for anti-money laundering (AML) and countering the financing of terrorism (CFT) at a global level.

2. The major task conducted by the FATF in 2002-2003 was the review of the Forty Recommendations.² In October 2002, a forum with the private sector representatives was organized to discuss the issues raised in the May 2002 Public Consultation Paper. Further consultation with the industry took place at the beginning of April 2003. The revised Forty Recommendations adopted by the FATF on 18 June 2003 introduce a number of substantial changes to strengthen the measures to combat money laundering and terrorist financing. These include:

- the adoption of a stronger standard for money laundering predicate offences;
- the extension of the Customer Due Diligence process for financial institutions; as well as enhanced customer identification measures for higher risk customers and transactions;
- the coverage of designated non-financial businesses and professions (casinos; real estate agents; dealers of precious metals/stones; accountants; lawyers, notaries and independent legal professionals; trust and company service providers);
- the inclusion of key institutional measures in anti-money laundering systems.
- The improvement of transparency of legal persons and arrangements

3. Since October 2001, the FATF Eight Special Recommendations on terrorist financing have been endorsed by many non-FATF members and international organisations and bodies. Given the relative newness of the Special Recommendations, the FATF has developed further interpretation and guidance on how to achieve effective implementation with respect to individual Special Recommendations. The FATF published a best practices paper on preventing the misuse of non-profit organisation by terrorists (Special Recommendation VIII) in October 2002, an interpretative note on Special Recommendation VI to prevent informal transfer systems from being misused by terrorists, and an interpretative note on Special Recommendation VII which focuses on the abuse of wire transfers by terrorist and their financiers, in February 2003. Finally, the June 2003 Plenary meeting agreed to a best practices paper concerning alternative remittance (Special Recommendation VI).

4. The FATF has also pursued its assessment activities to ensure world-wide acceptance and implementation of the Eight Special Recommendations. The FATF has received completed self-assessment questionnaires from 130 jurisdictions, and is now working to produce concrete results from this assessment process in order to determine priorities for technical assistance. In this respect, the FATF will also continue to work in close co-operation with the United Nations Security Council Counter-Terrorism Committee.

5. Another important achievement was the significant reinforcement of the collaboration of the FATF with the International Financial Institutions to assess the AML/CFT systems of countries

¹ The FATF President was Mr. Jochen Sanio, President of the Federal Financial Supervisory Authority of Germany.

² See Annex A.

worldwide. The IMF and World Bank have recognised the Forty and the Eight Special Recommendations as the International standards for combating money laundering and terrorist financing. In October 2002, the IMF, the World Bank and the FATF agreed to a common methodology to assess compliance with the FATF Recommendations. The FATF agreed to use this methodology for the mutual evaluations conducted by the FATF which will take place before the end of 2003.

6. As in previous rounds, a considerable part of the work of the FATF was devoted to monitoring the progress made by the non-cooperative countries and territories (NCCTs). The progress made by this initiative is reflected in more detail in a separate update of the reviews to identify NCCTs,³ carried out in 2000 and 2001.

7. As in previous years, the Task Force continued to monitor members' implementation of the FATF Recommendations on the basis of a self-assessment procedure.⁴

8. The review of current and future money laundering threats has continued to be an essential part of the FATF's work. Chaired by Italy, the annual exercise examined terrorist financing schemes, notably the misuse of non-profit organisations and informal money or value funds transfer systems (such as hawala, hundi, fei-chien and the black market peso exchange). The money laundering vulnerabilities in the securities sector; and the links between the diamond, gold and precious metals trade and money laundering and terrorist financing were also highlighted.

9. In the context of its dialogue with non-member countries, the FATF organized a joint workshop with China on 27-28 March 2003, in Beijing. Finally, the International Association of Insurance Supervisors (IAIS) and the Counter Terrorism Committee (CICTE) of the OAS were granted observer status within the FATF.

³ See *FATF Review to Identify Non-Cooperative Countries or Territories: Increasing the Worldwide Effectiveness of Anti-Money Laundering Measures*, 20 June 2003. This report is available at the following website address: http://www.fatf-gafi.org/NCCT_en.htm.

⁴ See Annex D.

INTRODUCTION

10. The Financial Action Task Force was established by the G-7 Summit in Paris in July 1989 to examine measures to combat money laundering. In 1990, the FATF issued Forty Recommendations to address this problem. The Recommendations were revised for the first time in 1996 and then again in June 2003 so as to take into account changes in money laundering methods, techniques and trends. In October 2001 the FATF expanded its mandate and issued Eight Special Recommendations to deal with the issue of terrorist financing.

11. During FATF-XIV, the membership of the FATF comprised twenty-nine governments⁵ and two regional organisations,⁶ representing major financial centres in all parts of the globe. These members were joined in June 2003 by South Africa and the Russian Federation which had participated in the work of the FATF as observers since October 2002 and February 2003, respectively. The delegations of the Task Force's members are drawn from a wide range of disciplines, including experts from the Ministries of Finance, Justice, Interior and External Affairs, financial regulatory authorities and law enforcement agencies.

12. In July 2002, Germany succeeded Hong Kong, China to the Presidency of the Task Force for its fourteenth round of work. Plenary meetings held in 2002-2003 took place at the headquarters of the OECD in Paris (two), at the French Ministry of Finance, Economy and Industry and in Berlin, Germany. A special experts' meeting was held at the end of 2002 in Rome, Italy, to consider methods, trends and counter-measures related to money laundering and terrorist financing. A number of meetings of specialised Working Groups dealing with the review of the Forty Recommendations and terrorist financing took place outside the regular meetings of the Plenary.

13. The FATF remains fully committed to the work of FATF-style regional bodies (FSRBs), namely the Asia/Pacific Group on Money Laundering (APG), the Caribbean Financial Action Task Force (CFATF), the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG), Moneyval Committee of the Council of Europe and South American Financial Action Task Force (GAFISUD). The FATF President and Secretariat, as well as several FATF members, attended the meetings of such groups. Finally during FATF-XIV, the FATF has continued to co-operate closely with international and regional organisations concerned with combating money laundering, and representatives of such bodies participated in the work of the FATF. Representatives from the African Development Bank, the Asia Development Bank, the Commonwealth Secretariat, the Egmont Group of Financial Intelligence Units, the European Central Bank (ECB), Europol, the International Association of Insurance Supervisors (IAIS), the International Monetary Fund (IMF), the Inter-American Development Bank (IADB), the Inter-American Drug Abuse Control Commission of the Organisation of American States (OAS/CICAD), the Inter-American Committee Against Terrorist of the Organization of American States (OAS/CICTE), Interpol, the International Organisation of Securities Commissions (IOSCO), the Offshore Group of Banking Supervisors (OGBS), the United Nations Office on Drugs and Crime (UNODC), the United Nations Security Council Counter-Terrorism Committee, the World Bank, and the World Customs Organisation (WCO) attended various FATF meetings during the year.

14. Parts I, II, III, IV and V of the report outline the progress made over the past twelve months in the following five areas:

- Reviewing the Forty Recommendations.

⁵ Argentina; Australia; Austria; Belgium; Brazil; Canada; Denmark; Finland; France; Germany; Greece; Hong Kong, China; Iceland; Ireland; Italy; Japan; Luxembourg; Mexico; the Kingdom of the Netherlands; New Zealand; Norway; Portugal; Russian Federation; Singapore; South Africa; Spain; Sweden; Switzerland; Turkey; the United Kingdom and the United States.

⁶ European Commission and Gulf Co-operation Council.

- Countering the financing of terrorism.
- Spreading the anti-money laundering message throughout the world.
- Trends and Techniques in Money Laundering and Terrorist Financing.
- Improving the implementation of the Forty Recommendations.

I. THE REVIEW OF THE FORTY RECOMMENDATIONS

A. THE REVIEW

15. A major initiative during 2002-2003 was the completion of the review of the FATF's Forty Recommendations. The FATF Forty Recommendations were originally drawn up in 1990 as an initiative to combat the misuse of the financial system by persons laundering drug money. From the outset, it was understood that the Recommendations should not be set in stone but should be subject to periodic review to reflect the current money laundering challenges. In 1996, based on the experience gained and reflecting the changes that had occurred in the money laundering problem, the Recommendations were revised for the first time. The 1996 Forty Recommendations have been endorsed by more than 130 countries and territories and are the international anti-money laundering standard.

16. However, money laundering methods and techniques change in response to the counter-measures that are developed to combat this crime. In recent years, the FATF has noted increasingly sophisticated combinations of techniques, such as the increased use of legal persons to disguise the true ownership and control of illegal proceeds, and an increased use of professionals to provide advice and assistance in laundering criminal funds. These factors, combined with the experience gained through the FATF's Non-Cooperative Countries and Territories (NCCT) process, and a number of national and international initiatives, led to the FATF deciding to review and revise the Forty Recommendations.

17. The review process for revising the Forty Recommendations was an extensive one, and was open to FATF members and observers, other countries, the financial and other relevant sectors, and any other interested parties. In May 2002, the FATF issued a public consultation document, which examined the issues, proposed options for dealing with them, and invited all countries, international organisations, the financial sector and other interested parties to express their views. More than 150 written comments were received pursuant to this consultation exercise, and in order to assess these comments and to advance the process of revising the Forty Recommendations, the FATF created a new working group, chaired by Canada. This group, which was open to FATF members and observers, and members of regional bodies, met almost every month to develop and refine the issues into a new set of Recommendations.

18. In order to follow up on the written comments received, in October 2002 the FATF held a forum with representatives of national and international associations from the financial and other sectors from all parts of the globe. This included delegates from the banking, securities and insurance industries, as well as representatives from the legal and accounting professions. More than 160 participants attended the meeting, and it provided an opportunity for a frank exchange of views on the proposals set out in the consultation paper, and for input that would be of benefit to the FATF working group.

19. As the process developed, and the text of the new Recommendations was developed, further informal consultation with industry took place in April 2003, which provided the sectors most directly affected with the chance to put forward final proposals on the Recommendations. Many of these proposals have been incorporated into the text of the Recommendations that was finally agreed. The substance of the new Forty Recommendations was discussed and agreed at a Special FATF Plenary meeting held in Paris on 7-9 May 2003, and the revised Forty Recommendations were formally agreed at the June 2003 Plenary in Berlin.

B. A COMPREHENSIVE FATF FRAMEWORK FOR COMBATING MONEY LAUNDERING AND TERRORIST FINANCING

20. The revised Forty Recommendations, when combined with the Eight Special Recommendations on Terrorist Financing, now provide a comprehensive and consistent framework of measures for anti-money laundering and combating terrorist financing (AML/CFT). They cover all aspects of a national system, including the criminal justice elements; the preventive measures to be taken by financial institutions and certain other businesses and professions; the institutional framework and transparency of legal persons; and international co-operation. The revised Forty Recommendations now apply not only to money laundering but also to terrorist financing, and when combined with the Eight Special Recommendations, they provide a set of enhanced measures that will help countries to prevent terrorism.

21. The revision of the Recommendations is a significant one, and there are many important additions or changes, which will help to strengthen national AML/CFT systems. The most important changes are as follows:

- The money laundering offence (Recommendation 1) – countries must make all serious offences predicate offences to the crime of money laundering. At a minimum, each country should include as predicate offences a range of offences within each of the 20 designated categories of offences. If the country determines the predicate offences by reference to a threshold linked to the term of imprisonment for the underlying offences, then certain alternative minimum thresholds are set out. Foreign predicate offences should be as wide as the domestic predicates.
- Customer due diligence (CDD)(Recommendation 5) – the new Recommendation and its Interpretative Note sets out the fundamental measures that financial institutions must take to identify and verify the identity of customers and beneficial owners, and to conduct ongoing due diligence. These requirements set firmer and more detailed standards, but also provide the necessary degree of flexibility, and are in line with current industry practice. In addition to the fundamental obligations, the Recommendation also deals with other issues such as the timing of verification, the measures to be taken with respect to existing customers and for legal persons or arrangements, and when simplified CDD measures may be appropriate.
- Politically exposed persons and correspondent banking (Recommendations 6 & 7) – the FATF identified these two areas as requiring additional due diligence measures, due to the risks of money laundering or terrorist financing. The extra steps will help to ensure that financial institutions have the necessary information and the systems required to deal with the enhanced risks.
- Reliance on third parties and introduced business (Recommendation 9) – some countries allow their financial institutions to rely on persons other than employees and agents to perform some of the required CDD measures on customers. The FATF recognises that this is a common commercial practice, and permits countries to allow their institutions to rely on third parties provided that the conditions laid out in the Recommendation are met. The ultimate responsibility remains with the FI relying on the third party.
- Suspicious transaction reporting (Recommendation 13) – since 1996, the FATF has required mandatory suspicious transaction reporting (STR), and the changes that have been made are intended to clarify several aspects of this requirement. These include: (i) the requirement applies to both proceeds of a criminal activity and to funds related to terrorist financing (see also SR IV); (ii) “proceeds of a criminal activity” means at a minimum proceeds from the

predicate offences required under Recommendation 1, but the FATF strongly encourages countries to bring the reporting obligation at least into line with the predicate offences for their money laundering offence; (iii) there must be a direct legal requirement to report (an “indirect reporting obligation” based on the risk of being prosecuted for money laundering is not sufficient); and (iv) attempted suspicious transactions must be reported.

- Designated non-financial businesses and professions (Recommendations 12 & 16) – as noted above, for a number of years the FATF has observed a displacement effect, whereby money launderers seek to use businesses or professions outside the financial sector, due to the preventive measures being put in place in the financial sector. After examining the available data, it was agreed that the following businesses and professions should be covered by the Forty Recommendations: Casinos; Real estate agents; Dealers in precious metals and Dealers in precious stones; Lawyers, notaries, other independent legal professionals and accountants; and Trust and Company Service Providers.
- Recommendation 12 provides that the customer due diligence and record keeping measure also apply to these businesses and professions, though this obligation is limited to situations where they prepare for or carry out the types of transactions referred to in the Recommendation. Under Recommendation 16 there is an obligation to report suspicious transactions, but again, for certain businesses and professions this is limited to situations where they prepare for or carry out transactions for a customer. In addition, the Recommendation exempts certain professionals from reporting where legal professional privilege or professional secrecy applies.
- Shell banks (Recommendation 18) – countries should not allow the establishment of shell banks nor allow their financial institutions to have correspondent relations with such banks. A shell bank is a bank incorporated in a jurisdiction in which it has no physical presence and which is unaffiliated with a regulated financial group.
- Regulation and supervision (Recommendations 23-25) – all countries need adequate measures to ensure that financial institutions and other businesses and professions are complying with their obligations. The required measures take into account the risks and the regulatory structures that already exist in the relevant sectors. The required measures are: (i) financial institutions and casinos should not be owned or managed by criminals; (ii) the measures applicable to banks, insurance and securities firms for prudential purposes also apply when combating money laundering; (iii) bureaux de change and money remittance businesses must at a minimum be licensed or registered, and monitored for compliance; (iv) other financial institutions should be regulated and subject to supervision or oversight having regard to the risk of money laundering or terrorist financing; (v) casinos must be licensed and supervised; and (vi) on a risk sensitive basis, other businesses and professions must have effective systems for monitoring and ensuring compliance, which could either be by a government authority or by a self-regulatory organisation. In addition, competent authorities must establish guidelines and provide feedback.
- Institutional measures (Recommendations 26-32) – these Recommendations require countries to establish a financial intelligence unit (FIU), which will receive STR; to designate law enforcement agencies for AML/CFT investigations; and for financial supervisors to have a role in AML/CFT. These authorities should have appropriate duties and powers, the necessary resources, and effective mechanisms to co-operate and co-ordinate. To ensure that systems are effective and that this can be reviewed, comprehensive AML/CFT statistics must be kept e.g. the number of STR received.
- Transparency of legal persons and arrangements (Recommendations 33 & 34) – the FATF has consistently found that the lack of transparency concerning the ownership and control of legal persons (e.g. companies) and legal arrangements (e.g. trusts) is a problem for money

laundering investigations. The measures required under commercial or other laws regarding the obtaining or access to such information vary widely from country to country. These Recommendations therefore set out the key objective of ensuring that adequate, accurate and timely information on the beneficial ownership and control of legal persons and arrangements is obtainable or accessible. In particular, countries must be able to show that companies issuing bearer shares cannot be misused for money laundering.

- International co-operation (Recommendations 35-40) – several of the Recommendations in the international co-operation section have been developed and refined, with Recommendation 36 on mutual legal assistance being expanded to cover several concepts that are in the 25 NCCT Criteria. The most significant addition is Recommendation 40, which deals with international co-operation other than mutual legal assistance and extradition e.g. co-operation between administrative and law enforcement authorities concerned with combating money laundering and terrorist financing, including FIUs. This prescribes the need for the widest possible co-operation, and for clear and effective gateways.
- Risk based approach (several references) – an important concept that is mentioned in a number of Recommendations and Interpretative Notes (particularly Recommendation 5) is that, within the limits set out, countries and institutions may determine the extent of the measures that have to be taken by reference to the risk of money laundering or terrorist financing for that customer, type of transaction or product. For example, see paragraphs 10 & 12 of the Interpretative Note to Recommendation 5.

II. COUNTERING THE FINANCING OF TERRORISM

22. Following the events of 11th September 2001 in the United States, FATF expanded its mandate to include the combating of terrorist financing. Since June 2002, the FATF has begun developing a process to identify weaknesses in the world-wide efforts to combat terrorist financing. This process will include the development of guidance on implementing the Eight Special Recommendations and the identification of jurisdictions with inadequate measures to combat the financing of terrorism. A working group, co-chaired by Spain and the United States, has been mandated to carry out these tasks.

A. GUIDANCE ON IMPLEMENTING THE EIGHT SPECIAL RECOMMENDATIONS

23. To reinforce efforts to implement the Eight Special Recommendations (SRs) on terrorist financing, the FATF issued guidance on three SRs during 2002-2003⁷. The FATF decided first of all to develop guidance for SR VIII (Non-Profit Organisations) focusing on how best to protect charitable fundraising from being misused as a cover for terrorist financing. It adopted a best practices paper for SR VIII in October 2002, which among other things suggests certain strategies for non-profit organisations, including verification of programme activities and ensuring financial transparency. Given the complexity of issues relating to SR VIII, the FATF continues to examine ways of implementing this SR and will likely provide additional guidance on this subject in the future.

24. The FATF issued an Interpretative Note [and a Best Practices Paper] for SR VI (Alternative Remittance) in February 2003. This was followed by a Best Practices Paper issued in June 2003. These two documents further clarify the need for all money/value transfer systems to be registered or licensed, along with having their services subject to the full range of obligations under relevant FATF Recommendations. This guidance addresses a very important element in preventing the financing of terrorism – increasing the transparency of payment flows through all forms of money/value transfer systems, including those traditionally operating outside the conventional financial system.

⁷ The guidance issued in 2002/2003 is at Annex B.

25. Also in February 2003, the FATF adopted an Interpretative Note to SR VII (Wire Transfers). It gives specific guidance on how to ensure that basic information on the originator of wire transfers travels with and is immediately available to appropriate law enforcement supervisory authorities or prosecutorial authorities, financial intelligence units and beneficiary financial institutions. As part of the preparation of this guidance, the FATF held a public consultation period during which concerned parts of the private financial sector were able to comment on the proposed interpretative note. Jurisdictions have until February 2005 to fully implement SR VII in recognition of the fact that they will need time to make relevant legislative or regulatory changes and to allow financial institutions to make necessary adaptations of their systems and procedures. Additionally, after one year the FATF will review whether de minimis thresholds should remain an option in implementing SR VII.

B. THE SELF-ASSESSMENT OF FATF MEMBERS VIS-À-VIS THE EIGHT SPECIAL RECOMMENDATIONS

26. Following the adoption of the Eight Special Recommendations on terrorist financing, the FATF began assessing the level of implementation by FATF members of the Special Recommendations through a self-assessment exercise. The assessment was carried out by means of a questionnaire containing a series of questions on each of the SRs. As with the self-assessment process used for determining compliance with the Forty Recommendations, the questions were designed to elicit details that help to establish whether the jurisdiction has in fact implemented a particular Special Recommendation. The questionnaire takes into account and cross references the guidance issued by the UN Security Council Committee established for monitoring the implementation of UN Security Council Resolution 1373 (2001) of 28 September 2001 [S/RES/1373(2001)]. Results of this first self-assessment process were published in last year's annual report.

27. During 2002-2003, FATF Members have continued their efforts to implement the Eight Special Recommendations, and these changes have been reflected in the updated information continued in this year's annual report. Over three-quarters of FATF members are now fully compliant with SR II (Criminalising the financing of terrorism and associated money laundering), SR III (Freezing and confiscating terrorist assets) and SR V (International co-operation). The experience gained by individual members in dealing with implementation of SRs VI, VII and VIII helped in shaping the guidance issued on these recommendations this year, and further progress is expected as Members develop measures using the interpretative notes and best practices.

28. FATF members have made considerable strides in moving toward full implementation of SR I (Ratification and implementation of UN instruments). Last year, only four members had ratified the UN Convention on the Suppression of Terrorist Financing (1999); however, this year twenty-one members have ratified the Convention. The overall compliance level for SR I remains low however, because many FATF jurisdictions have yet to implement fully the various UN Security Council Resolutions. With regard to assessing compliance levels for SR VIII, FATF members continue to consider the best way to accomplish this task taken into account the best practices paper issued by FATF on this subject in October 2002. The FATF is likely to continue examining appropriate assessment criteria in the context of development of further guidance on this recommendation.

C. WORLD-WIDE COMPLIANCE WITH THE EIGHT SPECIAL RECOMMENDATIONS, AND INTERNATIONAL CO-OPERATION

World-wide self-assessment exercise

29. As indicated above, the FATF began a self-assessment process for implementation of the Eight Special Recommendations by its own members in December 2001. In February 2002, the FATF initiated a similar process for non-FATF members. By October 2002, some 100 non-FATF members

had provided responses on self-assessment. This material from non-FATF members was analysed by the FATF using the same procedure as employed for analysing the self-assessment questionnaires for FATF members, and – for jurisdictions belonging to FATF-style regional bodies (FSRBs) – the results were shared with the relevant FSRB. At the beginning of 2003, the FATF President wrote to jurisdictions which had not returned a completed self-assessment questionnaire to encourage them to participate in the exercise.

30. The level of implementation of the Eight Special Recommendations varies widely among non-FATF members as reflected by the self-assessment questionnaires submitted so far. While a number of jurisdictions appear to have had similar results to those of FATF members, many others seem to be at the very beginning of the process. Indeed, quite a few jurisdictions face the double challenge of establishing effective anti-money laundering programmes at the same time as attempting to put measures into place for countering terrorist financing. For these reasons, the FATF began during 2002-2003 using the self-assessment questionnaires from non-FATF members to help donors prioritise their offers of technical assistance related to the implementation of the Eight Special Recommendations. The work in this area is being carried out in close collaboration with the United Nations Security Council Counter Terrorism Committee (UN CTC), the International Monetary Fund, the World Bank, other relevant international organisations, and the FSRBs.

31. To date, just over one hundred non-FATF members have provided responses for the FATF self-assessment initiative on terrorist financing. When taken together with the questionnaires submitted by FATF Members, the world-wide response includes almost two-thirds of all countries and territories. The FATF is encouraged by the level of participation. Nevertheless, it still calls on all jurisdictions that have not participated in the exercise to complete the self-assessment questionnaire and forward it to the FATF Secretariat. For those jurisdictions that have already submitted questionnaires, the FATF encourages them to continue to provide updates as their implementation of the Eight Special Recommendations improves.

Co-operation with other international organisations

32. The mobilisation against terrorist financing for FATF and non-FATF members alike is closely related to the co-operation between the FATF and the international community. During 2002-2003, the FATF has continued to emphasise the need for co-operation with the FATF-style regional bodies and international organisations and bodies, such as the United Nations, the Egmont Group of Financial Intelligence Units, G-20 Finance Ministers and Central Bank Governors' Deputies, and the international financial institutions, which play an ever increasing role in the international effort against money laundering and terrorist financing.

33. In December 2002, the FATF President addressed the UN CTC in New York, and the FATF Secretariat briefed the G-20 Finance Ministers and Central Bank Governors' Deputies meeting in March 2003 on the FATF's initiatives to combat the financing of terrorism. The FATF Secretariat also participated in a regional workshop to counter the financing of terrorism held in Singapore in January 2003 and in the UN CTC meeting with representatives of all relevant international and regional organisations and bodies which took place in New York on 6 March 2003. Representatives of the UN CTC also continue to update the FATF on its work during FATF Plenary meetings.

III. SPREADING THE ANTI-MONEY LAUNDERING MESSAGE THROUGHOUT THE WORLD

34. As the primary objective of its current mandate, the FATF is committed to promoting anti-money laundering initiatives in all continents and regions of the globe and to building a world-wide anti-money laundering network. This strategy consists of three main components: enlarging the FATF

membership, developing credible and effective FATF-style regional bodies, and increasing co-operation with the relevant international organisations.

35. The FATF continued its collaboration with these relevant international organisations/bodies, and participated in several anti-money laundering events organised by other bodies. International anti-money laundering efforts are discussed at FATF Plenary meetings, which are attended by all the relevant organisations and bodies. During 2002-2003, co-operation with the international organisations was marked by the development of a common methodology to assess compliance with anti-money laundering/counter terrorist financing standards. This methodology is based on the FATF Recommendations, the Basel Committee, IOSCO and IAIS principles.

36. In addition, FATF has continued its important and ongoing work on non-cooperative countries and territories (NCCTs) in the fight against money laundering by monitoring the continued progress made by NCCTs, and by recommending that FATF members apply counter-measures to those NCCTs which had not made adequate progress.

A. FATF EXPANSION

(i) General

37. According to the objectives agreed upon in the review of the FATF's future (carried out in 1998), the FATF has decided to expand its membership to include a limited number of strategically important countries⁸ which could play a major role in their regions in the process of combating money laundering.

38. The criteria for admission are as follows:

- to be fully committed at the political level: (i) to implement the 1996 Recommendations within a reasonable timeframe (three years), and (ii) to undergo annual self-assessment exercises and two rounds of 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 offence; and
- to have already made it mandatory for financial institutions to identify their customers and to report unusual or suspicious transactions.

(ii) First mutual evaluations of observer countries

39. Following their written commitment of 2002 made at Ministerial level to endorse the Forty Recommendations, to undergo mutual evaluations and to play an active role in their region, South Africa and the Russian Federation were subject to a first mutual evaluation of their AML/CFT anti-money laundering systems in 2003. The principal objective of these evaluations was to determine whether these countries complied with certain fundamental anti-money laundering requirements, the implementation of which is a pre-condition to becoming a full member of the FATF. The required money laundering counter-measures are: to make the laundering of the proceeds of drug trafficking

⁸ Irrespective of their level of economic development.

and other serious crimes a criminal offence; and to require financial institutions to identify their customers and to report suspicious transactions. Summaries of the first mutual evaluation reports of South Africa and the Russian Federation follow.

South Africa

40. South Africa has developed a comprehensive legal structure to combat money laundering. Money laundering was first criminalised for drug trafficking in 1992, and the scope of the offence was then broadened in 1996. Currently, the main statutes are the Prevention of Organised Crime Act 1998 (POCA) and the Financial Intelligence Centre Act 2001 (FICA). Although certain financial sector obligations existed under previous legislation, the FICA creates a broad and more organised framework of anti-money laundering measures.

41. In South Africa, the main sources of criminal proceeds are generated by organised crime groups which engage in narcotics and abalone smuggling, vehicle theft, arms and human trafficking, and mineral and precious stone trafficking. The use of “419” fraud schemes remains a threat, as well as other types of fraud using counterfeit cheques, credit cards, and pyramid schemes. Violent crimes such as robbery and hijacking are also concerns. The levels of serious crime have stabilised over the past several years. But officials indicate that drug trafficking has been increasing at a high rate.

42. Criminals use various means to launder their proceeds in South Africa. These means include the purchase of properties and goods, the establishment of companies and trusts for laundering the proceeds of crime, the misuse of businesses, the use of casinos, and using the informal, cash-based sector. The money laundering investigations that have occurred involved predicate offences of fraud, theft, corruption, racketeering, and gambling.

43. South Africa is a regional financial centre with a modern financial system and banking infrastructure. There are 50 registered banks operating in South Africa. Twenty-seven banks are locally- controlled and have 8,455 South African branches and 246 branches abroad. Seven banks are foreign-controlled and have 27 branches in South Africa. In addition, there are two mutual banks, and foreign-registered banks have 14 registered branches in South Africa. South Africa has an exchange control regime. Currency exchange business can only be conducted by Authorised Dealers in Foreign Exchange, which are appointed by the Minister of Finance and regulated by the Exchange Control Depart (EXCON) of the South Africa Reserve Bank. There are currently 38 Authorised Dealers, the majority of which are banks.

44. South Africa has 73 regulated long-term insurance companies, 97 short-term non-life insurance companies, 15,000 licensed financial advisors and intermediaries that include approximately 350 investment managers. There are various collective investment schemes run by 29 local managers, and approximately 15,000 pension funds run by 450 approved administrators. There are 29 casinos currently operating.

45. Under the POCA 1998, predicate crimes for money laundering now apply to all underlying “unlawful activity” both within and outside of South Africa. This covers not only all criminal offences, but also other activity that contravenes South African law. The offence applies to “own funds” laundering, acts committed intentionally (actual knowledge) or negligently (“ought reasonably to have known”). This is also defined to include belief that a fact is reasonably possible. Criminal liability also extends to legal entities, and there are severe sanctions for committing an offence. While the offence is broadly worded, it is a matter of concern that there have been only two money laundering convictions since 1996. Although this may be partly due to the fact that some law enforcement agencies are new, it also appears that existing agencies and prosecutors have generally focused only on investigating and prosecuting the predicate offences, and South Africa should make efforts to increase the number of money laundering prosecutions that are brought.

46. The financing of terrorism, terrorist acts, or terrorist organisations is not yet a criminal offence, and thus not a predicate offence for money laundering in South Africa. A draft bill that will address many aspects of the fight against terrorism and terrorist financing has been presented to Parliament and is presently being considered by a Parliamentary Committee.

47. The POCA contains comprehensive measures to freeze and confiscate the proceeds and instrumentalities of crime, including both criminal confiscation and civil forfeiture. South Africa has also applied increased resources to this area, and these measures have been quite successful, with a steady annual increase in the property that has been frozen and confiscated. Despite the otherwise comprehensive nature of these provisions, South Africa cannot currently seize property used to finance terrorism and has only limited ability to freeze funds in financial institutions, and therefore cannot fully implement the relevant FATF Recommendations and UN Security Council Resolutions.

48. South Africa has a number of agencies that investigate and prosecute cases involving money laundering. The National Prosecuting Authority (NPA) provides a national framework for prosecutions. Within the NPA, the Directorate of Special Operations (DSO), also known as “the Scorpions,” investigates and prosecutes a range of more serious cases. The NPA’s Asset Forfeiture Unit (AFU) supports the police and other law enforcement structures in all aspects of forfeiture. The South African Police Service (SAPS) investigates criminal activity generally, and has allocated the responsibility for investigating money laundering to specific units. The South Africa Revenue Service (SARS), which includes the Customs Service, is responsible for revenue collection and the investigation of tax evasion and evasion of customs duties, and works closely with law enforcement agencies on money laundering matters.

49. Investigators have adequate legal means to obtain bank records and other information and evidence regarding alleged offences. Investigators also have sufficient legal tools for a wide range of investigative techniques, including controlled delivery, undercover operations, and wiretaps.

50. The FICA established the Financial Intelligence Centre (FIC) to receive, analyse, and disseminate suspicious transaction reports (STRs). The FIC became operational and began receiving STRs on 3 February 2003. In a short period of time, the FIC has made significant strides towards becoming an operational FIU and appears adequately structured, funded, staffed, and provided with the necessary resources and powers to fully perform its authorised functions. The legal provisions allow for co-operation with domestic authorities and foreign counterparts and appear comprehensive, but have not yet been fully put into practice. It is too early to assess the effectiveness of the FIC, but early results appear promising.

51. South Africa has broad powers to provide a wide range of mutual legal assistance (MLA) and extradition related to money laundering matters, and can provide MLA even where there is no dual criminality. Thus, it can exchange information relating to terrorist financing investigations, but cannot provide other types of assistance such as asset seizure or extradition for terrorist financing. South Africa has acceded to the 1988 Vienna Convention, has ratified the 1999 UN Convention on the Suppression of Terrorist Financing, and is working to ratify the 2000 Palermo Convention. It has also entered into many bilateral treaties and agreements, either for MLA or at a law enforcement level.

52. South Africa has had an obligation to report suspicious transactions since 1996, and under the POCA 1998 this required all businesses that suspected that property was the proceeds of an unlawful activity to make a report to the South African Police Service. Under section 29 of FICA, which came into effect on 3 February 2003, all businesses are required to report to the FIC cases where they suspect that property is the proceeds of an unlawful activity and also any transactions that have no apparent business or lawful purpose, are intended to avoid reporting duties under the Act, are relevant to tax evasion, or are otherwise related to money laundering. The reporting obligation is therefore very broad. Similarly, the legal provisions concerning protection from proceedings, and no “tipping-off” are comprehensive. The FIC and other supervisory bodies still need to issue guidelines to assist in the identification of suspicious activities, and propose doing so once they have gathered further STR

data. This should be done as expeditiously as possible. South Africa must also act swiftly to pass measures in relation to terrorist financing, including extending the STR obligation to this serious crime.

53. While the legal provisions are far-reaching, the results to date have been more variable. It is encouraging that the number of STRs filed with SAPS increased steadily from 140 (1997) to 1891 (2002), with a significant majority coming from banks. This increase continued in 2003 with the establishment of FIC, when banks and money remitters also filed more than 900 STRs between 3 February and 1 April 2003. However, prior to this, the number of STR from securities and investment firms, and from casinos, was very low, and efforts will need to be made to encourage all relevant industries to actively focus on identifying suspicious transactions. It is also concerning that since 1997 a total of 4523 STRs generated only 41 criminal investigations, which led to five convictions. It is hoped that the creation of the FIC and the new co-ordination mechanisms being established between law enforcement agencies will result in improved use of STR data.

54. The FICA also creates a range of anti-money laundering obligations for “accountable institutions,” which include banks, securities and investment firms, insurance companies, bureaux de change, money remitters, casinos, dealers in travellers’ cheques and money orders, as well as lawyers and accountants. These obligations include customer identification, record-keeping requirements, and internal controls, and through the implementing Regulations. They become effective on 30 June 2003.

55. The FICA requires that the identity of a client, the identity of the person acting on behalf of the client, and the person on whose behalf the client is acting be established and verified. While this requirement in the Act is generally satisfactory, there is no general duty to identify the beneficial owner. In fact, the Regulations appear to limit the scope of the law in relation to legal entities by only requiring the identification of persons who own at least 25% or more of the shares of a legal entity. In addition, if shares in a company are owned by another company, there is no obligation to identify the owners of that second company. The Regulations also contain a large number of exemptions from the customer identification and record keeping requirements, some of which seem to unduly limit the effectiveness of the law. The net result is that South Africa’s ability to identify the true owner of property is undermined, and the Regulations under FICA should be amended in this respect.

56. The laws and regulations relating to record-keeping are generally satisfactory. Exchange control regulations require comprehensive originator information to be recorded for funds transfers, and this information can be made available upon inquiry. There is currently no requirement for this information to remain with the transfer form; however, a new circular to be issued by EXCON will require this. Other anti-money laundering measures that are required include policies or guidance concerning jurisdictions that do not adequately apply the FATF Recommendations and in relation to foreign branches that operate in such jurisdictions. The laws and regulations concerning the maintenance of high standards of integrity and the necessary internal controls by financial institutions are satisfactory in most respects, and the key issue is to ensure that anti-money laundering requirements are being properly implemented by institutions.

57. The main supervisory bodies are the South African Reserve Bank (SARB) and the Financial Services Board (FSB). SARB supervises banks, money remittance and currency exchange business, while FSB supervises all other financial institutions. As obligations under FICA extend beyond the financial sector, it also lists a number of other supervisory bodies that are obliged to supervise their respective institutions for compliance with the Act. SARB and FSB have also played a limited anti-money laundering role prior to FICA, but have not yet completed on-site visits to check for compliance with anti-money laundering obligations. SARB, FSB and other supervisory bodies will need to play a more active role once FICA is fully in effect.

58. In addition, although FICA creates criminal penalties for non-compliance, the supervisors may only currently inspect for compliance in accordance with their existing legislation; the ability to use enforcement powers for anti-money laundering requirements is unclear. Amendments to enabling

legislation should be made to provide supervisors with clearly defined functions for combating money laundering and terrorist financing, and to allow them to inspect and sanction for non-compliance with FICA's provisions.

59. South Africa has the basic measures in place to effectively combat money laundering, and the FIU and other supervisory and investigative bodies appear adequately staffed and genuinely committed to implementing the new system. However, many of these measures are new and have not yet been fully put into effect, and all sectors will need to continue to increase attention and training on anti-money laundering issues. Moreover, although the overall framework should be effective in the longer term, the results achieved to date are limited, and all government agencies will need to co-ordinate their efforts to ensure that the new legislative and regulatory regime that is being put into place is effectively implemented. Most importantly, South Africa also needs to expeditiously develop a comprehensive framework to combat the financing of terrorism.

60. South Africa fully complies with Recommendation 4, as the money laundering offence is sufficiently broad. South Africa is largely compliant with Recommendation 10, and materially non-compliant with Recommendation 11. Customer identification and record keeping provisions do not become fully effective until 30 June 2003. In addition, certain exemptions may diminish the law's effectiveness, and there is no specific requirement for identification of the beneficial owner. As suspicious transaction reporting provisions are comprehensive, South Africa is fully compliant with Recommendation 15. Taking into account the entire system for combating money laundering, South Africa was admitted as a member of FATF.

The Russian Federation

61. In January 1997, the Russian Federation enacted Article 174 of the Criminal Code which purportedly criminalised money laundering. The true intention of the penal provision was to focus on financial transactions related to tax and capital flight. Amendments were made to the Criminal Code in August 2001, which resulted in Article 174 in its current form and Article 174.1. When these two provisions came into force on 1 February 2002, they together effectively criminalised money laundering. All offences in the Criminal Code (except those relating to tax and capital flight) are predicate offences for money laundering. The penalties for committing money laundering offences under either Article 174 or 174.1 are more severe if committed by an organised group, by a group of persons by prior agreement, or by a person in an official position. There are, however, some weaknesses in the law. For instance, money laundering is an offence under Articles 174 or 174.1 only if the transaction exceeds "2,000 times the minimum wage rate"—an amount roughly equivalent to RUB 600,000. This approach may allow criminal organisations to circumvent the law by compartmentalising laundering activities into smaller operations. The Russian Federation needs to address this weakness by removing the threshold to the money laundering offence. The language regarding entrepreneurial and economic crimes remains confusing and should be amended. As well, until recently, investigators and prosecutors generally pursued cases involving the predicate offence rather than money laundering because the predicate offence often carries harsher penalties. The Russian Federation not yet started addressing drug money laundering. To date, since the passage of Federal Law 115-FZ, there has been only one money laundering conviction based on materials from the FMC of Russia. Thus, it is impossible to judge the overall effectiveness of the entire anti-money laundering system at this time. The largest criminal problems in Russia are corruption, organised and financial crime. Domestic drug consumption and related crime are becoming a major problem. All of these involve money laundering. The critical test of the effectiveness of the anti-money laundering regime in Russia will be the successful investigation and prosecution of significant money laundering cases involving high-level official corruption and organised crime.

62. Terrorist financing is a criminal offence pursuant to Article 205.1 of the Criminal Code. Persons who provide a timely warning or otherwise assist in preventing a terrorist act are released from criminal responsibility provided that those circumstances can be proven by the investigative authorities under the supervision of the prosecutor and provided that those actions do not constitute

another crime. An official prosecuting a case or conducting an inquest will be punishable by imprisonment for 2 to 7 years should he/she illegally release from criminal liability a person suspected of or prosecuted for committing a crime.

63. The Russian Federation has ratified the 1988 United Nations Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (the Vienna Convention) and a number of other key international instruments relating to combating money laundering and terrorist financing. However, although the United Nations Convention Against Transnational Organised Crime was signed in 2000, it has not yet been ratified. The funds or assets of terrorists or terrorist financiers can be frozen without delay and this information subsequently submitted to the UN Security Council in accordance with the United Nations resolutions.

64. The cornerstone of the Russian Federation's anti-money laundering (AML)/counter-terrorist financing (CFT) measures is Federal Law No. 115-FZ "On Combating Legalisation (Laundering) of Criminally Gained Income and Financing of Terrorism" (Federal Law 115-FZ) which became effective on 1 February 2002 and was amended in October 2002 (amendments came into force from the beginning of January 2003) to include terrorist financing. Federal Law 115-FZ is comprehensive in that it places AML/CFT obligations (including reporting obligations) on all entities performing operations with monetary funds or other assets in the territory of the Russian Federation. This includes credit institutions, insurance companies, professional participants in the securities markets, leasing companies, pawnshops, post offices (who perform money remittance services), gambling services (such as totalizators, bookmakers, lotteries and prize funds), buyers and sellers of precious metals and stones, entities managing investment funds and entities managing non-government pension funds (collectively referred to as reporting organisations). Reporting organisations that fail to comply with the recording, record-keeping or reporting obligations of the AML/CFT laws or their own internal control rules and their executives are subject to fines from 500 to 5,000 minimum wages or 100 to 200 minimum monthly wages respectively pursuant to Article 15.27 of the Code of Administrative Offences. In certain circumstances, a non-compliant reporting organisation may have its license revoked. There are also criminal penalties for violating certain parts of the anti-money laundering law.

65. The Russian Federation's financial intelligence unit, the Financial Monitoring Committee of the Russian Federation (FMC of Russia), became operational on 1 February 2002 pursuant to Federal Law 115-FZ and Presidential Decree No. 1263 dated 1 November 2001 and, most importantly, Ordinance No. 211 of the Government of the Russian Federation dated 2 April 2002. Since becoming a member of the Egmont Group in June 2002, the FMC of Russia has signed co-operation agreements with foreign competent authorities in the sphere of combating money laundering. The FMC is independent but reports to the Ministry of Finance of the Russian Federation. The FMC headquarters is located in Moscow where it co-ordinates and oversees the activities of its seven regional offices located across the Russian Federation. The FMC Regional Offices do not operate independently; their operation and activities are centralised and controlled by the FMC headquarters. The FMC has responsibility for coordinating all of Russia's AML/CFT efforts and facilitating the sharing of information amongst all relevant organisations. It is also responsible for overseeing a number of entities that have AML/CFT obligations, but have no other supervisory body in their sphere of activity—leasing companies, pawnshops and gambling services.

66. Other supervisory bodies responsible for ensuring that the reporting organisations under their authority comply with AML/CFT laws are the Central Bank of the Russian Federation (Bank of Russia) (supervising credit institutions), the Insurance Supervision Department of the Ministry of Finance of the Russian Federation (ISD of the MF of Russia) (supervising insurance companies and entities managing non-government pension and investment funds), the Russian State Assay Office of the Ministry of Finance of the Russian Federation (AO of Russia) (supervising entities buying and selling precious metals or stones), the Ministry of Communications and Information of the Russian Federation (MCI of Russia) (supervising post offices) and the Federal Securities Market Commission (FSMC of Russia) (supervising professional participants in the securities sector).

67. Article 7 requires reporting organisations to report suspicious transactions to the FMC of Russia. Examples of suspicious transactions are defined in the law as complex or unusual transactions, or unusual patterns of transactions having no apparent economic or visible lawful purpose, or structured transactions (smurfing).

68. Additionally, Article 6 requires reporting organisations to report to the FMC about any transaction valued at RUB 600,000 and involving one or more of the characteristics listed in Article 6. These characteristics include: where cash is deposited/withdrawn from a legal entity's account in circumstances not consistent with the character of its economic activity, cash foreign currency is purchased/sold, securities are acquired for cash, a bearer cheque issued by a non-resident is cashed, notes of one denomination are exchanged for notes of another denomination, or cash funds are contributed to the authorised capital of a legal entity. Reporting organisations must also report to the FMC about any transaction involving a natural or legal person known to be involved in terrorist activities. This includes natural or legal persons determined by a foreign court to have been involved in terrorist activities, provided that the foreign court's ruling is recognised in the international agreements of the Russian Federation and its federal laws. A key concern is that credit institutions are over-reporting and/or there are too many categories listed in Article 6 of the Federal Law 115-FZ. Consideration should be given to carrying out additional educational and supervisory measures to ensure full implementation of the letter and spirit of the law.

69. While the physical cross-border transportation of foreign currency by non-resident natural persons was previously restricted, Russian legislation now provides that both resident and non-resident natural persons can export foreign currency under the same conditions. Currency in amounts exceeding USD 10,000 may be exported upon presentation of a customs declaration confirming the previous importation of the funds. For amounts below USD 10,000 but above USD 3,000, a written customs declaration must be submitted without additional documentation. For amounts equal to or below USD 3,000, no customs declaration is necessary. Written customs declarations must also be presented when removing precious metals or stones from Russia. The information collected by the customs authority through these measures is available on request to the FMC of Russia according to Article 9 of the Federal Law 115-FZ.

70. Since becoming operational, the FMC of Russia has received over a half million suspicious transaction reports. The Russian Federation has established a working system for filing suspicious transaction reports (STRs), analysing them and disseminating relevant information to law enforcement agencies. As well, the FMC's authority to obtain information for federal and local government agencies allows law enforcement access to a wide range of information that was previously inaccessible. Although the reporting system has resulted in a few criminal cases being investigated and one prosecuted, more must be done. Russian authorities state that a number of cases will soon be ready for prosecution within the next few months. From 1 February 2002 to 27 March 2003 the FMC of Russia received 145 international requests from FIUs and responded to 76 of these.

71. The Russian Federation has customer identification procedures in place that begin to address the more general requirements of the FATF 40 Recommendations. Federal Law 115-FZ and various regulations emanating from the competent authorities responsible for supervising reporting organisations require all reporting organisations to perform customer identification procedures on both natural and legal persons. For legal persons, information must be collected concerning the composition of founders (participants), the management structure and its powers, the size of registered and paid up base capital or of the initial fund and cost of property. The opening of correspondent accounts is also subject to identification procedures. A credit institution can refuse to open an account or perform a transaction if a natural or legal person fails to submit adequate customer identification or other information; however, credit institutions do not now have the authority to close accounts if there is a suspicion of ML/TF. The FATF has recommended that legislation be passed to give them this authority.

72. Despite the fact that these general measures largely comply with the FATF identification requirements, there are a number of significant shortcomings. Most significantly, the requirement to identify beneficial owners refers only to the notion of control of the funds without specifically relating to the notions of the source of funds or their beneficial ownership. This only partially addresses the identification of beneficial owners. The Russian Federation will need to address this shortcoming with more specific requirements relating to determination of beneficial ownership.

73. The opening of anonymous accounts has been prohibited since the Federal Law 115-FZ came into effect. Prior to that, anonymous accounts were not expressly prohibited; however, according to Russian authorities, they did not exist in practice in any event. After the adoption of the Federal Law 115-FZ only one bank in the Russian Federation provided for numbered accounts. Although client identification and documentation were performed when the accounts were opened, the FATF had previously identified numbered accounts as a weakness of the Russian system. Russian law prohibits the unilateral closing of bank accounts and changing the terms of the accounts to non-numbered accounts is a complex matter. Nevertheless, the Russian Federation has assured the FATF in the past that the contracts governing the terms of these accounts would be amended by February 2003. A small number of numbered accounts still exist, but transactions cannot be carried out unless the customer is fully identified.

74. There are a number of issues of concern relating to client identification in the Russian Federation. First, the legislation relating to client identification is very recent. Second, a “culture” of conducting client identification is still in the developing stages. Third, specific issues relating to client identification, beneficial ownership and enhanced due diligence are addressed in only a general way. For instance, there are no specific identification requirements for introducers (other than the procedure foreseen for accepting correspondent banks), for non-face-to-face relations or for trusts.

75. The law requires reporting organisations to keep records of documents confirming customer identity, account files and business correspondence for at least 5 years, even if the account or business relationship is terminated. Furthermore, all reporting organisations must make transaction records and information available to domestic competent authorities for AML/CFT investigations and prosecutions. Banking confidentiality does not pose an obstacle to the effectiveness of this system because Russian law expressly states that access to the reports and documents relating to ML/FT by authorised authorities is not a violation of banking secrecy.

76. Reporting organisations have an obligation to develop and implement internal control rules and appoint a compliance officer to ensure that they are followed. Internal control rules must establish procedures for ongoing account monitoring accounts, identifying suspicious transactions and transactions subject to obligatory control, collecting detailed customer and transaction information and reporting to the FMC of Russia as appropriate. Training and internal audit procedures should continue to be enhanced.

77. Persons with prior convictions for economic crimes or recent administrative offences in the finance, tax or securities market area are disqualified from being top executives or accountants of banks. Similar factors disqualify someone from being a controller or member of the management or professional staff of a professional participant of the securities market. However, the law does not address convictions for other serious crimes—particularly common money laundering predicate offences such as drug trafficking. Likewise, the Bank of Russia is not empowered to require a change in the composition of founders (participants) with a view to ensuring that such credit institutions are not in the control of criminals or their associates. .

78. The Bank of Russia recently audited the AML/CFT policies of all Russian banks, thereby positively fostering the introduction of AML/CFT law in the banking sector. Although most credit institutions perform their obligations as required by the AML/CFT law, approximately 9% of credit institutions and 11.7% credit institution branches were found to be non-compliant with one or more requirements of the AML/CFT regulations. Typical breaches involved inadequate record keeping,

failure to follow the client identification requirements as set out in the internal control rules, making mistakes when forming and submitting reports in electronic form to the Bank of Russia, or incorrectly classifying transactions as being not subject to obligatory control. As well, a number of credit institutions had adopted a “formal” approach when developing their internal control system, that reduces the effectiveness of AML/CFT measures and poses a danger that the credit institution will not confirm the source of funds as required by the Bank of Russia Directive 137-T.

79. The effectiveness of the Russian Federation’s AML/CFT system is likely to be severely limited by the inability of the Bank of Russia to issue binding regulations for credit institutions especially in all supervisory areas relating to ML/FT. In practice, this means that the only Bank of Russia regulations that are binding are those that correspond precisely to the federal law on money laundering and related matters. This makes it virtually impossible to adopt effective regulations enhancing and adequately specifying certain key requirements such as those relating to client identification. With respect to credit institutions, the Bank of Russia must be given statutory authority to issue binding regulations, particularly concerning key issues such as client identification and enhanced due diligence. An additional weakness is that the Bank of Russia is limited in its ability to intervene immediately if it has reason to believe that an audit or inspection relating to AML/CFT issues must be engaged without delay. The law must be amended to allow the Bank of Russia to conduct at any time audits or inspections of any period of activity of a credit institution relating to the implementation of AML/CFT laws and policy. Other supervisory bodies should be given similar powers.

80. Russian legislation provides for a variety of investigative techniques such as search, seizure and compelling the production of documents as well as the identification, freezing, seizing and confiscation of funds/assets.

81. As well, where sufficient grounds exist to suppose that property was obtained as the result of a crime, the investigator or public prosecutor can apply to the court to have the property frozen or seized. Law enforcement agencies have powers to identify and trace property that is, or may become, subject to confiscation or is suspected of being the proceeds of crime or used for terrorism financing. In accordance with its international agreements, the Russian Federation recognises rulings of foreign courts relating to the confiscation of proceeds from crime within its territory and can fully or partially transfer confiscated proceeds of crime to the foreign state whose court issued the confiscation order. As well, confiscation of funds and assets is an additional penalty for both money laundering and terrorist financing offences.

82. Russia has made significant progress since the enactment of the legislative framework for its anti-money laundering regime. Although the Russian system has some weaknesses that must be addressed, a solid foundation is in place. Moreover, all authorities involved in implementing and overseeing the AML/CFT system seem firmly committed to making it work effectively. The progress made so far is due to the political will and leadership of senior government officials, especially of the exemplary work of the FMC and the Bank of Russia.

83. The Russian Federation substantially complies with the essential FATF Recommendations concerning the minimum requirements for membership. In other words, it has established a money laundering offence for serious crimes (Recommendation 4) with a threshold that will need to be removed; it has implemented identification requirements for customers and beneficial owners (albeit somewhat unsatisfactorily) (Recommendations 10 and 11); and it has established and implemented a mandatory suspicious transaction reporting system (Recommendation 15). Taking into account the entire system for combating money laundering, the Russian Federation was admitted as a member of FATF.

B. DEVELOPMENT OF FATF–STYLE REGIONAL BODIES AND THE OGBS

84. Active efforts have continued to support or foster the development of FATF-style regional bodies (FSRBs) in all parts of the world. These groups, which have similar objectives and tasks to those of the FATF, provide the same peer pressure which encourages FATF members to improve their anti-money laundering systems. The FATF-style regional bodies have expanded or are in the process of expanding their mandate to include the fight against terrorist financing and to endorse the Eight Special Recommendations of the FATF. Such groups now exist in the Caribbean, Europe,⁹ Asia/Pacific, Eastern and Southern Africa, and in South America¹⁰. Further groups are still in the process of being established for Western and Central Africa. In parallel, the Offshore Group of Banking Supervisors (OGBS) is implementing a strategic plan of action from 2001-2004 to combat money laundering and terrorist financing.

Caribbean Financial Action Task Force

85. The Caribbean Financial Action Task Force (CFATF), which was the first FSRB, has a membership of twenty-nine States from the Caribbean basin.¹¹ It was established as the result of meetings convened in Aruba in May 1990 and Jamaica in November 1992. The main objective of the CFATF is to achieve the effective implementation of, and compliance with the nineteen CFATF and Forty FATF Recommendations. The CFATF Secretariat monitors members' implementation of the Kingston Ministerial Declaration through the following activities: self-assessment of the implementation of the Recommendations; an on-going programme of mutual evaluation of members; the annual updating and publication of Country Reports, which are prepared on each member; co-ordination of, and participation in training and technical assistance programmes; plenary meetings twice a year for technical representatives; and an annual Ministerial meeting.

86. Pivotal to the work of the CFATF is the monitoring mechanism of the mutual evaluation programme. In October 2002 in the Bahamas, the CFATF Council of Ministers adopted the mutual evaluation reports of Panama, Dominican Republic, Costa Rica, Cayman Islands, Trinidad and Tobago and the Bahamas. The CFATF pursues its second round of mutual evaluations using as benchmarks the CFATF and FATF Recommendations as well as the 25 NCCTs criteria. As a follow-up to the mutual evaluations, CFATF members report regularly to the CFATF Plenary on the improvements made in their individual legal/regulatory frameworks to combat money laundering.

Asia/Pacific Group on Money Laundering

87. The Asia/Pacific Group on Money Laundering (APG), established in 1997, currently consists of twenty six members¹² from South Asia, Southeast and East Asia and the South Pacific. The APG continues and has expanded its typologies work in close consultation with the FATF and other regional bodies. A fifth typologies workshop was held in Vancouver, Canada in October 2002. The APG's Technical Assistance and Training strategy continues to expand with the support of

⁹ For the non-FATF members of the Council of Europe.

¹⁰ A complete list of the members and observers of the FSRBs can be found on the FATF website at: http://www.fatf-gafi.org/Members_en.htm#OBSERVERS

¹¹ The members of the CFATF are: Anguilla, Antigua and Barbuda, Aruba, the Bahamas, Barbados, Belize, Bermuda, the British Virgin Islands, the Cayman Islands, Costa Rica, Dominica, Dominican Republic, Guatemala, Grenada, Guyana, Haiti, Honduras, Jamaica, Montserrat, the Netherlands Antilles, Nicaragua, Panama, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Suriname, Turks and Caicos Islands, Trinidad and Tobago and Venezuela.

¹² The members of the APG are: Australia; Bangladesh; Brunei Darussaleem, Chinese Taipei; Cook Islands; Fiji Islands; Hong Kong, China; India; Japan; Macau, China; Malaysia; Nepal, New Zealand; Niue; Pakistan; Republic of Indonesia; Republic of Korea; Republic of the Marshall Islands, Republic of Palau, Republic of the Philippines; Samoa; Singapore; Sri Lanka; Thailand; United States of America and Vanuatu.

international and regional organisations. As a consequence, the APG Secretariat will act as a focal point, where possible, for the co-ordination of anti-money laundering technical assistance and training in the region. The APG will also continue to work in the areas of underground banking and information sharing through two working groups. The APG will hold its sixth annual meeting at the end of August/beginning of September 2003.

88. Since the publication of the FATF Annual Report 2001-2002, the APG has continued its first round of mutual evaluations. On-site mutual evaluation visits took place to the Republic of Korea in August 2002 and to Palau in March 2003. In addition, the APG contributed two law enforcement experts to the IMF/World Bank-led assessment of APG member Bangladesh in October 2002. The reports on these mutual evaluations and the Bangladesh assessment will be considered by APG members at the APG's sixth annual meeting later in 2003.

MONEYVAL

89. In 2002, the PC-R-EV Committee formally changed its name to Moneyval. It was established in September 1997 by the Committee of Ministers of the Council of Europe, to conduct self and mutual assessment exercises of the anti-money laundering measures in place in the twenty-six Council of Europe countries which are not members of the Financial Action Task Force.¹³ Moneyval is a sub-committee of the European Committee on Crime Problems of the Council of Europe (CDPC). Its mandate was also extended to cover the terrorist financing issue.

90. Since the publication of the last FATF Annual Report (2001-2002), Moneyval has continued its second round of mutual evaluations looking particularly closely on the effectiveness of national anti-money laundering systems. To this effect, in conjunction with GRECO (Group of States against Corruption), it organized a joint training seminar for mutual evaluators in Paphos, Cyprus in November 2002. At its Plenary meeting in December 2002, reports were discussed on Hungary and Andorra. At its Plenary meeting in June 2002, Moneyval discussed and adopted second round reports on Slovenia, Cyprus and the Czech Republic.¹⁴ The Moneyval Plenary meeting in April 2003 discussed the reports of Malta and the Slovak Republic. Moneyval has in place a mechanism for written progress reports to be presented orally to the plenary by all countries one year after their report has been adopted.

The Eastern and Southern African Anti-Money Laundering Group (ESAAMLG)

91. The ESAAMLG, an FATF-style body of fourteen countries in the region,¹⁵ was launched at a meeting of Ministers and high level representatives in Arusha, Tanzania, on 26-27 August 1999. A Memorandum of Understanding (MoU), based on the experience of the FATF and other FATF-style regional bodies was agreed. A permanent secretariat has now been established. The ESAAMLG held its third meeting of the Task Force of Senior Officials and Ministers in Swaziland, in August 2002. A further meeting of Task Force officials took place in Dar es Salaam, Tanzania in March 2003. The ESAAMLG has agreed to launch a mutual evaluation programme of the anti-money laundering systems of its members. A mutual evaluation training seminar was held in Bagamoyo, Tanzania in January 2003 to train evaluators from ESAAMLG member countries. It is expected that two mutual evaluation reports will be completed by August 2003, when the next Ministerial and Task Force of Officials meetings of the ESAAMLG take place in Uganda.

¹³ The membership of the Committee is comprised of the Council of Europe member States which are not members of the FATF: Albania, Andorra, Armenia, Azerbaijan, Bosnia & Herzegovina, Bulgaria, Croatia, Cyprus, Czech Republic, Estonia, Georgia, Hungary, Latvia, Liechtenstein, Lithuania, Moldova, Malta, Poland, Romania, Russian Federation, San Marino, Serbia and Montenegro, Slovakia, Slovenia, "The Former Yugoslav Republic of Macedonia" and Ukraine.

¹⁴ Summaries of all adopted Moneyval reports carried out in 2002-2003 appear at Annex E.

¹⁵ Botswana, Kenya, Lesotho, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, Tanzania, Uganda, Zambia and Zimbabwe.

South American Financial Action Task Force (GAFISUD)

92. The GAFISUD, a new FATF-style regional body, was created at a meeting of Ministers in Cartagena, Colombia on 8 December 2000. In the presence of the President of Colombia and the President of FATF, a Memorandum of Understanding was signed by the nine members of the group¹⁶. The objectives of the above-mentioned MoU are to recognise and to apply the FATF Forty Recommendations, the Eight Special Recommendations and any other recommendations that the GAFISUD may adopt in the future, as well as to establish and make GAFISUD operational. A permanent secretariat is based in Buenos Aires, Argentina.

93. The fifth Plenary meeting of GAFISUD and also a Forum with private sector representatives of South America took place in Montevideo, Uruguay, in December 2002. GAFISUD has continued to implement its mutual evaluation programme with the discussion and approval of the mutual evaluation report on Bolivia and the validation and update of the FATF mutual evaluation reports of Argentina and Brazil. A second GAFISUD seminar for the training of mutual evaluators was held in Montevideo, in September 2002.

94. In conjunction with the CFATF, GAFISUD held its second typologies meeting in March 2003 in Panama. The GAFISUD Secretariat also continues to act as a clearing house for anti-money laundering training/educational efforts in the region.

Other initiatives in Africa

95. Following the December 1999 Summit of the Heads of State and Government of the Economic Community of West African States (ECOWAS) in Lomé (Togo), it was decided to establish an Inter-Governmental Action Group against Money Laundering (GIABA: *Groupe Inter-gouvernemental d'Action contre le Blanchiment en Afrique*). The statutes were approved at the ECOWAS Heads of State meeting in Bamako, Mali in December 2000. The provisional headquarters of GIABA are in Dakar, Senegal. A permanent Secretariat has not yet been appointed and no agreement has yet been reached on the funding scheme for this Group. The FATF is therefore concerned about the lack of progress made by GIABA, which is preventing it from becoming a recognised FATF-style regional body.

96. An Action Group against Money Laundering in Africa (GABAC: *Groupe d'Action contre le Blanchiment d'Argent en Afrique Centrale*) was created in December 2000, in N'Djamena, Chad, by the Conference of the Heads of State of the Economic and Monetary Community (CEMAC: *Communauté Economique et Monétaire d'Afrique Centrale*). In October 2002, the Central Bank of Central African States (BEAC: *Banque des Etats d'Afrique Centrale*) organized a seminar to discuss a draft regulation to combat money laundering and the financing of terrorism. The next step before the entry into effect of this text will be its approval by the Council of Ministers of CEMAC.

Offshore Group of Banking Supervisors

97. The conditions for membership in the Offshore Group of Banking Supervisors (OGBS)¹⁷ include a requirement that a clear political commitment be made to implement the FATF's Forty Recommendations. Since June 2001, it has implemented its strategic plan of action to combat money laundering covering a period of three years. The OGBS has pursued its programme of mutual

¹⁶ The members of GAFISUD are: Argentina, Bolivia, Brazil, Colombia, Chile, Ecuador, Peru, Paraguay and Uruguay.

¹⁷ The Membership of the OGBS includes Aruba; Bahamas; Bahrain; Barbados; Bermuda; Cayman Islands; Cyprus; Gibraltar; Guernsey; Hong Kong, China; Isle of Man; Jersey; Labuan; Macau, China; Mauritius; Netherlands Antilles; Panama; Singapore and Vanuatu.

evaluations in accordance with the procedures followed by the FATF. The mutual evaluation report on Gibraltar¹⁸ was discussed and approved at the OGBS meeting in September 2002.

C. CO-OPERATION WITH OTHER INTERNATIONAL ORGANISATIONS

International Financial Institutions

98. Over the past few years, the FATF has increased its collaboration with the International Financial Institutions (IFIs). The IMF and the World Bank are implementing the Action Plan on AML/CFT endorsed by the International Monetary and Financial Committee (IMFC) in November 2001 and the Development Committee in April 2002. The International Monetary Fund (IMF) and the World Bank have recognised the Forty Recommendations and the Eight Special Recommendations as the international standards for combating money laundering and terrorist financing. Since mid-2001, the FATF had worked closely with the IMF and World Bank to develop a common methodology for assessing the measures taken by jurisdictions to combat money laundering and to counter terrorist financing. The FATF, the IMF and the World Bank finalised this methodology at the October 2002, Plenary which also agreed on using it – on a one year trial basis – for future mutual evaluations conducted by the FATF. The IMF and the World Bank have embarked on a pilot programme of assessments (October 2002 to October 2003) using the common methodology in the Fund's offshore financial center assessments (OFC) and the Fund/Bank Financial Sector Assessment Programme (FSAP).

99. Using this methodology will mean that the IFIs and the FATF - along with any FATF-style regional bodies that decide to use it as well – will have a uniform basis with which to assess the level of implementation of AML/CFT measures based on the FATF Recommendations. A core uniform set of assessment documents has been developed by the IMF and World Bank staff and the FATF. Two FSRBs (GAFISUD, Moneyval) and the OGBS have endorsed the use of the methodology in their future mutual evaluations, and two others (APG and ESAAMLG) are expected to do so in the near future. The FATF, several FSRBs and the Egmont Group have agreed to provide independent AML/CFT experts to serve as law enforcement evaluators for IMF and World Bank assessments [evaluation terms]. The FATF is also working to assist the IMF by conducting the AML/CFT component of some of its FSAPs.

100. Evaluations conducted during the common methodology will also provide a basis for the World Bank, the United Nations and other providers of technical assistance to better assess needs and provide necessary assistance to jurisdictions with deficiencies in their systems. The IMF and the World Bank have set up a mechanism to co-ordinate the provision of technical assistance to countries to strengthen their economic, financial and legal systems in the area of anti-money laundering and countering the financing of terrorism. The World Bank has created the AML/CFT Technical Assistance database for use by the FATF, the FSRBs and the donor/providers of technical assistance, which became operational in December 2002.

101. Finally, at its February 2003 Plenary meeting, the FATF established a working group on the issues related to the international financial institutions, which will inter alia, assist in coordinating the role of the FATF and FATF members in the IMF and World Bank assessment process. The working groups will work with IMF and World Bank staff to revise the common methodology [now that the revision of the FATF Forty Recommendations has been completed]. It will also review the collaboration between the IMF, the World Bank and the FATF during the pilot programme.

¹⁸ A summary of the mutual evaluation of Gibraltar is included at Annex F.

Asian Development Bank

102. The Asian Development Bank (ADB) has several technical assistance projects in the area of combating money laundering. The ADB has also produced a Manual on AML/CFT which compiles a number of relevant texts and documents to enhance their dissemination and use among government officials in charge of AML/CFT issues.

Inter-American Development Bank

103. The Inter-American Development Bank (IADB) has undertaken a number of anti-money laundering activities, mainly in cooperation with regional organisations and bodies such as the OAS/CICAD, CFATF and GAFISUD. In 2003, the role of the IADB will focus on furthering the implementation of the revised Forty Recommendations, assisting banking supervision agencies in terms of regulation and monitoring of financial institutions, encouraging international judicial cooperation and providing internet training in money laundering prevention.

Interpol

104. Over the past years, a priority was placed on restructuring services at Interpol General Secretariat in order to set up new crime priorities and provide better operational support to its Member States. One particular action taken was the creation of new projects to focus on combating global terrorism and the funding of terrorist groups. In particular, Interpol has identified areas where, due to its unique position in the international law enforcement community, it can provide increased services to the Member Countries enabling them to access valuable information about terrorist organizations and individuals suspected of terrorist activities and financial support. Interpol's databases already possess this and are exploited for the benefit of Interpol's Member Countries. As terrorism is international in scope, Interpol, as the sole international police organisation, is uniquely positioned to play a central role in combating terrorism. Interpol welcomes the opportunity to establish closer working relationships with anti-terrorist units and criminal intelligence services throughout the world. Interpol will seek to forge partnerships with operational task forces that have recently been created to combat terrorism or to disrupt the financing of terrorism..

United Nations Office on Drugs and Crime

105. The Global Programme against Money Laundering (GPML) is a technical co-operation and research initiative implemented by the UN Office on Drugs and Crime (ODC). Its aim is to increase the effectiveness of international action against money laundering through comprehensive technical co-operation services offered to governments. The Programme is carried out in co-operation with other international and regional organisations. The GPML also coordinates the International Money Laundering Information Network (IMoLIN) website and the Anti-Money Laundering Information Database (AMLID), on behalf of the United Nations, the FATF, the Commonwealth Secretariat, the Council of Europe, Interpol, the Organisation of American States and the Asia/Pacific Group on Money Laundering.

106. In October 2002, the UNODC launched its Global Programme against Terrorism. The overall aim of the programme is to respond promptly and efficiently to requests for counter-terrorism in accordance with the priorities set by the Counter-Terrorism Committee, including in the area of terrorist financing.

Egmont Group

107. Since February 2002, the Egmont Group of Financial Intelligence Units (FIUs) has been an observer to FATF. Since its June 2002 annual meeting, the Egmont Group¹⁹ is comprised of 69 FIUs. The next Plenary meeting of the Egmont Group will take place in Sydney, Australia in July 2003. Besides internal administrative efforts, the Egmont Group's primary goal in 2002/2003 was the development of operational FIUs in those countries with key economies in parts of the world that lack FIUs. The Egmont Group will also focus on efforts to improve the extent of and the quality of information sharing.

European Union

108. The European Union adopted the second EU Anti-Money Laundering Directive of 4 December 2001 amending the 1991 European Council Directive on Prevention of the Use of the Financial System for the Purpose of Money Laundering (91/308/EEC). This text has greatly widened the range of predicate offences and extended the obligations of the 1991 Directive (in particular, customer identification and obligatory suspicious transaction reporting) to a range of non-financial activities and professions (including, under certain conditions, the legal professions). The EU member states should translate the Directive into domestic legislation by 15 June 2003.

The International Organisation of Securities Commissions (IOSCO)

109. IOSCO has pursued several anti-money laundering activities. Many IOSCO members have begun taking steps to adhere to the Multilateral Memorandum of Understanding (MoU) regarding information sharing and co-operation in enforcement matters which was adopted at IOSCO's Annual Conference in May 2002. In addition, the work of IOSCO's task force on customer identification and beneficial ownership is ongoing.

Organization of American States/Inter-American Commission for Drug Abuse Control (OAS/CICAD)

110. The CICAD continues to actively co-sponsor and co-ordinate a number of training seminars and technical assistance activities in the area of combating money laundering. The CICAD is also an advisory member of GAFISUD. In July 2001, the OAS/CICAD Group of Experts to Control Money Laundering met in Mexico City, and agreed that the FATF Eight Special Recommendations against terrorist financing should be adopted and included in an Annex to the OAS/CICAD Model Regulations. The second round of the CICAD's Multilateral Evaluation Mechanism, which includes 20 indicators on money laundering, was completed at the end of 2002, and has been published.

Commonwealth Secretariat

111. The Commonwealth Secretariat continues to support and further the work of ESAAMLG, and to organise and conduct various technical assistance and training initiatives with other organisations and countries. The Commonwealth Secretariat has developed model legal provisions and guidelines to implement UN Resolution 1373 and the FATF Special Recommendations on Terrorist Financing. Finally, the Commonwealth Secretariat has also begun preparations for reviewing its manual, 'A Model of Best Practice for Combating Money Laundering in the Financial Sector, which will be completed after the completion of the review of the Forty FATF Recommendations.

¹⁹ The full list of Egmont recognised FIUs may be found at the following website address: http://www.fatf-gafi.org/Ctry-orgpages/org-egmont_en.htm

Various international anti–money laundering events

112. In addition to the specific anti-terrorist events already mentioned and regular attendance at meetings of other international or regional bodies during 2002-2003, the FATF President accepted several invitations to participate in various international anti-money laundering conferences and seminars, including the 20th International Symposium on Economic Crime in Cambridge, United Kingdom in September 2002 where he gave a keynote address on the FATF and the fight against money laundering. On 27 June 2002, a few days prior to assuming the FATF Presidency, he addressed an IMF Executive Board Seminar. During the period, the FATF Secretariat also participated in several other international events, including the August 2002 Oxford conference on the Changing Face of International Co-Operation in Criminal Matters in the 21st century, the Ninth APEC Finance Ministers Meeting in Los Cabos, Mexico in September 2002, the Regional Conference on Countering Money Laundering and Terrorist Financing in Bali, Indonesia in December 2002, the IAIS Tripartite Insurance Fraud Conference in New Delhi, India, in January 2003, the Wolfsberg Group Conference in May 2003 in Switzerland, and several IMF/World Bank AML/CFT seminars.

FATF– China Seminar

113. On 27-28 March 2003, FATF and China organised a joint seminar in Beijing to discuss anti-money laundering and counter terrorist financing issues. The organisation of this seminar reflected the interest of FATF to establish a dialogue between China and the FATF in the global fight against money laundering and the financing of terrorism. The Seminar was attended by participants from several FATF members and the Secretariat, and representatives of the APG Co-Chairs. China was represented by delegates mainly drawn from the Ministry of Foreign Affairs, the Ministry of Public Security, the Ministry of Finance, the People's Bank of China and the State Administration of Foreign Exchange.

114. The seminar discussed money laundering and terrorist financing methods and techniques, the Forty and Eight Special Recommendations, the essential components of AML and CFT regimes, the mutual evaluation procedure and international co-operation issues. The seminar contributed to a better mutual understanding of the issues involved, and led to a productive exchange of views.

D. NON-COOPERATIVE COUNTRIES OR TERRITORIES ²⁰.

115. Since 1999, the FATF has engaged in substantial work on the problems raised by countries and territories which do not co-operate in the combat of money laundering. The aim of the work is to enhance the level of protection for the world's financial system and to prevent the circumvention of the anti-laundering measures introduced over the last ten years. The work which FATF has undertaken on non-cooperative jurisdictions is fully in line with measures elaborated by the international community to protect the global financial system from money laundering and render it more transparent.

116. For more than four years, the FATF has been working on this initiative, which seeks to ensure effective prevention, detection and repression of money laundering. Four regional review groups (Americas, chaired by the United States; Asia/Pacific, chaired by Japan; Europe, chaired by France; Africa and Middle East, chaired by Italy) meet regularly to prepare the non-cooperative countries and territories (NCCTs) discussions in the Plenary.

117. Throughout the NCCT process, the FATF has sought to ensure its openness, fairness and objectivity. When jurisdictions have been considered for review under this initiative, they have been notified of this fact, have had the opportunity to respond to the findings of the initial draft reports and later to meet with FATF experts in a face-to-face meeting to discuss any unresolved questions.

²⁰ See *FATF Annual Review of Non-Cooperative Countries or Territories*, 20 June 2003. This report is available at the following website address: http://www.fatf-gafi.org/NCCT_en.htm.

118. Three years after the release of the first review of NCCTs, it remains clear that this initiative has triggered significant improvements in anti-money laundering systems throughout the world. Of the 23 jurisdictions placed on the NCCTs in 2000 and 2001, only nine remain there. No new jurisdictions were reviewed since 2001; however, the FATF continues to monitor progress as a priority item at each Plenary meeting and encourages jurisdictions to take further action to remedy the deficiencies identified in the process through public statements.

119. To decide whether a jurisdiction should be removed from the list, the FATF must first be satisfied that the jurisdiction has addressed the deficiencies previously identified by enacting significant legislation and regulations. In assessing progress by NCCTs, the FATF gives particular importance to the relevant aspects of criminal law, financial supervision, customer identification, suspicious transactions reporting and international co-operation. Any new legislation or regulations must not only have been enacted but also have come into effect. Furthermore, the FATF also takes steps to ensure that the jurisdictions concerned are indeed implementing effectively the necessary changes. The FATF has also designed a rigorous monitoring mechanism to ensure sustained efforts in implementation.

120. FATF members continue to express their willingness to provide technical assistance to jurisdictions identified through the NCCT initiative as these jurisdictions attempt to improve their anti-money laundering systems.

121. For those jurisdictions which were identified as non-cooperative in 2000 and in 2001 and which had not made adequate progress, the FATF has a policy to recommend further counter-measures in a gradual, proportionate and flexible manner. The purpose of the counter-measures is to reduce the vulnerability of the international financial system and to increase the world-wide effectiveness of anti-money laundering measures. By enacting legislative amendments in December 2002 that significantly enhanced the scope of its 1995 Money Laundering Law, Nigeria avoided the application of counter-measures. By enacting appropriate legislation in March 2003 to amend its Anti-Money Laundering Act 2001, the Philippines also avoided the application of counter-measures.

122. Due to Ukraine's failure to enact legislation meeting international standards, the FATF recommended that counter-measures be applied to Ukraine as of 20 December 2002. However, due to comprehensive reforms after that time that address the main identified deficiencies, the FATF withdrew the application of counter-measures on 14 February 2003. Counter-measures have been applied to Nauru since December 2001. That FATF welcomes Nauru's recent legislation efforts to eliminate offshore shell banks. The FATF encourages Nauru to take the additional steps to ensure that shell banks cease to operate and cease banking activity.

123. Based on the progress they made during the year, the Russian Federation, Dominica, Niue, Marshall Islands, Grenada, and St. Vincent & the Grenadines were removed from the list of NCCTs. All the work of the FATF on the non-cooperative jurisdictions in 2002-2003 is reflected in the above-mentioned separate Annual Review.

IV. TRENDS AND TECHNIQUES IN MONEY LAUNDERING AND TERRORIST FINANCING

124. The annual FATF typologies exercise brings together experts from law enforcement and regulatory authorities of FATF members and other jurisdictions to exchange information on significant cases and operations related to money laundering or terrorist financing²¹. It thus provides a critical

²¹ The meeting of experts for FATF-XIV took place in November 2002 in Rome, Italy, and was chaired by Dr. Carlo Santini, Director General of the Ufficio Italiano dei Cambi.

opportunity for operational experts to identify and describe current trends in these areas and to comment on the effectiveness of relevant counter-measures. Building on the work of earlier studies and input from FATF members, the yearly exercise focuses on a series of special topics.

125. Understanding and clearly describing the potential for terrorist misuse of the financial system remains a key FATF concern in its work on examining typologies. This year, the exercise followed up on earlier indications that non-profit organisations (NPOs) were somehow being used by terrorists as a mechanism for hiding their financial support operations. Information provided by FATF delegations and experts participating in this year's exercise confirmed that the NPO sector is vulnerable to abuse, and several examples provided appear to confirm this observation. The experts believed that NPOs, given the diversity of form and oversight systems, can be used by terrorist groups either as a means of collecting funds for eventual support of terrorist activity or as a cover for the movement of such funds. In many cases, the NPOs themselves are not entirely aware of this misuse.

126. Informal money or value transfer (IMVT) systems were once again a subject of FATF typologies work, this time to see whether they could be used for moving terrorist funds. IMVT systems can be complex and often exist alongside or, in some jurisdictions, in place of conventional financial services for moving funds. They are often also referred to as alternative remittance or underground banking, as well as by certain regionally specific terms such as hawala, hundi, fei-chien or black market peso exchange. The primary purpose for such systems in many locations is to move legitimately earned funds from one geographic area to another. Certain of them predate Western or conventional banking systems by several centuries. Nevertheless, IMVT systems generally operate outside financial regulatory structures and thus are vulnerable to being used by terrorists as well as other criminals that desire to move funds. In some cases, there appears to be evidence that IMVT systems have been used by terrorists or organisations that may be assisting them. In some other instances, experts presented examples in which some groups were attempting to get around requirements to register IMVT services by re-establishing themselves as non-profit organisations.

127. The FATF-XIV Typologies Exercise examined other areas in which the primary risks or vulnerabilities lie in their potential use for money laundering. The securities sector, for example, has long been viewed by certain FATF experts as a mechanism for the layering of illegal funds. Case examples provided for this year's exercise indicated that in some instances it is still possible to introduce cash proceeds into the financial system through certain securities markets by co-opting professional operators. Some experts also indicated that the assumption within certain securities sectors that all know your customer and due diligence procedures have been performed for customers or funds coming from elsewhere in the financial system leads to another potential weakness. In a few examples, FATF experts showed still another advantage for launderers who decide to use the securities market for their activities. Besides successfully laundering their funds, some schemes using market mechanisms have the potential to produce profit from the laundering scheme.

128. The markets for gold, diamonds, and other precious metals or gemstones have often been cited as potential areas through which illegal funds may be channelled. The inherent high-value of these goods, their ability to retain their value changes in their form of presentation, and ease of convertibility, along with their compact and relatively easily transportable nature also make them attractive to the money launderer. Gold and diamonds, in particular, can be used both as a source of illegal value to be laundered – through smuggling or illegal trade – or as the actual laundering vehicle – through the outright buying and selling. The primary sources of illegal funds laundered through such markets are illegal narcotics trafficking, organised crime activities and smuggling (including in the goods themselves). FATF experts also provided a few examples in which gold or diamond trading has been used to move funds or simply to store value for persons or groups associated with terrorism.

129. FATF experts this year also examined other trends both in their written contributions for the exercise and during the experts meeting. With regard to statistics on disclosures of suspicious transactions, the experts noted that the September 11th terrorist attacks have precipitated a marked increase in reporting that has, for many jurisdictions, not yet abated. The introduction of the euro in

physical form appears only to have resulted in increased reporting in certain financial sectors just prior to and after the introduction and only in certain Euro zone members. Additionally, a few case examples were provided this year that deal with insurance as a means of laundering criminal funds. From these examples, it appears that the insurance sector may possess similar potential laundering vulnerabilities to those of the securities sector. This last area may warrant renewed study in the context of future FATF typologies exercises.

V. IMPROVING MEMBERS' IMPLEMENTATION OF THE FORTY RECOMMENDATIONS

130. FATF members are clearly committed to the discipline of multilateral monitoring and peer review. Therefore, a notable part of FATF's work has continued to focus on monitoring the implementation by its members of the Forty Recommendations on the basis of a self-assessment and mutual evaluation procedure. The self-assessment exercise consists of a detailed questionnaire and an in-depth discussion at the final Plenary meeting. The mutual evaluation procedure provides a comprehensive monitoring mechanism for the examination of the counter-measures in place in member countries and of their effectiveness. Together, they provide the necessary peer pressure for a thorough implementation of the Forty Recommendations in members.

A. 2002–2003 SELF-ASSESSMENT EXERCISE

131. The mutual evaluation process is the primary mechanism used by the FATF for measuring progress made by its members in implementing anti-money laundering measures. Mutual evaluations also serve as the principle means for evaluating the overall effectiveness of national anti-money laundering systems. However, given the less frequent nature of mutual evaluations, the FATF conducts annual self-assessment exercises to establish a periodic record of members' progress in implementing relevant measures. This annual exercise is based mainly on information provided directly by each jurisdiction and has focused during the last few years on measures that have been put into place since the previous exercise. It thus represents a sort of inventory of measures implemented in any given year. Since the conclusion of the second round of mutual evaluations for FATF Members, it has also been the sole method for following this progress toward full implementation.

132. The self-assessment process examines the implementation of key legal, financial and international co-operation measures relating to the 28 FATF Recommendations requiring specific action.²² All FATF members have implemented most, if not all of the Recommendations requiring specific action. In the financial area, FATF members are judged on whether they have implemented measures both for banks and for the four main categories of non-bank financial institutions (bureaux de change, stockbrokers, insurance companies and money remittance/transfer companies). Combining these five types of financial institutions into a single category increases the emphasis on uniform application of anti-money laundering measures for all financial institutions.

B. MUTUAL EVALUATIONS

133. The second and major element for monitoring the implementation of the FATF Recommendations is the mutual evaluation process. Each member is examined in turn by the FATF on the basis of a report drawn up by a team of three or four selected experts, drawn from the legal, financial and law enforcement fields of other FATF members. The purpose of this exercise is to provide a comprehensive and objective assessment of the extent to which the country in question has moved forward in implementing effective measures to counter money laundering and to highlight areas in which further progress may still be required.

²² The Recommendations requiring specific action are: Recommendations 1-5, 7, 8, 10-12, 14-21, 26-29, 32-34, 37, 38 and 40.

134. As the third round of evaluations of FATF members has been delayed pending the conclusion of the review of the Forty Recommendations, only the evaluation reports concerning new members were discussed during FATF-XIV (see Section II. A.). As agreed by the October 2002 Plenary meeting, these mutual evaluations were carried out on the basis of the new common methodology (see Section II. C.). Before the end of 2003, the FATF will also conduct the second mutual evaluation of the three countries which became full members in June 2000 (Argentina, Brazil and Mexico). The objectives of these evaluations will be to follow-up on the first mutual evaluations and to assess the effectiveness of the measures in place.

135. Finally, in conjunction with the Gulf Co-operation Council (GCC), the FATF will carry out the mutual evaluation of Saudi Arabia also on the basis of the common methodology.²³ Since 1999, GCC member states have made a noticeable effort to evaluate the level of implementation and effectiveness of anti-money laundering systems within the GCC. Five members of the GCC (Bahrain, Kuwait, Oman, Qatar and the United Arab Emirates) have now undergone mutual evaluations. Once the mutual evaluation report on Saudi Arabia has been discussed and approved, the mutual evaluations programme for GCC member states will be completed.

CONCLUSION

136. During 2002-2003, the FATF made significant progress in the fight against money laundering and terrorist financing. In updating its Forty Recommendations for combating money laundering, the FATF accomplished one of the most important tasks it has undertaken since the adoption of the Eight Special Recommendations on terrorist financing in October 2001. The successful completion of the revision of the Forty Recommendations showed that the Task Force has remained firm in its resolve, yet flexible in its approach, to fighting money laundering whose techniques are constantly evolving.

137. As a consequence of the expansion of the mandate of the FATF to address the issue of financing of terrorism, the work of the FATF has been significantly reshaped since the end of 2001 and significant steps have been achieved. However, further progress remains to be made in the area of combating terrorist financing. This task will continue to be a major priority for FATF's activities.

138. Despite the notable progress made, there is an absolute need for continuing action at the international level to deepen and widen the fight against money laundering and terrorist financing. This vital issue will be addressed in the review of the FATF's future activities, structure and membership which will take place in 2003-2004 under the Presidency of Sweden.

²³ The GCC is in the unique position of being a member of FATF, even though the individual member states of the GCC are not FATF members. The GCC member states are: Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates.